



Safe. Solid. Sound.





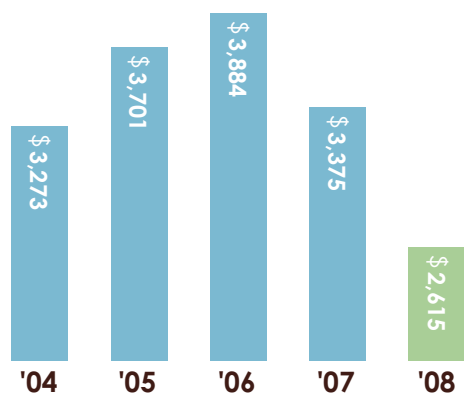
Safe. Solid. Sound.



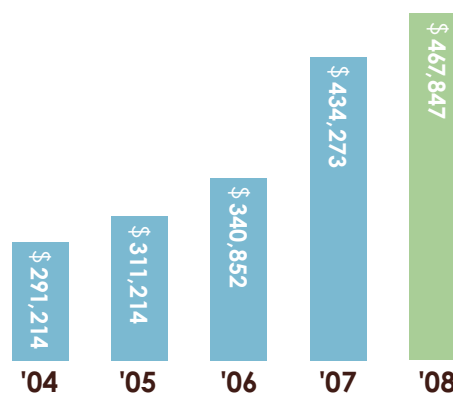
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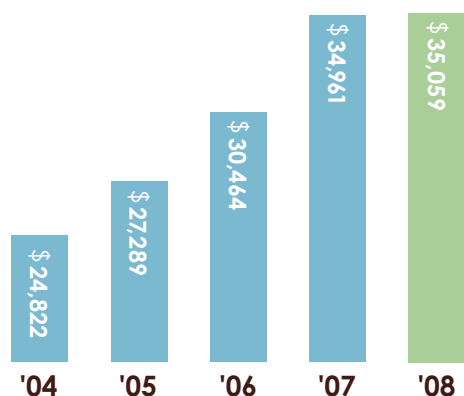
# Statistical Summary



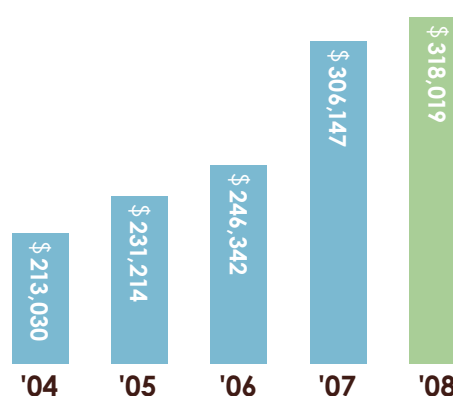
Net Income (in thousands)



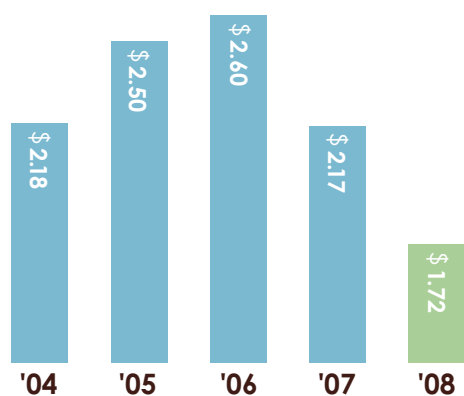
Total Assets (in thousands)



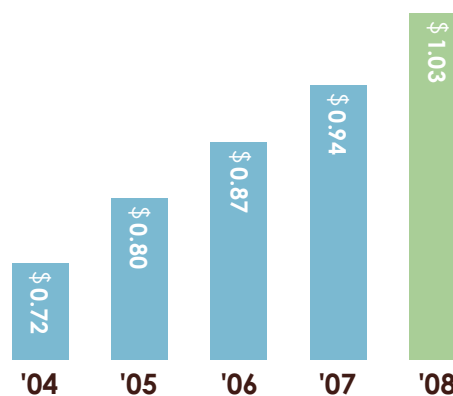
Equity Capital (in thousands)



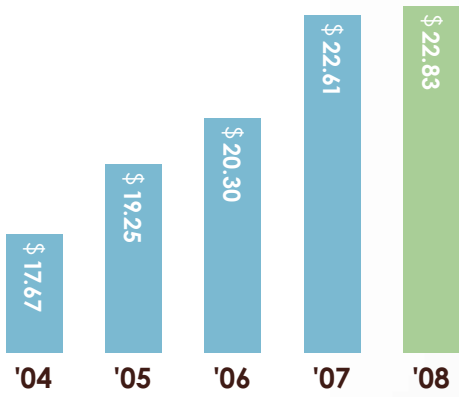
Net Loans Outstanding (in thousands)



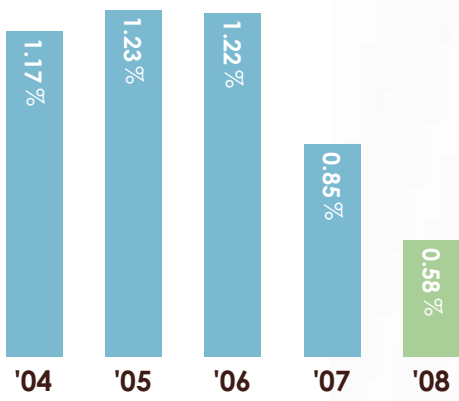
Basic Earnings Per Share



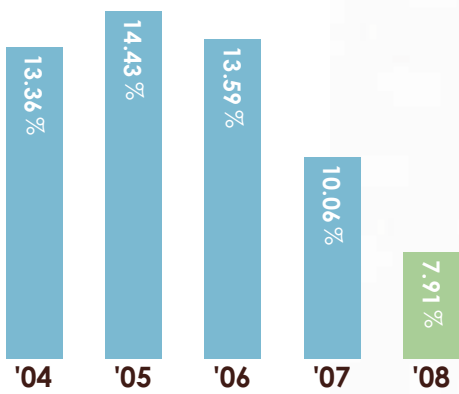
Dividends Per Share



Book Value Per Share



Return on Average Assets



Return on Average Equity

## Decade of Progress

	1999	2000	2001
Interest Income	\$ 11,448,619	\$ 12,770,170	\$ 13,706,569
Interest Expense	5,048,276	5,909,884	6,747,922
Net Interest Income	6,400,343	6,860,286	6,958,647
Provision for Loan Loss	296,000	275,000	170,000
Net Interest Income After Provision for Loan Losses	6,104,343	6,585,286	6,788,647
Noninterest Income, Including Security Gains/Losses	804,358	982,663	1,194,193
Noninterest Expense	4,254,374	4,408,617	4,741,374
Income Before Income Taxes	2,654,327	3,159,332	3,241,466
Income Taxes	735,318	992,661	970,859
Net Income	\$ 1,919,009	\$ 2,166,671	\$ 2,270,607
Total Assets	\$165,512,453	\$176,488,813	\$197,857,964
Deposits	135,094,459	147,166,046	167,382,728
Equity Capital	17,689,055	18,243,362	19,786,807
Loans Outstanding, Net	119,471,741	133,266,893	150,766,103
Allowance For Loan Losses	1,756,137	2,037,322	2,062,252
Net Charge Offs (Recoveries)	78,589	(6,185)	145,070
Full Time Employees (Average Equivalents)	61	57	64
Number of Offices	4	4	5
Earnings Per Share	\$ 1.25	\$ 1.50	\$ 1.54
Dividends Per Share	0.38	0.40	0.52
Book Value Per Share	12.13	12.96	13.93
Dividends Pay-out Ratio	29.82%	27.47%	34.00%
Cash Dividends Paid	\$ 572,343	\$ 595,255	\$ 772,068
Return on Average Assets	1.21%	1.31%	1.22%
Return on Average Equity	11.17%	12.83%	11.89%



	2002	2003	2004	2005	2006	2007	2008
	\$ 14,119,963	\$ 14,647,163	\$ 15,732,536	\$ 17,378,504	\$ 19,494,550	\$ 24,871,934	\$ 26,037,813
	6,148,086	5,724,907	5,768,898	6,654,614	8,567,442	13,530,919	14,058,084
	7,971,877	8,922,256	9,963,638	10,723,890	10,927,108	11,341,015	11,979,729
	300,000	315,000	174,000	302,000	60,000	429,391	608,000
	7,671,877	8,607,256	9,789,638	10,421,890	10,867,108	10,911,624	11,371,729
	1,143,217	1,428,144	1,779,231	2,119,237	2,427,455	2,632,592	2,226,506
	5,206,339	6,105,450	6,965,706	7,424,640	7,938,373	9,372,650	10,596,353
	3,608,755	3,929,950	4,603,163	5,116,487	5,356,190	4,171,566	3,001,882
	1,107,806	1,131,330	1,330,000	1,415,156	1,471,943	796,223	387,003
	\$ 2,500,949	\$ 2,798,620	\$ 3,273,163	\$ 3,701,331	\$ 3,884,247	\$ 3,375,343	\$ 2,614,879
	\$226,245,533	\$262,369,448	\$291,213,986	\$311,214,191	\$340,603,704	\$434,273,056	\$467,846,935
	187,384,494	219,839,910	239,885,451	249,449,640	271,050,193	362,918,000	394,819,602
	21,746,408	23,504,314	24,822,024	27,289,365	30,463,934	34,961,384	35,059,248
	172,642,646	190,358,883	213,029,852	231,213,699	246,341,647	306,146,646	318,018,530
	2,300,485	2,521,270	2,623,431	2,841,098	2,848,887	3,299,276	3,556,763
	61,767	94,215	71,839	84,333	52,211	415,065	350,513
	66	72	73	75	80	91	101
	5	6	6	6	8	9	10
	\$ 1.68	\$ 1.89	\$ 2.18	\$ 2.50	\$ 2.60	\$ 2.17	\$ 1.72
	0.58	0.65	0.72	0.80	0.87	0.94	1.03
	15.35	16.49	17.67	19.25	20.30	22.56	22.83
	34.30%	34.37%	32.72%	31.69%	33.43%	43.07%	60.25%
	\$ 857,751	\$ 961,901	\$ 1,070,833	\$ 1,173,044	\$ 1,298,567	\$ 1,453,707	\$ 1,575,482
	1.17%	1.13%	1.17%	1.23%	1.22%	0.85%	0.58%
	12.08%	12.39%	13.36%	14.43%	13.59%	10.06%	7.91%

NOTES: (1) The above per share amounts have been restated to reflect a two for one stock split effected in 2000 and 5% stock dividends paid in 2002, 2003, 2004, 2005, 2006 and 2007.



# Security for the Future

## Letter to Our Shareholders



Thomas G. Caldwell – *President and Chief Executive Officer*

### To our Shareholders and Friends

Safe. Solid. Sound.

Perhaps in our lifetime, those three words have never carried such significant meaning. They do, however, fully convey the status of our company and its two affiliate banks. With a global economic crisis serving as a backdrop, I am pleased to report that during 2008 we achieved strong profitability and consistent asset growth, while maintaining a solid capital base.

Net income for the year 2008 was \$2.6 million. While representing a decline from the prior year's earnings, it also reflects on the ability of your company to navigate through turbulent economic times that have found many larger financial service companies reporting record losses. Our

diluted earnings per share were \$1.69. This provided us the ability to add to our capital, while paying an increased cash dividend of \$1.03 per share.

In our letter to you last year, we discussed the broader economic turmoil that was experienced in 2007. The year 2008, as we all now know, proved to be even a far more challenging year for the directors and management teams of Middlefield Banc Corp., The Middlefield Banking Company (Middlefield) and Emerald Bank (Emerald). We have taken, and will continue to take, strategic actions that will continue to position our company as a bastion of strength and stability in a battered industry.

Beginning in 2008, the U.S. Treasury's Troubled Asset Relief Program/Capital Purchase Program facilitated the flow of taxpayer dollars from Washington to many of the large financial institutions in the form of capital injections. The stated goal of these programs is to provide financial strength to the industry and to encourage lending.

While this goal may be noble in nature, we have determined to not be participants in these programs. Your company and its banks maintain capital positions in excess of regulatory well-capitalized standards. Furthermore, we are open for lending and have never hesitated in working to provide necessary funding to those within our communities. It is the basis of what we do day-in and day-out. The same may be said for the great majority of our peers within the industry.

We are pleased to report that total assets at the end of 2008 stood at \$467.9 million, representing growth of 7.7% from the total reported at the end of 2007. While this level of growth is slightly below what we have experienced in recent years, it is reflective of market conditions during the past year. Pricing on both deposits and loans became somewhat irrational as several of our large competitors struggled to maintain liquidity and to achieve positive earnings. While there remains some questionable pricing within the industry, we have seen the same diminish as some of the large institutions have been forced into consolidation and others have fallen under more strict regulatory oversight.



Also during 2008, our service base expanded with the opening of the Cortland office of Middlefield in June and the purchase of an existing branch by Emerald in November, located in Westerville. Both of these offices will have a short-term negative impact on earnings. However, we do view both markets as presenting strong growth opportunities and fitting for our focus on community-based one-on-one banking.

Deposit levels ended 2008 at \$394.8 million, an increase of \$31.9 million over the prior year-end. While the greater portion of that growth came within higher costing certificates of deposit, lower rate products also saw moderate levels of increase. Our net loans outstanding finished 2008 at \$318.0 million. Although not reaching the levels that we desired, this balance does represent an increase during the year of \$11.9 million. We continue to seek good lending opportunities within our communities and are appreciative of your willingness to direct the same to us.

Earnings were impacted by higher costs in both salaries and occupancy associated with expansion of our branch networks. Similarly, our data processing costs increased, indicative of the larger customer base being served and the broader array of products and services offered. Our provision for loan losses for the year was \$608,000. This figure is driven by increased loan delinquency, a direct result of the economic climate within which we operate. Finally, the uncertainty in the economy is exhibited in wide swings in pricing for investment securities. This led to our recording an other-than-temporary impairment charge on two mortgage backed securities held at Middlefield in the amount of \$376,000. We do expect that the final loss, if any, will be considerably less than that amount.

As we have continued our transition of Emerald Bank to a full service commercial bank, it was our pleasure to welcome James L. Long as President and Chief Executive Officer of that affiliate. Jim brings more than thirty years of sound financial services experience, having spent the majority of his career in the central Ohio markets. Glenn E. Aidt, Emerald's founding President, continues to provide valuable insights, serving as Vice Chairman of Emerald's board of directors.

Middlefield Banc Corp. board member Donald E. Villers will be retiring at the 2009 Annual Meeting of Shareholders. Don first joined Middlefield in 1987 and has contributed to our growth by shaping our focus on those most key to our success – our local communities. We wish to thank Mr. Villers for his dedicated service and leadership. We wish him well in his future endeavors.

As we look toward 2009 and the potential of an economic recovery in 2010, please be comfortable in the knowledge that we are managing the company for long-term success. Our company and our banks are well-capitalized and our balance sheet remains strong. We will continue to face the challenges based in economic activity, credit quality, and real estate values, but our efforts remain focused, being guided by active management with a disciplined, sound approach.

We are appreciative of the confidence that you continue to have in our ability to provide a safe investment and a sound return. Our optimism for the future is grounded in our belief in private ownership of financial service companies and our commitment to provide only the finest in community-based financial services. It is these guiding principles that keep Middlefield Banc Corp. safe, solid, and sound.

Sincerely,

**Thomas G. Caldwell**  
*President and Chief Executive Officer*

# Letter from the Chairman



Richard T. Coyne – *Chairman, Board of Directors*

## Chairman's Report to the Shareholders

In two thousand and eight our traditional banking policies successfully helped us through a turbulent year. Middlefield Banc Corp. was able to grow its assets, deposits and net loans.

The communities of Cortland and Westerville have enthusiastically welcomed our new branches. We expect these new branches to grow and prosper.

We are proud of our officers and employees who continue the work of making our community bank a positive experience for all our customers.

Our focus will remain on improving our products and services and in providing a good return to our shareholders.

Thank you for your support of Middlefield Banc Corp.

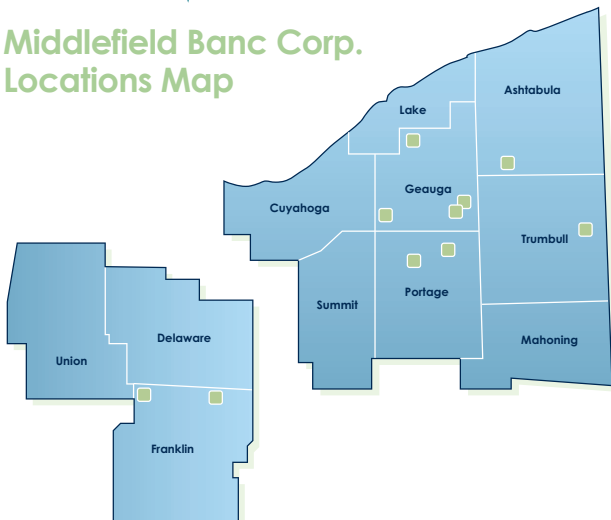
Very truly yours,

A handwritten signature in black ink that reads "Richard T. Coyne". The signature is fluid and cursive, written in a professional style.

Richard T. Coyne  
*Chairman, Board of Directors*



## Middlefield Banc Corp. Locations Map



# Middlefield Banc Corp. Board of Directors

## Board of Directors



**Richard T. Coyne** – 1997  
*Chairman, Board of Directors,  
Middlefield Banc Corp.  
The Middlefield Banking Company*  
Retired: Jaco Products and Capital Plastics



**James J. McCaskey** – 2004  
President  
McCaskey Landscape and Design, LLC



**Donald E. Villers** – 1987  
Retired: Copperweld Steel



**Carolyn J. Turk, C.P.A.** – 2004  
Chief Financial Officer/Treasurer  
Molded Fiber Glass Companies



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



**William J. Skidmore** – 2007  
Northeast Ohio Senior District Manager  
Waste Management of Ohio, Inc.



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



**Kenneth E. Jones** – 2008  
President  
Chesapeake Financial Advisors



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



**Robert W. Toth\*** – 2008  
Retired: Gold Key Processing, Ltd

\* denotes The Middlefield Banking Company Director only



# Building a Strong Foundation

# Emerald Bank Directors, Officers & Staff



## Board of Directors

**Kenneth E. Jones** – 2004  
*Chairman, Board of Directors, Emerald Bank*  
President  
Chesapeake Financial Advisors

**Glenn E. Aidt** – 2004  
*Vice Chairman, Board of Directors, Emerald Bank*

**George J. Kontogiannis, AIA** – 2004  
Chief Executive Officer  
The Kontogiannis Companies

**Joseph C. Zanetos** – 2004  
President  
Anthony-Thomas Candy Co.

**Clayton W. Rose, III, C.P.A.** – 2006  
Shareholder  
Rea & Associates, Inc.

**Thomas G. Caldwell** – 2007  
*President and Chief Executive Officer*  
*Middlefield Banc Corp.*  
*The Middlefield Banking Company*

**Richard T. Coyne** – 2007  
*Chairman, Board of Directors, Middlefield Banc Corp.*  
*The Middlefield Banking Company*  
Retired: Jaco Products and Capital Plastics

**James L. Long** – 2008  
*President and Chief Executive Officer*  
*Emerald Bank*

## Officers

**James L. Long** – 2008  
*President and Chief Executive Officer*

**Glenn E. Aidt** – 2004  
*Vice Chairman*

**Donald L. Stacy** – 2007  
*Chief Financial Officer and Treasurer*

**Eric A. Forrest** – 2008  
*Assistant Vice President*  
*Commercial Banking*

**Charles T. Woodson** – 2008  
*Banking Officer*  
*Westerville Branch Manager*

## Staff

### Dublin Office:

**Barbara Howard** – 2004 – *Accounting Clerk*  
**Valorie Thorpe** – 2004 – *Branch Supervisor*  
**Georgia Wilkerson** – 2004 – *Loan Processor*  
**Elaine Gaub** – 2005 – *Customer Services*  
**Lisa Stokes** – 2006 – *Customer Services*

### Westerville Branch:

**Rebekah Bolton** – 2008 – *Customer Services*  
**Tracy Needham** – 2008 – *Customer Services*  
**Nathan Reynolds** – 2008 – *Customer Services*

## Emerald Bank Branch Locations



**Dublin Branch** *Drive up ATM*  
6215 Perimeter Drive  
Dublin, Ohio 43017  
614.793.4631 • fax: 614.793.8922



**Westerville Branch** *Drive up ATM*  
17 North State Street  
Westerville, Ohio 43081  
614.890.7832 • fax: 614.890.4633



## The Middlefield Banking Company Staff

### Staff

#### Main Office:

Kevin Mitchell – 2007 – *Branch Manager*  
Louise Fenselon – 1984 – *Head Teller*  
Bonnie Steele – 1985 – *Customer Services*  
Diana Koller – 1998 – *Teller*  
Amanda Cummings – 2006 – *Teller*  
Jenna Janssen – 2006 – *Teller\**  
Jeanette Meardith – 2006 – *Receptionist*  
Kristina Stephens – 2006 – *Customer Services*  
Darlene Beaver – 2007 – *Teller*  
Linda Chandler – 2007 – *Teller*  
Katie Wolfert – 2007 – *Teller\**  
Brenda Bowden – 2008 – *Teller*

#### West Branch:

Patti Haendel – 1982 – *Customer Services*  
Rachel Lilly – 1985 – *Head Teller*  
Rachel Reese – 2005 – *Teller\**  
Amy Kothera – 2006 – *Teller*  
Jodi Fisher – 2008 – *Teller*  
Linda Hammel – 2008 – *Teller*  
Brandon Mihalisin – 2008 – *Teller\**  
Bethany Pentek – 2008 – *Teller*  
Becky Starcher – 2008 – *Teller\**

#### Garrettsville Branch:

Gretchen Cram – 2008 – *Branch Manager*  
Vickie Moss – 1998 – *Teller*  
Colleen Steele – 1998 – *Teller*  
Nicole Meszaros – 2005 – *Teller*  
Dawn Semich – 2005 – *Customer Services*  
LynnRae Derthick – 2006 – *Teller*  
Leah McPhail – 2006 – *Teller\**

#### Mantua Branch:

Joan Sweet – 2002 – *Branch Manager*  
Rebecca Reinard – 2002 – *Head Teller*  
Jodie Lawless – 2004 – *Teller*  
Jamie Alexander – 2007 – *Teller\**

#### Chardon Branch:

Amanda DiMeolo – 2001 – *Customer Services*  
Gretchen Mihalic – 2001 – *Teller\**  
Kim Koynock – 2005 – *Teller\**  
Beverly Palinsky – 2005 – *Teller\**  
Dorothy Brown – 2006 – *Head Teller*

#### Orwell Branch:

Jennifer Gabrielson – 1997 – *Branch Manager*  
Jessica Slusher – 2006 – *Teller\**  
Lisa Swango – 2006 – *Customer Services*  
Michelle Scott – 2007 – *Teller*  
Melissa Gay – 2008 – *Teller\**  
Heather Rokosky – 2008 – *Teller\**

#### Newbury Branch:

Kathryn Shanholtzer – 2007 – *Branch Manager*  
Diane Thomas – 2006 – *Teller\**  
Susan Grosik – 2008 – *Teller*  
Helen Milburn – 2008 – *Customer Services*

#### Cortland Branch:

Tiffany Stewart – 2005 – *Teller*  
Onita Kocka – 2008 – *Teller\**  
Sherry Krok – 2008 – *Customer Services*  
Donna Marcello – 2008 – *Teller\**

#### Loan Department:

Helen Stowe – 1985 – *Loan Administrative Assistant*  
Jane Armstrong – 1998 – *Lender*  
Vivian Helmick – 1998 – *Loan Administrative Assistant*  
Carolyn Fackler – 2001 – *Loan Administrative Assistant*  
Sarah Brook – 2004 – *Loan Administrative Assistant*  
Jamie Peck – 2003 – *Loan Collection Manager*  
Sue Trumbull – 2005 – *Loan Receptionist*  
Joan Limpert – 2006 – *Loan Administrative Assistant*  
Brian Martinko – 2006 – *Lender*

#### Operations:

Karen Westover – 1983 – *Bookkeeper*  
Pamela Malcuit – 1989 – *Bookkeeper*  
Donna Williams – 1990 – *Bookkeeper*  
Lauren Harth – 1995 – *Audit Assistant\**  
Tara Morgan – 1997 – *Proof Operator*  
Bonnie Hofstetter – 1998 – *Courier\**  
Lisa Sanborn – 2000 – *Bookkeeper*  
Melody Askey – 2005 – *Compliance Assistant*  
Marcia Dzikowski – 2008 – *Float Teller*  
David Harth – 2008 – *Facility Maintenance*  
Linda Moore – 2008 – *Float Teller*  
Carrie Reiter – 2008 – *Courier\**

#### Financial Services:

Thomas Hart – 2004 – *Financial Consultant*

\* denotes part time

# The Middlefield Banking Company Officers

## 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 Lender*

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

Dennis E. Linville – 2006  
*Senior Vice President*  
*Area Executive*

Kathleen M. Johnson – 1971  
*Vice President*  
*Chief Accounting Officer*

Joann Vance – 1986  
*Vice President*  
*Human Resource Administrator*

Christine A. Polzer – 1989  
*Vice President*  
*Network Administrator*

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

Alfred F. Thompson, Jr. – 1996  
*Vice President*  
*Loan Administration*

Sharon R. Jarold – 2001  
*Vice President/Lending*

Thomas Munson – 2003  
*Vice President/Lending*

Karen Branham – 1983  
*Assistant Vice President*  
*Bookkeeping Manager*

Gail Neikirk – 1983  
*Assistant Vice President*  
*Executive Secretary*

Thomas R. Neikirk – 1994  
*Assistant Vice President*  
*West Branch Manager*

Marlin J. Moschell – 2000  
*Assistant Vice President*  
*Orwell Lending Officer*

Timothy McCreary – 2004  
*Assistant Vice President*  
*Chardon Branch Manager*

Matthew Bellin – 2006  
*Assistant Vice President*  
*Commercial Lender*

Kathy Vanek – 1998  
*Banking Officer*  
*Cortland Branch Manager*

## The Middlefield Banking Branch Locations



**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



**Chardon Branch** *Drive up ATM*  
348 Center Street, P.O. Box 1078  
Chardon, Ohio 44024  
888.801.1666 • 440.286.1222 • fax: 440.286.1111



**Garrettsville Branch** *Drive up ATM*  
8058 State Street  
Garrettsville, Ohio 44231  
888.801.2121 • 330.527.2121 • fax: 330.527.4210



**Newbury Branch** *Drive up ATM*  
11110 Kinsman Road, Suite 1, P.O. Box 208  
Newbury, Ohio 44065  
888.801.1666 • 440.564.7000 • fax: 440.564.7004



**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



**Orwell Branch** *Drive up ATM*  
30 South Maple Street, P.O. Box 66  
Orwell, Ohio 44076  
888.801.1666 • 440.437.7200 • fax: 440.437.1111



**Mantua Branch** *Walk up ATM*  
10519 Main Street, P.O. Box 648  
Mantua, Ohio 44255  
877.274.0881 • 330.274.0881 • fax: 330.274.0883



**Cortland Branch** *Drive up ATM*  
3450 Niles-Cortland Road, P.O. Box 636  
Cortland, Ohio 44410  
888.801.1666 • 330.637.3208 • fax: 330.637.3207



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# Consolidated Financial Statements

Consolidated Balance Sheet	December 31,	
	2008	2007
<b>ASSETS</b>		
Cash and due from banks	\$ 9,795,248	\$ 9,072,972
Federal funds sold	7,548,000	8,631,963
Interest-bearing deposits in other institutions	112,215	110,387
Cash and cash equivalents	17,455,463	17,815,322
Investment securities available for sale	104,270,366	85,967,764
Loans	321,575,293	309,445,922
Less allowance for loan losses	3,556,763	3,299,276
Net loans	318,018,530	306,146,646
Premises and equipment	8,448,915	7,044,685
Goodwill	4,558,687	4,371,206
Bank-owned life insurance	7,440,687	7,153,381
Accrued interest and other assets	7,654,287	5,774,052
<b>TOTAL ASSETS</b>	<b>\$467,846,935</b>	<b>\$434,273,056</b>
<b>LIABILITIES</b>		
Deposits:		
Noninterest-bearing demand	\$ 42,357,154	\$ 41,348,219
Interest-bearing demand	26,404,660	19,566,035
Money market	27,845,438	22,684,041
Savings	68,968,844	76,895,857
Time	229,243,506	202,423,848
Total deposits	394,819,602	362,918,000
Short-term borrowings	1,886,253	1,510,607
Other borrowings	33,903,019	32,395,319
Accrued interest and other liabilities	2,178,813	2,487,746
<b>TOTAL LIABILITIES</b>	<b>\$432,787,687</b>	<b>\$399,311,672</b>
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, no par value; 10,000,000 shares authorized, 1,725,381 and 1,701,546 shares issued	27,301,403	26,650,123
Retained earnings	14,786,353	13,746,956
Accumulated other comprehensive loss	(294,901)	(52,969)
Treasury stock, at cost; 189,530 shares in 2008 and 151,745 shares in 2007	(6,733,607)	(5,382,726)
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>35,059,248</b>	<b>34,961,384</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$467,846,935</b>	<b>\$434,273,056</b>

See accompanying notes to consolidated financial statements.

Year Ended December 31,

<b>Consolidated Statement of Income</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>
<b>INTEREST AND DIVIDEND INCOME</b>			
Interest and fees on loans	\$ 21,426,372	\$ 21,063,258	\$ 17,092,516
Interest-bearing deposits in other institutions	12,468	155,550	20,175
Federal funds sold	135,104	498,040	117,115
Investment securities:			
Taxable	2,538,237	1,265,673	1,143,375
Tax-exempt	1,810,319	1,773,292	1,038,318
Other dividend income	115,313	116,121	83,051
<b>TOTAL INTEREST AND DIVIDEND INCOME</b>	<b>26,037,813</b>	<b>24,871,934</b>	<b>19,494,550</b>
<b>INTEREST EXPENSE</b>			
Deposits	12,352,211	11,633,010	7,157,226
Short-term borrowings	46,084	92,720	167,475
Other borrowings	1,120,491	1,269,910	1,226,877
Junior subordinated debt	539,298	535,279	15,864
<b>TOTAL INTEREST EXPENSE</b>	<b>14,058,084</b>	<b>13,530,919</b>	<b>8,567,442</b>
<b>NET INTEREST INCOME</b>	11,979,729	11,341,015	10,927,108
Provision for loan losses	608,000	429,391	60,000
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	11,371,729	10,911,624	10,867,108
<b>NONINTEREST INCOME</b>			
Service charges on deposit accounts	1,888,059	1,954,992	1,800,173
Investment securities gains (losses), net	(344,049)	7,942	(5,868)
Earnings on bank-owned life insurance	287,305	280,638	239,761
Other income	395,191	389,020	393,389
<b>TOTAL NONINTEREST INCOME</b>	<b>2,226,506</b>	<b>2,632,592</b>	<b>2,427,455</b>
<b>NONINTEREST EXPENSE</b>			
Salaries and employee benefits	4,911,671	4,458,075	3,675,120
Occupancy	885,904	745,935	507,250
Equipment	539,040	525,250	440,878
Data processing costs	803,230	699,185	634,707
Professional fees	586,873	422,991	333,932
Ohio state franchise tax	468,000	424,873	360,000
Advertising	372,988	316,112	331,644
Postage and freight	243,765	208,554	189,629
Other expense	1,784,882	1,571,675	1,465,213
<b>TOTAL NONINTEREST EXPENSE</b>	<b>10,596,353</b>	<b>9,372,650</b>	<b>7,938,373</b>
Income before income taxes	3,001,882	4,171,566	5,356,190
Income taxes	387,003	796,223	1,471,943
<b>NET INCOME</b>	<b>\$ 2,614,879</b>	<b>\$ 3,375,343</b>	<b>\$ 3,884,247</b>
<b>EARNINGS PER SHARE</b>			
Basic	\$ 1.72	\$ 2.17	\$ 2.61
Diluted	1.69	2.14	2.57

See accompanying notes to consolidated financial statements.

# Consolidated Financial Statements

Consolidated Statement of Changes in Stockholders' Equity	Common Stock		Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity	Comprehensive Income (Loss)
	Shares	Amount					
<b>Balance, December 31, 2005</b>	\$ 1,434,987	\$ 15,976,335	\$ 14,959,891	\$ (677,088)	\$ (2,969,773)	\$ 27,289,365	
Net income			3,884,247			3,884,247	\$ 3,884,247
Other comprehensive income:							
Unrealized gain on available-for-sale securities, net of reclassification adjustment, net of taxes of \$80,416				156,101		156,101	156,101
Comprehensive income							<u>\$ 4,040,348</u>
Exercise of stock options	2,439	62,115				62,115	
Purchase of treasury stock					(238,534)	(238,534)	
Common stock issued	7,420	305,711				305,711	
Five percent stock dividend (including cash paid for fractional shares)	67,284	2,842,749	(2,859,600)			(16,851)	
Dividend reinvestment plan	7,757	320,347				320,347	
Cash dividends (\$.87 per share)			(1,298,567)			(1,298,567)	
<b>Balance, December 31, 2006</b>	1,519,887	19,507,257	14,685,971	(520,987)	(3,208,307)	30,463,934	
Net income			3,375,343			3,375,343	\$ 3,375,343
Other comprehensive income:							
Unrealized gain on available-for-sale securities, net of reclassification adjustment, net of taxes of \$241,100				468,018		468,018	468,018
Comprehensive income							<u>\$ 3,843,361</u>
Exercise of stock options	538	14,182				14,182	
Expense related to stock options		26,435	12,695			39,130	
Purchase of treasury stock (56,665 shares)					(2,174,419)	(2,174,419)	
Common stock issued as a result of the acquisition of Emerald Bank	92,447	3,662,750				3,662,750	
Common stock issued	5,735	221,360				221,360	
Five percent stock dividend (including cash paid for fractional shares)	73,547	2,857,301	(2,873,346)			(16,045)	
Dividend reinvestment plan	9,392	360,838				360,838	
Cash dividends (\$.94 per share)			(1,453,707)			(1,453,707)	
<b>Balance, December 31, 2007</b>	1,701,546	26,650,123	13,746,956	(52,969)	(5,382,726)	34,961,384	
Net income			2,614,879			2,614,879	\$ 2,614,879
Other comprehensive income:							
Unrealized loss on available-for-sale securities, net of reclassification adjustment, net of tax benefit of \$124,632				(241,932)		(241,932)	(241,932)
Comprehensive income							<u>\$ 2,372,947</u>
Exercise of stock options	992	19,642				19,642	
Expense related to stock options		15,048				15,048	
Purchase of treasury stock (37,785 shares)					(1,350,881)	(1,350,881)	
Common stock issued	6,888	194,514				194,514	
Dividend reinvestment plan	15,955	422,076				422,076	
Cash dividends (\$.103 per share)			(1,575,482)			(1,575,482)	
<b>Balance, December 31, 2008</b>	\$ 1,725,381	\$ 27,301,403	\$ 14,786,353	\$ (294,901)	\$ (6,733,607)	\$ 35,059,248	
Components of comprehensive income (loss):			2008	2007	2006		
Change in net unrealized gain (loss) on investments available for sale			\$ (469,004)	\$ 472,771	\$ 152,228		
Realized losses (gains) included in net income, net of taxes of \$116,977, \$2,448, and \$1,995			227,072	(4,753)	3,873		
<b>TOTAL</b>			\$ (241,932)	\$ 468,018	\$ 156,101		

See accompanying notes to consolidated financial statements.

Year Ended December 31,

<b>Consolidated Statement of Cash Flows</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>
<b>OPERATING ACTIVITIES</b>			
Net income	\$ 2,614,879	\$ 3,375,343	\$ 3,884,247
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	608,000	429,391	60,000
Depreciation and amortization	645,186	597,741	578,592
Amortization of premium and discount on investment securities	182,656	226,766	233,044
Amortization of net deferred loan fees	(143,673)	(65,763)	(78,577)
Investment securities (gains) losses, net	344,049	(7,942)	5,868
Earnings on bank-owned life insurance	(287,305)	(280,638)	(239,761)
Deferred income taxes	(269,947)	97,308	(58,058)
Compensation expense on stock options	15,048	26,435	-
Increase in accrued interest receivable	94,061	(292,056)	(87,907)
Decrease (increase) in accrued interest payable	(210,461)	540,144	350,939
Other, net	(395,623)	(352,696)	(142,067)
Net cash provided by operating activities	3,196,870	4,294,033	4,506,320
<b>INVESTING ACTIVITIES</b>			
Investment securities available for sale:			
Proceeds from repayments and maturities	16,912,691	10,583,584	11,109,971
Purchases	(39,061,652)	(32,990,009)	(16,932,389)
Proceeds from sales	2,953,089	-	658,976
Investment securities held to maturity:			
Proceeds from repayments and maturities	-	-	95,643
Proceeds from sale of securities	-	102,942	-
Increase in loans, net	(13,388,057)	(20,959,699)	(15,109,371)
Acquisition of subsidiary bank	-	(1,828,301)	-
Purchase of Federal Home Loan Bank stock	(142,100)	(91,100)	(93,000)
Purchase of bank-owned life insurance	-	-	(1,000,000)
Purchase of premises and equipment	(1,407,631)	(570,065)	(585,837)
Proceeds from the sale of other real estate owned	-	61,229	-
Deposit acquisition premium	-	(2,124,212)	-
Net cash used for investing activities	\$ (34,133,660)	\$ (47,815,631)	\$ (21,856,007)
<b>FINANCING ACTIVITIES</b>			
Net increase in deposits	\$ 25,804,674	\$ 38,528,910	\$ 21,600,553
Increase (decrease) in short-term borrowings, net	375,645	(99,131)	(5,101,176)
Proceeds from other borrowings	13,500,000	2,000,000	16,248,000
Repayment of other borrowings	(11,992,300)	(8,967,419)	(6,713,473)
Purchase of treasury stock	(1,350,881)	(2,174,419)	(238,534)
Exercise of stock options	19,642	14,182	62,115
Common stock issued	-	221,360	305,711
Proceeds from dividend reinvestment plan	616,590	360,838	320,347
Tax effect of stock options	-	12,695	-
Cash dividends	(1,575,482)	(1,469,752)	(1,315,418)
Net cash received from deposit acquisition	5,179,043	19,270,054	-
Net cash provided by financing activities	30,576,931	47,697,318	25,168,125
Increase (decrease) in cash and cash equivalents	(359,859)	4,175,720	7,818,438
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	17,815,322	13,639,602	5,821,164
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	\$ 17,455,463	\$ 17,815,322	\$ 13,639,602
<b>SUPPLEMENTAL INFORMATION</b>			
Cash paid during the year for:			
Interest on deposits and borrowings	\$ 14,268,548	\$ 12,910,196	\$ 8,216,503
Income taxes	600,000	850,000	1,498,363
<b>SUMMARY OF BUSINESS ACQUISITION</b>			
Fair value of tangible assets acquired	\$ -	\$ 42,657,925	\$ -
Fair value of core deposit intangible acquired	-	103,781	-
Fair value of liabilities assumed	-	(38,408,610)	-
Stock issued for the purchase of acquired company's common stock	-	(3,662,750)	-
Cash paid in the acquisition	-	(3,887,110)	-
Deferred tax asset	-	889,361	-
Goodwill recognized	\$ -	\$ (2,307,403)	\$ -

See accompanying notes to consolidated financial statements.

# 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 (“MBC”). MBC is a state-chartered bank located in Ohio. On April 19, 2007, Middlefield Banc Corp. acquired Emerald Bank (“EB”), an Ohio-chartered savings bank headquartered in Dublin, Ohio. The Company and its subsidiaries 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 ten locations. The Company is supervised by the Board of Governors of the Federal Reserve System, while MBC and EB are 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 subsidiaries, MBC and EB (the “Banks”). 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.

Securities are periodically reviewed for other-than-temporary impairment based upon a number of factors including, but not limited to, the length of time and extent to which the market value has been less than cost, the financial condition of the underlying issuer, the ability of the issuer to meet contractual obligations, the likelihood of the security’s ability to recover any decline in its market value, and management’s intent and ability to hold the security for a period of time sufficient to allow for a recovery in market value. Among the factors that are considered in determining management’s intent and ability is a review of the Company’s capital adequacy, interest rate risk position, and liquidity. The assessment of a security’s ability to recover any decline in market value, the ability of the issuer to meet contractual obligations, and management’s intent and ability requires considerable judgment. A decline in value that is considered to be other-than-temporary is recorded as a loss within noninterest income in the Consolidated Statement of Income.

## 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 non-accrual loans is recorded as income or applied against principal according to management's judgment as to the collectibility of such principal.

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 non-accrual 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.

# Notes to Consolidated Financial Statements

## Goodwill

Goodwill represents the excess of the cost of businesses acquired over the fair value of the net assets acquired. The Company accounts for goodwill in accordance with Statement of Financial Accounting Standards (“FAS”) No. 142, “*Goodwill and Other Intangible Assets*.” This statement, among other things, requires a two-step process for testing the impairment of goodwill on at least an annual basis. This approach could cause more volatility in the Company’s reported net income because impairment losses, if any, could occur irregularly and in varying amounts. The Company performs an annual impairment analysis of goodwill based on the fair value of the reporting unit determined by estimating the expected present value of future cash flows.

## Intangible Assets

Intangible assets include core deposit intangibles, which are a measure of the value of consumer demand and savings deposits acquired in business combinations accounted for as purchases. The core deposit intangibles are being amortized to expense over a 10 year life on a straight-line basis. The recoverability of the carrying value of intangible assets is evaluated on an ongoing basis, and permanent declines in value, if any, are charged to expense.

## Bank-Owned Life Insurance (BOLI)

The Company owns insurance on the lives of a certain group of key employees. The policies were purchased to help offset the increase in the costs of various fringe benefit plans including healthcare. The cash surrender value of these policies is included as an asset on the consolidated balance sheet and any increases in the cash surrender value are recorded as noninterest income on the consolidated statements of income. In the event of the death of an insured individual under these policies, the Company would receive a death benefit, which would be recorded as noninterest income.

## Income Taxes

The Company and its subsidiaries 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-Based Compensation

The Company accounts for stock compensation based on the grant date fair value of all share-based payment awards that are expected to vest, including employee share options to be recognized as employee compensation expense over the requisite service period.

The cash flows from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for stock-based awards (excess tax benefits) are classified as financing cash flows. Excess tax benefits of \$12,695 have been classified as a financing cash inflow for the year ended December 31, 2007, in the Consolidated Statement of Cash Flows. There were no excess tax benefits recognized in 2008 and 2006.

For purposes of computing 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 option is amortized into compensation expense on a straight-line basis between the grant date for the option and each vesting date. 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)
2006	2.27	4.67	7.18	9.94
2007	2.53	3.70 - 4.80	4.09	9.94
2008	8.54	3.53 - 3.73	33.29	9.94

During the years ended December 31, 2008 and 2007, the Company recorded \$15,048 and \$26,435 of compensation cost related to unvested share-based compensation awards granted in 2007 and 2006, respectively. As of December 31, 2008, there was approximately \$66,981 of unrecognized compensation cost related to unvested share-based compensation awards granted in 2008 that is expected to be recognized in 2009.

The weighted-average fair value of each stock option granted for 2008, 2007, and 2006, was \$2.70, \$3.35, and \$7.19, respectively. The total intrinsic value of options exercised during the years ended December 31, 2008, 2007, and 2006, was \$5,486, \$2,717, and \$16,219, respectively.

### Cash Flow Information

The Company has defined cash and cash equivalents as those amounts included in the Consolidated Balance Sheet captions as “Cash and due from banks,” “Federal funds sold,” and “Interest-bearing deposits with other institutions” with original maturities of less than 90 days.

### Advertising Costs

Advertising costs are expensed as the costs are incurred. Advertising expenses amounted to \$372,988, \$316,112, and \$331,644, for 2008, 2007, and 2006, respectively.

### Reclassification of Comparative Amounts

Certain comparative amounts for prior years have been reclassified to conform to current-year presentations. Such reclassifications did not affect net income or retained earnings.

### Recent Accounting Pronouncements

In December 2007, the FASB issued FAS No. 141 (revised 2007), *Business Combinations* (“FAS 141(R)”), which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in an acquiree, including the recognition and measurement of goodwill acquired in a business combination. FAS No. 141(R) is effective for fiscal years beginning on or after December 15, 2008. Earlier adoption is prohibited. The Company is currently evaluating the impact the adoption of the standard will have on the Company’s results of operations.

# Notes to Consolidated Financial Statements

In December 2007, the FASB issued FAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements — an amendment of ARB No. 51*. FAS No. 160 amends ARB No. 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary, which is sometimes referred to as minority interest, is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. Among other requirements, this statement requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure, on the face of the consolidated income statement, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. FAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. Earlier adoption is prohibited. The Company is currently evaluating the impact the adoption of the standard will have on the Company's results of operations.

In March 2008, the FASB issued FAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*, to require enhanced disclosures about derivative instruments and hedging activities. The new standard has revised financial reporting for derivative instruments and hedging activities by requiring more transparency about how and why an entity uses derivative instruments; how derivative instruments and related hedged items are accounted for under FAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*; and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. FAS No. 161 requires disclosure of the fair values of derivative instruments and their gains and losses in a tabular format. It also requires entities to provide more information about their liquidity by requiring disclosure of derivative features that are credit risk-related. Further, it requires cross-referencing within footnotes to enable financial statement users to locate important information about derivative instruments. FAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. 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 2008, the FASB ratified EITF Issue No. 08-4, *Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjusted Conversion Ratios*. This issue provides transition guidance for conforming changes made to EITF Issue No. 98-5, *Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjusted Conversion Ratios*, that resulted from EITF Issue No. 00-27, *Application of Issue No. 98-5 to Certain Convertible Instruments*, and FAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liability and Equity*. The conforming changes are effective for financial statements issued for fiscal years ending after December 15, 2008, with earlier application permitted. The adoption of this FSP is not expected to have a material effect on the Company's results of operations or financial position.

In May 2008, the FASB issued FASB Staff Position (FSP) No. APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. This FSP provides guidance on the accounting for certain types of convertible debt instruments that may be settled in cash upon conversion. Additionally, this FSP specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. The FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The adoption of this FSP is not expected to have a material effect on the Company's results of operations or financial position.

In February 2008, the FASB Staff Position (FSP) issued FSP No. FAS 140-3, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions*. This FSP concludes that a transferor and transferee should not separately account for a transfer of a financial asset and a related repurchase financing unless (a) the two transactions have a valid and distinct business or economic purpose for being entered into separately, and (b) the repurchase financing does not result in the initial transferor regaining control over the financial asset. The FSP is effective for financial statements issued for fiscal years beginning on or after November 15, 2008, and interim periods within those fiscal years. The adoption of this FSP is not expected to have a material effect on the Company's results of operations or financial position.

In April 2008, the FASB issued FASB Staff Position (FSP) No. 142-3, *Determination of the Useful Life of Intangible Assets* (“FSP 142-3”). FSP 142-3 amends the factors that should be considered in developing assumptions about renewal or extension used in estimating the useful life of a recognized intangible asset under FAS No. 142, *Goodwill and Other Intangible Assets*. This standard is intended to improve the consistency between the useful life of a recognized intangible asset under FAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under FAS No. 141R and other GAAP. FSP 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The measurement provisions of this standard will apply only to intangible assets of the Company acquired after the effective date.

In June 2008, the FASB issued FASB Staff Position (FSP) No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*, to clarify that instruments granted in share-based payment transactions can be participating securities prior to the requisite service having been rendered. A basic principle of the FSP is that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and are to be included in the computation of EPS pursuant to the two-class method. The provisions of this FSP are effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. All prior-period EPS data presented (including interim financial statements, summaries of earnings, and selected financial data) are required to be adjusted retrospectively to conform to the provisions of the FSP. The adoption of this FSP is not expected to have a material effect on the Company’s results of operations or financial position.

In October 2008, the FASB issued FSP No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is not Active*. This FSP clarifies the application of FAS Statement No. 157, *Fair Value Measurements*, in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. This FSP shall be effective upon issuance, including prior periods for which financial statements have not been issued. Revisions resulting from a change in the valuation technique or its application shall be accounted for as a change in accounting estimate (FAS Statement No. 154, *Accounting Changes and Error Corrections*). The disclosure provisions of Statement 154 for a change in accounting estimate are not required for revisions resulting from a change in valuation technique or its application. The Company is currently evaluating the impact the adoption of the FSP will have on the Company’s results of operations.

In December 2008, the FASB issued FASB Staff Position (FSP) No. FAS 132(R)-1, *Employers’ Disclosures about Postretirement Benefit Plan Assets*. This FSP amends FASB Statement No. 132 (revised 2003), *Employers’ Disclosures about Pensions and Other Postretirement Benefits*, to improve an employer’s disclosures about plan assets of a defined benefit pension or other postretirement plan. The disclosures about plan assets required by the FSP are to be provided for fiscal years ending after December 15, 2009. The Company is currently evaluating the impact the adoption of the FSP will have on the Company’s results of operations.

## 2. MERGERS AND ACQUISITIONS

On November 15, 2006, Middlefield Banc Corp. entered into an Agreement and Plan of Merger for the acquisition of Emerald Bank, an Ohio-chartered savings bank headquartered in Dublin, Ohio. Middlefield Banc Corp. organized an interim bank subsidiary under Ohio commercial bank law to carry out the merger with Emerald Bank. The Agreement and Plan of Merger was amended on January 3, 2007 to make the new interim bank subsidiary, known as EB Interim Bank, a party to the agreement. At the effective time of the merger Emerald Bank merged into the new interim subsidiary, which is the surviving corporation and which operates under the name Emerald Bank as a wholly owned commercial bank subsidiary of Middlefield Banc Corp. The purchase price for Emerald Bank totaled \$7,326,890 with one half of the merger consideration payable in cash and the other half in shares of Middlefield Banc Corp. common stock. The merger was approved by both bank regulators and Emerald Bank stockholders. The transaction was completed on April 19, 2007. Emerald Bank operates as a separate banking subsidiary of Middlefield Banc Corp. under the Emerald Bank name, employing a commercial bank charter.

# Notes to Consolidated Financial Statements

The following unaudited pro forma condensed combined financial information presents the results of operations of the Company had the merger taken place at January 1, 2007.

	Twelve Months Ended December 31,	
	2008	2007
Interest income	\$ 26,037,813	\$ 25,712,096
Interest expense	14,058,084	14,041,702
Net interest income	11,979,729	11,670,394
Provision for loan losses	608,000	475,493
Net interest income after provisions for loan losses	11,371,729	11,194,901
Noninterest income	2,226,506	2,659,299
Noninterest expense	10,596,353	10,385,875
Income before income taxes	3,001,882	3,468,325
Provisions for income taxes	387,003	639,923
Net income including restructuring charges	2,614,879	2,828,402
Restructuring charges of \$418,848, net of tax benefit of \$142,408	-	276,440
Net income excluding restructuring charges	\$ 2,614,879	\$ 3,104,842
Net loss per share including restructuring charges	\$ 1.72	\$ 1.82
Basic	\$ 1.69	\$ 1.79
Diluted		
Net income per share excluding restructuring charges		
Basic	\$ 1.72	\$ 2.00
Diluted	\$ 1.69	\$ 1.97

Merger and restructuring charges are recorded in unaudited pro forma condensed combined financial information, and include incremental costs to integrate Emerald Bank with the Company's operations. These charges represent costs associated with these one-time activities and do not represent ongoing costs of the fully integrated combined organization. These one-time charges, as shown in the table above, were expensed as incurred at Emerald Bank prior to the acquisition.

	Twelve Months Ended December 31,	
	2007	
Compensation and benefits	\$ 40,092	
Professional fees	221,389	
Acceleration of contracts	157,367	
Total	\$ 418,848	

On November 9, 2008, EB completed its acquisition of certain deposit liabilities attributable to a third-party financial institution's branch office located in Westerville, Ohio. The acquisition included management personnel, certain other assets, and retail deposits of approximately \$5.9 million. EB recorded goodwill and core deposit intangible of approximately \$354,995.

On August 1, 2007, MBC completed its acquisition of certain deposit liabilities attributable to a third-party financial institution's branch office located in Middlefield, Ohio. The acquisition included management personnel and retail deposits of approximately \$21 million. MBC recorded goodwill and core deposit intangible of approximately \$2.1 million.

### 3. 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.

	2008	2007	2006
Weighted-average common shares outstanding	1,710,861	1,666,265	1,586,463
Average treasury stock shares	(177,888)	(110,667)	(92,809)
Weighted-average common shares and common stock equivalents used to calculate basic earnings per share	1,532,973	1,555,598	1,493,654
Additional common stock equivalents (stock options) used to calculate diluted earnings per share	13,440	21,649	22,999
Weighted-average common shares and common stock equivalents used to calculate diluted earnings per share	1,546,413	1,577,247	1,516,653

Options to purchase 40,307 shares of common stock at prices ranging from \$30.45 to \$40.24 were outstanding during the year ended December 31, 2008 but were not included in the computation of diluted earnings per share as they were anti-dilutive due to the strike price being greater than the average market price as of December 31, 2008. Options to purchase 25,897 shares of common stock at prices ranging from \$36.73 to \$40.24 were outstanding during the year ended December 31, 2007, but were not included in the computation of diluted earnings per share as they were anti-dilutive due to the strike price being greater than the average market price as of December 31, 2007. For the year ended December 31, 2006, there were no anti-dilutive options outstanding.

### 4. STOCK DIVIDEND

The Board of Directors approved a 5 percent stock dividend to stockholders of record as of December 1, 2007, payable December 15, 2007. As a result of the dividend, 73,547 additional shares of the Company's common stock were issued, common stock was increased by \$2,857,301, and retained earnings decreased by \$2,873,346.

The Board of Directors approved a 5 percent stock dividend to stockholders of record as of December 1, 2006, payable December 15, 2006. As a result of the dividend, 67,284 additional shares of the Company's common stock were issued, common stock was increased by \$2,842,749, and retained earnings decreased by \$2,859,600.

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.

# Notes to Consolidated Financial Statements

## 5. INVESTMENT SECURITIES AVAILABLE FOR SALE

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>2008</b>				
U.S. government agency securities	\$ 4,376,650	\$ 126,912	\$ -	\$ 4,503,562
Obligations of states and political subdivisions:				
Taxable	499,528	-	(3,278)	496,250
Tax-exempt	44,328,318	405,958	(1,050,244)	43,684,032
Mortgage-backed securities	54,568,407	1,042,038	(1,046,085)	54,564,360
Total debt securities	103,772,903	1,574,908	(2,099,607)	103,248,204
Equity securities	944,283	141,079	(63,200)	1,022,162
Total	\$104,717,186	\$ 1,715,987	\$ (2,162,807)	\$104,270,366

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>2007</b>				
U.S. government agency securities	\$ 7,872,500	\$ 55,058	\$ (422)	\$ 7,927,136
Obligations of states and political subdivisions:				
Taxable	749,234	-	(6,845)	742,389
Tax-exempt	47,262,680	188,253	(522,389)	46,928,544
Mortgage-backed securities	29,219,323	161,252	(334,940)	29,045,635
Total debt securities	85,103,737	404,563	(864,596)	84,643,704
Equity securities	944,283	396,477	(16,700)	1,324,060
Total	\$ 86,048,020	\$ 801,040	\$ (881,296)	\$ 85,967,764

The amortized cost and fair value of debt securities at December 31, 2008, 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	Fair Value
Due in one year or less	\$ 1,243,594	\$ 1,257,988
Due after one year through five years	5,638,739	5,740,175
Due after five years through ten years	12,764,409	12,884,932
Due after ten years	84,126,161	83,365,109
Total	\$103,772,903	\$103,248,204

Investment securities with approximate carrying values of \$26,102,154 and \$23,974,806 at December 31, 2008 and 2007, respectively, were pledged to secure deposits and other purposes as required by law.

Proceeds from sales of investment securities available for sale were \$2,953,089 during 2008. Gross gains and gross losses realized were \$34,509 and \$2,109, respectively, during 2008. Proceeds from sales of investment securities available for sale and gross losses realized were \$658,976 and \$5,868, respectively, during 2006. There were no sales of investment securities available for sale during 2007.

Proceeds from the sale of investment securities held to maturity and gross gains realized were \$102,942 and \$7,942, respectively, during 2007. The Company transferred investment securities held to maturity with a carrying amount of \$19,899 and fair value of \$20,641 to investment securities available for sale during 2007. The Company no longer maintains a held-to-maturity portfolio.

The Company's investment in two private-label collateralized mortgage obligations aggregating \$1.4 million were impaired as a result of the Company's determination that declines in their fair market value were other than temporary. As a result of this determination, the Company recognized a \$376,449 before tax, non-cash charge, which was recorded as a reduction to noninterest income.

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, 2008 and 2007.

	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
<b>2008</b>						
Obligations of states and political subdivisions	\$17,777,295	\$ (561,005)	\$ 7,820,417	\$ (492,517)	\$25,597,712	\$ (1,053,522)
Mortgage-backed securities	16,107,618	(966,793)	5,062,619	(79,292)	21,170,237	(1,046,085)
Equity securities	221,500	(28,500)	11,250	(34,700)	232,750	(63,200)
Total	\$34,106,413	\$ (1,556,298)	\$12,894,286	\$ (606,509)	\$47,000,699	\$ (2,162,807)

	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
<b>2007</b>						
U.S. government agency securities	\$ -	\$ -	\$ 498,930	\$ (422)	\$ 498,930	\$ (422)
Obligations of states and political subdivisions	12,102,406	(223,753)	19,818,047	(305,481)	31,920,453	(529,234)
Mortgage-backed securities	4,753,699	(42,409)	12,503,364	(292,331)	17,257,063	(334,940)
Equity securities	-	-	29,250	(16,700)	29,250	(16,700)
Total	\$16,856,105	\$ (266,362)	\$32,849,591	\$ (614,934)	\$49,705,696	\$ (881,296)

There are 124 securities that are considered temporarily impaired at December 31, 2008. The Company reviews its position quarterly and has asserted that at December 31, 2008, 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 these unrealized losses are not other than temporary but are the result of interest rate changes that are not expected to result in the non-collection of principal and interest during the period.

# Notes to Consolidated Financial Statements

## 6. LOANS

Major classifications of loans are summarized as follows:

	2008	2007
Commercial and industrial	\$ 66,523,227	\$ 67,009,564
Real estate – construction	7,964,892	6,704,054
Real estate – mortgage:		
Residential	199,354,277	193,514,047
Commercial	42,789,470	36,818,070
Consumer installment	4,943,427	5,400,187
	321,575,293	309,445,922
Less allowance for loan losses	3,556,763	3,299,276
Net loans	\$318,018,530	\$306,146,646

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, 2008 and 2007, loans outstanding to individuals and businesses are dependent upon the local economic conditions in its immediate trade area.

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

Information regarding nonperforming loans at December 31 is as follows:

	2008	2007
90 days or more past due and accruing interest	\$ 2,226,632	\$ 1,917,480
Non-accrual loans (inclusive of impaired loans)	6,254,748	3,744,451
Total nonperforming loans	\$ 8,481,380	\$ 5,661,931

Information regarding impaired loans at December 31 is as follows:

	2008	2007
Impaired loans without a related allowance for loan loss	\$ -	\$ -
Impaired loans with a related allowance for loan loss	2,661,300	2,481,272
Related allowance for loan loss	439,340	348,006
Average recorded investment in impaired loans	1,886,661	1,117,297
Interest income recognized	13,078	126,305

## 7. ALLOWANCE FOR LOAN LOSSES

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

	2008	2007	2006
Balance, January 1	\$ 3,299,276	\$ 2,848,887	\$ 2,841,098
Add:			
Additions from acquisitions	-	436,063	-
Provisions charged to operations	608,000	429,391	60,000
Recoveries	64,353	13,839	28,663
Less loans charged off	414,866	428,904	80,874
Balance, December 31	\$ 3,556,763	\$ 3,299,276	\$ 2,848,887

## 8. PREMISES AND EQUIPMENT

Major classifications of premises and equipment are summarized as follows:

	2008	2007
Land and land improvements	\$ 1,896,376	\$ 1,537,930
Building and leasehold improvements	8,858,066	7,620,924
Furniture, fixtures, and equipment	4,111,853	3,801,814
	14,866,295	12,960,668
Less accumulated depreciation and amortization	6,417,380	5,915,983
Total	\$ 8,448,915	\$ 7,044,685

Depreciation charged to operations was \$518,296 in 2008, \$504,058 in 2007, and \$468,148 in 2006.

## 9. GOODWILL AND INTANGIBLE ASSETS

Goodwill totaled \$4,558,687 at December 31, 2008 and \$4,371,206 at December 31, 2007. During 2008, the Company recorded goodwill totaling \$187,481 in connection with the acquisition of a third-party financial institution's branch office. In 2007, the Company recorded goodwill totaling \$2,339,403 in connection with the acquisition of Emerald Bank, and the Company recorded goodwill totaling \$2,031,803 in connection with the acquisition of a third-party financial institution's branch office.

The Company recorded core deposit intangibles in 2008 of \$109,300 in connection with the acquisitions of a third-party financial institution's branch office.

The Company recorded core deposit intangibles in 2007 of \$103,781 and \$182,100 in connection with the acquisitions of Emerald Bank and a third-party financial institution's branch office, respectively.

# Notes to Consolidated Financial Statements

Core deposit intangible assets are amortized on a straight-line basis over their estimated lives of ten years. Amortization expense totaled \$30,409 in 2008 and \$11,913 in 2007. The estimated aggregate future amortization expense for core deposit intangible assets as of December 31, 2008 is as follows:

2009	\$ 39,518
2010	39,518
2011	39,518
2012	39,518
2013	39,518
Thereafter	155,269
Balance, December 31	\$ 352,859

## 10. OTHER ASSETS

The components of other assets are as follows:

	2008	2007
FHLB stock	\$ 1,873,100	\$ 1,731,000
Accrued interest on investment securities	528,067	475,043
Accrued interest on loans	918,306	1,065,391
Deferred tax asset, net	1,767,873	1,398,408
Other	2,566,941	1,104,210
Total	\$ 7,654,287	\$ 5,774,052

## 11. DEPOSITS

Time deposits at December 31, 2008, mature \$159,240,534, \$33,596,734, \$11,213,508, \$6,212,959, and \$18,979,771 during 2009, 2010, 2011, 2012, and 2013, respectively.

The aggregate of all time deposit accounts of \$100,000 or more amounted to \$69,663,278 and \$51,016,057 at December 31, 2008 and 2007, respectively.

Maturities on time deposits of \$100,000 or more at December 31, 2008, are as follows:

Within three months	\$ 11,084,068
Beyond three but within six months	15,137,052
Beyond six but within twelve months	18,782,587
Beyond one year	24,659,571
Total	\$ 69,663,278

## 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:

	2008	2007	2006
Balance at year-end	\$ 1,886,253	\$ 1,510,607	\$ 1,609,738
Average balance outstanding	2,967,069	2,383,902	3,281,340
Maximum month-end balance	6,057,893	5,768,057	8,245,406
Weighted-average rate at year-end	1.10%	2.96%	4.35%
Weighted-average rate during the year	1.55%	3.89%	5.10%

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 3.0 percent, from Lorain National Bank. At December 31, 2008 and December 31, 2007, there were no outstanding borrowings under this line.

## 13. OTHER BORROWINGS

Other borrowings consist of advances from the FHLB as follows:

Description	Maturity range		Weighted-average interest rate	Stated interest rate range		2008	2007
	from	to		from	to		
Fixed rate	02/13/09	12/27/10	4.25%	2.61%	5.07%	\$ 4,250,000	\$ 5,250,000
Fixed rate amortizing	05/18/09	09/04/28	4.00	2.70	5.51	17,405,019	8,897,319
Convertible	07/28/10	10/09/12	5.30	4.14	6.45	4,000,000	10,000,000
Junior subordinated debt	12/21/37	12/21/37	6.58	6.58	6.58	8,248,000	8,248,000
						\$33,903,019	\$32,395,319

The scheduled maturities of advances outstanding, as of December 31, 2008, are as follows:

Year Ending December 31,	Amount	Weighted-Average Rate
2009	\$ 7,682,102	4.13%
2010	6,320,897	4.85
2011	2,378,922	3.92
2012	3,819,871	4.04
2013	1,393,211	3.96
Beyond 2013	12,308,016	5.73
	\$33,903,019	4.81%

# Notes to Consolidated Financial Statements

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.

Fixed rate amortizing advances from the FHLB 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 \$78 million at December 31, 2008.

In December 2006, the Company formed a special purpose entity (“Entity”) to issue \$8,000,000 of floating rate, obligated mandatorily redeemable securities and \$248,000 in common securities as part of a pooled offering. The rate is fixed through January 2012 at 6.58 percent and floats quarterly thereafter, equal to LIBOR plus 1.67 percent. The Entity may redeem them, in whole or in part, at face value after January 30, 2012. The Company borrowed the proceeds of the issuance from the Entity in December 2006 in the form of an \$8,248,000 note payable, which is included in the liabilities section of the Company’s Consolidated Balance Sheet. Debt issue costs of \$248,000 have been capitalized and are being amortized through the first call date.

## 14. OTHER LIABILITIES

The components of other liabilities are as follows:

	2008	2007
Accrued interest payable	\$ 1,299,114	\$ 1,509,575
Other	879,699	978,171
Total	\$ 2,178,813	\$ 2,487,746

## 15. INCOME TAXES

The provision for federal income taxes consists of:

	2008	2007	2006
Current payable	\$ 656,950	\$ 698,915	\$ 1,530,001
Deferred	(269,947)	97,308	(58,058)
Total provision	\$ 387,003	\$ 796,223	\$ 1,471,943

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:

	2008	2007
Deferred tax assets:		
Allowance for loan losses	\$ 1,114,868	\$ 1,008,069
Net unrealized loss on securities	151,919	27,287
Supplemental retirement plan	134,121	123,339
Origination costs	7,811	25,115
Alternative minimum tax credits	65,637	-
Investment security basis adjustment	127,993	-
Intangibles	45,295	-
Net operating losses	502,676	606,806
Gross deferred tax assets	2,150,320	1,790,616
Deferred tax liabilities:		
Deferred origination fees, net	29,523	55,637
Premises and equipment	83,425	113,170
Other	269,499	223,400
Gross deferred tax liabilities	382,447	392,207
Net deferred tax assets	\$ 1,767,873	\$ 1,398,409

No valuation allowance was established at December 31, 2008 and 2007, 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:

	2008		2007		2006	
	Amount	% of Pre-tax Income	Amount	% of Pre-tax Income	Amount	% of Pre-tax Income
Provision at statutory rate	\$ 1,020,640	34.0%	\$ 1,418,332	34.0%	\$ 1,821,105	34.0%
Tax-free income	(713,193)	(23.8)	(702,123)	(16.8)	(437,874)	(8.2)
Nondeductible interest expense	96,250	3.2	102,830	2.5	54,673	1.0
Other	(16,694)	(0.7)	(22,816)	(0.6)	34,039	0.6
Actual tax expense and effective rate	\$ 387,003	12.7%	\$ 796,223	19.1%	\$ 1,471,943	27.4%

The Company adopted the provisions of FIN No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109," effective January 1, 2007. FIN No. 48 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Benefits from tax positions should be recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should

# Notes to Consolidated Financial Statements

be derecognized in the first subsequent financial reporting period in which that threshold is no longer met. FIN No. 48 also provides guidance on the accounting for and disclosure of unrecognized tax benefits, interest, and penalties. The adoption of FIN No. 48 did not have a significant impact on the Company's financial statements.

## 16. EMPLOYEE BENEFITS

### Retirement Plan

The Banks maintain section 401(k) employee savings and investment plans for all full-time employees and officers of the Banks with more than one year of service. The Banks' contributions to the plans are 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 MBC contributions are fully vested after six years beginning at the second year in 20 percent increments. EB contributions are vested at 25 percent for less than a year of employment, 50 percent after one year, 75 percent after two years, and fully vested after three years. Contributions for 2008, 2007, and 2006 to these plans amounted to \$95,752, \$79,959, and \$71,516, respectively.

### Supplemental Retirement Plan

MBC 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 Plan for the years ended December 31:

	2008	2007	2006
Components of net periodic pension costs			
Service cost	\$ 12,656	\$ 11,991	\$ 9,510
Interest cost	12,813	12,189	9,791
Net periodic pension cost	\$ 25,469	\$ 24,180	\$ 19,301

### Executive Deferred Compensation Plan

During 2006, MBC implemented an Executive Deferred Compensation Plan (the "Plan") to provide post-retirement payments to members of senior management. The Plan agreements are noncontributory, defined contribution arrangements that provide supplemental retirement income benefits to three officers, with contributions made solely by MBC. During 2008 and 2007, MBC contributed \$26,145 and \$49,932 to the Plan, respectively. There were no contributions made to the Plan in 2006.

### 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 160,000 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:

	2008	Weighted-Average Exercise Price	2007	Weighted-Average Exercise Price
Outstanding, January 1	88,211	\$ 28.04	77,287	\$ 26.23
Granted	24,837	23.71	14,840	37.27
Exercised	(992)	19.80	(565)	25.10
Forfeited	(1,591)	23.48	(3,351)	22.11
Outstanding, December 31	110,465	\$ 27.21	88,211	\$ 28.04
Exercisable at year-end	85,628	28.22	83,724	27.86

The following table summarizes the characteristics of stock options at December 31, 2008:

Grant Date	Exercise Price	Outstanding			Exercisable	
		Shares	Contractual Average Life	Average Exercise Price	Shares	Average Exercise Price
June 14, 1999	\$ 23.70	2,074	0.45	\$ 23.70	2,074	\$ 23.70
November 23, 1999	23.13	2,934	0.90	23.13	2,934	23.13
December 11, 2000	17.90	10,274	1.95	17.90	10,274	17.90
December 9, 2002	22.33	9,552	3.94	22.33	9,552	22.33
December 8, 2003	24.29	20,917	4.94	24.29	20,917	24.29
May 12, 2004	27.35	907	5.33	27.35	907	27.35
December 13, 2004	30.45	13,073	5.95	30.45	13,073	30.45
December 14, 2005	36.73	8,595	6.95	36.73	8,595	36.73
December 10, 2006	40.24	3,675	7.95	40.24	3,675	40.24
April 19, 2007	37.33	9,140	8.31	37.33	9,140	37.33
May 16, 2007	37.48	1,337	8.41	37.48	1,337	37.48
December 10, 2007	37.00	3,150	8.95	37.00	3,150	37.00
January 2, 2008	36.25	1,337	9.12	36.25	-	-
November 10, 2008	23.00	23,500	9.95	23.00	-	-
		110,465			85,628	

For the years ended December 31, 2008, 2007, and 2006, the Company granted 150 shares, 130 shares, and 90 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.

# Notes to Consolidated Financial Statements

## 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:

	2008	2007
Commitments to extend credit	\$56,648,649	\$49,375,176
Standby letters of credit	1,357,173	466,647
Total	\$58,005,822	\$49,841,823

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 Banks unless the loans are secured by specific obligations. Further, such secured loans are limited in amount of 10 percent of the Banks' common stock and capital surplus.

### Dividends

MBC and EB are subject to dividend restrictions that generally limit 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, for MBC, the amount available for payment of dividends for 2009 approximates \$2,731,000 plus 2009 profits retained up to the date of the dividend declaration. For EB, the amount available for payment of dividends for 2009 approximates \$62,000 plus 2009 profits retained up to the date of the dividend declaration.

## 19. REGULATORY CAPITAL

Federal regulations require the Company and the Banks 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, 2008 and 2007, the FDIC categorized the Banks 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 and its subsidiaries’ actual capital ratios are presented in the following table that shows that all regulatory capital requirements were met as of December 31, 2008.

	Middlefield Banc Corp. December 31, 2008		The Middlefield Banking Co. December 31, 2008		Emerald Bank December 31, 2008	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (to Risk-Weighted Assets)						
Actual	\$42,281,067	13.57%	\$32,793,489	12.30%	\$ 7,472,699	16.73%
For Capital Adequacy Purposes	24,931,715	8.00	21,324,640	8.00	3,572,686	8.00
To Be Well Capitalized	31,164,644	10.00	26,655,800	10.00	4,465,857	10.00
Tier I Capital (to Risk-Weighted Assets)						
Actual	\$38,689,258	12.41%	\$29,956,378	11.24%	\$ 6,912,474	15.48%
For Capital Adequacy Purposes	12,465,858	4.00	10,662,320	4.00	1,786,343	4.00
To Be Well Capitalized	18,698,787	6.00	15,993,480	6.00	2,679,514	6.00
Tier I Capital (to Average Assets)						
Actual	\$38,689,258	8.66%	\$29,956,378	7.69%	\$ 6,912,474	12.91%
For Capital Adequacy Purposes	17,860,169	4.00	15,578,777	4.00	2,142,047	4.00
To Be Well Capitalized	22,325,211	5.00	19,473,471	5.00	2,677,558	5.00

# Notes to Consolidated Financial Statements

The Company's and its subsidiaries' actual capital ratios are presented in the following table that shows that all regulatory capital requirements were met as of December 31, 2007.

	Middlefield Banc Corp. December 31, 2007		The Middlefield Banking Co. December 31, 2007		Emerald Bank December 31, 2007	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (to Risk-Weighted Assets)						
Actual	\$ 42,664,943	14.56%	\$ 32,028,171	12.67%	\$ 7,777,400	19.50%
For Capital Adequacy Purposes	23,441,926	8.00	20,230,160	8.00	3,190,160	8.00
To Be Well Capitalized	29,302,408	10.00	25,287,700	10.00	3,987,700	10.00
Tier I Capital (to Risk-Weighted Assets)						
Actual	\$ 39,194,767	13.38%	\$ 29,205,547	11.55%	\$ 7,300,748	18.31%
For Capital Adequacy Purposes	11,720,963	4.00	10,115,080	4.00	1,595,080	4.00
To Be Well Capitalized	17,581,445	6.00	15,172,620	6.00	2,392,620	6.00
Tier I Capital (to Average Assets)						
Actual	\$ 39,194,767	9.23%	\$ 29,205,547	7.82%	\$ 7,300,748	14.38%
For Capital Adequacy Purposes	16,990,099	4.00	14,946,917	4.00	2,030,504	4.00
To Be Well Capitalized	21,237,623	5.00	18,683,646	5.00	2,538,130	5.00

## 20. FAIR VALUE DISCLOSURE MEASUREMENTS

Effective January 1, 2008, the Company adopted FAS No. 157, which, among other things, requires enhanced disclosures about assets and liabilities carried at fair value. FAS No. 157 establishes a hierarchal disclosure framework associated with the level of pricing observability utilized in measuring assets and liabilities at fair value. The three broad levels defined by FAS No. 157 hierarchy are as follows:

**Level I:** Quoted prices are available in active markets for identical assets or liabilities as of the reported date.

**Level II:** Pricing inputs are other than the quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities includes items for which quoted prices are available but traded less frequently and items that are fair-valued using other financial instruments, the parameters of which can be directly observed.

**Level III:** Assets and liabilities that have little to no pricing observability as of the reported date. These items do not have two-way markets and are measured using management's best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

The following table presents the assets measured on a recurring basis on the consolidated statements of financial condition at their fair value as of December 31, 2008 by level within the fair value hierarchy. As required by FAS No. 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	December 31, 2008			Total
	Level I	Level II	Level III	
Assets Measured on a Recurring Basis:				
Investment securities available for sale	\$ 1,022,162	\$ 96,568,054	\$ 6,680,150	\$104,270,366

Financial instruments are considered Level III when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. In addition to these unobservable inputs, the valuation models for Level III financial instruments typically also rely on a number of inputs that are readily observable either directly or indirectly. Level III financial instruments also include those for which the determination of fair value requires significant management judgment or estimation. The following table presents the changes in the Level III fair-value category for the year ended December 31, 2008.

The following represent fair value measurements using significant unobservable inputs (Level III):

	Available-for-Sale Securities
Balance, January 1, 2008,	\$ -
Total gains or losses (realized/unrealized)	-
Included in earnings	(376,449)
Included in other comprehensive income	-
Purchases, issuances, and settlements	-
Transfers in and/or out of Level III	7,056,599
Balance, December 31, 2008	\$ 6,680,150
The amount of total gains or losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at the reporting date	\$ (376,449)

Gains and losses (realized and unrealized) included in earnings (or changes in net assets) for the year ended December 31, 2008 are reported as investment securities gains (losses), net on the Consolidated Statement of Income.

At December 31, 2008, the Company changed its valuation technique for certain private-label collateralized mortgage obligations (“CMOs”). Previously, the Company relied on prices compiled by third-party vendors using observable market data (Level II) to determine the values of these securities. However, FAS 157 assumes that fair values of financial assets are determined in an orderly transaction and not a forced liquidation or distressed sale at the measurement date. Based on financial market conditions at December 31, 2008, the Company concluded the fair values obtained from third-party vendors reflected forced liquidation or distressed sales for these CMOs. Therefore, the Company estimated fair value based on a discounted cash flow methodology using appropriately adjusted discount rates reflecting nonperformance and liquidity risks. The change in the valuation technique for these CMOs resulted in a transfer of \$6,680,150 into Level III financial assets.

# Notes to Consolidated Financial Statements

The following table presents the assets measured on a nonrecurring basis on the consolidated statements of financial condition at their fair value as of December 31, 2008, by level within the fair value hierarchy. Impaired loans that are collateral dependent are written down to fair value through the establishment of specific reserves. Techniques used to value the collateral that secure the impaired loan include: quoted market prices for identical assets classified as Level I inputs; observable inputs, employed by certified appraisers, for similar assets classified as Level II inputs. In cases where valuation techniques included inputs that are unobservable and are based on estimates and assumptions developed by management based on the best information available under each circumstance, the asset valuation is classified as Level III inputs.

	December 31, 2008			
	Level I	Level II	Level III	Total
Assets Measured on a Nonrecurring Basis:				
Impaired loans	\$ -	\$ 1,194,594	\$ 1,027,366	\$ 2,221,960

## 21. FAIR VALUE DISCLOSURE OF FINANCIAL INSTRUMENTS

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

	2008		2007	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:				
Cash and cash equivalents	\$ 17,455,463	\$ 17,455,463	\$ 17,815,322	\$ 17,815,322
Investment securities available for sale	104,270,366	104,270,366	85,967,764	85,967,764
Net loans	318,018,530	317,010,526	306,146,646	307,323,642
Bank-owned life insurance	7,440,687	7,440,687	7,153,381	7,153,381
Federal Home Loan Bank stock	1,873,100	1,873,100	1,731,000	1,731,000
Accrued interest receivable	1,446,373	1,446,373	1,540,434	1,540,434
Financial liabilities:				
Deposits	\$394,819,602	\$399,946,594	\$362,918,000	\$364,271,994
Short-term borrowings	1,886,253	1,886,253	1,510,607	1,510,607
Other borrowings	33,903,019	35,771,019	32,395,319	32,262,319
Accrued interest payable	1,299,114	1,299,114	1,509,575	1,509,575

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:

#### **Cash and Cash Equivalents, 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 Available for Sale**

The fair value of investment securities 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. Fair value for certain private-label collateralized mortgage obligations were determined utilizing discounted cash flow models, due to the absence of a current market to provide reliable market quotes for the instruments.

#### **Loans**

The fair value is estimated by discounting future cash flows using current market inputs at which loans with similar terms and qualities would be made to borrowers of similar credit quality. Where quoted market prices were available, primarily for certain residential mortgage loans, such market rates were utilized as estimates for fair value.

#### **Deposits and Other Borrowed Funds**

The fair values of certificates of deposit and other borrowed funds are based on the discounted value of contractual cash flows. The discount rates are estimated using rates currently offered for similar instruments with similar remaining maturities. Demand, savings, and money market deposits 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.

# Notes to Consolidated Financial Statements

## 22. PARENT COMPANY

Following are condensed financial statements for the Company.

CONDENSED BALANCE SHEET	December 31,	
	2008	2007
ASSETS		
Cash and due from banks	\$ 695,025	\$ 1,199,416
Interest-bearing deposits in other institutions	112,215	110,387
Investment securities available for sale	1,022,162	1,324,060
Other assets	248,000	420,175
Investment in subsidiary bank	41,435,443	40,452,190
<b>TOTAL ASSETS</b>	<b>\$43,512,845</b>	<b>\$43,506,228</b>
LIABILITIES		
Junior subordinated debt	\$ 8,248,000	\$ 8,248,000
Other liabilities	205,597	296,844
STOCKHOLDERS' EQUITY	35,059,248	34,961,384
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$43,512,845</b>	<b>\$43,506,228</b>

CONDENSED STATEMENT OF INCOME	Year Ended December 31,		
	2008	2007	2006
INCOME			
Dividends from subsidiary bank	\$ 2,184,241	\$ 2,018,050	\$ 1,277,306
Interest income	10,029	154,199	19,931
Other	5,108	6,965	-
<b>TOTAL INCOME</b>	<b>2,199,378</b>	<b>2,179,214</b>	<b>1,297,237</b>
EXPENSES			
Interest expense	539,298	535,280	18,387
Other	379,076	269,861	180,651
<b>TOTAL INCOME</b>	<b>918,374</b>	<b>805,141</b>	<b>199,038</b>
Income before income tax benefit	1,281,004	1,374,073	1,098,199
Income tax benefit	(322,991)	(218,952)	(60,644)
Income before equity in undistributed net income of subsidiary	1,603,995	1,593,025	1,158,843
Equity in undistributed net income of subsidiary	1,010,884	1,782,318	2,725,404
<b>NET INCOME</b>	<b>\$ 2,614,879</b>	<b>\$ 3,375,343</b>	<b>\$ 3,884,247</b>

CONDENSED STATEMENT OF CASH FLOWS	Year Ended December 31,		
	2008	2007	2006
<b>OPERATING ACTIVITIES</b>			
Net income	\$ 2,614,879	\$ 3,375,343	\$ 3,884,247
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed net income of Middlefield Banking Company	(981,770)	(1,749,538)	(2,725,404)
Equity in undistributed net income of Emerald Bank	(29,114)	(32,780)	-
Compensation expense on stock options	15,048	26,435	-
Other	168,526	76,419	15,865
Net cash provided by operating activities	1,787,569	1,695,879	1,174,708
<b>INVESTING ACTIVITIES</b>			
Deferred acquisition costs	-	-	(123,175)
Investment in unconsolidated subsidiary	-	-	(248,000)
Purchase of investment securities	-	(250,000)	(250,020)
Net assets of Emerald Bank acquired	-	(5,912,621)	-
Net cash used for investing activities	-	(6,162,621)	(621,195)
<b>FINANCING ACTIVITIES</b>			
Issuance of trust-preferred securities	-	-	8,248,000
Purchase of treasury stock	(1,350,881)	(2,174,419)	(238,534)
Exercise of stock options	19,642	14,182	62,115
Proceeds from dividend reinvestment and purchase plan	616,589	582,198	626,058
Tax effect of stock options	-	12,695	-
Cash dividends	(1,575,482)	(1,469,752)	(1,315,418)
Net cash provided by (used for) financing activities	(2,290,132)	(3,035,096)	7,382,221
Increase (decrease) in cash	(502,563)	(7,501,838)	7,935,734
CASH AT BEGINNING OF YEAR	1,309,803	8,811,641	875,907
CASH AT END OF YEAR	\$ 807,240	\$ 1,309,803	\$ 8,811,641

# Notes to Consolidated Financial Statements

## 23. SELECTED QUARTERLY FINANCIAL DATA (Unaudited)

	Three Months Ended			
	March 31, 2008	June 30, 2008	September 30, 2008	December 31, 2008
Total interest income	\$ 6,588,203	\$ 6,512,636	\$ 6,550,445	\$ 6,386,529
Total interest expense	3,757,986	3,513,850	3,398,663	3,387,585
Net interest income	2,830,217	2,998,786	3,151,782	2,998,944
Provision for loan losses	75,000	95,000	187,000	251,000
Net interest income after provision for loan losses	2,755,217	2,903,786	2,964,782	2,747,944
Total noninterest income	637,451	637,217	680,247	271,591
Total noninterest expense	2,515,672	2,578,974	2,729,581	2,772,126
Income before income taxes	876,996	962,029	915,448	247,409
Income taxes	140,000	179,000	211,000	(132,997)
Net income	\$ 736,996	\$ 783,029	\$ 704,448	\$ 380,406
Per share data:				
Net income				
Basic	\$ 0.48	\$ 0.51	\$ 0.46	\$ 0.26
Diluted	0.47	0.51	0.46	0.25
Average shares outstanding				
Basic	1,548,043	1,530,255	1,523,044	1,530,686
Diluted	1,568,380	1,548,607	1,525,373	1,532,597

	Three Months Ended			
	March 31, 2007	June 30, 2007	September 30, 2007	December 31, 2007
Total interest income	\$ 5,391,747	\$ 6,235,712	\$ 6,573,178	\$ 6,671,297
Total interest expense	2,779,298	3,359,372	3,666,111	3,726,138
Net interest income	2,612,449	2,876,340	2,907,067	2,945,159
Provision for loan losses	45,000	69,391	60,000	255,000
Net interest income after provision for loan losses	2,567,449	2,806,949	2,847,067	2,690,159
Total noninterest income	621,628	648,243	653,810	708,911
Total noninterest expense	2,273,702	2,320,833	2,416,933	2,361,182
Income before income taxes	915,375	1,134,359	1,083,944	1,037,888
Income taxes	163,000	235,128	223,000	175,095
Net income	\$ 752,375	\$ 899,231	\$ 860,944	\$ 862,793
Per share data:				
Net income				
Basic	\$ 0.51	\$ 0.57	\$ 0.54	\$ 0.55
Diluted	0.49	0.56	0.54	0.55
Average shares outstanding				
Basic	1,497,417	1,578,583	1,585,225	1,561,771
Diluted	1,519,911	1,600,045	1,604,693	1,582,872



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 subsidiaries as of December 31, 2008 and 2007, 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, 2008. 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 subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ending December 31, 2008, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 20 to the consolidated financial statements, effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*.

We were not engaged to examine management's assertion about the effectiveness of the Company's internal control over financial reporting as of December 31, 2008, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting and, accordingly, we do not express an opinion thereon.

*S. R. Snodgrass, A.C.*

S.R. Snodgrass, A.C.  
Wexford, PA  
March 9, 2009

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

## Overview

The consolidated review and analysis of Middlefield Banc Corp. ("Company") is intended to assist the reader in evaluating the performance of the Company for the years ended December 31, 2008, 2007, and 2006. This information should be read in conjunction with the consolidated financial statements and accompanying notes to the financial statements.

The Company is an Ohio corporation organized to become the holding company of The Middlefield Banking Company ("MBC"). MBC is a state-chartered bank located in Ohio. On April 19, 2007, the Company acquired Emerald Bank ("EB"), an Ohio-chartered commercial bank headquartered in Dublin, Ohio. The Company and its two banking subsidiaries 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 Banks are subject to regulation and supervision by the Federal Deposit Insurance Corporation and the Ohio Division of Financial Institutions. MBC and EB are members of the Federal Home Loan Bank (FHLB) of Cincinnati, which is one of the twelve regional banks comprising the FHLB System.

This Management's Discussion and Analysis section of the Annual Report contains 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 the Company's control. Although the Company 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 the Company 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 2008

On November 9, 2008, EB completed its acquisition of certain deposit liabilities attributable to a third-party financial institution's branch office located in Westerville, Ohio. The acquisition included management personnel and retail deposits of approximately \$5.9 million. EB recorded goodwill and core deposit intangible of approximately \$355,000.

## 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 previous pages of this Annual Report.

The allowance for loan loss balance as of December 31, 2008 totaled \$3.6 million representing a \$258,000 increase from the end of 2007. For the year of 2008, the provision for credit losses was \$608,000, which represented an increase from the \$429,000 allocated during 2007. This level of provision during 2008 is reflective of the changing economic conditions adversely impacting the market areas served by the company's affiliate banks, which have caused non-performing loans to increase. Asset quality is a high-priority in our overall business plan as it relates to long-term asset growth projections. During 2008, net charge offs declined by \$65,000 compared to 2007. Two key ratios to monitor asset quality performance are net charge offs/average loans and the allowance for loan losses/non-performing loans. At year-end 2008, these ratios were .11% and 41.9% respectively compared to .15% and 58.3% in 2007.

### Valuation of Securities

Securities are classified as held-to-maturity or available-for-sale on the date of purchase. Only those securities classified as held-to-maturity are reported at amortized cost. Available-for-sale and trading securities are reported at fair value with unrealized gains and losses included in accumulated other comprehensive income, net of related deferred income taxes, on the Consolidated Balance Sheets and noninterest income in the Consolidated Statements of Income, respectively. The fair value of a security is determined based on quoted market prices. If quoted market prices are not available, fair value is determined based on quoted prices of similar instruments. Realized securities gains or losses are reported within noninterest income in the Consolidated Statements of Income. The cost of securities sold is based on the specific identification method. Available-for-sale securities are reviewed quarterly for possible other-than-temporary impairment. The review includes an analysis of the facts and circumstances of each individual investment such as the severity of loss, the length of time the fair value has been below cost, the expectation for that security's performance, the creditworthiness of the issuer and the Banc Corp.'s intent and ability to hold the security to recovery. A decline in value that is considered to be other-than-temporary is recorded as a loss within noninterest income in the Consolidated Statements of Income. The Company believes the price movements in these securities are dependent upon the movement in market interest rates. The Company's management also maintains the intent and ability to hold securities in an unrealized loss position to the earlier of the recovery of losses or maturity.

### Income Taxes

The Company estimates income tax expense based on amounts expected to be owed to the various tax jurisdictions in which the Company conducts business. On a quarterly basis, management assesses the reasonableness of its effective tax rate based upon its current estimate of the amount and components of net income, tax credits and the applicable statutory tax rates expected for the full year. The estimated income tax expense is recorded in the Consolidated Statements of Income.

Deferred income tax assets and liabilities are determined using the balance sheet method and are reported in accrued taxes, interest, and expenses in the Consolidated Balance Sheets. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax basis of assets and liabilities and recognizes enacted changes in tax rates and laws. Deferred tax assets are recognized to the extent they exist and are subject to a valuation allowance based on management's judgment that realization is more-likely-than-not.

Accrued taxes represent the net estimated amount due to taxing jurisdictions and are reported in accrued taxes, interest, and expenses in the Consolidated Balance Sheets. The Company evaluates and assesses the relative risks and appropriate tax treatment of transactions and filing positions after considering statutes, regulations, judicial precedent, and other information, and maintains tax accruals consistent with its evaluation of these relative risks and merits. Changes to the estimate of accrued taxes occur periodically due to changes in tax rates, interpretations of tax laws, the status of examinations being conducted by taxing

# Management's Discussion and Analysis

## of Financial Condition and Results of Operations

authorities, and changes to statutory, judicial, and regulatory guidance that impact the relative risks of tax positions. These changes, when they occur, can affect deferred taxes and accrued taxes as well as the current period's income tax expense and can be significant to the operating results of the Company.

### Changes in Financial Condition

**General.** The Company's total assets increased \$33.6 million or 7.7% to \$467.9 million at December 31, 2008 from \$434.3 million at December 31, 2007. This increase was composed of a net increase in investment securities of \$18.3 million, net loans receivable of \$11.9 million, and accrued interest and other assets of \$1.9 million.

The increase in the Company's total assets reflects a corresponding increase in total liabilities of \$33.5 million or 8.4% to a total balance of \$432.8 million at December 31, 2008 from \$399.3 million at December 31, 2007. The Company also experienced an increase in total stockholders' equity of \$98,000 to a new balance of \$35.1 million as of December 31, 2008 from \$35.0 million at December 31, 2007.

The increase in total liabilities was primarily due to deposit growth for the year. Total deposits increased \$31.9 million or 8.8% to \$394.8 million at December 31, 2008 from \$362.9 million at December 31, 2007. The net increase in total stockholders' equity can be attributed to an increase in common stock and net income offset by an increase in treasury stock of \$1.4 million.

**Cash on hand, Interest-earning deposits and Federal funds sold.** Cash on hand, interest-earning deposits, and federal funds sold represent cash equivalents which decreased a combined \$360,000 or 2.0% to \$17.5 million at December 31, 2008 from \$17.8 million at December 31, 2007. 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 2008 can be attributed principally to a decline in Federal funds sold balances.

**Securities.** Management's goal in structuring the portfolio is to maintain a prudent level of liquidity while providing an acceptable rate of return without sacrificing asset quality. Maturing securities have historically provided sufficient liquidity. The balance of total securities increased \$18.3 million or 21.3% as compared to 2007, with the ratio of securities to total assets also increasing to 22.3% at December 31, 2008, compared to 19.8% at December 31, 2007. This trend of higher security investments was driven by an increase in mortgage-backed securities of \$25.5 million or 87.9% as compared to year-end 2007. The growth in this segment of investments was the result of attractive yield opportunities and a desire to increase diversification within the Company's securities portfolio. This growth was partially offset by a decline in government agency and obligations of state and political subdivisions securities of \$3.4 million and \$3.5 million from year-end 2007.

The Company continues to benefit from the advantages of mortgage-backed securities, which totaled \$54.6 million or 52.3% of the Company's total investment portfolio at December 31, 2008. The primary advantage of mortgage-backed securities has been the increased cash flows due to the more rapid (monthly) repayment of principal as compared to other types of investment securities, which deliver proceeds upon maturity or call date. The weighted average federal tax equivalent (FTE) yield on securities at year-end 2008 was 5.48%, as compared to 5.28% at year-end 2007 and 4.72% at year-end 2006. While the Company's focus is to generate interest revenue primarily through loan growth, management will continue to invest excess funds in securities when opportunities arise.

Substantially, all of our securities are valued based on quoted market prices. However, certain securities are less actively traded and do not always have quoted market prices. The determination of their fair value, therefore, requires judgment, as this determination may require benchmarking to similar instruments or analyzing default and recovery rates. Examples include certain collateralized mortgage and debt obligations and high-yield debt securities.

**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 commercial loans to finance the business operations and, to a lesser extent, construction and consumer loans. Net loans receivable increased \$11.9 million or 3.9% to \$318.0 million at December 31, 2008 from \$306.2 million at December 31, 2007. Included in this growth were increases in most loan types including residential, commercial, and construction real estate of \$5.8, \$6.0, and \$1.3 million, respectively.

The product mix in the loan portfolio includes commercial loans comprising 20.7%, construction loans 2.5%, residential real estate loans 62.0%, commercial real estate loans 13.3%, and consumer loans 1.5% at December 31, 2008 compared with 21.7%, 2.2%, 62.5%, 11.9%, and 1.8%, respectively, at December 31, 2007.

Loans contributed 82.3% of total interest income in 2008 and 84.7% in 2007. The loan portfolio yield of 6.75% in 2008 was 35 basis points greater than the average yield for total interest earning assets. Management recognizes that while the loan portfolio holds some of the Company's highest yielding assets, it is inherently the most risky portfolio. Accordingly, management attempts to balance credit risk versus return with conservative credit standards. Management has developed and maintains comprehensive underwriting guidelines and a loan review function that monitors credits during and after the approval process. To minimize risks associated with changes in the borrower's future repayment capacity, the Company generally requires scheduled periodic principal and interest payments on all types of loans and normally requires collateral.

The Company will continue to monitor the relatively mild pace of its loan portfolio growth during 2009. The Company's lending markets remain challenging and have impacted loan growth due to increased payoffs and a flat to declining level of loan originations during 2008. The Company anticipates total loan growth to be marginal, with volume to continue at a flat to moderate pace throughout 2009. The Company remains committed to sound underwriting practices without sacrificing asset quality and avoiding exposure to unnecessary risk that could weaken the credit quality of the portfolio.

**FHLB stock.** FHLB stock increased \$142,000 or 8.2% to \$1.9 million at December 31, 2008 from \$1.7 million at December 31, 2007, primarily as a result of increased asset size of both affiliates that is used to calculate the minimum stock requirement.

**Goodwill.** Goodwill results from prior business acquisitions and represents the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Goodwill is assessed annually for impairment and any such impairment is recognized in the period identified by a charge to earnings. In assessing goodwill for impairment, management estimates the fair value of the Company's banking subsidiary to which the goodwill relates. To arrive at fair value estimates, management considers prices received upon sale of other banking institutions of similar size and with similar operating results. Purchase prices as a multiple of earnings, book value, tangible book value, and deposits are considered and applied to the Company's banking subsidiary.

The process of evaluating goodwill for impairment requires management to make significant estimates and judgments. The use of different estimates, judgments or approaches to estimate fair value could result in a different conclusion regarding impairment of goodwill. Based on the analysis, management has determined that there is no goodwill impairment.

The Company routinely utilizes the services of an independent third party that is regarded in the banking industry as an expert in valuing core deposits and monitoring the ongoing value of core deposit intangibles and goodwill on an annual basis. Goodwill increased from \$4.4 million in 2007 to \$4.6 million in 2008. This increase was due to the goodwill created from the acquisition of a third party financial institution's branch office in early November of 2008.

**Bank-owned life insurance.** Bank owned life insurance (BOLI) is universal life insurance, purchased by the Company, on the lives of the Company'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 Company as the owner of the policies. BOLI increased by \$287,000 to \$7.4 million at December 31, 2008 from \$7.2 million at the end of 2007 as a result of the earnings of the underlying insurance policies.

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**Deposits.** Interest-earning assets are funded generally by both interest-bearing and noninterest-bearing core deposits. Deposits are influenced by changes in interest rates, economic conditions, and competition from other banks. The Company considers various sources when evaluating funding needs including, but not limited to, deposits, which represented 91.7% of the Company's total funding sources at December 31, 2008. The deposit base consists of demand deposits, savings, money market accounts, and time deposits. Total deposits increased \$31.9 million or 8.8% to \$394.8 million at December 31, 2008 from \$362.9 million at December 31, 2007.

Time deposits, particularly certificates of deposit ("CD's"), remain the most significant source of funding for the Company's earning assets, making up 58.1% of total deposits. During 2008, time deposits increased \$26.8 million or 13.2% from year-end 2007. This increase was primarily due to customers' fleeing to safety from the volatility of the stock market. As market rates have declined over the past year, the Company has seen the cost of its retail CD balances re-price downward to reflect current deposit rates.

Partially offsetting the increases in time deposits was the decline in the Company's savings balances, which were down \$7.9 million or 10.3% to finish at \$69.0 million at year-end 2008 as compared to \$76.9 million at year-end 2007. This decline was due to a \$14.2 million reduction in prime savings accounts at EB. EB experienced a \$16.2 million increase in CDs in 2008 to offset this decline.

Also partially offsetting savings decreases was growth in the Company's interest-bearing demand deposits, which were up \$6.9 million or 35.0% from year-end 2007. The Company will continue to experience increased competition for deposits in its market areas, which should challenge net growth in its deposit balances. The Company will continue to evaluate its deposit portfolio mix to properly utilize both retail and wholesale funds to support earning assets and minimize interest costs.

**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, junior subordinated debt, and repurchase agreement borrowings. Borrowed funds increased \$1.9 million or 5.6% to \$35.8 million at December 31, 2008 from \$33.9 million at December 31, 2007. FHLB advances increased \$1.5 million with short-term borrowings increasing \$375,000.

**Stockholders' equity.** The Company maintains a capital level that exceeds regulatory requirements as a margin of safety for its depositors and shareholders. All of the capital ratios exceeded the regulatory well capitalized guidelines. Shareholders' equity totaled \$35.1 million at December 31, 2008, compared to \$35.0 million at December 31, 2007, which represents growth of 0.3%. Contributing most to this increase was year-to-date net income of \$2.6 million. Partially offsetting the growth in capital were cash dividends paid of \$1.6 million, or \$1.03 per share, year-to-date, and \$1.4 million in treasury stock repurchases. Cash dividends paid for 2008 represents a 9.6% increase as compared to 2007.

The Company may repurchase additional common shares from time to time as authorized by its stock repurchase program. The Company's Board of Directors has approved annual extensions to the plan. Most recently, the Board of Directors extended the stock repurchase program from May 12, 2008 to May 12, 2009, and authorized to repurchase up to 77,000 of its common shares through open market and privately negotiated purchases.

Furthermore, the Company maintains a dividend reinvestment and stock purchase plan. The plan allows shareholders to purchase additional shares of company stock. A benefit of the plan is to permit the shareholders to reinvest cash dividends as well as make supplemental purchases without the usual payment of brokerage commissions. During 2008, shareholders invested more than \$613,000 through the dividend reinvestment and stock purchase plan. These proceeds resulted in the issuance of 22,693 new shares.

**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,

	2008			2007			2006		
	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	\$317,226	\$ 21,426	6.75%	\$288,022	\$ 21,063	7.31%	\$240,452	\$ 17,093	7.11%
Investments securities (3)	96,277	4,349	5.48%	74,820	3,040	5.28%	57,520	2,181	4.72%
Interest-bearing deposits with other banks	7,701	263	3.41%	13,829	770	5.57%	4,503	221	4.91%
Total interest-earning assets	421,204	26,038	6.40%	376,671	24,873	6.85%	302,475	19,495	6.62%
Noninterest-earning assets	29,407			21,307			16,231		
Total assets	450,610			397,979			318,706		
Interest-bearing liabilities:									
Interest-bearing demand deposits	\$ 24,178	297	1.23%	\$ 15,541	359	2.31%	\$ 11,280	133	1.18%
Money market deposits	25,042	783	3.13%	25,057	1,026	4.09%	13,675	374	2.73%
Savings deposits	70,868	1,363	1.92%	68,882	1,695	2.46%	57,831	910	1.57%
Certificates of deposit	216,732	9,912	4.57%	172,552	8,581	4.97%	135,763	5,740	4.23%
Borrowings	36,229	1,702	4.70%	36,639	1,870	5.10%	30,767	1,410	4.58%
Total interest-bearing liabilities	373,049	14,058	3.77%	318,671	13,531	4.25%	249,316	8,567	3.44%
Noninterest-bearing liabilities									
Other liabilities	44,762			45,769			40,799		
Stockholders' equity	33,051			33,539			28,591		
Total liabilities and stockholders' equity	\$450,862			\$397,979			\$318,706		
Net interest income		\$ 11,980			\$ 11,342			\$ 10,928	
Interest rate spread (1)			2.63%			2.60%			3.19%
Net yield on interest-earning assets (2)			3.06%			3.25%			3.79%
Ratio of average interest-earning assets to average interest-bearing liabilities			112.91%			118.20%			121.32%

(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.

(3) Tax equivalent adjustments to interest income for tax-exempt securities were \$932, \$913, and \$535 for 2008, 2007, and 2006 respectively.

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	2008 versus 2007 Increase (decrease) due to			2007 versus 2006 Increase (decrease) due to		
	Volume	Rate	Total	Volume	Rate	Total
	(Dollars in thousands)			(Dollars in thousands)		
Interest income						
Loans receivable	\$ 2,136	\$ (1,773)	\$ 363	\$ 3,382	\$ 588	\$ 3,970
Investments securities	1,133	176	1,309	817	42	859
Other interest-earning assets	(341)	(166)	(507)	458	91	549
Total interest-earning assets	2,928	(1,763)	1,165	4,657	721	5,378
Interest expense						
Interest-bearing demand deposits	200	(261)	(62)	50	176	226
Money market deposits	(1)	(242)	(243)	311	341	652
Savings deposits	49	(381)	(332)	174	611	785
Certificates of deposit	2,197	(866)	1,331	1,555	1,286	2,841
Other interest-bearing liabilities	(21)	(147)	(168)	269	191	460
Total interest-bearing liabilities	2,424	(1,897)	527	2,359	2,605	4,964
Change in net interest income	\$ 504	\$ 134	\$ 638	\$ 2,298	\$ (1,884)	\$ 414

## Changes in Results of Operations

### 2008 Results Compared to 2007 Results

**General.** The Company posted net income of \$2.6 million, compared to \$3.4 million for the year ended December 31, 2007. On a per share basis, 2008 earnings were \$1.69 per diluted share, representing a decrease from the \$2.14 per diluted share for the year ended December 31, 2007. The return on average equity for the year ended December 31, 2008 was 7.91% and its return on average assets was 0.58%. The \$760,000 or 22.5% decline in net income between 2008 and 2007 can primarily be attributed to an increase in total noninterest expense of \$1.2 million.

**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 by \$638,000 in 2008 to \$12.03 million compared to \$11.3 million for 2007. This increase is the net result of a \$1.2 million rise in interest income which was partially offset by a rise in interest expense of \$527,000. Interest-earning assets averaged \$421.2 million during 2008 representing a \$44.5 million or 11.8% increase since year-end 2007. The Company's average interest-bearing liabilities increased 54.4% from \$318.6 million in 2007 to \$373.1 million in 2008.

The Company finances its earning assets with a combination of interest-bearing and interest-free funds. The interest-bearing funds are composed of deposits, short-term borrowings, and long-term debt. Interest paid for the use of these funds is the second factor in the net interest income equation. Interest-free funds, such as demand deposits and stockholders' equity, require no interest expense and, therefore, contribute significantly to net interest income.

The profit margin, or spread, on invested funds is a key performance measure. The Company monitors two key performance indicators — net interest spread and net interest margin. The net interest spread represents the difference between the average rate earned on interest-earning assets and the average rate paid on interest-bearing liabilities. The net interest margin represents the overall profit margin: net interest income as a percentage of total interest-earning assets. This performance indicator gives effect to interest earned for all investable funds including the substantial volume of interest-free funds. For 2008 the net interest margin, measured on a fully taxable equivalent basis, decreased to 3.06% compared to 3.25% in 2007.

**Interest income.** Interest income increased \$1.2 million or 4.7% to \$26.0 million for 2008, compared to \$24.9 million for 2007. The increase in interest income can be attributed to the growth of interest earned investment securities of \$1.3 million or 43.1%. This change was primarily attributable to an increase in the average balance of investment securities of \$21.5 million or 28.7% to \$96.3 million for the year ended December 31, 2008 as compared to \$74.8 million for the year ended December 31, 2007. In addition to growth, there was also an increase in the investment security yield to 5.48% for 2008, compared to 5.28% for 2007.

Interest earned on loans increased \$363,000 to \$21.4 million for 2008, compared to \$21.1 million for 2007. This increase was primarily attributable to the growth of the average balance of loans of \$29.2 million to \$317.2 million for the year ended December 31, 2008 as compared to \$288.0 million for the year ended December 31, 2007. In addition to growth there was also a decline in the loan yield to 6.75% for 2008, compared to 7.31% for 2007. This decline was due to the fact that a large percentage of the loan portfolio uses the prime rate as its index. The prime rate declined by 400 basis points from 7.25% to 3.25% in 2008.

**Interest expense.** Interest expense increased by \$527,000 or 3.9% to \$14.1 for 2008, compared with \$13.5 million for 2007. This change in interest expense can be attributed to an increase in the average balance of interest-bearing liabilities which was partially offset by a 48 basis point decline in the rate paid on these liabilities. For the year ended December 31, 2008, the average balance of interest-bearing liabilities grew by \$54.4 million to \$373.1 million as compared to \$318.7 million for the year ended December 31, 2007. Interest incurred on deposits grew by \$719,000 for the year from \$11.6 million in 2007 to \$12.4 million for year-end 2008. The change in deposit expense was due to both an increase in the average balance of \$54.8 million in 2008 which was partially offset by a 43 basis point decline during the year. Interest incurred on FHLB advances, repurchase agreements, junior subordinated debt, and other borrowings declined \$192,000 or 10.1% to \$1.7 million for 2008, compared to \$1.9 million for 2007. The decline was primarily attributable to a 40 basis point decrease in the rate paid on these borrowings during the year.

**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 \$608,000 in 2008 as compared to \$429,000 in 2007. 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. This level of provision during 2008 is reflective of the changing economic conditions adversely impacting the market areas served by the Company's affiliate banks, which have caused charge offs and non-performing loans to increase. Net charge offs for 2008 was \$351,000, which was below the \$423,000 of net charged offs during 2007. The allowance for loan losses at December 31, 2008 stood at \$3,557,000 or 1.11% of total loans.

**Noninterest income.** Noninterest income, exclusive of other than temporary charges of \$376,000, decreased \$29,000 for the twelve-month period ending December 31, 2008 over the equal reporting period of 2007. The decreases were primarily the result of a decline in deposit service charges, which corresponds to a reduction in overdraft fees and statement service charges at MBC. These reductions were driven, in part, by a wider acceptance of the free checking account product in that market. The other-than-temporary impairment charge relates to two mortgage backed securities held by one of the Company's subsidiary banks. Management has concluded that it is probable that there has been an adverse change in estimated cash flows for those securities, which management deemed to be other-than-temporarily impaired in accordance with generally accepted accounting principles.

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**Noninterest expense.** Total noninterest expense for the full year of 2008 was 13.1% higher than the level of 2007. The factors that primarily led to the increase were costs associated with the operation of additional offices, increased staffing levels related to those offices, and associated higher levels of equipment depreciation. While The Middlefield Banking Company opened its office in Cortland, Ohio, in June of 2008, its Newbury, Ohio, office was completing its second year of operation in 2008. Emerald Bank expanded into Westerville, Ohio, with the purchase of a branch office in early November 2008. Deposit insurance premiums paid to the FDIC during the period ended December 31, 2008 increased \$139,000 over the prior year, as that agency sought to maintain the legally prescribed coverage ratio. Audit and exam expense increased \$101,000 during 2008 as the company continued its efforts to ensure compliance with the provisions of the Sarbanes-Oxley Act of 2002 and other regulatory mandates. Data processing costs for 2008 increased \$104,000 over the prior year. This increased expense was driven by an increase in customer relationships and the expansion of product offerings.

**Provision for income taxes.** The provision for income taxes declined \$409,000 or 51.4% to \$387,000 for 2008, compared to \$796,000 for 2007. This decrease was primarily the result of a decline in income before taxes of \$1.2 million or 28.0% to \$3.0 million for 2008, compared to \$4.2 million for 2007. The Company's federal rate in 2008 totaled 12.9% compared to 19.1% in 2007.

### 2007 Results Compared to 2006 Results

**General.** The Company posted net income of \$3.4 million, compared to \$3.9 million for the year ended December 31, 2006. On a per share basis, 2007 earnings were \$2.14 per diluted share, representing a decrease from the \$2.57 per diluted share for the year ended December 31, 2006. The return on average equity for the year ended December 31, 2007 was 10.06% and its return on average assets was 0.85%. The \$509,000 or 13.1% decline in net income between 2007 and 2006 can primarily be attributed to an increase in total noninterest expense of \$1.4 million resulting from a 54 basis point reduction of the net interest margin.

Net interest income, the principal source of the Company's earnings, represents the difference between interest income on interest-earning assets and interest expense on interest-bearing liabilities. For 2007, net interest income increased \$414,000 or 3.8% from 2006.

**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 by \$415,000 in 2007 to \$11.3 million compared to \$10.9 million for 2006. This increase is the net result of a \$5.4 million rise in interest income which was partially offset by a rise in interest expense of \$5.0 million. Interest-earning assets averaged \$376.7 million during 2007, representing a \$74.2 million or 24.5% increase since year-end 2006. The Company's average interest-bearing liabilities increased 27.8% from \$249.3 million in 2006 to \$318.7 million in 2007.

The Company finances its earning assets with a combination of interest-bearing and interest-free funds. The interest-bearing funds are composed of deposits, short-term borrowings, and long-term debt. Interest paid for the use of these funds is the second factor in the net interest income equation. Interest-free funds, such as demand deposits and stockholders' equity, require no interest expense and, therefore, contribute significantly to net interest income.

The profit margin, or spread, on invested funds is a key performance measure. The Corporation monitors two key performance indicators — net interest spread and net interest margin. The net interest spread represents the difference between the average rate earned on interest-earning assets and the average rate paid on interest-bearing liabilities. The net interest margin represents the overall profit margin: net interest income as a percentage of total interest-earning assets. This performance indicator gives effect to interest earned for all investable funds including the substantial volume of interest-free funds. For 2007 the net interest margin, measured on a fully taxable equivalent basis, decreased to 3.25%, compared to 3.79% in 2006.

**Interest income.** Interest income increased \$5.4 million or 27.6% to \$24.9 million for 2007, compared to \$19.5 million for 2006. This increase in interest income can be attributed to the growth of interest earned on loans of \$4.0 million. This change was primarily attributable to an increase in the average balance of loans outstanding of \$47.6 million or 19.8% to \$288.0 million for the year ended December 31, 2007 as compared to \$240.59 million for the year ended December 31, 2006. In addition to growth, there was also an increase in the loan yield to 7.31% for 2007, compared to 7.11% for 2006.

Interest earned on securities increased \$859,000 to \$3.1 million for 2007, compared to \$2.2 million for 2006. This increase was primarily attributable to the growth of the average balance of securities of \$17.3 million to \$74.8 million for the year ended December 31, 2007 as compared to \$57.5 million for the year ended December 31, 2006.

**Interest expense.** Interest expense increased by \$5.0 million or 57.9% to \$13.5 million for 2007, compared with \$8.6 million for 2006. This increase in interest expense can be attributed to both an increase in the average balance of interest-bearing liabilities along with an 81 basis point increase in the rate paid on these liabilities. For the year ended December 31, 2007, the average balance of interest-bearing liabilities grew by \$69.4 million to \$318.7 million as compared to \$249.3 million for the year ended December 31, 2006. Interest incurred on deposits grew by \$4.5 million for the year from \$7.2 million in 2006 to \$11.7 million for year-end 2007. This change was due mainly to the large deposit growth for the year along with the increase in rate. Interest incurred on FHLB advances, repurchase agreements, junior subordinated debt, and other borrowings increased \$460,000 or 32.6% to \$1.9 million for 2007, compared to \$1.4 million for 2006. This increase was primarily attributable to an increase in the average balance of the junior subordinated debt which was borrowed late in the 4<sup>th</sup> quarter of 2006.

**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 \$429,000 in 2007 as compared to \$60,000 in 2006. 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.

**Noninterest income.** Noninterest income increased \$204,000 or 8.45% to \$2.6 million for 2007, compared to \$2.4 million for 2006. This increase can be attributed to increases in fees and service charges of \$155,000, earnings of bank-owned life insurance of \$41,000, and a gain realized on the sale of investment securities of \$13,000. The improvement in fees and service charges was largely due to increased fees collected on overdraft checking accounts.

**Noninterest expense.** Noninterest expenses increased \$1.4 million or 18.1% to \$9.4 million for 2007, compared to \$7.9 million for 2006. The growth can be attributed to increases in compensation and employee benefits and occupancy expense which increased \$783,000 and \$239,000 respectively. Factors that primarily led to the increase were costs associated with the operation of additional offices, increased staffing levels related to those offices, and associated higher levels of equipment depreciation. In addition to these items, the company recognized increased costs during the year to ensure compliance with the provisions of the Sarbanes-Oxley Act of 2002 and costs associated with the acquisition of Emerald Bank, and the assumption of the aforementioned branch deposits.

**Provision for income taxes.** The provision for income taxes declined \$676,000 or 45.9% to \$796,000 for 2007, compared to \$1.5 million for 2006. This decrease was primarily the result of a decline in income before taxes of \$1.2 million or 22.1% to \$4.2 million for 2007, compared to \$5.4 million for 2006. The Company's federal rate in 2007 totaled 19.1% compared to 27.5% in 2006. The income tax provision was also affected by the growth of the tax free investment portfolio of \$9.1 million which was a 23.8% increase over the balance at the end of 2006.

# Management's Discussion and Analysis

## of Financial Condition and Results of Operations

### 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 re-pricing 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 and 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, 2008 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, 2008 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, 2008 for portfolio equity:

	Increase +200 BP	Decrease -200 BP
Net interest income—increase (decrease)	(2.49)%	6.47 %
Portfolio equity—increase (decrease)	(8.79)%	(6.19)%

**Allowance for loan losses.** The allowance for loan losses represents the amount management estimates is 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, 2008, the Company's allowance for loan losses showed an increase of \$258,000 for a balance of \$3.6 million compared to \$3.3 million from December 31, 2007. The allowance now represents 1.11% of the gross loan portfolio as compared to 1.07% 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 Company'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 general allowance for homogeneous loan pools, 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 Company 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, 2008, 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 Company'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.

# Notes to Consolidated Financial Statements

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

	For the Years Ended December 31,		
	2008	2007	2006
	(Dollars in thousands)		
Allowance balance at beginning of period	\$ 3,299	\$ 2,849	\$ 2,841
Addition from acquisition	-	436	-
Loans charged off:			
Commercial and industrial	(278)	(251)	(8)
Real estate – construction	-	-	-
Real estate – mortgage:			
Residential	(2)	(26)	-
Commercial	-	-	-
Consumer installment	(135)	(151)	(72)
Total loans charged off	(415)	(428)	(80)
Recoveries of loans previously charged off:			
Commercial and industrial	30	-	-
Real estate – construction	-	-	-
Real estate – mortgage:			
Residential	2	-	-
Commercial	-	-	-
Consumer installment	33	13	28
Total recoveries	65	13	28
Net loans charged off	(350)	(415)	(52)
Provision for loan losses	608	429	60
Allowance balance at end of period	\$ 3,557	\$ 3,299	\$ 2,849
Loans outstanding:			
Average	\$ 317,226	\$ 288,022	\$ 240,452
End of period	321,575	309,446	249,191
Ratio of allowance for loan losses to loans outstanding at end of period	1.11%	1.07%	1.14%
Net charge offs to average loans	(0.11)	(0.14)	(0.02)

The following table illustrates the allocation of the Company'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,					
	2008		2007		2006	
	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)		(Dollars in thousands)		(Dollars in thousands)	
Type of Loans:						
Commercial and industrial	\$ 961	20.7%	\$ 1,060	21.7%	\$ 1,126	27.5%
Real estate – construction	-	2.5	99	2.2	25	1.0
Real estate – mortgage:						
Residential	2,048	62.0	1,527	62.5	1,147	65.4
Commercial	521	13.3	512	11.9	158	4.0
Consumer installment	27	1.5	101	1.7	116	2.1
Unallocated	-	-	-	-	277	-
Total	\$ 3,557	100%	\$ 3,299	100%	\$ 2,849	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 non-accrual 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 Company 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 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 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 non-accrual loan, in which case the portion of the payment related to interest is recognized as income.

The following table summarizes nonperforming assets by category.

	At December 31,		
	2008	2007	2006
Loans accounted for on a non-accrual basis:			
Commercial and industrial	\$ 1,530	\$ 1,231	\$ 200
Real estate – construction	469	643	-
Real estate – mortgage:			
Residential	3,902	1,825	952
Commercial	351	33	-
Consumer installment	2	12	28
Total non-accrual loans	6,254	3,744	1,180
Accruing loans which are contractually past due 90 days or more:			
Commercial and industrial	558	574	90
Real estate – construction	-	-	-
Real estate – mortgage:			
Residential	1,659	1,333	-
Commercial	-	-	110
Consumer installment	9	11	9
Total accruing loans which are contractually past due 90 days or more	2,226	1,918	209
Total non-performing loans	\$ 8,480	\$ 5,662	\$ 1,389
Real estate owned	1,106	-	-
Other non-performing assets	-	-	-
Total non-performing assets	\$ 9,586	\$ 5,662	\$ 1,389
Total non-performing loans to total loans	2.64%	1.83%	0.56%
Total non-performing loans to total assets	1.81%	1.30%	0.41%
Total non-performing assets to total assets	2.05%	1.30%	0.41%

# Management's Discussion and Analysis

## of Financial Condition and Results of Operations

Non-performing loans as a percentage of total loans at December 31, 2008 increased to 2.67% from 1.83% for 2007. The Company had non-accrual loans of \$6,255,000 and \$3,744,000 at December 31, 2008 and 2007, respectively. Interest income recognized on non-accrual loans during all of the periods was insignificant. 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.

### Liquidity and Capital Resources

**Liquidity.** Liquidity management for the Company 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 the Company. 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.

The Company'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 the Company's operating, investing, and financing activities during any given period. At December 31, 2008 cash and cash equivalents totaled \$17.5 million or 3.7% of total assets while investment securities classified as available for sale totaled \$104.3 million or 22.3% of total assets. Management believes that the liquidity needs of the Company are satisfied by the current balance of cash and cash equivalents, readily available access to traditional funding sources, FHLB advances, junior subordinated debt, and the portion of the investment and loan portfolios that mature within one year. These sources of funds will enable the Company to meet cash obligations and off-balance sheet commitments as they come due.

Operating activities provided net cash of \$3.2 million, \$4.3 million, and \$4.5 million for 2008, 2007, and 2006, respectively, generated principally from net income of \$2.6 million, \$3.4 million, and \$3.9 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 increases of \$13.4 million as well as investment purchases of \$39.1 million. Partially offsetting the usage of investment activities is \$16.9 million of proceeds from investment security maturities and repayments. For the same period ended 2007, investing activities used \$47.8 million in funds, principally for the net origination of loans and the purchase of investment securities of \$21.0 million and \$33.0 million, respectively. During the same period ended 2006, cash usages primarily consisted of loan originations of \$15.1 million as well as investment purchases of \$16.9 million.

Financing activities consist of the solicitation and repayment of customer deposits, borrowings and repayments, treasury stock activity, and the payment of dividends. During 2008, net cash provided by financing activities totaled \$34.1 million, principally derived from an increase in deposit accounts in general, and certificates specifically. During 2007, net cash provided by financing activities totaled \$47.7 million, principally derived from an increase in deposit accounts. During the same period ended 2006, net cash provided by financing activities was \$25.2 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 the Company's commitment to make loans, as well as management's assessment of the Company's ability to generate funds. The Company anticipates that it will have sufficient liquidity to satisfy estimated short-term and long-term funding needs.

**Capital Resources.** The Company's primary source of capital has been retained earnings. Historically, the Company 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.

The Company and its subsidiaries are subject to federal regulations imposing minimum capital requirements. Management monitors both the Company's and banks' Total risk-based, Tier I risk-based and Tier I leverage capital ratios to assess compliance with regulatory guidelines. At December 31, 2008, both the Company and its subsidiaries exceeded the minimum risk-based and leverage capital ratio requirements. The Company's Total risk-based, Tier I risk-based and Tier I leverage ratios were 13.57%, 12.41%, and 8.66% at December 31, 2008. MBC's Total risk-based, Tier I risk-based and Tier I leverage ratios were 12.30%, 11.24%, and 7.69%, and EB's were 16.73%, 15.48%, and 12.91%, respectively, at December 31, 2008.

## Market Price of and Dividends on the Registrant's Common Equity and Related Stockholder Matters

The Company had approximately 1,041 stockholders of record as of February 6, 2009. There is no established market for the Company's common stock. The stock is traded very infrequently. Bid prices are quoted from time to time in the "pink sheets" under the symbol "MBCN." The "pink sheets" is a quotation service for over-the-counter securities that is maintained by Pink OTC Markets Inc., a privately owned company. The following table shows the high and low bid prices of and cash dividends paid on the Company's common stock in 2008 and 2007, 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
<b>2008</b>			
First Quarter	\$ 37.25	\$ 36.00	\$ 0.250
Second Quarter	\$ 37.00	\$ 30.00	\$ 0.260
Third Quarter	\$ 29.25	\$ 21.00	\$ 0.260
Fourth Quarter	\$ 28.00	\$ 20.00	\$ 0.260
<b>2007</b>			
First Quarter	\$ 39.76	\$ 36.43	\$ 0.229
Second Quarter	\$ 38.10	\$ 36.33	\$ 0.229
Third Quarter	\$ 37.38	\$ 36.19	\$ 0.233
Fourth Quarter	\$ 38.81	\$ 36.00	\$ 0.245

# 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  
888.801.1666 • 440.632.1666  
fax 440.632.1700

## 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](mailto:dstacy@middlefieldbank.com)

## Market Makers

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

Sweney Cartwright & Co.  
17 South High Street  
Columbus, Ohio 43215  
614.228.5391 • 800.334.7481

Stifel, Nicolaus & Co., Inc.  
18 Columbia Turnpike  
Florham, NJ 07932  
800.342.2325

Howe Barnes Hoefler & Arnett, Inc.  
222 South Riverside Plaza  
Chicago, Illinois 60606  
312.655.3000

## Notice of Annual Meeting

The Annual Meeting of Shareholders of Middlefield Banc Corp. will be held at 1:00 p.m. on Wednesday, May 13, 2009, at:

Sun Valley Banquet and Party Center  
10000 Edwards Lane  
Aurora, Ohio 44202

## 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.  
2100 Corporate Drive, Suite 400  
Wexford, Pennsylvania 15090-7647  
724.934.0344

## Internet Information

Information on the company and its subsidiary banks is available on the Internet at [www.middlefieldbank.com](http://www.middlefieldbank.com) and [www.emeraldbank.com](http://www.emeraldbank.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 or Emerald Bank. For information regarding this program, please call 888.801.1666.

## Market for Middlefield's Common Equity & Related Stockholder Matters

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Third Quarter	\$ 37.38	\$ 36.19	\$ 0.233
Fourth Quarter	\$ 38.81	\$ 36.00	\$ 0.245



Safe. Solid. Sound.





**Main Office**

15985 East High Street  
440.632.1666

**West Branch**

15545 West High Street  
440.632.1666

**Garrettsville Branch**

8058 State Street  
330.527.2121

**Mantua Branch**

10519 Main Street  
330.274.0881

**Chardon Branch**

348 Center Street  
440.286.1222

**Orwell Branch**

30 South Maple Street  
440.437.7200

**Newbury Branch**

11110 Kinsman Road  
440.564.7000

**Cortland Branch**

3450 Niles-Cortland Road  
330.637.3208



**Dublin Branch**

6215 Perimeter Drive  
614.793.4631

**Westerville Branch**

17 North State Street  
614.890.7832



[www.middlefieldbank.com](http://www.middlefieldbank.com)

15985 East High Street, Middlefield, Ohio 888.801.1666

Middlefield Banc Corp.