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IBT BANCORP INC /MI/
Form 10-Q
August 07, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the quarterly period ended June 30, 2007

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the transition period from _____ to _____

Commission File Number: 0-18415

IBT Bancorp, Inc.
(Exact name of registrant as specified in its charter)

Michigan
(State or other jurisdiction of
incorporation or organization)

38-2830092
(I.R.S. Employer
identification No.)

200 East Broadway, Mt. Pleasant, MI
(Address of principal executive offices)

48858
(Zip code)

(989) 772-9471
(Registrant's telephone number, including area code)

N/A
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (Check One).

Large accelerated filer Accelerated Filer Non-accelerated filer

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). [] Yes [X] No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock no par value, 6,338,368 as of July 13, 2007

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CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED) (Dollars in thousands)

| | June 30 2007 ----- | December 31 2006 ----- |
|--|--------------------------|------------------------------|
| ASSETS | | |
| Cash and demand deposits due from banks | \$ 23,602 | \$ 31,359 |
| Federal funds sold | 6,240 | -- |
| | ----- | ----- |
| TOTAL CASH AND CASH EQUIVALENTS | 29,842 | 31,359 |
| Trading securities | 41,777 | -- |
| Securities available for sale (amortized | | |

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| | | |
|--|-----------|-----------|
| cost of \$165,987 in 2007 and \$214,600 in 2006) | 164,201 | 213,450 |
| Mortgage loans available for sale | 850 | 2,734 |
| Loans | | |
| Agricultural | 48,959 | 47,302 |
| Commercial | 227,674 | 212,701 |
| Installment | 30,485 | 30,389 |
| Residential real estate mortgage | 300,101 | 300,650 |
| | ----- | ----- |
| TOTAL LOANS | 607,219 | 591,042 |
| Less allowance for loan losses | 7,744 | 7,605 |
| | ----- | ----- |
| NET LOANS | 599,475 | 583,437 |
| Premises and equipment | 21,392 | 20,754 |
| Corporate-owned life insurance policies | 12,971 | 12,763 |
| Accrued interest receivable | 5,443 | 5,765 |
| Acquisition intangibles and goodwill, net | 27,146 | 27,288 |
| Other assets | 15,168 | 12,577 |
| | ----- | ----- |
| TOTAL ASSETS | \$918,265 | \$910,127 |
| | ===== | ===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Deposits | | |
| Noninterest bearing | \$ 82,919 | \$ 83,902 |
| NOW accounts | 100,972 | 111,406 |
| Certificates of deposit and other savings | 408,353 | 388,176 |
| Certificates of deposit over \$100,000 | 131,913 | 142,356 |
| | ----- | ----- |
| TOTAL DEPOSITS | 724,157 | 725,840 |
| Other borrowed funds (\$7,405 carried at fair value in 2007) | 67,376 | 58,303 |
| Escrow funds payable | 3,545 | 2,416 |
| Accrued interest and other liabilities | 4,397 | 7,819 |
| | ----- | ----- |
| TOTAL LIABILITIES | 799,475 | 794,378 |
| Shareholders' Equity | | |
| Common stock -- no par value 10,000,000 shares authorized; outstanding-- 6,338,368 in 2007 (6,335,861 in 2006) | 115,249 | 114,785 |
| Retained earnings | 5,449 | 4,451 |
| Accumulated other comprehensive loss | (1,908) | (3,487) |
| | ----- | ----- |
| TOTAL SHAREHOLDERS' EQUITY | 118,790 | 115,749 |
| | ----- | ----- |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$918,265 | \$910,127 |
| | ===== | ===== |

See notes to condensed consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(UNAUDITED)
(Dollars in thousands except per share data)

Six Months Ended
June 30

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| | 2007 | 2006 |
|--|------------|-----------|
| | ----- | ----- |
| NUMBER OF SHARES OF COMMON STOCK OUTSTANDING | | |
| Balance at beginning of year | 6,335,861 | 4,974,715 |
| Common stock dividends | -- | 497,299 |
| Issuance of common stock | 25,241 | 19,238 |
| Common stock repurchased | (22,734) | -- |
| | ----- | ----- |
| BALANCE END OF PERIOD | 6,338,368 | 5,491,252 |
| | ===== | ===== |
| COMMON STOCK | | |
| Balance at beginning of year | \$ 114,785 | \$ 72,296 |
| Common stock dividends | -- | 20,887 |
| Transfer | -- | (12,000) |
| Issuance of common stock | 990 | 1,093 |
| Share-based payment awards under equity compensation plan | 452 | 231 |
| Common stock repurchased | (978) | -- |
| | ----- | ----- |
| BALANCE END OF PERIOD | 115,249 | 82,507 |
| RETAINED EARNINGS | | |
| Balance at beginning of year | 4,451 | 10,112 |
| Net income | 3,566 | 3,008 |
| Common stock dividends | -- | (20,887) |
| Transfer | -- | 12,000 |
| Adjustment to initially apply FASB Statement No. 159, net of tax | (1,050) | -- |
| Cash dividends (\$0.24 per share in 2007 and \$0.22 per share in 2006) | (1,518) | (1,213) |
| | ----- | ----- |
| BALANCE END OF PERIOD | 5,449 | 3,020 |
| ACCUMULATED OTHER COMPREHENSIVE LOSS | | |
| Balance at beginning of year | (3,487) | (1,506) |
| Adjustment to initially apply fair value provisions of FASB Statement No. 159, net of tax | 897 | -- |
| Other comprehensive income (loss) | 682 | (895) |
| | ----- | ----- |
| BALANCE END OF PERIOD | (1,908) | (2,401) |
| | ----- | ----- |
| TOTAL SHAREHOLDERS' EQUITY END OF PERIOD | \$ 118,790 | \$ 83,126 |
| | ===== | ===== |

See notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
(Dollars in thousands except per share data)

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|-----------------------|-------------------------------|----------|-----------------------------|----------|
| | ----- | ----- | ----- | ----- |
| | 2007 | 2006 | 2007 | 2006 |
| | ----- | ----- | ----- | ----- |
| INTEREST INCOME | | | | |
| Loans, including fees | \$10,875 | \$ 8,693 | \$21,398 | \$16,860 |

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| | | | | |
|--|----------|----------|----------|----------|
| Investment securities | | | | |
| Taxable | 897 | 1,242 | 1,642 | 2,320 |
| Nontaxable | 919 | 676 | 1,705 | 1,325 |
| Trading account securities | 720 | -- | 1,420 | -- |
| Federal funds sold and other | 128 | 64 | 266 | 138 |
| | ----- | ----- | ----- | ----- |
| TOTAL INTEREST INCOME | 13,539 | 10,675 | 26,431 | 20,643 |
| INTEREST EXPENSE | | | | |
| Deposits | 5,661 | 3,893 | 11,247 | 7,449 |
| Borrowings | 893 | 633 | 1,556 | 1,139 |
| | ----- | ----- | ----- | ----- |
| TOTAL INTEREST EXPENSE | 6,554 | 4,526 | 12,803 | 8,588 |
| | ----- | ----- | ----- | ----- |
| NET INTEREST INCOME | 6,985 | 6,149 | 13,628 | 12,055 |
| Provision for loan losses | 224 | 216 | 350 | 383 |
| | ----- | ----- | ----- | ----- |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 6,761 | 5,933 | 13,278 | 11,672 |
| NONINTEREST INCOME | | | | |
| Service charges and fees | 1,217 | 1,159 | 2,349 | 2,189 |
| Title insurance revenue | 653 | 673 | 1,127 | 1,147 |
| Trust fees | 228 | 217 | 446 | 431 |
| Gain on sale of mortgage loans | 46 | 54 | 99 | 111 |
| Net (loss) gain on trading activities | (201) | -- | 26 | -- |
| Other | 284 | 233 | 591 | 459 |
| | ----- | ----- | ----- | ----- |
| TOTAL NONINTEREST INCOME | 2,227 | 2,336 | 4,638 | 4,337 |
| NONINTEREST EXPENSES | | | | |
| Compensation and benefits | 3,920 | 3,484 | 7,817 | 7,013 |
| Occupancy | 431 | 412 | 889 | 868 |
| Furniture and equipment | 847 | 723 | 1,663 | 1,436 |
| Other | 1,635 | 1,350 | 3,268 | 2,960 |
| | ----- | ----- | ----- | ----- |
| TOTAL NONINTEREST EXPENSES | 6,833 | 5,969 | 13,637 | 12,277 |
| INCOME BEFORE FEDERAL INCOME TAXES | 2,155 | 2,300 | 4,279 | 3,732 |
| Federal income taxes | 399 | 506 | 713 | 724 |
| | ----- | ----- | ----- | ----- |
| NET INCOME | \$ 1,756 | \$ 1,794 | \$ 3,566 | \$ 3,008 |
| | ===== | ===== | ===== | ===== |
| EARNINGS PER SHARE | | | | |
| Basic | \$ 0.28 | \$ 0.33 | \$ 0.56 | \$ 0.55 |
| | ===== | ===== | ===== | ===== |
| Diluted | \$ 0.27 | \$ 0.32 | \$ 0.55 | \$ 0.53 |
| | ===== | ===== | ===== | ===== |
| CASH DIVIDENDS PER BASIC SHARE | \$ 0.12 | \$ 0.11 | \$ 0.24 | \$ 0.22 |
| | ===== | ===== | ===== | ===== |

See notes to condensed consolidated financial statements.

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| | Ended June 30 | | June 30 | |
|---|---------------|----------|----------|----------|
| | 2007 | 2006 | 2007 | 2006 |
| NET INCOME | \$ 1,756 | \$ 1,794 | \$ 3,566 | \$ 3,008 |
| Unrealized losses on available-for-sale securities: | | | | |
| Unrealized holding losses arising during period | (2,222) | (1,076) | (2,025) | (1,459) |
| Reclassification adjustment for net realized losses included in net income | -- | 103 | 30 | 103 |
| Net unrealized losses | (2,222) | (973) | (1,995) | (1,356) |
| Tax effect | 754 | 331 | 678 | 461 |
| Unrealized losses, net of tax | (1,468) | (642) | (1,317) | (895) |
| Change in unrecognized actuarial loss of defined benefit pension plan, principally due to curtailment | 3,029 | -- | 3,029 | -- |
| Tax effect | (1,030) | -- | (1,030) | -- |
| Change in unrecognized actuarial loss of defined benefit pension plan, principally due to curtailment, net of tax | 1,999 | -- | 1,999 | -- |
| Adjustment to initially apply FASB Statement No. 159 | -- | -- | 1,359 | -- |
| Tax effect | -- | -- | (462) | -- |
| FASB Statement No. 159 adjustment, net of tax | -- | -- | 897 | -- |
| OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX | 531 | (642) | 1,579 | (895) |
| COMPREHENSIVE INCOME | \$ 2,287 | \$ 1,152 | \$ 5,145 | \$ 2,113 |

See notes to condensed consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(Dollars in thousands)

| Six months ended June 30 | |
|-----------------------------|-------|
| 2007 | 2006 |
| ----- | ----- |
| ----- | ----- |

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| | | |
|---|-----------|-----------|
| OPERATING ACTIVITIES | | |
| Net income | \$ 3,566 | \$ 3,008 |
| Reconciliation of net income to cash provided by operations: | | |
| Provision for loan losses | 350 | 383 |
| Depreciation | 977 | 920 |
| Net amortization of investment securities | 77 | 404 |
| Realized loss on sale of investment securities | 30 | 103 |
| Amortization and impairment of mortgage servicing rights | 105 | 81 |
| Earnings on corporate owned life insurance policies | (208) | (204) |
| Amortization of acquisition intangibles | 142 | 47 |
| Deferred income tax benefit | 23 | -- |
| Share-based payment awards | 452 | 231 |
| Changes in operating assets and liabilities which provided (used) cash: | | |
| Trading securities (including unrealized depreciation of \$57 in 2007) | 36,062 | -- |
| Loans held for sale | 1,884 | (881) |
| Accrued interest receivable | 322 | 162 |
| Other assets | (3,236) | (422) |
| Escrow funds payable | 1,129 | (5,282) |
| Accrued interest and other liabilities | (228) | (572) |
| | ----- | ----- |
| NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES | 41,447 | (2,022) |
| INVESTING ACTIVITIES | | |
| Activity in available-for-sale securities | | |
| Maturities, calls, and sales | 34,666 | 28,654 |
| Purchases | (65,358) | (43,648) |
| Net increase in loans | (16,388) | (23,297) |
| Purchases of premises and equipment | (1,615) | (1,225) |
| Purchase of corporate owned life insurance policies | -- | (499) |
| Acquisition of title office | -- | (400) |
| | ----- | ----- |
| NET CASH USED IN INVESTING ACTIVITIES | (48,695) | (40,415) |
| FINANCING ACTIVITIES | | |
| Net (decrease) increase in noninterest bearing deposits | (983) | 609 |
| Net (decrease) increase in interest bearing deposits | (700) | 22,670 |
| Net increase in other borrowed funds | 8,920 | 18,846 |
| Cash dividends paid on common stock | (1,518) | (1,213) |
| Proceeds from the issuance of common stock | 990 | 868 |
| Common stock repurchased | (978) | -- |
| | ----- | ----- |
| NET CASH PROVIDED BY FINANCING ACTIVITIES | 5,731 | 41,780 |
| | ----- | ----- |
| DECREASE IN CASH AND CASH EQUIVALENTS | (1,517) | (657) |
| Cash and cash equivalents at beginning of year | 31,359 | 30,825 |
| | ----- | ----- |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | \$ 29,842 | \$ 30,168 |
| | ===== | ===== |

See notes to condensed consolidated financial statements.

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NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals with the exception of the fair value election described in Note 5) considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended June 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. For further information, refer to the consolidated financial statements and footnotes thereto included in the Corporation's annual report for the year ended December 31, 2006.

All amounts other than share and per share amounts have been rounded to the nearest thousand (\$000) in this report.

Effective October 3, 2006, FSB Bank, a subsidiary of the Corporation, acquired Farwell State Savings Bank. The consolidated financial statements include the results of operations of Farwell State Savings Bank from that time. Refer to Management's Discussion and Analysis for further consideration of the impact of this transaction on the consolidated financial statements.

NOTE 2 - COMPUTATION OF EARNINGS PER SHARE

Basic earnings per share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustments to income that would result from the assumed issuance. Potential common shares that may be issued by the Corporation relate solely to outstanding shares in the Corporation's Deferred Director fee plan.

Earnings per common share have been computed based on the following:

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|-------------------------------|-----------|-----------------------------|-----------|
| | 2007 | 2006 | 2007 | 2006 |
| Average number of common shares outstanding for basic calculation* | 6,334,752 | 5,489,968 | 6,336,898 | 5,487,677 |
| Potential effect of shares in the Deferred Director fee plan* | 179,067 | 164,398 | 178,329 | 161,390 |
| Average number of common shares outstanding used to calculate diluted earnings per common share | 6,513,819 | 5,654,366 | 6,515,227 | 5,649,067 |

* As adjusted for the 10% stock dividend paid February 15, 2006

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NOTE 3 - OPERATING SEGMENTS

The Corporation's reportable segments are based on legal entities that account for at least 10% of net operating results. The accounting policies are the same as those discussed in Note 1 to the Consolidated Financial Statements included in the Corporation's annual report for the year ended December 31, 2006 with the exception of those new pronouncements adopted during 2007 (see Notes 5 and 6). The Corporation evaluates performance based principally on net income and asset quality of the respective segments. In April 2007, the individual bank charters of Isabella Bank and Trust and FSB Bank were consolidated into one bank charter as a part of the Corporation's strategy to increase efficiency. Retail banking operations now represent over 90% of the Corporation's total operating results. As such, no segment reporting is presented.

NOTE 4 - DEFINED BENEFIT PENSION PLAN

The Corporation has a defined benefit pension plan covering substantially all of its employees. Benefits are based on years of service and the employees' five highest consecutive years of compensation out of the last ten years of service. The funding policy is to contribute annually the maximum amount that can be deducted for federal income tax purposes. Contributions are intended to provide not only for benefits attributed to services to date but also for those expected to be earned in the future.

In December 2006, the Board of Directors voted to curtail the defined benefit plan effective March 1, 2007. The effect of the curtailment is to freeze the current participant's accrued benefits as of March 1, 2007 and to limit participation in the plan only to eligible employees as of December 31, 2006. Subsequent to the decision to curtail the defined benefit plan, the Corporation elected to increase its level of contributions to the Corporation's 401(k) plan effective January 1, 2007.

The sum of the effects resulting from the plan curtailment was a loss of \$37 for the six months ended June 30, 2007, determined as follows:

| | Before Curtailment | Effect of Curtailment | After Curtailment |
|--|-----------------------|--------------------------|----------------------|
| Accumulated benefit obligation | \$ (8,197) | \$ -- | \$ (8,197) |
| Effect of future salary increases | (2,956) | (2,956) | -- |
| | (11,153) | (2,956) | (8,197) |
| Plan assets at fair value | 9,244 | -- | 9,244 |
| | (1,909) | (2,956) | 1,047 |
| Funded status | | | |
| Items not yet recognized in earnings: | | | |
| Unrecognized prior service cost | 37 | 37 | -- |
| Unrecognized net loss | 4,061 | 2,956 | 1,105 |
| | \$ 2,189 | \$ 37 | \$ 2,152 |
| Prepaid pension cost (net amount recognized) | \$ 2,189 | \$ 37 | \$ 2,152 |

On December 31, 2006 the Corporation adopted Statement of Financial Accounting Standards (SFAS) No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" (SFAS No. 158). SFAS No. 158 required the Corporation to recognize on a prospective basis the funded status of the defined

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benefit pension plan on the Corporation's consolidated balance sheet and recognize as a component of other comprehensive income, net of tax, actuarial gains or losses and prior service costs that arise during each reporting period but are not included as components of net periodic benefit cost.

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The components of net periodic benefit cost for the three and six month periods ended June 30 are as follows:

| | Pension Benefits | | | |
|---|-------------------------------|--------|-----------------------------|--------|
| | Three months ended June 30 | | Six months ended June 30 | |
| | 2007 | 2006 | 2007 | 2006 |
| NET PERIODIC BENEFIT COST | | | | |
| Service cost on benefits earned for services rendered during the period | \$ 27 | \$ 159 | \$ 55 | \$ 319 |
| Interest cost on projected benefit obligation | 131 | 152 | 253 | 304 |
| Expected return on plan assets | (159) | (139) | (318) | (278) |
| Amortization of unrecognized prior service cost | 2 | 5 | 2 | 9 |
| Amortization of unrecognized actuarial net loss | 14 | 58 | 22 | 116 |
| | 15 | 235 | 14 | 470 |
| NET PERIODIC BENEFIT COST | | | | |
| Loss on plan curtailment | (3) | -- | 37 | -- |
| | \$ 12 | \$ 235 | \$ 51 | \$ 470 |
| TOTAL PERIODIC BENEFIT COST | \$ 12 | \$ 235 | \$ 51 | \$ 470 |

The Corporation contributed \$350 and \$1,128 to the pension plan during the six month periods ended June 30, 2007 and 2006, respectively.

NOTE 5 - FINANCIAL INSTRUMENTS RECORDED AT FAIR VALUE

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"). SFAS No. 159 expands the use of fair value accounting but does not affect existing standards which require assets or liabilities to be carried at fair value. Under SFAS No. 159, a company may elect to measure many financial instruments and certain other assets and liabilities at fair value. The fair value measurement option is not allowable for deposit or withdrawable on demand liabilities. If the use of fair value is elected, any upfront costs and fees related to the item must be recognized in earnings and cannot be deferred, e.g., debt issue costs. The fair value election is irrevocable and is generally made on an instrument-by-instrument basis, even if an entity has similar instruments that it elects not to measure based on fair value. At the adoption date, unrealized gains and losses on existing items for which fair value has been elected are reported as a cumulative adjustment to beginning retained earnings as of January 1, 2007. Subsequent to the adoption of SFAS No. 159, changes in fair value are recognized in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 and is required to be adopted by IBT Bancorp in the first quarter of fiscal 2008. IBT Bancorp elected to early adopt SFAS No. 159 effective January 1, 2007, the impact of which is detailed in the table below. For further discussion on the financial statement impact of adopting this

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standard, see Management's Discussion and Analysis in Item 2 of this report and the information presented.

As shown in the following table, the Corporation elected to transfer \$77,839 of its \$213,450 available for sale securities to trading status to facilitate more active trading of these securities. In determining which available for sale securities to transfer, the Corporation considered interest rates, duration, marketability, and balance sheet management strategies. The securities transferred included US Government Agencies, variable rate mortgage backed securities, taxable municipal bonds, and a limited number of tax exempt bonds. During the second quarter of 2007, the Corporation sold \$34,290 of trading securities, purchased \$3,677, and repositioned its funding position from a net fed funds purchased position of \$6,675 to a fed funds sold position of \$6,240 at June 30, 2007. During the remainder of 2007, the Corporation plans to reduce its overall trading securities position to approximately 2.0% to 3.0% of total assets. Management believes this level to be the optimum amount needed to provide liquidity and interest margin protection.

The Corporation also elected to transfer \$7,526 of long term, relatively high interest rate, Federal Home Loan Bank advances to trading status upon the adoption of SFAS No. 159 to provide a hedge against significant movement in interest rates. During the second quarter there were no changes in trading borrowings.

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| | Balance Sheet 1/1/2007 Prior to Adoption | Net Gain / (Loss) Upon Adoption | Balance 1/1/2007 Adoption |
|--|--|---------------------------------------|---------------------------------|
| | ----- | ----- | ----- |
| Investment securities | \$79,198 | \$(1,359) | \$77,839 |
| FHLB borrowings included in other borrowed funds | (7,256) | (232) | (7,488) |
| | | ----- | |
| Pretax cumulative effect of adoption of the fair value option | | (1,591) | |
| Increase in deferred tax asset | | 541 | |
| | | ----- | |
| Cumulative effect of adoption of the fair value option (charged as a reduction to retained earnings) | | \$(1,050) | |
| | | ===== | |

In September 2006, the FASB issued SFAS No. 157 "Fair Value Measurements" (SFAS No. 157). SFAS No. 157 establishes a common definition for fair value to be applied to GAAP guidance requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. SFAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. As the Corporation has elected early adoption of SFAS No. 159, it has also early adopted SFAS No. 157, as required by SFAS No. 159.

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Fair value is the price that would be received to sell an asset or transfer a liability in an orderly transaction between market participants at the measurement date. To increase consistency and comparability in fair value measurements and related disclosures, the fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). In some cases, the inputs used to measure fair value might fall in different levels of the fair value hierarchy. The level in the fair value hierarchy within which the fair value measurement in its entirety falls shall be determined based on the lowest level input that is significant to the fair value measurement in its entirety.

Level 1 instruments are those assets for which the identical item is traded on an active exchange, such as publicly-traded instruments. The majority of the fair value amounts included in current period earnings resulted from Level 2 fair value methodologies; that is, the Corporation is able to value the assets and liabilities based on observable market data for similar instruments.

For further discussion on the financial statement impact of adopting these standards, see Management's Discussion and Analysis in Item 2 of this report.

| Description ----- | Fair Value Measurements at June 30, 2007 Using | | |
|---|---|---|--|
| | Fair Value Measurements 6/30/2007 ----- | Quoted Prices in Active Markets for Identical Assets (Level 1) ----- | Significant Other Observable Inputs (Level 2) ----- |
| Recurring Items | | | |
| Trading securities | \$ 41,777 | \$2,985 | \$ 38,792 |
| Investment securities available for sale | 164,201 | 3,977 | 160,224 |
| Mortgage loans available for sale | 850 | 850 | -- |
| Other borrowed funds | 7,405 | -- | 7,405 |
| Nonrecurring Items | | | |
| Mortgage servicing rights | 2,191 | -- | 2,191 |
| Other real estate owned | 633 | -- | 633 |

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| Changes in Fair Value for the 3-month Period Ended June 30, 2007 for Items Measured at Fair Value Pursuant to Election of the Fair Value Option ----- | Changes in Fair Value for Period Ended June 30, 2007 Measured at Fair Value Pursuant to Election of the Fair Value Option ----- | | | |
|---|---|---------|-------|----------|
| Other | Total Changes in Fair Values | Trading | Other | To in |
| | | | | |

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| Description | Trading Gains and (Losses) | Gains and (Losses) | Included in Current Period Earnings | Gains and (Losses) | Gains and (Losses) | I Cu |
|---------------------------|----------------------------------|--------------------------|---|--------------------------|--------------------------|---------|
| ----- | ----- | ----- | ----- | ----- | ----- | --- |
| RECURRING ITEMS | | | | | | |
| Trading securities | \$ (282) | \$ -- | \$ (282) | \$ (57) | \$ -- | |
| Other borrowed funds | 81 | -- | 81 | 83 | -- | |
| NONRECURRING ITEMS | | | | | | |
| Mortgage servicing rights | -- | 1 | 1 | -- | -- | |
| Other real estate owned | -- | -- | -- | -- | (26) | |

During the three month period ended March 31, 2007, in accordance with the provisions of SFAS 156, mortgage servicing rights with a carrying amount of \$2,187 were written down to their fair value of \$2,186, resulting in an impairment charge of \$1, while during the three month period ended June 30, 2007, mortgage servicing rights with a carrying amount of \$2,190 were written up to their fair value of \$2,191, resulting in a decrease in the impairment of \$1. Such adjustments were included in earnings for the six month period ended June 30, 2007.

During the three month period ended March 31, 2007, in accordance with the provisions of SFAS 144, other real estate owned with a carrying amount of \$643 was written down to its fair value of \$617, resulting in an impairment charge of \$26, which was included in earnings for the six month period ended June 30, 2007.

NOTE 6 - RECENT ACCOUNTING PRONOUNCEMENTS

In June 2006, the Financial Accounting Standards Board ("FASB") issued Financial Accounting Standards Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes". FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes". FIN 48 prescribes a recognition threshold and measurement attributable for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. On January 1, 2007, the Corporation adopted FIN 48. The adoption of this standard did not impact the Corporation's consolidated financial statements.

In June 2006, the Emerging Issues Task Force ("EITF") reached a tentative conclusion reflected in the draft abstract for EITF Issue No. 06-5, "Accounting for Purchases of Life Insurance-Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4." The Task Force's tentative conclusion states that a policyholder should consider certain additional amounts included in the contractual terms of the policy in determining the amount that could be realized under the insurance contract. This issue is effective for fiscal years beginning after December 15, 2006. The provisions of EITF 06-5 did not have an impact on the Corporation's consolidated financial statements.

In February 2006 the FASB issued SFAS No. 155 " Accounting for Certain Hybrid Instruments," which allows financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from its host) if the holder elects to account for the whole instrument on a fair value basis. The issuance of Statement 155 provides the following: 1. Clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133; 2. Establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation; 3. Clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and 4.

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Amends Statement 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS 155 is effective for all financial instruments acquired or issued after the beginning of the first fiscal year beginning after September 15, 2006. The Corporation adopted SFAS No.155 on January 1, 2007 and it did not have a material impact on the Corporation's consolidated financial statements.

In March 2006 the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets," which affects the accounting for servicing rights, which includes mortgage servicing rights and those associated with other types of financial assets transferred in

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securitizations such as auto loans, student loans, credit cards, commercial real estate and equipment financing. Specifically, Statement No. 156 requires that all separately recognized servicing rights be initially measured at fair value, if practicable. For subsequent accounting for servicing assets and liabilities, entities would choose either to amortize and recognize over a period of estimated net servicing income or net servicing loss (currently required under Statement 140) or remeasure at fair value at each subsequent reporting date. The choice to measure at fair value would make it easier to account for hedges of servicing rights, which currently are difficult to apply under Statement No. 133. Statement No. 156 is effective for all servicing assets or liabilities acquired or assumed after the beginning of the first fiscal year beginning after September 15, 2006. In addition, an entity may elect to apply fair value measurement to existing servicing rights upon adoption. The Corporation adopted SFAS No.156 on January 1, 2007 and it did not have a material impact on the Corporation's consolidated financial statements.

In July of 2006, the Emerging Issues Task Force ("EITF") of FASB issued a draft abstract for EITF Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements." The EITF reached a consensus that for an endorsement split-dollar life insurance arrangement within the scope of this Issue, an employer should recognize a liability for future benefits. IBT Bancorp has purchased corporation-owned life insurance on certain of its employees. The cash surrender value of these policies is carried as an asset on the consolidated balance sheets in accrued interest and other assets. The carrying value was \$12,971 at June 30, 2007. These life insurance policies are generally subject to endorsement split-dollar life insurance arrangements. These arrangements were designed to provide a pre-and postretirement benefit for senior officers of the Corporation. The Corporation is required to apply EITF Issue No. 06-4 beginning January 1, 2008, and is currently evaluating the effect the implementation of EITF Issue No. 06-4 will have on the consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157 "Fair Value Measurements" (SFAS No. 157). SFAS No. 157 establishes a common definition for fair value to be applied to GAAP guidance requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. SFAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 unless SFAS No. 159 is adopted, in which case SFAS No. 157 would need to be adopted concurrently. The results of the adoption of this standard are

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disclosed in Note 5.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" which provides entities with an option to report selected financial assets and liabilities at fair value, with the objective to reduce both the complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS No. 159 permits fair value to be used for both the initial and subsequent measurements on a contract-by-contract election, with changes in fair value to be recognized in earnings as those changes occur. SFAS No. 159 also revises provisions of SFAS No. 115 that apply to available-for-sale and trading securities. This statement is effective for fiscal years beginning after November 15, 2007, with an option to early adopt effective January 1, 2007. After review of the standard, the Corporation has early adopted the standard. The impact of the adoption is presented in Note 5.

In September 2006, the Securities and Exchange Commission (SEC) released Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" (SAB 108), which is effective for fiscal years ending on or after November 15, 2006. SAB 108 provides guidance on how the effects of prior-year uncorrected financial statement misstatements should be considered in quantifying a current year misstatement. SAB 108 requires public companies to quantify misstatements using both an income statement (rollover) and balance sheet (iron curtain) approach and evaluate whether either approach results in a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. If prior year errors that had been previously considered immaterial now are considered material based on either approach, no restatement is required so long as management properly applied its previous approach and all relevant facts and circumstances were considered. Adjustments considered immaterial in prior years under the method previously used, but now considered material under the dual approach required by SAB 108, are to be recorded upon initial adoption of SAB 108. The adoption of this standard did not have a material effect on the Corporation's consolidated financial statements.

NOTE 7 - COMMON STOCK REPURCHASES

On March 22, 2007, the Board of Directors adopted a repurchase plan which provides for repurchase of up to 150,000 shares of the Corporation's common stock. Any shares repurchased under this plan are reverted to authorized but unissued shares. During the six months ended June 30, 2007, a total of 22,734 shares were repurchased for cash of \$978, including 9,734 shares pursuant to this plan during the second quarter.

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ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is management's discussion and analysis of the major factors that influenced IBT Bancorp's financial performance. This analysis should be read in conjunction with the Corporation's 2006 annual report and with the unaudited condensed consolidated financial statements and notes, as set forth on pages 3 through 13 of this report.

CRITICAL ACCOUNTING POLICIES: A summary of the Corporation's significant accounting policies is set forth in Note 1 of the Consolidated Financial Statements included in the Corporation's Annual Report for the year ended December 31, 2006. Of these significant accounting policies, the Corporation

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considers its policies regarding the allowance for loan losses to be its most critical accounting policy.

The allowance for loan losses requires management's most subjective and complex judgment. Changes in economic conditions can have a significant impact on the allowance for loan losses and, therefore, the provision for loan losses and results of operations. The Corporation has developed appropriate policies and procedures for assessing the adequacy of the allowance for loan losses, recognizing that this process requires a number of assumptions and estimates with respect to its loan portfolio. The Corporation's assessments may be impacted in future periods by changes in economic conditions, the impact of regulatory examinations, and the discovery of information with respect to borrowers which is not known to management at the time of the issuance of the consolidated financial statements. For additional discussion concerning the Corporation's allowance for loan losses and related matters, see Provision for Loan Losses and Allowance for Loan Losses in the Corporation's 2006 Annual Report and herein.

RESULTS OF OPERATIONS

The following table outlines the results of operations for the periods ended June 30, 2007 and 2006. Return on average assets measures the ability of the Corporation to profitably and efficiently employ its resources. Return on average equity indicates how effectively the Corporation is able to generate earnings on shareholder invested capital.

SUMMARY OF SELECTED FINANCIAL DATA

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|----------------------------------|---------|-----------------------------|----------|
| | 2007 | 2006 | 2007 | 2006 |
| INCOME STATEMENT DATA | | | | |
| Net interest income | \$6,985 | \$6,149 | \$13,628 | \$12,055 |
| Provision for loan losses | 224 | 216 | 350 | 383 |
| Net income | 1,756 | 1,794 | 3,566 | 3,008 |
| PER SHARE DATA | | | | |
| Earnings per share: | | | | |
| Basic | \$ 0.28 | \$ 0.33 | \$ 0.56 | \$ 0.55 |
| Diluted | 0.27 | 0.32 | 0.55 | 0.53 |
| Cash dividends per common share | 0.12 | 0.11 | 0.24 | 0.22 |
| RATIOS | | | | |
| Average primary capital to average assets | 13.43% | 11.70% | 13.43% | 11.69% |
| Net income to average assets | 0.76 | 0.94 | 0.77 | 0.80 |
| Net income to average equity | 5.95 | 8.62 | 6.08 | 7.31 |

NET INTEREST INCOME

Net interest income equals interest income less interest expense and is the primary source of income for IBT Bancorp. Interest income includes loan fees of \$345 and \$576 in 2007, for the three and six month periods ended June 30, 2007, respectively, as compared to \$318 and \$556 during the same periods in 2006. For analytical purposes, net interest income is adjusted to a "taxable equivalent" basis by adding the income tax savings from interest on tax-exempt loans and securities, thus making year-to-year comparisons more meaningful.

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(Continued on page 17)

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AVERAGE BALANCES; INTEREST RATE AND NET INTEREST INCOME

The following schedules present the daily average amount outstanding for each major category of interest earning assets, nonearning assets, interest bearing liabilities, and noninterest bearing liabilities. This schedule also presents an analysis of interest income and interest expense for the periods indicated. All interest income is reported on a fully taxable equivalent (FTE) basis using a 34% tax rate. Nonaccruing loans, for the purpose of the following computations, are included in the average loan amounts outstanding. Federal Reserve and Federal Home Loan Bank restricted equity holdings are included in Other.

Results for the three and six month periods ended June 30, 2007 and June 30, 2006 are as follows:

| | Three Months Ended | | | | |
|---|--------------------|-------------------------|---------------------|------------------|-------------------------|
| | June 30, 2007 | | | June 30, 2006 | |
| | Average Balance | Tax Equivalent Interest | Average Yield\ Rate | Average Balance | Tax Equivalent Interest |
| INTEREST EARNING ASSETS: | | | | | |
| Loans | \$601,805 | \$10,875 | 7.23% | \$495,276 | \$ 8,111 |
| Taxable investment securities | 64,899 | 897 | 5.53% | 124,605 | 1,111 |
| Nontaxable investment securities | 96,947 | 1,438 | 5.93% | 74,617 | 1,111 |
| Trading account securities | 63,939 | 767 | 4.80% | -- | -- |
| Federal funds sold | 4,400 | 59 | 5.36% | 392 | -- |
| Other | 6,248 | 69 | 4.42% | 4,921 | -- |
| Total earning assets | 838,238 | 14,105 | 6.73% | 699,811 | 11,443 |
| NON EARNING ASSETS: | | | | | |
| Allowance for loan losses | (7,660) | | | (6,942) | |
| Cash and due from banks | 20,155 | | | 25,512 | |
| Premises and equipment | 21,364 | | | 17,292 | |
| Accrued income and other assets | 56,015 | | | 28,492 | |
| Total assets | \$928,112 | | | \$764,165 | |
| INTEREST BEARING LIABILITIES: | | | | | |
| Interest-bearing demand deposits | \$110,883 | 556 | 2.01% | \$101,157 | |
| Savings deposits | 187,462 | 1,057 | 2.26% | 155,204 | |
| Time deposits | 344,549 | 4,048 | 4.70% | 283,918 | 2,111 |
| Other borrowed funds | 76,351 | 893 | 4.68% | 53,629 | |
| Total interest bearing liabilities | 719,245 | 6,554 | 3.64% | 593,908 | 4,222 |
| NONINTEREST BEARING LIABILITIES: | | | | | |
| Demand deposits | 80,366 | | | 69,902 | |
| Other | 10,450 | | | 17,071 | |
| Shareholders' equity | 118,051 | | | 83,284 | |
| Total liabilities and equity | \$928,112 | | | \$764,165 | |

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| | | | | |
|--|-------|----------|-------|-------|
| Net interest income (FTE) | ===== | \$ 7,551 | ===== | \$ 6, |
| Net yield on interest earning assets (FTE) | | | ----- | ----- |
| | | | 3.60% | |
| | | | ===== | |

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| | Six Months Ended | | | | |
|--|------------------|-------------------------|---------------------|-----------------|-------------------------|
| | June 30, 2007 | | | June 30, 2006 | |
| | Average Balance | Tax Equivalent Interest | Average Yield\ Rate | Average Balance | Tax Equivalent Interest |
| INTEREST EARNING ASSETS: | | | | | |
| Loans | \$600,444 | \$21,398 | 7.13% | \$490,078 | \$16,860 |
| Taxable investment securities | 60,685 | 1,642 | 5.41% | 120,683 | 2,320 |
| Nontaxable investment securities | 90,593 | 2,676 | 5.91% | 73,138 | 2,100 |
| Trading account securities | 70,732 | 1,512 | 4.28% | -- | -- |
| Federal funds sold | 5,209 | 139 | 5.34% | 942 | 200 |
| Other | 5,674 | 127 | 4.48% | 5,053 | 110 |
| Total earning assets | 833,337 | 27,494 | 6.60% | 689,894 | 21,410 |
| NON EARNING ASSETS: | | | | | |
| Allowance for loan losses | (7,655) | | | (6,935) | |
| Cash and due from banks | 19,962 | | | 27,402 | |
| Premises and equipment | 21,160 | | | 17,302 | |
| Accrued income and other assets | 55,822 | | | 28,648 | |
| Total assets | \$922,626 | | | \$756,311 | |
| INTEREST BEARING LIABILITIES: | | | | | |
| Interest-bearing demand deposits | \$114,705 | 1,109 | 1.93% | \$103,954 | 740 |
| Savings deposits | 182,689 | 1,941 | 2.12% | 156,108 | 1,220 |
| Time deposits | 352,093 | 8,197 | 4.66% | 276,565 | 5,480 |
| Other borrowed funds | 65,199 | 1,556 | 4.77% | 49,218 | 1,130 |
| Total interest bearing liabilities | 714,686 | 12,803 | 3.58% | 585,845 | 8,580 |
| NONINTEREST BEARING LIABILITIES: | | | | | |
| Demand deposits | 79,853 | | | 69,664 | |
| Other | 10,849 | | | 18,477 | |
| Shareholders' equity | 117,238 | | | 82,325 | |
| Total liabilities and equity | \$922,626 | | | \$756,311 | |
| Net interest income (FTE) | | \$14,691 | | | \$12,830 |
| Net yield on interest earning assets (FTE) | | | ----- | | ----- |
| | | | 3.53% | | |
| | | | ===== | | |

VOLUME AND RATE VARIANCE ANALYSIS

The following table sets forth the effect of volume and rate changes on interest income and expense for the periods indicated. For the purpose of this table, changes in interest due to volume and rate were determined as follows:

Volume Variance - change in volume multiplied by the previous year's rate.
Rate Variance - change in the fully taxable equivalent (FTE) rate multiplied by the prior year's volume.

The change in interest due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

| | Three Months Ended June 30, 2007 compared to June 30, 2006 Increase (Decrease) Due to | | | Six Months Ended June 30, 2007 compared to June 30, 2006 Increase (Decrease) Due to | | |
|-------------------------------------|--|---------|---------|--|----------|---------|
| | Volume | Rate | Net | Volume | Rate | Net |
| CHANGES IN INTEREST INCOME: | | | | | | |
| Loans | \$1,918 | \$ 264 | \$2,182 | \$ 3,914 | \$ 624 | \$4,538 |
| Taxable investment securities | (722) | 377 | (345) | (1,412) | 734 | (678) |
| Nontaxable investment securities | 330 | 38 | 368 | 514 | 62 | 576 |
| Trading account securities | 767 | -- | 767 | 1,512 | -- | 1,512 |
| Federal funds sold | 54 | -- | 54 | 113 | 5 | 118 |
| Other | 15 | (5) | 10 | 14 | (4) | 10 |
| Total changes in interest income | 2,362 | 674 | 3,036 | 4,655 | 1,421 | 6,076 |
| CHANGES IN INTEREST EXPENSE: | | | | | | |
| Interest bearing demand deposits | 38 | 152 | 190 | 83 | 284 | 367 |
| Savings deposits | 149 | 278 | 427 | 232 | 486 | 718 |
| Time deposits | 673 | 478 | 1,151 | 1,657 | 1,056 | 2,713 |
| Other borrowings | 266 | (6) | 260 | 380 | 37 | 417 |
| Total changes in interest expense | 1,126 | 902 | 2,028 | 2,352 | 1,863 | 4,215 |
| Net change in interest margin (FTE) | \$1,236 | \$(228) | \$1,008 | \$ 2,303 | \$(442) | \$1,861 |

NET INTEREST INCOME, CONTINUED

As shown in the preceding tables, the Corporation has experienced steady decreases in the net yield on interest earning assets since 2006. The main contributing factors to this decrease are the following:

- The inverted yield curve during the first six months of 2007.
- Rates paid on interest bearing liabilities have increased at a faster

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rate than those earned on interest earning assets.

- The Corporation's increased reliance on higher cost time deposits and other borrowed funds.

During much of 2006 and throughout the first six months of 2007, the yield curve was inverted, which means that short term rates were higher than long term rates. This yield curve has encouraged customers to invest their funds in short term deposits and to borrow long term with fixed rate loans. Banks typically make money through the assumption of credit and interest rate risk. Interest rate risk is related to borrowing funds short term and investing them long term. The current yield curve has provided the Corporation with little opportunity to do this effectively. The table above shows a negative impact on net interest margin due to rate of \$228 and \$442 when the three and six month periods ended June 30, 2007 are compared to the same periods in 2006. These decreases were offset by increases related to volume of \$1,236 and \$2,303, in the three and six month periods ended June 30, 2007, respectively. The total volume and rate variances resulted in net increases in net FTE interest margin of \$1,008 and \$1,861, when the three and six month periods ended June 30, 2007 are compared to the same periods in 2006.

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To offset the decreases in net yield on interest earning assets from the unfavorable rate environment, the Corporation has taken a measured growth posture, which has resulted in a substantial increase in commercial loans. This commercial loan growth coupled with the acquisition of the Farwell State Savings Bank has allowed the Corporation to increase net interest income through volume.

When management looks forward to the remainder of 2007, the net interest position will continue to be challenging with respect to interest rates. The driving force behind this challenge continues to be the yield curve. During the quarter ended June 30, 2007, long term rates have increased slightly, resulting in a shift in the yield curve, which is now essentially flat. Management anticipates that the yield curve will continue to normalize throughout the remainder of 2007; however, this correction is expected to be slow. As a result, the Corporation does not anticipate any significant relief in interest rate pressure in the near future. To help offset the decline in income due to rates, the Corporation will continue to grow its balance sheet, while accepting smaller interest rate margins.

IBT Bancorp, Inc. (IBT) elected early adoption of Statement of Financial Accounting Standards ("SFAS") No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, and SFAS No. 157, Fair Value Measurements. SFAS No. 159, which was issued in February 2007, generally permits the measurement of selected eligible financial instruments at fair value at specified election dates. Subsequent to the issuance of SFAS No. 159 the IBT Audit Committee, Board of Directors, management, and investment advisors reviewed the Corporation's assets and liabilities to determine which fluctuate in value based on changes in market interest rates to determine the potential impact of the new standard. As a result of their considerations, IBT elected early adoption of the new accounting standard effective January 1, 2007. The purpose of the early adoption of this standard was to provide IBT an opportunity to accelerate the restructuring of its balance sheet to better manage interest rate risk now and in the future.

The impact of the Corporation's restructuring plan implemented during the second quarter of 2007 was a 0.15% increase in FTE net interest margin when the quarter ended June 30, 2007 is compared to the quarter ended March 31, 2007. The

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restructuring strategies pursued are discussed in the analysis of changes in financial condition beginning on page 25.

ALLOWANCE FOR LOAN LOSSES

The viability of any financial institution is ultimately determined by its management of credit risk. Total loans outstanding represent 66.1% of the Corporation's total assets and is the Corporation's single largest concentration of risk. The allowance for loan losses is management's estimation of potential future losses inherent in the existing loan portfolio. Factors used to evaluate the loan portfolio, and thus to determine the current charge to expense, include recent loan loss history, financial condition of borrowers, amount of nonperforming and impaired loans, overall economic conditions, and other factors. The following table summarizes the Corporation's charge off and recovery activity for the six month periods ended June 30, 2007 and 2006.

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| | Six Months Ended June 30 | |
|--|-----------------------------|-----------|
| | 2007 | 2006 |
| Allowance for loan losses - January 1 | \$ 7,605 | \$ 6,899 |
| Loans charged off | | |
| Commercial and agricultural | 26 | 103 |
| Real estate mortgage | 125 | 181 |
| Consumer | 301 | 171 |
| | ----- | ----- |
| TOTAL LOANS CHARGED OFF | 452 | 455 |
| Recoveries | | |
| Commercial and agricultural | 79 | 76 |
| Real estate mortgage | 3 | 15 |
| Consumer | 159 | 123 |
| | ----- | ----- |
| TOTAL RECOVERIES | 241 | 214 |
| | ----- | ----- |
| Net loans charged off | 211 | 241 |
| Provision charged to income | 350 | 383 |
| | ----- | ----- |
| ALLOWANCE FOR LOAN LOSSES - JUNE 30 | \$ 7,744 | 7,041 |
| | ===== | ===== |
| YEAR TO DATE AVERAGE LOANS | \$600,444 | \$490,078 |
| | ===== | ===== |
| NET LOANS CHARGED OFF TO AVERAGE LOANS OUTSTANDING | 0.04% | 0.05% |
| | ===== | ===== |
| TOTAL AMOUNT OF LOANS OUTSTANDING AT JUNE 30 | \$607,219 | \$506,298 |
| | ===== | ===== |
| ALLOWANCE FOR LOAN LOSSES AS A % OF LOANS | 1.28% | 1.39% |
| | ===== | ===== |

Since June 2006, the Corporation has experienced an increase in the percent of loans classified as nonperforming. While the Corporation has seen increases in its nonperforming loans, net loans charged off as a percentage of loans has declined. The majority of the increase in non-accrual loans is related to two credits. These credits are both well collateralized and management believes the

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principal will be recovered in full. As shown in the following table, a substantial portion of the increase in accruing loans past due 90 days or more is related to the addition of Farwell loan portfolio in the fourth quarter of 2006. Based on management's analysis of the allowance for loan losses, the current allowance falls within the acceptable range and, therefore, the allowance for loan losses is considered adequate as of June 30, 2007.

The nationwide increase in residential mortgage loans past due and in foreclosures has received considerable attention by both the press and regulators. Based on information provided by The Mortgage Bankers Association, the increases in both past dues and foreclosures are related to fixed and adjustable rate sub-prime mortgages. Additionally, a substantial portion of sub-prime adjustable rate mortgages are scheduled to reset at higher rates in the next 12 months. As a result of the rate resetting on these mortgages, it is expected that troubled sub-prime loans will increase substantially through the end of 2008. The increase in troubled residential mortgage loans, higher fixed and variable interest rates, and a tightening of underwriting standards will most likely result in a further increased inventory of unsold homes from its current level of 8.9 months. The inventory of unsold homes has not reached these levels since the 1991 recession. The combination of all of these factors will most likely further reduce average home values and thus homeowner's equity.

While IBT does not originate variable rate mortgages, nor does it hold mortgage loans, which when made were sub-prime, the difficulties experienced in the sub-prime market has the potential to adversely impact the entire market, and thus the overall credit quality of the IBT residential mortgage portfolio.

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NONPERFORMING ASSETS

| | June 30 | | | |
|---|--------------|---------|----------------------|-----|
| | 2007 | | | |
| | Consolidated | Farwell | Adjusted w/o Farwell | Con |
| Nonaccrual loans | \$4,409 | \$ 186 | \$4,223 | |
| Accruing loans past due 90 days or more | 2,212 | 1,374 | 838 | |
| Restructured loans | 688 | -- | 688 | |
| | ----- | ----- | ----- | |
| TOTAL NONPERFORMING LOANS | 7,309 | 1,560 | 5,749 | |
| Other real estate owned | 633 | 298 | 335 | |
| | ----- | ----- | ----- | |
| TOTAL NONPERPERFORMING ASSETS | \$7,942 | \$1,858 | \$6,084 | |
| | ===== | ===== | ===== | |
| NONPERFORMING LOANS AS A % OF TOTAL LOANS | 1.20% | 2.47% | 1.06% | |
| | ===== | ===== | ===== | |
| NONPERFORMING ASSETS AS A % OF TOTAL ASSETS | 0.86% | 2.04% | 0.74% | |
| | ===== | ===== | ===== | |

To management's knowledge, there are no other loans which cause management to have serious doubts as to the ability of a borrower to comply with their loan repayment terms.

NONINTEREST INCOME AND EXPENSES

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The following discussions of noninterest income and noninterest expenses have been adjusted for the acquisition of the Farwell State Savings Bank in October 2006 to make them comparable with the prior period numbers.

NONINTEREST INCOME

Noninterest income consists of trust fees, deposit service charges, fees for other financial services, gains on the sale of mortgage loans, title insurance revenue, and other. Significant account balances are highlighted in the accompanying tables with additional descriptions of significant fluctuations of both quarter to date and year to date variances following:

| | Three Months Ended | | | |
|---|--------------------|---------|----------------------|--|
| | June 30 | | | |
| | 2007 | | | |
| | Consolidated | Farwell | Adjusted w/o Farwell | |
| Service charges and fee income | | | | |
| NSF and overdraft fees | \$ 731 | \$41 | \$ 690 | |
| Freddie Mac servicing fee | 158 | -- | 158 | |
| ATM and debit card fees | 199 | -- | 199 | |
| Service charges on deposit accounts | 83 | 15 | 68 | |
| All other | 46 | 14 | 32 | |
| | ----- | --- | ----- | |
| Total service charges and fees | 1,217 | 70 | 1,147 | |
| Title insurance revenue | 653 | -- | 653 | |
| Trust fees | 228 | -- | 228 | |
| Gain on sale of mortgage loans | 46 | -- | 46 | |
| Net loss on trading activities | (201) | -- | (201) | |
| Other | | | | |
| Increase in cash value of corporate owned life insurance policies | 105 | -- | 105 | |
| Brokerage and advisory fees | 61 | -- | 61 | |
| Loss on sale of investment securities | -- | -- | -- | |
| All other | 118 | 6 | 112 | |
| | ----- | --- | ----- | |
| Total other | 284 | 6 | 278 | |
| | ----- | --- | ----- | |
| TOTAL NONINTEREST INCOME | \$2,227 | \$76 | \$2,151 | |
| | ===== | === | ===== | |

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| | Six Months Ended | | | |
|--|------------------|---------|----------------------|--|
| | June 30 | | | |
| | 2007 | | | |
| | Consolidated | Farwell | Adjusted w/o Farwell | |

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| | | | |
|---|---------|-------|---------|
| Service charges and fee income | | | |
| NSF and overdraft fees | \$1,409 | \$ 73 | \$1,336 |
| Freddie Mac servicing fee | 314 | -- | 314 |
| ATM and debit card fees | 340 | -- | 340 |
| Service charges on deposit accounts | 166 | 28 | 138 |
| All other | 120 | 27 | 93 |
| | ----- | ---- | ----- |
| Total service charges and fees | 2,349 | 128 | 2,221 |
| Title insurance revenue | 1,127 | -- | 1,127 |
| Trust fees | 446 | -- | 446 |
| Gain on sale of mortgage loans | 99 | -- | 99 |
| Net gain on trading activities | 26 | -- | 26 |
| Other | | | |
| Increase in cash value of corporate owned life insurance policies | 210 | -- | 210 |
| Brokerage and advisory fees | 125 | -- | 125 |
| Loss on sale of investment securities | (30) | -- | (30) |
| All other | 286 | 6 | 280 |
| | ----- | ---- | ----- |
| Total other | 591 | 6 | 585 |
| | ----- | ---- | ----- |
| TOTAL NONINTEREST INCOME | \$4,638 | \$134 | \$4,504 |
| | ===== | ===== | ===== |

As a result of the persistent compression on interest margins, management continuously analyzes various fees related to deposit accounts, including service charges, NSF and overdraft fees, and ATM and debit card fees. Based on these analyses, the Corporation makes any necessary adjustments to ensure that its fee structure is within a range of its competitors, while at the same time making sure that the fees remain fair to deposit customers. Management does not expect significant changes to its deposit fee structure in 2007.

The decline from the gain on sale of mortgage loans and title insurance revenue is a result of the continued slow demand in residential mortgages. Management does not anticipate the demand for residential mortgages to significantly fluctuate for the remainder of 2007.

The losses incurred on trading activities during the second quarter of 2007 are a result of the increase in long term investment rates. While the Corporation did incur net trading losses during this period, it is still in a net gain position for the six month period ended June 30, 2007. Management does expect trading losses to continue to increase based on the fact that it is anticipated that long term rates will continue to increase throughout 2007. However, the increases in long term rates provide the Corporation with the ability to sell lower yielding investments and replace them with higher yielding ones.

The first six months of 2007 have been some of the most productive months in the Corporation's history for brokerage and advisory services. These results are due to the increased confidence of consumers in the stock market as well as an increase in customer base and a conscious effort by management to expand the Bank's presence in the local market. The Corporation anticipates this trend to continue throughout 2007.

The losses on sales of available for sale investment securities incurred by the Corporation in the first quarter resulted from selling investments nearing maturity at low interest rates and reinvesting the proceeds in higher yielding longer term securities as part of asset and liability management. Management expects that the additional interest income earned upon the reinvestment of the proceeds will exceed the losses recognized by the fourth quarter of 2007.

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When the three month period ended June 30, 2007 is compared to the same period in 2006, there was a substantial decrease in other noninterest income. This decrease can be attributed to the fact that Isabella Bank and Trust sold its consumer credit card portfolio in May 2006 and recorded a gain on the sale of the portfolio. The Bank is now collecting monthly commissions related to this sold portfolio, which accounts for the increase in year to date income when the six month period ended June 30, 2007 is compared to the same period in 2006.

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NONINTEREST EXPENSES

Noninterest expenses include compensation, occupancy, furniture and equipment, and other expenses. Significant account balances are highlighted in the accompanying tables with additional descriptions of significant fluctuations of both quarter to date and year to date variances following:

| | Three Months Ended | | | |
|--------------------------------|----------------------|---------|----------------------|----------------------|
| | June 30 | | | 2006 Consolidated |
| | 2007 Consolidated | Farwell | Adjusted w/o Farwell | |
| Compensation | | | | |
| Leased employee salaries | \$2,824 | \$177 | \$2,647 | \$2,462 |
| Leased employee benefits | 1,059 | 83 | 976 | 988 |
| All other | 37 | 5 | 32 | 34 |
| Total compensation | 3,920 | 265 | 3,655 | 3,484 |
| Occupancy | | | | |
| Depreciation | 114 | 6 | 108 | 93 |
| Outside services | 90 | 8 | 82 | 80 |
| Property taxes | 90 | 4 | 86 | 83 |
| Utilities | 80 | 5 | 75 | 70 |
| Building rent | 15 | -- | 15 | 39 |
| Building repairs | 31 | -- | 31 | 32 |
| All other | 11 | -- | 11 | 15 |
| Total occupancy | 431 | 23 | 408 | 412 |
| Furniture and equipment | | | | |
| Depreciation | 381 | 7 | 374 | 347 |
| Service contracts | 161 | -- | 161 | 187 |
| Computer costs | 152 | 35 | 117 | 106 |
| ATM and debit card | 126 | 6 | 120 | 68 |
| All other | 27 | 9 | 18 | 15 |
| Total furniture and equipment | 847 | 57 | 790 | 723 |
| Other | | | | |
| Audit and SOX compliance fees | 97 | 3 | 94 | 164 |
| Marketing | 182 | 4 | 178 | 152 |

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| | | | | |
|----------------------------|---------|-------|---------|---------|
| Directors fees | 199 | 23 | 176 | 152 |
| Printing and supplies | 96 | 3 | 93 | 97 |
| Education and travel | 131 | 4 | 127 | 54 |
| Postage and freight | 113 | 15 | 98 | 106 |
| All other | 817 | 133 | 684 | 625 |
| | ----- | ----- | ----- | ----- |
| Total other | 1,635 | 185 | 1,450 | 1,350 |
| | ----- | ----- | ----- | ----- |
| TOTAL NONINTEREST EXPENSES | \$6,833 | \$530 | \$6,303 | \$5,969 |
| | ===== | ===== | ===== | ===== |

22

| | Six Months Ended | | | |
|-------------------------------|------------------|---------|----------------------|--------------|
| | June 30 | | | |
| | 2007 | | | 2006 |
| | Consolidated | Farwell | Adjusted w/o Farwell | Consolidated |
| | ----- | ----- | ----- | ----- |
| Compensation | | | | |
| Leased employee salaries | \$ 5,597 | \$ 359 | \$ 5,238 | \$ 4,925 |
| Leased employee benefits | 2,140 | 166 | 1,974 | 2,009 |
| All other | 80 | 9 | 71 | 79 |
| | ----- | ----- | ----- | ----- |
| Total compensation | 7,817 | 534 | 7,283 | 7,013 |
| | ----- | ----- | ----- | ----- |
| Occupancy | | | | |
| Depreciation | 224 | 13 | 211 | 199 |
| Outside services | 177 | 16 | 161 | 165 |
| Property taxes | 183 | 8 | 175 | 167 |
| Utilities | 180 | 9 | 171 | 164 |
| Building rent | 35 | -- | 35 | 78 |
| Building repairs | 68 | -- | 68 | 68 |
| All other | 22 | -- | 22 | 27 |
| | ----- | ----- | ----- | ----- |
| Total occupancy | 889 | 46 | 843 | 868 |
| | ----- | ----- | ----- | ----- |
| Furniture and equipment | | | | |
| Depreciation | 753 | 14 | 739 | 721 |
| Service contracts | 334 | -- | 334 | 363 |
| Computer costs | 312 | 74 | 238 | 196 |
| ATM and debit card | 210 | 10 | 200 | 128 |
| All other | 54 | 19 | 35 | 28 |
| | ----- | ----- | ----- | ----- |
| Total furniture and equipment | 1,663 | 117 | 1,546 | 1,436 |
| | ----- | ----- | ----- | ----- |
| Other | | | | |
| Audit and SOX compliance fees | 295 | 9 | 286 | 575 |
| Marketing | 356 | 8 | 348 | 305 |
| Directors fees | 393 | 48 | 345 | 298 |
| Printing and supplies | 199 | 8 | 191 | 202 |
| Education and travel | 239 | 4 | 235 | 132 |
| Postage and freight | 226 | 25 | 201 | 211 |

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| | | | | |
|----------------------------|----------|---------|----------|----------|
| All other | 1,560 | 266 | 1,294 | 1,237 |
| | ----- | ----- | ----- | ----- |
| Total other | 3,268 | 368 | 2,900 | 2,960 |
| | ----- | ----- | ----- | ----- |
| TOTAL NONINTEREST EXPENSES | \$13,637 | \$1,065 | \$12,572 | \$12,277 |
| | ===== | ===== | ===== | ===== |

Leased employee salaries expense continues to increase as a result of annual merit increases and the continued growth of the Corporation. The decrease in leased employee benefits is primarily attributed to the Corporation changing medical insurance administrators in the third quarter of 2006. One of the advantages of the change was that the Corporation's premium payments would be capped based on the current year's projected claims. This change in medical insurance administrators along with the curtailment of the defined benefit pension plan in March 2007 will allow the Corporation to decrease its employee benefits expense for the remainder of 2007.

Upon completion of a new Canadian Lakes branch location, the building lease for the facility that had previously housed the Canadian Lakes office was terminated. This lease termination resulted in a one time penalty, which was included in rent expense. The completion of the project also resulted in an increase in building depreciation expense. The Corporation anticipates building rent and building depreciation to approximate current levels for the remainder of 2007.

The increases in computer costs are a result of the Corporation's continuous investment in its technological infrastructure as well as increases in fees charged by vendors. This constant reinvestment helps the Corporation maintain a competitive edge in an ever changing marketplace. Management expects that computer expenses will approximate current levels for the remainder of 2007.

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ATM and debit card fees have increased as the result of both increases in activity as well as increases in fees charged by vendors. This increase in fees was offset by increases in ATM and debit card fee income. Management anticipates these fees to continue at a similar level throughout the remainder of 2007.

Management has been diligently working to decrease audit and (Sarbanes Oxley) SOX compliance fees. In the first six months of 2007, this became a reality. These fees decreased as a result of the following factors:

- Many similar processes between subsidiaries have been centralized.
- Testing previously outsourced is now being performed internally as a result of an expanded internal audit department.
- A substantial portion of the 2006 year end audit work was performed prior to year end, where in prior years, most of it had been completed after year end.

Management does anticipate that audit and SOX compliance fees will approximate current levels throughout 2007 as a result of the continued centralization and streamlining of back room functions.

The Corporation places a strong emphasis on continuing education. These educational programs help provide team members with a competitive edge in the market place. In the third quarter of 2006, the Corporation began offering Dale Carnegie training to its employees. This program is designed to help develop and

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optimize the communication skills of its participants. Management feels that this investment in its employees today will pay dividends for years to come.

The increases in directors fees are a result of additional meeting during the first six months of the year related to ongoing strategic planning.

All other expenses include consulting fees, legal fees, title insurance expenses, as well as other miscellaneous expenses that are not individually significant.

ANALYSIS OF CHANGES IN FINANCIAL CONDITION

| | June 30 2007 | December 31 2006 | \$ Change | % Change (unannualized) |
|---|-----------------|---------------------|------------|----------------------------|
| | ----- | ----- | ----- | ----- |
| ASSETS | | | | |
| Cash and cash equivalents | \$ 29,842 | \$ 31,359 | \$ (1,517) | -4.8% |
| Trading securities | 41,777 | -- | 41,777 | N/A |
| Securities available for sale | 164,201 | 213,450 | (49,249) | -23.1% |
| Mortgage loans available for sale | 850 | 2,734 | (1,884) | -68.9% |
| Loans | 607,219 | 591,042 | 16,177 | 2.7% |
| Allowance for loan losses | (7,744) | (7,605) | (139) | 1.8% |
| Bank premises and equipment | 21,392 | 20,754 | 638 | 3.1% |
| Other assets | 60,728 | 58,393 | 2,335 | 4.0% |
| | ----- | ----- | ----- | ----- |
| TOTAL ASSETS | \$918,265 | \$910,127 | \$ 8,138 | 0.9% |
| | ===== | ===== | ===== | ===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | |
| LIABILITIES | | | | |
| Deposits | \$724,157 | \$725,840 | \$ (1,683) | -0.2% |
| Other borrowed funds | 67,376 | 58,303 | 9,073 | 15.6% |
| Escrow funds payable | 3,545 | 2,416 | 1,129 | 46.7% |
| Accrued interest and other liabilities | 4,397 | 7,819 | (3,422) | -43.8% |
| | ----- | ----- | ----- | ----- |
| TOTAL LIABILITIES | 799,475 | 794,378 | 5,097 | 0.6% |
| SHAREHOLDERS' EQUITY | 118,790 | 115,749 | 3,041 | 2.6% |
| | ----- | ----- | ----- | ----- |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$918,265 | \$910,127 | \$ 8,138 | 0.9% |
| | ===== | ===== | ===== | ===== |

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The Corporation's management team has been given the goal to increase average assets by 8.0% over 2006. For the period ending June 30, 2007 the Corporation is below its balance sheet growth target; however, management does anticipate continued growth throughout the remainder of 2007.

As previously mentioned, the Corporation commenced a balance sheet reorganization strategy in 2007 which resulted in a transfer of securities available for sale to trading securities. The Corporation's overall intent was to sell a portion of the trading securities to enhance the ongoing restructuring of assets and liabilities as part of our interest rate risk management.

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Since January 1, 2007, the Corporation has reduced its trading securities by \$36,062 as a result of sales, calls, and maturities. Management has used these proceeds to shift from a fed funds borrowing position of \$6,765 as of December 31, 2006 to a fed funds sold position of \$6,240 at June 30, 2007, resulting in a position change of \$13,005. Deposits have decreased \$1,683 since December 31, 2006. The remainder of the proceeds from the sales, calls, and maturities of trading account securities were used to fund a \$16,177 increase in loans since December 31, 2006.

The net result of the restructuring has reduced the difference between assets and liabilities repricing within one year from a net liability repricing position of 11.1% as of March 31, 2007 to 4.9% as of June 30, 2007. This reduction in our net liability repricing position provides protection against any dramatic change in our net interest margins if rates were to continue increasing during the remainder of 2007.

In addition to the balance sheet restructuring resulting from the sales of trading securities, IBT implemented a strategy to purchase high quality tax exempt municipal bonds with funding in the form of fixed rate Federal Home Loan Bank advances. This strategy has resulted in a \$16,025 increase in tax exempt available for sale securities since January 1, 2007.

The decline of mortgage loans available for sale is a result of the continued softening of demand for residential mortgage loans. The residential real estate mortgage loan market is expected to be consistent throughout the remainder of 2007.

The Corporation observed a substantial increase in escrow funds payable during the first six months of 2007. This increase can be attributed to Internal Revenue Code Section ("IRC") 1031 exchange account balances being deposited by customers of IBT Title and Insurance Agency, Inc. ("IBT Title"). These IRC 1031 accounts allow owners of business or investment property to defer realized gains from the sale of business or investment property if the funds are reinvested in another property. As such, these balances can fluctuate significantly between periods as the funds are deposited and reinvested.

The following table outlines the changes in the loan portfolio:

| | June 30 2007 | December 31 2006 | \$ Change | % Change (unannualized) |
|----------------------------------|-----------------|---------------------|-----------|----------------------------|
| | ----- | ----- | ----- | ----- |
| Commercial | \$227,674 | \$212,701 | \$14,973 | 7.0% |
| Agricultural | 48,959 | 47,302 | 1,657 | 3.5% |
| Residential real estate mortgage | 300,101 | 300,650 | (549) | -0.2% |
| Installment | 30,485 | 30,389 | 96 | 0.3% |
| | ----- | ----- | ----- | ----- |
| TOTAL GROSS LOANS | \$607,219 | \$591,042 | \$16,177 | 2.7% |
| | ===== | ===== | ===== | ===== |

As shown in the above table, management has been successful in increasing its commercial loan portfolio and this trend is expected to continue. The Corporation has also seen an increase in agricultural loans during the first six months of 2007. Agricultural loans are not expected to vary significantly from current levels for the remainder of 2007.

The decline in residential real estate mortgage loans is a result of the continued soft mortgage market in Michigan. However, the Corporation does anticipate that residential real estate mortgages will increase moderately

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during 2007. The installment loan portfolio has been steadily decreasing over the past few years as a result of increased competition as well as a result of the sale of the consumer credit card portfolio in the second quarter of 2006. Management anticipates the installment loan portfolio to remain stable throughout the remainder of 2007.

The following table outlines the changes in the deposit portfolio:

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| | June 30 2007 | December 31 2006 | \$ Change | % Change (unannualized) |
|-------------------------------------|-----------------|---------------------|------------|----------------------------|
| | ----- | ----- | ----- | ----- |
| Noninterest bearing demand deposits | \$ 82,919 | \$ 83,902 | \$ (983) | -1.2% |
| Interest bearing demand deposits | 100,972 | 111,406 | (10,434) | -9.4% |
| Savings deposits | 191,409 | 178,001 | 13,408 | 7.5% |
| Certificates of deposit | 315,998 | 320,226 | (4,228) | -1.3% |
| Brokered certificates of deposit | 26,116 | 27,446 | (1,330) | -4.8% |
| Internet certificates of deposit | 6,743 | 4,859 | 1,884 | 38.8% |
| | ----- | ----- | ----- | ----- |
| TOTAL | \$724,157 | \$725,840 | \$ (1,683) | -0.2% |
| | ===== | ===== | ===== | ===== |

As shown in the preceding table, the Corporation has been unable to fund the loan growth with core deposits and instead it has been funded with the proceeds from the sales of trading securities.

The increase in savings deposits is primarily in money market accounts. Currently the rates on these accounts are attractive to our customers as the Corporation strives to price these products competitively. The declines in brokered certificates of deposits are the result of the maturity of these products and the Corporation monitoring the cost of funding and replacing these accounts with other funding sources including internet certificates of deposit, which are typically less costly.

CAPITAL

The capital of the Corporation consists solely of common stock, capital surplus, retained earnings, and accumulated other comprehensive loss. The Corporation offers dividend reinvestment and employee and director stock purchase plans. Under the provisions of these Plans, the Corporation issued 25,241 shares of common stock generating \$990 of capital during the first six months of 2007, as compared to 19,238 shares of common stock generating \$1,093 of capital in the same period in 2006. The Corporation also offers share based payment awards through its equity compensation plan. Pursuant to this plan, the Corporation generated \$452 and \$231 of capital in 2007 and 2006, respectively.

In October 2002 the Board of Directors authorized management to repurchase up to \$2,000 in dollar value of the Corporation's common stock. In March 2007, the Board of Directors adopted a new plan which allowed for the repurchase of up to 150,000 shares. During 2007, the Corporation has repurchased 22,734 shares of common stock at an average price of \$43.02 under the new and old plans. There were no shares repurchased in 2006.

Accumulated other comprehensive loss decreased \$1,579 and consists of a \$1,317

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increase in unrealized loss on available-for-sale investment securities, \$1,999 of comprehensive income as a result of the curtailment of the Corporation's defined benefit pension plan, and a \$897 cumulative adjustment related to the adoption of SFAS Statement No. 159.

There are no significant regulatory constraints placed on the Corporation's capital. The Federal Reserve Board's current recommended minimum primary capital to assets requirement is 6.0%. The Corporation's primary capital to adjusted average assets, which consists of shareholders' equity plus the allowance for loan losses less acquisition intangibles, was 11.1 % as of June 30, 2007. There are no commitments for significant capital expenditures.

The Federal Reserve Board has established a minimum risk based capital standard. Under this standard, a framework has been established that assigns risk weights to each category of on and off-balance-sheet items to arrive at risk adjusted total assets. Regulatory capital is divided by the risk adjusted assets with the resulting ratio compared to the minimum standard to determine whether a corporation has adequate capital. The minimum standard is 8%, of which at least 4% must consist of equity capital net of goodwill. The following table sets forth the percentages required under the Risk Based Capital guidelines and the Corporation's values at June 30, 2007:

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PERCENTAGE OF CAPITAL TO RISK ADJUSTED ASSETS

| IBT Bancorp June 30, 2007 | | |
|------------------------------|----------|--------|
| | Required | Actual |
| | ----- | ----- |
| Equity Capital | 4.00% | 15.8% |
| Secondary Capital | 4.00% | 1.3% |
| | ---- | ---- |
| Total Capital | 8.00% | 17.1% |
| | ==== | ==== |

IBT Bancorp's secondary capital includes only the allowance for loan losses. The percentage for the secondary capital under the required column is the maximum amount allowed from all sources.

The Federal Reserve and FDIC also prescribe minimum capital requirements for the Corporation's subsidiary Bank. At June 30, 2007, the Bank exceeded these minimum capital requirements.

LIQUIDITY

The primary sources of the Corporation's liquidity are cash and cash equivalents, trading securities, and available-for-sale securities. These categories totaled \$235,820 or 25.7% of assets as of June 30, 2007 as compared to \$244,809 or 26.9% as of December 31, 2006. Liquidity is important for financial institutions because of their need to meet loan funding commitments, depositor withdrawal requests and various other commitments including expansion of operations, investment opportunities, and payment of cash dividends. Liquidity varies significantly daily, based on customer activity.

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Operating activities provided \$41,447 of cash in the first six months of 2007 as compared to using \$2,022 in the same period in 2006. Net cash provided by financing activities equaled \$5,731 and \$41,780 in the six month periods ended June 30, 2007 and 2006, respectively. The Corporation's investing activities used cash amounting to \$48,695 in the first six months of 2007 and \$40,415 in the same period in 2006. The accumulated effect of the Corporation's operating, investing, and financing activities used \$1,517 and \$657 in the six months ended June 30, 2007 and 2006, respectively.

The primary source of funds for the Bank is deposits. The Bank emphasizes interest-bearing time deposits as part of their funding strategy. The Bank also seeks noninterest bearing deposits, or checking accounts, which reduce the Bank's cost of funds in an effort to expand the customer base.

In recent periods, the Corporation has experienced some competitive challenges in obtaining additional deposits to fuel growth. As depositors continue to have wider access to the Internet and other real-time interest rate monitoring resources, deposit sourcing and pricing has become more competitive. Deposit growth is achievable, but at a competitive price, with tight net interest margins, especially during these most recent periods of low interest rates.

In addition to these primary sources of liquidity, the Corporation has the ability to borrow in the federal funds market and at both the Federal Reserve Bank and the Federal Home Loan Bank, some of which have been classified as trading liabilities to mitigate the Corporation's interest rate risk. The Corporation's liquidity is considered adequate by the management of the Corporation.

FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET ARRANGEMENTS

The Corporation is party to financial instruments with off-balance-sheet risk. These instruments are entered into in the normal course of business to meet the financing needs of its customers. These financial instruments, which include commitments to extend credit and standby letters of credit, involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The contract or notional amounts of these instruments reflect the extent of involvement the Corporation has in a particular class of financial instruments.

The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. The Corporation uses the same credit policies in deciding to make these commitments as it does for extending loans to customers.

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Commitments to extend credit, which totaled \$81,475 at June 30, 2007, are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have variable interest rates, fixed expiration dates, or other termination clauses and may require the payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Standby letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements, including

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commercial paper, bond financing, and similar transactions. At June 30, 2007, the Corporation had a total of \$3,990 in outstanding standby letters of credit.

Generally, these commitments to extend credit and letters of credit mature within one year. The credit risk involved in these transactions is essentially the same as that involved in extending loans to customers. The Corporation evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon the extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, and other income producing commercial properties.

Isabella Bank and Trust (IB&T), a subsidiary of the Corporation, sponsors the IBT Foundation (the "Foundation"), which is a nonprofit entity formed for the purpose of distributing charitable donations to recipient organizations generally located in the communities serviced by Isabella Bank and Trust. IB&T periodically makes charitable contributions in the form of cash transfers to the Foundation. The Foundation is administered by members of the Corporation's Board of Directors. The assets and transactions of the Foundation are not included in the consolidated financial statements of IBT Bancorp, Inc. The assets of the Foundation as of June 30, 2007 were \$1,227.

FORWARD LOOKING STATEMENTS

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Corporation intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and is including this statement for purposes of these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Corporation, are generally identifiable by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project," or similar expressions. The Corporation's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations and future prospects of the Corporation and its subsidiaries include, but are not limited to, changes in: interest rates, general economic conditions, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality or composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Corporation's market area, and accounting principles, policies and guidelines. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Further information concerning the Corporation and its business, including additional factors that could materially affect the Corporation's financial results, is included in the Corporation's filings with the Securities and Exchange Commission.

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Corporation's primary market risks are interest rate risk and, to a lesser extent, liquidity risk. The Corporation has very limited foreign exchange risk and does not utilize interest rate swaps or derivatives in the management of its interest rate risk. The Corporation does have a significant amount of loans extended to borrowers involved in agricultural production. Cash flow and ability

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to service debt of such customers is largely dependent on growing conditions and the commodity prices for corn, soybeans, sugar beets, milk, beef and a variety of dry beans. The Corporation mitigates these risks by using conservative price and production yields when calculating a borrower's available cash flow to service their debt.

Interest rate risk ("IRR") is the exposure to the Corporation's net interest income, its primary source of income, to changes in interest rates. IRR results from the difference in the maturity or repricing frequency of a financial institution's interest earning assets and its interest bearing liabilities. Interest rate risk is the fundamental method in which financial institutions earn income and create shareholder value. Excessive exposure to interest rate risk could pose a significant risk to the Corporation's earnings and capital.

The Federal Reserve, the Corporation's primary Federal regulator, has adopted a policy requiring the Board of Directors and senior management to effectively manage the various risks that can have a material impact on the safety and soundness of the Corporation. The risks include credit, interest rate, liquidity, operational, and reputational. The Corporation has policies, procedures and internal controls for measuring and managing these risks. Specifically, the IRR policy and procedures include defining acceptable types and terms of investments and funding sources, liquidity requirements, limits on investments in long term assets, limiting the mismatch in repricing opportunity of assets and liabilities, and the frequency of measuring and reporting to the Board of Directors.

The Corporation uses several techniques to manage interest rate risk. The first method is gap analysis. Gap analysis measures the cash flows and/or the earliest repricing of the Corporation's interest bearing assets and liabilities. This analysis is useful for measuring trends in the repricing characteristics of the balance sheet. Significant assumptions are required in this process because of the imbedded repricing options contained in assets and liabilities. A substantial portion of the Corporation's assets are invested in loans and investment securities. These assets have imbedded options that allow the borrower to repay the balance prior to maturity without penalty. The amount of prepayments is dependent upon many factors, including the interest rate of a given loan in comparison to the current interest rates; for residential mortgages the level of sales of used homes; and the overall availability of credit in the market place. Generally, a decrease in interest rates will result in an increase in the Corporation's cash flows from these assets. Investment securities, other than those that are callable, do not have any significant imbedded options. Saving and checking deposits may generally be withdrawn on request without prior notice. The timing of cash flow from these deposits is estimated based on historical experience. Time deposits have penalties which discourage early withdrawals. Cash flows may vary based on current offering rates, competition, customer need for deposits, and overall economic activity. As noted above, the Corporation has reclassified a portion of its investment portfolio and its borrowings into trading accounts. Management feels that these practices help it mitigate the volatility of the current interest rate environment.

The second technique used in the management of interest rate risk is to combine the projected cash flows and repricing characteristics generated by the gap analysis and the interest rates associated with those cash flows and projected future interest income. By changing the amount and timing of the cash flows and the repricing interest rates of those cash flows, the Corporation can project the effect of changing interest rates on its interest income.

The following table provides information about the Corporation's assets and liabilities that are sensitive to changes in interest rates as of June 30, 2007. The Corporation has no interest rate swaps, futures contracts, or other derivative financial options, except for derivative loan commitments, which are

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not significant. The principal amounts of assets and time deposits maturing were calculated based on the contractual maturity dates. Savings and NOW accounts are based on management's estimate of their future cash flows.

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(dollars in thousands)

June 30, 2007

| | 2008 | 2009 | 2010 | 2011 | 2012 | Thereafter |
|--------------------------------------|-----------|-----------|-----------|----------|----------|------------|
| Rate sensitive assets | | | | | | |
| Other interest bearing assets | \$ 7,516 | \$ -- | \$ -- | \$ -- | \$ -- | \$ -- |
| Average interest rates | 4.36% | -- | -- | -- | -- | -- |
| Trading securities | \$ 13,293 | \$ 4,391 | \$ 1,431 | \$ 3,910 | \$ 4,714 | \$14,038 |
| Average interest rates | 5.31% | 5.83% | 5.53% | 5.03% | 4.90% | 4.68% |
| Fixed interest rate securities | \$ 47,925 | \$ 12,018 | \$ 13,337 | \$13,668 | \$12,562 | \$64,691 |
| Average interest rates | 4.81% | 4.62% | 4.79% | 4.46% | 4.82% | 3.69% |
| Fixed interest rate loans | \$114,424 | \$112,962 | \$107,153 | \$84,571 | \$67,582 | \$31,217 |
| Average interest rates | 6.74% | 6.57% | 6.71% | 6.79% | 7.31% | 6.26% |
| Variable interest rate loans | \$ 52,710 | \$ 13,359 | \$ 16,478 | \$ 3,092 | \$ 2,356 | \$ 1,315 |
| Average interest rates | 8.13% | 8.27% | 8.57% | 7.97% | 7.50% | 6.89% |
| Rate sensitive liabilities | | | | | | |
| Borrowed funds | \$ 10,562 | \$ 17,558 | \$ 12,000 | \$ 3,256 | \$10,000 | \$14,000 |
| Average interest rates | 4.74% | 5.13% | 4.82% | 5.94% | 4.41% | 4.84% |
| Savings and NOW accounts | \$133,090 | \$ 73,898 | \$ 68,527 | \$16,866 | \$ -- | \$ -- |
| Average interest rates | 3.48% | 1.17% | 0.75% | 0.67% | 0.00% | -- |
| Fixed interest rate time deposits | \$227,793 | \$ 58,661 | \$ 28,461 | \$14,873 | \$11,964 | \$ 263 |
| Average interest rates | 4.48% | 4.36% | 4.45% | 4.57% | 4.84% | 4.84% |
| Variable interest rate time deposits | \$ 1,910 | \$ 4,932 | \$ -- | \$ -- | \$ -- | \$ -- |
| Average interest rates | 2.97% | 4.36% | -- | -- | -- | -- |

June 30, 2006

| | 2007 | 2008 | 2009 | 2010 | 2011 | Thereafter |
|--------------------------------|-----------|----------|----------|----------|----------|------------|
| Rate sensitive assets | | | | | | |
| Other interest bearing assets | \$ 2,494 | \$ -- | \$ -- | \$ -- | \$ -- | \$ -- |
| Average interest rates | 1.75% | -- | -- | -- | -- | -- |
| Fixed interest rate securities | \$ 55,057 | \$47,298 | \$22,288 | \$13,904 | \$23,220 | \$34,770 |
| Average interest rates | 4.42% | 3.55% | 3.76% | 4.21% | 4.43% | 3.76% |
| Fixed interest rate loans | \$117,514 | \$73,395 | \$76,869 | \$59,016 | \$62,798 | \$30,139 |
| Average interest rates | 6.29% | 6.30% | 6.32% | 6.38% | 6.77% | 5.86% |
| Variable interest rate loans | \$ 50,764 | \$15,411 | \$12,396 | \$ 4,594 | \$ 2,483 | \$ 919 |
| Average interest rates | 9.25% | 8.71% | 8.49% | 8.42% | 8.53% | 9.18% |

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| | | | | | | |
|--------------------------------------|-----------|----------|----------|----------|----------|----------|
| Rate sensitive liabilities | | | | | | |
| Borrowed funds | \$ 32,112 | \$ 4,000 | \$12,613 | \$ 4,000 | \$ 5,286 | \$13,000 |
| Average interest rates | 4.95% | 3.64% | 4.89% | 4.11% | 5.69% | 4.84% |
| Savings and NOW accounts | \$ 90,398 | \$68,189 | \$64,721 | \$20,484 | \$ 5,522 | \$ -- |
| Average interest rates | 3.04% | 1.06% | 0.69% | 0.64% | 0.77% | -- |
| Fixed interest rate time deposits | \$183,852 | \$44,487 | \$23,093 | \$24,592 | \$13,801 | \$ 823 |
| Average interest rates | 4.24% | 4.21% | 3.88% | 4.28% | 4.52% | 4.92% |
| Variable interest rate time deposits | \$ 855 | \$ 492 | \$ -- | \$ -- | \$ -- | \$ -- |
| Average interest rates | 4.07% | 4.09% | -- | -- | -- | -- |

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ITEM 4 - CONTROLS AND PROCEDURES

DISCLOSURE CONTROLS AND PROCEDURES

The Corporation's management carried out an evaluation, under the supervision and with the participation of the Principal Executive Officer and Principal Financial Officer, of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15(d)-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")) as of June 30, 2007, pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Principal Executive Officer and Principal Financial Officer concluded that the Corporation's disclosure controls and procedures as of June 30, 2007, were effective to ensure that information required to be disclosed by the Corporation in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

During the most recent fiscal quarter, although the Corporation has consolidated its Banks' charters and various internal controls procedures, no changes have occurred in the Corporation's key controls over financial reporting that materially affected, or is likely to materially affect, the Corporation's internal control over financial reporting.

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PART II - OTHER INFORMATION

ITEM 1A - RISK FACTORS

There have been no material changes to the risk factors disclosed in Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2006.

ITEM 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(A) NONE

(B) NONE

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(C) REPURCHASES OF COMMON STOCK

On March 22, 2007, the Board of Directors adopted a repurchase plan which allowed for the repurchase of up to 150,000 shares of the Corporation's common stock. This authorization does not have an expiration date. The following table provides information for the three month period ended June 30, 2007, with respect to this plan:

| (Dollars in thousands) | Shares Repurchased | | Total Number of Shares Purchased as Part of Publicly Announced Plan or Program | Maximum Shares That May Be Purchased Under the Plans or Programs |
|------------------------|--------------------|----------------------------|--|--|
| ----- | Number | Average Price Per Share | ----- | ----- |
| Balance, March 31 2007 | | | | 150,000 |
| April 1 - 30, 2007 | 3,663 | \$44.00 | 3,663 | 146,337 |
| May 1 - 31, 2007 | 1,000 | 44.00 | 1,000 | 145,337 |
| June 1 - 30, 2007 | 5,071 | 44.20 | 5,071 | 140,266 |
| | ----- | ----- | ----- | ----- |
| Balance, June 30 2007 | 9,734 | \$44.10 | 9,734 | 140,266 |
| | ===== | ===== | ===== | ===== |

ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITIES HOLDERS

The registrant's annual meeting of shareholders was held on May 15, 2007. At the meeting the shareholders voted upon the following matters:

Election of Directors to terms ending 2010:

| | For | Withheld |
|------------------|-----------|----------|
| | ----- | ----- |
| James C. Fabiano | 4,018,755 | 53,101 |
| David W. Hole | 4,018,540 | 53,316 |
| Dale Weburg | 4,010,028 | 61,828 |

The terms of the following directors continued after the meeting:

Ronald E. Schumacher
Richard J. Barz
Sandra L. Caul
W. Michael McGuire
Dennis P. Angner
David J. Maness
W. Joseph Manifold
William J. Strickler

ITEM 6 - EXHIBITS

(a) Exhibits

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- 31(a) Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by the Principal Executive Officer
- 31(b) Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by the Principal Financial Officer
- 32 Section 1350 Certification of Principal Executive Officer and Principal Financial Officer

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SIGNATURES

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

IBT Bancorp, Inc.

Date: July 26, 2007

/s/ Dennis P. Angner

Dennis P. Angner
Chief Executive Officer

/s/ Peggy L. Wheeler

Peggy L. Wheeler
Principal Financial Officer

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