

PUBLIC DISCLOSURE

December 6, 2010

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

Farmers State Bank of Denton
423 Broadway
P.O. Box 1047
Denton, Montana 59430
RSSD 595953

Federal Reserve Bank of Minneapolis
90 Hennepin Avenue, P.O. Box 291
Minneapolis, MN 55480-0291

NOTE: This document is an evaluation of this institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of the institution. This evaluation is not, nor should it be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion, or opinion of the federal financial supervisory agency concerning the safety and soundness of this financial institution.

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Definitions for many of the terms used in this performance evaluation can be found in section 228.12 of Regulation BB. For additional convenience, a Glossary of Common CRA Terms is attached as Appendix A at the end of this performance evaluation.

INSTITUTION'S CRA RATING: This institution is rated "Satisfactory."

The following factors support Farmers State Bank of Denton's satisfactory Community Reinvestment Act (CRA) rating.

- The bank's lending to farms of different sizes and to borrowers of different income levels is very good.
- The bank's lending within its assessment area is very good.
- The bank's net loan-to-deposit ratio is satisfactory, given the bank's asset size and the credit needs in the assessment area.
- The geographic distribution of loans is satisfactory.

SCOPE OF EVALUATION

The bank's CRA performance was evaluated using the Small Bank CRA Evaluation Procedures. This evaluation is based on the bank's small farm and consumer loan activity. These loans represent the major product lines by number of loans or dollar amount. Table 1 shows the bank's recent lending activity.

<i>Loan Type</i>	<i>Total Number of Loans</i>	<i>%</i>	<i>Total Amount of Loans</i>	<i>%</i>
Small Farm	171	62.2	\$7,034,129	83.4
Consumer	72	26.2	\$ 653,694	7.8
Small Business	32	11.6	\$ 747,137	8.8
Total	275	100.0	\$8,434,960	100.0

The analysis is based on a statistical sample of 93 small farm and 53 consumer loans from September 1, 2009, to August 31, 2010.

DESCRIPTION OF INSTITUTION

The bank is able to effectively meet the community credit needs in its assessment area given its office location, size, and products. The bank received a satisfactory rating at the conclusion of its previous CRA performance evaluation on October 17, 2006.

Office. Farmers State Bank of Denton is a full-service bank, with its only office located in Denton, Montana. The bank's lobby hours are 8:00 a.m. to 5:00 p.m. Monday through Friday. The bank does not have drive-up facilities or an automated teller machine. The bank's location and hours of operation are appropriate for the area it serves.

Loan portfolio. The bank's size does not restrict its ability to fulfill the credit needs of small farms and consumers in the assessment area. According to the September 30, 2010, Report of Condition (ROC), the bank's assets totaled \$18.0 million, with a loan portfolio of \$13.6 million. The bank's asset size increased 11.9% since the previous evaluation. The ROC data shows that the bank's loan portfolio is 77.8% agricultural, 12.3% commercial, and 9.9% consumer loans. Since the previous evaluation, the agricultural and commercial loan portfolios increased by 29.2% and 21.4%, respectively. Conversely, the consumer loan portfolio decreased by 35.0%.

Credit products. Given the bank’s rural location, it is primarily an agricultural lender, although it offers a variety of loan products to serve the needs of small farms, small businesses, and residents in its assessment area. The bank’s primary loan products include agricultural loans for operating expenses and for equipment and livestock purchases. The bank also offers agricultural loans guaranteed by the U.S. Department of Agriculture. In addition, the bank offers commercial and consumer purpose loans.

Although the bank does not originate residential real estate loans, it refers residents inquiring about such loans to nearby financial institutions that offer these loans. The evaluation did not identify any unmet credit needs in the assessment area.

Community contacts. In addition to having discussions with bank management, examiners contacted a member of the community who is familiar with economic issues in the assessment area. Information from this contact and bank management was used in the evaluation of the bank’s CRA performance.

DESCRIPTION OF ASSESSMENT AREA

Assessment area. The bank has one assessment area in central Montana and has not made any changes to its assessment area since the previous evaluation. The assessment area is defined as Fergus and Judith Basin counties. Denton is located approximately 40 miles northwest of Lewistown, Montana, in Fergus County, and 100 miles east of Great Falls, Montana. The assessment area consists of three middle-income census tracts, all of which have been classified as distressed and underserved for each year since the previous evaluation.

According to the June 30, 2010, Federal Deposit Insurance Corporation (FDIC) Deposit Market Share Report, the Farmers State Bank of Denton had total deposits of approximately \$14.8 million, which represents 5.1% of deposits throughout Fergus and Judith Basin counties. The bank ranks last in deposit market share among the five FDIC-insured financial institutions with offices in these counties.

Table 2 illustrates the demographic characteristics of the assessment area based on data from the 2000 U.S. Census and 2009 Dun & Bradstreet information.

<i>Income Categories</i>	<i>Tract Distribution</i>		<i>Families by Tract Income</i>		<i>Families < Poverty Level as % of Families by Tract</i>		<i>Families by Family Income</i>	
	#	%	#	%	#	%	#	%
Low Income	0	0.0	0	0.0	0	0.0	758	19.6
Moderate Income	0	0.0	0	0.0	0	0.0	765	19.8
Middle Income	3	100.0	3,866	100.0	447	11.6	1,056	27.3
Upper Income	0	0.0	0	0.0	0	0.0	1,287	33.3
Total Assessment Area	3	100.0	3,866	100.0	447	11.6	3,866	100.0
<i>Income Categories</i>	<i>Housing Units by Tract</i>	<i>Housing Types by Tract</i>						
		<i>Owner-Occupied</i>			<i>Rental</i>		<i>Vacant</i>	
		#	%	%	#	%	#	%
Low Income	0	0	0.0	0.0	0	0.0	0	0.0
Moderate Income	0	0	0.0	0.0	0	0.0	0	0.0
Middle Income	6,883	4,316	100.0	62.7	1,495	21.7	1,072	15.6
Upper Income	0	0	0.0	0.0	0	0.0	0	0.0
Total Assessment Area	6,883	4,316	100.0	62.7	1,495	21.7	1,072	15.6

TABLE 2
Assessment Area Demographics

<i>Income Categories</i>	<i>Total Businesses by Tract</i>		<i>Businesses by Tract and Revenue Size</i>					
	#	%	<i>≤ \$1 Million</i>		<i>> \$1 Million</i>		<i>Revenue Not Reported</i>	
			#	%	#	%	#	%
Low Income	0	0.0	0	0.0	0	0.0	0	0.0
Moderate Income	0	0.0	0	0.0	0	0.0	0	0.0
Middle Income	855	100.0	776	100.0	49	100.0	30	100.0
Upper Income	0	0.0	0	0.0	0	0.0	0	0.0
Total Assessment Area	855	100.0	776	100.0	49	100.0	30	100.0
Percentage of Total Businesses:			90.8		5.7		3.5	
<i>Income Categories</i>	<i>Total Farms by Tract</i>		<i>Farms by Tract and Revenue Size</i>					
	#	%	<i>≤ \$1 Million</i>		<i>> \$1 Million</i>		<i>Revenue Not Reported</i>	
			#	%	#	%	#	%
Low Income	0	0.0	0	0.0	0	0.0	0	0.0
Moderate Income	0	0.0	0	0.0	0	0.0	0	0.0
Middle Income	307	100.0	305	100.0	2	100.0	0	0.0
Upper Income	0	0.0	0	0.0	0	0.0	0	0.0
Total Assessment Area	307	100.0	305	100.0	2	100.0	0	100.0
Percentage of Total Farms:			99.3		0.7			

Population. Denton is a small rural community in central Montana. According to the U.S. Census, the population of Denton was 301 in 2000, and the estimated 2009 population was 278. Census data shows the population of Lewistown, the Fergus County seat, was 5,813 in 2000, and its estimated 2009 population was 5,933. Finally, the population of the bank’s assessment area was 14,222 in 2000, and the estimated 2009 population was 13,259. The estimated 2009 data indicates slight population decreases in the overall assessment area (7.2%) and in Denton (7.3%) and a 2.1% increase in Lewistown. The community contact and bank management indicated some younger residents leave the area for career and educational opportunities elsewhere, hence the slow decline in population.

Income. For purposes of classifying borrowers’ income, this evaluation uses the Department of Housing and Urban Development’s estimated 2009 and 2010 median family income for nonmetropolitan areas of Montana. This figure is \$53,500 for 2009 and \$54,200 for 2010. For purposes of classifying census tract income level, this evaluation uses the median family income from the 2000 census for nonmetropolitan areas of Montana, which was \$39,050.

Economy. According to bank management and the community contact, the agricultural industry, which consists mainly of cow/calf operations and spring and winter wheat growers, is the key economic driver in the assessment area. The overall health of the agricultural industry has been stable in recent years. Bank management stated that the area is known for raising top-quality cattle and the market for cattle is very good. Weather and timely moisture have been good for dryland wheat recently, and yields over the past five years have been very good. Despite good prices for livestock and commodities, input costs continue to rise, causing hardship for some operations. Rising fuel costs affect area producers by driving up costs of transportation, fuel oil, fertilizer, and machinery. According to bank management, most producers are smaller operators and are unable to purchase new farm equipment; prices for used machinery are artificially high as a result.

Alternative land uses are few but include some wind energy development in areas surrounding the assessment area. Previously, many people from outside the state were very interested in purchasing land tracts for sporting and recreational purposes, which drove up the cost of land. Since the previous

evaluation, this practice has decreased significantly, but prices remain too high to purchase land for grazing or crops. However, according to the community contact, land prices have declined in recent years.

Nonagricultural employers are mainly in the Lewistown area and include several retail establishments, health care facilities, and local government, including school districts. In addition, Lewiston has some small manufacturers. The community contact stated that average wages have increased recently in Fergus County to approximately \$13 to \$14 per hour. Bank management estimated that average wages in the assessment area are \$25,000 to \$30,000. According to the U.S. Department of Labor (Department), the 2009 average unemployment rates for Fergus and Judith Basin counties were 4.9% and 4.8%, respectively, lower than the statewide rate of 6.2%. In addition, the Department's wage census data indicate the 2009 average pay was \$29,152 in Fergus County and \$23,771 in Judith Basin County. Bank management and the community contact stated that the majority of families in the area, including agricultural producers, need two sources of income typically in order to secure health benefits and additional income.

The bank has an established agricultural lending niche in the assessment area. The bank enjoys a long-term, stable customer base for its loan products.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

The bank's performance in meeting the credit needs of its assessment area is satisfactory. To determine the bank's CRA rating, examiners analyzed the following criteria, in order of importance:

- Lending to farms of different sizes and to borrowers of different income levels
- Lending inside the assessment area
- Net loan-to-deposit ratio
- Geographic distribution of loans
- Record of responding to complaints regarding the bank's CRA performance

In assigning the rating, examiners placed the greatest weight on the bank's lending to farms of different sizes and to borrowers of different income levels.

LENDING TO BORROWERS OF DIFFERENT INCOME LEVELS AND TO FARMS OF DIFFERENT SIZES

The bank's lending to borrowers of different income levels and to farms of different sizes is very good.

Small farm lending. The bank's lending to small farms in its assessment area is good. Table 3 shows the percentage of loans made to farms of different sizes.

TABLE 3				
Small Farm Lending in the Assessment Area				
<i>Small Farm Originations</i>	<i>≤ \$100,000</i>	<i>>\$100,000 to ≤ \$250,000</i>	<i>> \$250,000 to < \$500,000</i>	<i>Total Originations</i>
Percentage of Small Farm Loans	90.8%	8.0%	1.1%	100.0%
Percentage of Loans to Farms with Revenues of \$1 Million or Less	100.0%	100.0%	100.0%	100.0%

The bank extended all of the small farm loans in the sample to farms with gross annual revenues of \$1 million or less. In addition, the bank extended a substantial majority of its small farm loans in amounts of \$100,000 or less. According to the 2009 Dun & Bradstreet data, 99.3% of farms in the assessment area reported revenues of \$1 million or less. The bank's lending to small farms compares well to the demographics of the assessment area.

Consumer lending. The bank's lending to low- and moderate-income borrowers is excellent. Table 4 shows the percentages of consumer loans made to borrowers of different income levels.

	<i>Low Income</i>		<i>Moderate Income</i>		<i>Middle Income</i>		<i>Upper Income</i>		<i>Unknown Income</i>	
	#	\$	#	\$	#	\$	#	\$	#	\$
Consumer	45.0%	28.4%	30.0%	32.1%	12.5%	29.0%	2.5%	2.0%	10.0%	8.6%
Percentage of Households by Income Levels**	25.0%		17.6%		21.1%		36.3%		NA	
*Median family income for nonmetropolitan areas of Montana is \$53,500 for 2009 and \$54,200 for 2010.										
**Based on 2000 census data.										
Note: Because the percentages presented in the table are rounded to the nearest tenth, some columns or rows may not total exactly 100.0%.										

The bank originated 75.0% of its consumer loans to low- and moderate-income borrowers, far exceeding the percentage of low- and moderate-income households in the assessment area (42.6%). As shown, 45.0% of consumer loans were made to low-income borrowers, representing 28.4% of consumer loan dollars. In addition, 30.0% of consumer loans were made to moderate-income borrowers, representing 32.1% of consumer loan dollars. Loan size can also be an indicator of a bank's willingness to meet assessment area credit needs. Small-dollar consumer loans are generally used to fund borrowers' living expenses. The bank originated 42.5% of the consumer loans within the assessment area for amounts of \$3,000 or less. Of these loans, 82.4% were made to low- and moderate-income borrowers. The bank's lending to low- and moderate-income borrowers is excellent and shows its willingness to serve its customer base.

Overall, the bank's lending to individuals of different income levels and to farms of different sizes is very good. A substantial majority of consumer loans were originated to low- and moderate-income borrowers, and all of the small farm loans were to farms with revenues of \$1 million or less.

COMPARISON OF CREDIT EXTENDED INSIDE AND OUTSIDE THE ASSESSMENT AREA

The bank's lending activity within the assessment area is very good. Table 5 shows the percentages of loans the bank extended inside and outside the assessment area for each category by total number and dollar amount.

<i>Loan Category</i>	<i>Inside</i>				<i>Outside</i>			
	<i>#</i>	<i>%</i>	<i>\$(000s)</i>	<i>%</i>	<i>#</i>	<i>%</i>	<i>\$(000s)</i>	<i>%</i>
Small Farm	87	93.5	3,525	98.6	6	6.5	49	1.4
Consumer	40	75.5	383	79.8	13	24.5	97	20.2
Total	127	87.0	3,907	96.4	19	13.0	149	3.6

Overall, the bank originated a majority of loans by number volume and dollar volume within its assessment area. The level of small farm loans originated within the assessment area is excellent, both by number volume and dollar volume. The level of consumer loans made in the assessment area is good but lower than at the previous evaluation. At that evaluation, 95.0% of consumer loans, by both number volume and dollar volume, were extended inside the bank's assessment area. The bank is a relationship lender, and bank management stated that all loans made outside the assessment area were made to existing customers who moved from the area or to family members of existing long-term customers. The bank is actively lending inside its assessment area.

LOAN-TO-DEPOSIT RATIO ANALYSIS

The bank's net loan-to-deposit ratio is satisfactory given the bank's asset size and financial condition and the credit needs of the assessment area. Table 6 shows the 17-quarter average net loan-to-deposit ratios for the bank and two other banks in the area that are also primarily agricultural lenders, although not similarly sized.

<i>Bank Name and Location</i>	<i>Assets as of September 30, 2010 (in millions)</i>	<i>Average Net Loan-to-Deposit Ratio</i>
Farmers State Bank of Denton, Denton, Montana	\$ 18,012	84.4%
Basin State Bank, Stanford, Montana	\$128,787	88.9%
First Bank Montana, Lewistown, Montana	\$183,416	90.9%

Since the previous evaluation, the bank's quarterly net loan-to-deposit ratio has ranged from 73.1% to 95.0%, which reflects the seasonality of agricultural lending. Bank management stated that loan demand is typically highest in the summer and early fall months, and producers typically pay off loans when they sell commodities in the fall.

Although the bank's average net loan-to-deposit ratio is lower than at the previous evaluation, when it was 93%, it compares favorably to the average net loan-to-deposit ratio of its national peer group. The September 30, 2010, Uniform Bank Performance Report indicates the bank's net loan-to-deposit ratio of 88.7% is higher than the national peer group's net loan-to-deposit ratio of 63.5%. The national peer group consists of all insured commercial banks having assets of less than or equal to \$50 million in a nonmetropolitan area with one full-service office. Bank management indicated that agricultural loan demand is mainly related to operating lines of credit and livestock purchases. Demand for equipment loans has dropped, as banks are typically unable to compete with dealers' interest rates. Furthermore, because of overall good growing seasons, yields, and prices, many producers have not needed to maximize their outstanding lines of credit.

No similarly situated financial institutions are located within the bank's assessment area. Bank management indicated that relations among local banks in the assessment area are good. Some competition for agricultural loans exists in the assessment area, since the other local banks are larger and often more attractive to larger operators. Competition for commercial and consumer loans is lower due to generally lower demand for these loan types.

The community contact did not identify any unmet credit needs in the assessment area. The factors discussed indicate an overall satisfactory responsiveness to the credit needs in the assessment area.

GEOGRAPHIC DISTRIBUTION OF LOANS

The geographic distribution of the bank's loans in the assessment area is satisfactory and does not reveal any unexplained gaps in lending patterns. The bank's assessment area consists of three middle-income census tracts, all of which are classified as distressed and underserved. Bank management and the community contact did not identify any clear or significant geographic concentrations of low- and moderate-income people in the assessment area. The bank extended small farm and consumer loans in all census tracts in the assessment area, and the geographic dispersion of its loans is good.

RECORD OF RESPONSE TO CRA-RELATED COMPLAINTS

Neither the bank nor the Federal Reserve Bank of Minneapolis received any complaints about the bank's CRA performance since the previous evaluation.

FAIR LENDING OR OTHER ILLEGAL CREDIT PRACTICES REVIEW

The evaluation did not reveal any evidence of violations of antidiscrimination laws or regulations the bank is subject to (including Regulation B--Equal Credit Opportunity Act and the Fair Housing Act) or other illegal credit practices inconsistent with the bank helping to meet community credit needs.

Appendix A

Glossary of Common CRA Terms

Aggregate lending: The number of loans originated and purchased by all reporting lenders in specified income categories as a percentage of the aggregate number of loans originated and purchased by all reporting lenders in the metropolitan statistical area/assessment area.

Census tract: A small subdivision of metropolitan and other densely populated counties. Boundaries do not cross county lines; however, they may cross the boundaries of metropolitan statistical areas. Census tracts usually have between 2,500 and 8,000 persons, and their physical size varies widely depending on population density. Census tracts are designed to be homogeneous with respect to population characteristics, economic status, and living conditions to allow for statistical comparisons.

Community development: Affordable housing (including multifamily rental housing) for low- or moderate-income individuals; community services targeted to low- or moderate-income individuals; activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's Development Company or Small Business Investment Company programs (13 C.F.R. 121.301) or have gross annual revenues of \$1 million or less; or activities that revitalize or stabilize low- or moderate-income geographies.

Effective September 1, 2005, the Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, and Federal Deposit Insurance Corporation (the Agencies) have adopted the following additional language as part of the revitalize or stabilize definition of community development.

Activities that revitalize or stabilize:

- (i) Low- or moderate-income geographies;
- (ii) Designated disaster areas; or
- (iii) Distressed or underserved nonmetropolitan middle-income geographies designated by the Agencies based on:
 - a. Rates of poverty, unemployment, and population loss or
 - b. Population size, density, and dispersion. Activities that revitalize and stabilize geographies designated based on population size, density, and dispersion if they help meet essential community needs, including the needs of low- and moderate-income individuals.

Consumer loan: A loan to one or more individuals for household, family, or other personal expenditures. It does not include a home mortgage, small business, or small farm loan. This definition includes the following categories: motor vehicle loans, credit card loans, home equity loans, other secured consumer loans, and other unsecured consumer loans.

Family: Includes a householder and one or more other persons living in the same household who are related to the householder by birth, marriage, or adoption. The number of family households always equals the number of families; however, a family household may also include nonrelatives living with the family. Families are classified by type as either a married-couple family or other family, which is further classified into "male householder" (a family with a male householder and no wife present) or "female householder" (a family with a female householder and no husband present).

Full-scope review: Performance is analyzed considering performance context, quantitative factors (e.g., geographic distribution, borrower distribution, and total number and dollar amount of investments), and qualitative factors (e.g., responsiveness).

Geography: A census tract delineated by the United States Bureau of the Census in the most recent decennial census.

Home Mortgage Disclosure Act (HMDA): The statute that requires certain mortgage lenders that do business or have banking offices in a metropolitan statistical area to file annual summary reports of their mortgage lending activity. The reports include data such as the race, gender, and income of applicants; the amount of loan requested; and the disposition of the application (e.g., approved, denied, and withdrawn).

Home mortgage loans: Includes home purchase and home improvement loans as defined in the HMDA regulation. This definition also includes multifamily (five or more families) dwelling loans, loans for the purchase of manufactured homes, and refinancings of home improvement and home purchase loans.

Household: Includes all persons occupying a housing unit. Persons not living in households are classified as living in group quarters. In 100 percent tabulations, the count of households always equals the count of occupied housing units.

Limited-scope review: Performance is analyzed using only quantitative factors (e.g., geographic distribution, borrower distribution, and total number and dollar amount of investments).

Low-income: Individual income that is less than 50 percent of the area median income or a median family income that is less than 50 percent, in the case of a geography.

Market share: The number of loans originated and purchased by the institution as a percentage of the aggregate number of loans originated and purchased by all reporting lenders in the metropolitan area/assessment area.

Metropolitan statistical area (MSA): An area, defined by the Office of Management and Budget, based on the concept of a core area with at least one urbanized area that has a population of at least 50,000. The MSA comprises the central county or counties containing the core, plus adjacent outlying counties having a high degree of social and economic integration with the central county as measured through commuting.

Middle-income: Individual income that is at least 80 percent and less than 120 percent of the area median income or a median family income that is at least 80 percent and less than 120 percent, in the case of a geography.

Moderate-income: Individual income that is at least 50 percent and less than 80 percent of the area median income or a median family income that is at least 50 percent and less than 80 percent, in the case of a geography.

Multifamily: Refers to a residential structure that contains five or more units.

Other products: Includes any unreported optional category of loans for which the institution collects and maintains data for consideration during a CRA examination. Examples of such activity include consumer loans and other loan data an institution may provide concerning its lending performance.

Owner-occupied units: Includes units occupied by the owner or co-owner, even if the unit has not been fully paid for or is mortgaged.

Qualified investment: A qualified investment is defined as any lawful investment, deposit, membership share, or grant that has as its primary purpose community development.

Rated area: A rated area is a state or multistate metropolitan area. For an institution with domestic branches in only one state, the institution's CRA rating would be the state rating. If an institution maintains domestic branches in more than one state, the institution will receive a rating for each state in which those branches are located. If an institution maintains domestic branches in two or more states within a multistate metropolitan area, the institution will receive a rating for the multistate metropolitan area.

Small loan to business: A loan included in "loans to small businesses" as defined in the Consolidated Report of Condition and Income (Call Report). These loans have original amounts of \$1 million or less and typically are either secured by nonfarm or nonresidential real estate or classified as commercial and industrial loans.

Small loan to farm: A loan included in "loans to small farms" as defined in the instructions for preparation of the Consolidated Report of Condition and Income (Call Report). These loans have original amounts of \$500,000 or less and are either secured by farmland or classified as loans to finance agricultural production and other loans to farmers.

Upper-income: Individual income that is more than 120 percent of the area median income or a median family income that is more than 120 percent, in the case of geography.

(For additional information, please see the Definitions sections of Regulation BB at 12 C.F.R. 228.12.)