Sanofi
Form 20-F
March 06, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

(Mark One)

¨ **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**
OR

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2011

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
OR

¨ **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Date of event requiring this shell company report . . . . . .

For the transition period from to

Commission File Number: 001-31368

Sanofi

(Exact name of registrant as specified in its charter)

N/A

(Translation of registrant s name into English)

France

(Jurisdiction of incorporation or organization)

54, Rue La Boétie, 75008 Paris, France

(Address of principal executive offices)

Karen Linehan, Senior Vice President Legal Affairs and General Counsel

54, Rue La Boétie, 75008 Paris, France. Fax: 011 + 33 1 53 77 43 03. Tel: 011 + 33 1 53 77 40 00

(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class:	**Name of each exchange on which registered:**
American Depositary Shares, each representing one half of one ordinary share, par value 2 per share	New York Stock Exchange
Ordinary shares, par value 2 per share	New York Stock Exchange (for listing purposes only)
Contingent Value Rights	NASDAQ Global Market

Securities registered pursuant to Section 12(g) of the Act: None

The number of outstanding shares of each of the issuer s classes of capital or common stock as of December 31, 2011 was:

Ordinary shares: 1,340,918,811

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

YES x NO ¨.

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

YES ¨ NO x.

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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x 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 x Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP ¨ International Financial Reporting Standards as issued by the International Accounting Standards Board x Other ¨

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 ¨ Item 18 ¨

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES ¨ NO x.

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PRESENTATION OF FINANCIAL AND OTHER INFORMATION

The consolidated financial statements contained in this annual report on Form 20-F have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and with IFRS as adopted by the European Union, as of December 31, 2011.

Unless the context requires otherwise, the terms Sanofi, the Company, the Group, we, our or us refer to Sanofi and its consolidated subsid

All references herein to United States or U.S. are to the United States of America, references to dollars or $ are to the currency of the United States, references to France are to the Republic of France, and references to euro and are to the currency of the European Union member states (including France) participating in the European Monetary Union.

Brand names appearing in this annual report are trademarks of Sanofi and/or its affiliates, with the exception of:

- trademarks used or that may be or have been used under license by Sanofi and/or its affiliates, such as Actonel® trademark of Warner Chilcott; Avilomics a trademark of Avila Therapeutics Inc.; BiTE® a trademark of Micromet Inc., Copaxone® a trademark of Teva Pharmaceuticals Industries, Cortizone-10® a trademark of Johnson & Johnson (except in the United-States where it is a trademark of the Group); Dynamic Electrochemistry® a trademark of AgaMatrix Inc.; epiCard (e-cue) a trademark of Intellijject; Gardasil® a trademark of Merck & Co.; Hyalgan® a trademark of Fidia Farmeceutici S.p.A, under license agreement in the United States; Leukine® a trademark of Alcafleu; Mutagrip® a trademark of Institut Pasteur; Optinate® a trademark of Warner Chilcott on certain geographical areas and of Shionogi Pharma Inc. in the United States; Pancréate a trademark of CureDM; Prevelle® a trademark of Mentor Worldwide LLC USA; RetinoStat® a trademark of Oxford Biomedica; and RotaTeq® a trademark of Merck & Co.;

- trademarks sold by Sanofi and/or its affiliates to a third party, such as Altace® a trademark of King Pharmaceuticals in the United States; Benzaclin® a trademark of Valeant in the United States and Canada, Carac® a trademark of Valeant in the United States; DDAVP® a trademark of Ferring (except in the United States where it is a trademark of the Group); Lactacyd® a trademark of GSK in certain countries; Liberty®, LibertyLink® and StarLink® trademarks of Bayer; Maalox® a trademark of Novartis in the United States, Canada and Puerto Rico; and Sculptra® a trademark of Valeant; and,

- other third party trademarks such as Acrel® a trademark of Warner Chilcott; ACT® a trademark of Johnson & Johnson on certain geographical areas (except the United States and other countries where it is a trademark of Signal Investment); Aspirine®, Cipro®, Advantage® and Advantix® trademarks of Bayer; Eprinex® a trademark of Merck & Co. in certain countries; Humaneered a trademark of KaloBios Pharmaceuticals; IC31® a trademark of Intercell; iPhone® a trademark of Apple Inc.; LentiVector® and RetinoStat® trademarks of Oxford BioMedica; Libertas a trademark of Apotex in the United States and of International Contraceptive & SRH Marketing Limited in the United Kingdom; Mediator® a trademark of Biofarma; PetArmor® a trademark of Velcera, Inc.; Rotarix® a trademark of GSK; Sklice® a trademark of Topaz Pharmaceuticals LLC; Trajenta® a trademark of Boehringer Ingelheim; Unisom® a trademark of Johnson & Johnson on certain geographical areas (except the United States where it is a trademark of Signal Investment); and Xyzal® a trademark of GSK in certain countries and of UCB Farchim SA in some others.

Not all trademarks related to investigational agents have been authorized as of the date of this annual report by the relevant health authorities; for instance Lyxumia® and Aubagio trade names have not been approved by the FDA.

The data relative to market shares and ranking information for pharmaceutical products presented in particular in Item 4. Information on the Company B. Business Overview Markets Marketing and distribution are based on sales data from IMS Health MIDAS (IMS), retail and hospital, for calendar year 2011, in constant euros (unless otherwise indicated).

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While we believe that the IMS sales data we present below are generally useful comparative indicators for our industry, they may not precisely match the sales figures published by the companies that sell the products (including our company and other pharmaceutical companies). In particular, the rules used by IMS to attribute the sales of a product covered by an alliance or license agreement do not always exactly match the rules of the agreement.

In order to allow a reconciliation with our basis of consolidation as defined in Item 5. Operating and Financial Review and Prospects Presentation of Net Sales, IMS data shown in the present document have been adjusted and include:

(i) sales as published by IMS excluding Sanofi sales generated by the vaccines business, equating to the scope of our pharmaceutical operations;

(ii) IMS sales of products sold under alliance or license agreements which we recognize in our consolidated net sales but which are not attributed to us in the reports published by IMS; and

(iii) adjustments related to the exclusion of IMS sales for products which we do not recognize in our consolidated net sales but which are attributed to us by IMS.

Data relative to market shares and ranking information presented herein for our vaccines business are based on internal estimates unless stated otherwise.

Product indications described in this annual report are composite summaries of the major indications approved in the product s principal markets. Not all indications are necessarily available in each of the markets in which the products are approved. The summaries presented herein for the purpose of financial reporting do not substitute for careful consideration of the full labeling approved in each market.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This annual report contains forward-looking statements. We may also make written or oral forward-looking statements in our periodic reports to the Securities and Exchange Commission on Form 6-K, in our annual report to shareholders, in our offering circulars and prospectuses, in press releases and other written materials and in oral statements made by our officers, directors or employees to third parties. Examples of such forward-looking statements include:

projections of operating revenues, net income, business net income, earnings per share, business earnings per share, capital expenditures, cost savings, restructuring costs, positive or negative synergies, dividends, capital structure or other financial items or ratios;

statements of our profit forecasts, trends, plans, objectives or goals, including those relating to products, clinical trials, regulatory approvals and competition; and

statements about our future events and economic performance or that of France, the United States or any other countries in which we operate.

This information is based on data, assumptions and estimates considered as reasonable by the Company as at the date of this annual report and undue reliance should not be placed on such statements.

Words such as believe, anticipate, plan, expect, intend, target, estimate, project, predict, forecast, guideline, should and intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

Forward-looking statements involve inherent, known and unknown, risks and uncertainties associated with the regulatory, economic, financial and competitive environment, and other factors that could cause future results and objectives to differ materially from those expressed or implied in the forward-looking statements. The list below indicates some of the risk factors faced by the Company:

we rely on our patents and proprietary rights to provide exclusive rights to market certain of our products, and if such patents and other rights were limited or circumvented, our financial results could be materially and adversely affected ;

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product liability claims could adversely affect our business, results of operations and financial condition ;

changes in the laws or regulations that apply to us could affect the Group s business, results of operations and financial condition ;

generic versions of some of our products may be approved for sale in one or more of their major markets ;

our long-term objectives may not be fully realized ;

we may fail to adequately renew our product portfolio whether through our own research and development or through acquisitions and strategic alliances ;

we may lose market share to competing remedies or generic brands if they are perceived to be equivalent or superior products ;

the diversification of the Group s business exposes us to additional risks ;

our products and manufacturing facilities are subject to significant government regulations and approvals, which are often costly and could result in adverse consequences to our business if we fail to comply with the regulations or maintain the approvals ;

we incurred substantial debt in connection with the acquisition of Genzyme which may limit our business flexibility compared to some of our peers ;

we face uncertainties over the pricing and reimbursement of pharmaceutical products ;

the ongoing slowdown of global economic growth and the financial crisis could have negative consequences for our business ;

the manufacture of our products is technically complex, and supply interruptions, product recalls or inventory losses caused by unforeseen events may reduce sales, adversely affect our operating results and financial condition and delay the launch of new products ; and

risks related to financial markets.

We caution you that the foregoing list of risk factors is not exclusive and a number of important factors, discussed under Item 3. Key Information D. Risk Factors below, could affect the future results and cause actual results to differ materially from those contained in any forward-looking statements. Additional risks, not currently known or considered immaterial by the Group, may have the same unfavorable effect and investors may lose all or part of their investment.

Forward-looking statements speak only as of the date they are made. Other than required by law, we do not undertake any obligation to update them in light of new information or future developments.

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PART I

Item 1. Identity of Directors, Senior Management and Advisers

N/A

Item 2. Offer Statistics and Expected Timetable

N/A

Item 3. Key Information

A. Selected Financial Data

SUMMARY OF SELECTED FINANCIAL DATA

The tables below set forth selected consolidated financial data for Sanofi. These financial data are derived from the Sanofi consolidated financial statements. The Sanofi consolidated financial statements for the years ended December 31, 2011, 2010 and 2009 are included in Item 18 of this annual report.

The consolidated financial statements of Sanofi for the years ended December 31, 2011, 2010 and 2009 have been prepared in compliance with IFRS issued by the International Accounting Standards Board (IASB) and with IFRS adopted by the European Union as of December 31, 2011. The term IFRS refers collectively to international accounting and financial reporting standards (IAS and IFRS) and to interpretations of the interpretations committees (SIC and IFRIC) mandatorily applicable as of December 31, 2011.

Sanofi reports its financial results in euros.

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SELECTED CONDENSED FINANCIAL INFORMATION

	As of and for the year ended December 31,				
(million, except per share data)	**2011**	**2010**	**2009**	**2008**	**2007**
IFRS Income statement data[a]					
Net sales	33,389	32,367	29,785	27,568	28,052
Gross profit	24,156	24,638	23,125	21,480	21,636
Operating income	5,731	6,535	6,435	4,394	5,911
Net income attributable to equity holders of Sanofi	5,693	5,467	5,265	3,851	5,263
Basic earnings per share ( )[a]/[b] **:**					
Net income attributable to equity holders of Sanofi	4.31	4.19	4.03	2.94	3.91
Diluted earnings per share ( )[a]/[c] **:**					
Net income attributable to equity holders of Sanofi	4.29	4.18	4.03	2.94	3.89
IFRS Balance sheet data					
Goodwill and other intangible assets	61,718	44,411	43,480	43,423	46,381
Total assets	100,165	85,264	80,251	71,987	71,914
Outstanding share capital	2,647	2,610	2,618	2,611	2,657
Equity attributable to equity holders of Sanofi	56,219	53,097	48,322	44,866	44,542
Long term debt	12,499	6,695	5,961	4,173	3,734
Cash dividend paid per share ( )[d]	2.65 [e]	2.50	2.40	2.20	2.07
Cash dividend paid per share ($) [d]/[f]	3.43 [e]	3.34	3.46	3.06	3.02

[a] *The results of operations of Merial, for 2010 and 2009, previously reported as held-for-exchange, have been reclassified and included in net income of continuing in accordance with IFRS 5.36., following the announcement that Merial and Intervet/Schering-Plough are to be maintained as two separate businesses operating independently.*

[b] *Based on the weighted average number of shares outstanding in each period used to compute basic earnings per share, equal to 1,321.7 million shares in 2011, 1,305.3 million shares in 2010, 1,305.9 million shares in 2009, 1,309.3 million shares in 2008, and 1,346.9 million shares in 2007.*

[c] *Based on the weighted average in each period of the number of shares outstanding plus stock options and restricted shares with a potentially dilutive effect; i.e., 1,326.7 million shares in 2011, 1,308.2 million shares in 2010, 1,307.4 million shares in 2009, 1,310.9 million shares in 2008, and 1,353.9 million shares in 2007.*

[d] *Each American Depositary Share, or ADS, represents one half of one share.*

[e] *Dividends for 2011 will be proposed for approval at the annual general meeting scheduled for May 4, 2012.*

[f] *Based on the relevant year-end exchange rate.*

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SELECTED EXCHANGE RATE INFORMATION

The following table sets forth, for the periods and dates indicated, certain information concerning the exchange rates for the euro from 2007 through March 2012 expressed in U.S. dollars per euro. The information concerning the U.S. dollar exchange rate is based on the noon buying rate in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate). We provide the exchange rates below solely for your convenience. We do not represent that euros were, could have been, or could be, converted into U.S. dollars at these rates or at any other rate. For information regarding the effect of currency fluctuations on our results of operations, see Item 5. Operating and Financial Review and Prospects and Item 11. Quantitative and Qualitative Disclosures about Market Risk.

	Period-end Rate	Average Rate [1]	High	Low
		(U.S. dollar per euro)		
2007	1.46	1.38	1.49	1.29
2008	1.39	1.47	1.60	1.24
2009	1.43	1.40	1.51	1.25
2010	1.33	1.32	1.45	1.20
2011	1.30	1.40	1.49	1.29
Last 6 months				
2011				
September	1.34	1.37	1.43	1.34
October	1.39	1.37	1.42	1.33
November	1.35	1.36	1.38	1.32
December	1.30	1.32	1.35	1.29
2012				
January	1.31	1.29	1.32	1.27
February	1.34	1.32	1.35	1.31
March [2]	1.32	1.32	1.33	1.32

[1] *The average of the Noon Buying Rates on the last business day of each month during the relevant period for the full year average, and on each business day of the month for the monthly average. The latest available Noon Buying Rate being February 24, 2012, we have used European Central Bank Rates for the period from February 27, 2012 till February 29, 2012.*

[2] *In each case, measured through March 5, 2012.*

On March 5, 2012 the European Central Bank Rate was 1.3220 per euro.

B. Capitalization and Indebtedness

N/A

C. Reasons for Offer and Use of Proceeds

N/A

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D. Risk Factors

Important factors that could cause actual financial, business, research or operating results to differ materially from expectations are disclosed in this annual report, including without limitation the following risk factors and the factors described under Cautionary Statement Regarding Forward-Looking Statements . In addition to the risks listed below, we may be subject to other material risks that as of the date of this report are not currently known to us or that we deem immaterial at this time.

Risks Relating to Legal Matters

We rely on our patents and proprietary rights to provide exclusive rights to market certain of our products, and if such patents and other rights were limited or circumvented, our financial results could be materially and adversely affected.

Through patent and other proprietary rights such as supplementary protection certificate in Europe for instance, we hold exclusivity rights for a number of our research-based products. However, the protection that we are able to obtain varies from product to product and country to country and may not be sufficient to maintain effective product exclusivity because of local variations in the patents, differences in national law or legal systems, development in law or jurisprudence, or inconsistent judgments. We are involved in litigation worldwide to enforce certain of these patent rights against generics and proposed generics (see Item 8. Financial Information A. Consolidated Financial Statements and Other Financial Information Information on Legal or Arbitration Proceedings for additional information). Moreover, patent rights are limited in time and do not always provide effective protection for our products: competitors may successfully avoid patents through design innovation, we may not hold sufficient evidence of infringement to bring suit, or our infringement claim may not result in a decision that our rights are valid, enforceable or infringed. Moreover, a number of countries are increasingly easing the introduction of generic drugs or biosimilar products through accelerated approval procedures.

Even in cases where we ultimately prevail in our infringement claim, legal remedies available for harm caused to us by infringing products may be inadequate to make us whole. A competitor may launch a generic product at risk before the initiation or completion of the court proceedings, and the court may decline to grant us a preliminary injunction to halt further at risk sales and remove the infringing product from the market. Additionally, while we would be entitled to obtain damages in such a case, the amount that we may ultimately be awarded and able to collect may be insufficient to compensate all harm caused to us.

Further, our successful assertion of a given patent against one competing product is not necessarily predictive of our future success or failure in asserting the same patent against a second competing product because of such factors as possible differences in the formulations. Also a successful result in one country may not predict success in another country because of local variations in the patents.

To the extent valid third-party patent rights cover our products, we or our partners may be required to obtain licenses from the holders of these patents in order to manufacture, use or sell these products, and payments under these licenses may reduce our profits from these products. We may not be able to obtain these licenses on favorable terms, or at all. If we fail to obtain a required license or are unable to alter the design of our technology to fall outside the scope of a third-party patent, we may be unable to market some of our products, which may limit our profitability.

Product liability claims could adversely affect our business, results of operations and financial condition.

Product liability is a significant business risk for any pharmaceutical company, and the Group s ongoing diversification could increase our product liability exposure (see notably The diversification of the Group s business exposes us to additional risks below). Substantial damage awards and/or settlements have been made notably in the United States and other common law jurisdictions against pharmaceutical companies based on claims for injuries allegedly caused by the use of their products. Such claims can also be accompanied by consumer fraud claims by customers or third-party payers seeking reimbursement of the cost of the product. Often the side effect profile of pharmaceutical drugs cannot be fully established based on preapproval clinical studies involving only several hundred to several thousand patients. Routine review and analysis of the continually growing body of post-marketing safety surveillance and clinical trials provide additional information for example, potential evidence of rare, population-specific or long-term adverse reactions or of drug

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interactions that were not observed in preapproval clinical studies and may cause product labeling to evolve, including restrictions of therapeutic indications, new contraindications, warnings or precautions, and occasionally even the suspension or withdrawal of a product marketing authorization. Several pharmaceutical companies have withdrawn products from the market because of newly detected or suspected adverse reactions to their products, and as a result of such withdrawal now face significant product liability claims. We are currently defending a number of product liability claims (see Note D.22.a) to the consolidated financial statements included at Item 18 of this annual report) and there can be no assurance that the Group will be successful in defending against each of these claims or will not face additional claims in the future. Also our risk exposure also increased due to the fact that we are now commercializing some devices using new technologies which, in case of malfunction, could cause unexpected damages and trigger our liability (see We are increasingly dependent on information technologies and networks. below).

Although we continue to insure a portion of our product liability with third-party carriers, product liability coverage is increasingly difficult and costly to obtain, particularly in the United States, and in the future it is possible that self-insurance may become the sole commercially reasonable means available for managing the product liability financial risk of our pharmaceutical and vaccines businesses (see Item 4. Information on the Company B. Business Overview Insurance and Risk Coverage). Due to insurance conditions, even when the Group has insurance coverage, recoveries from insurers may not be totally successful. Moreover the insolvency of a carrier could negatively affect our ability to achieve the practical recovery of the coverage for which we have already paid a premium.

Product liability claims, regardless of their merits or the ultimate success of the Group s defense, are costly, divert management attention, may harm our reputation and can impact the demand for our products. Substantial product liability claims, if successful, could adversely affect our business, results of operations and financial condition.

Claims and investigations relating to competition law, marketing practices and pricing could adversely affect our business, results of operations and financial condition.

The marketing of our products is heavily regulated, and alleged failures to comply fully with applicable regulations could subject us to substantial fines, penalties and injunctive or administrative remedies, potentially leading to the imposition of additional regulatory controls or exclusion from government reimbursement programs. Sanofi and certain of its subsidiaries are under investigation by various government entities and are defending a number of lawsuits relating to antitrust and/or pricing and marketing practices, including, for example in the United States, class action lawsuits and whistle blower litigation. See Note D.22.c) to our consolidated financial statements included at Item 18 of this annual report.

Because many of these cases allege substantial unquantified damages, may be subject to treble damages and frequently seek significant punitive damages and penalties, it is possible that any final determination of liability or settlement of these claims or investigations could have a material adverse effect on our business, results of operations or financial condition.

There are other legal matters in which adverse outcomes could have a material adverse effect on our business, results of operations and financial condition.

The Group faces significant litigation and government investigations or audits, including allegations of securities law violations, claims related to employment matters, patent and intellectual property disputes, consumer law claims and tax audits.

Unfavorable outcomes in these matters, or in similar matters to be faced in the future, could preclude the commercialization of products, negatively affect the profitability of existing products and subject us to substantial fines, penalties and injunctive or administrative remedies, potentially leading to the imposition of additional regulatory controls or exclusion from government reimbursement programs. Any such result could materially and adversely affect our results of operations, financial condition, or business. See Item 8. Financial Information A. Consolidated Financial Statements and Other Financial Information Information on Legal or Arbitration Proceedings and Note D.22. to our consolidated financial statements included at Item 18 of this annual report.

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Changes in the laws or regulations that apply to us could affect the Group s business, results of operations and financial condition.

Governmental authorities are increasingly looking to facilitate generic and biosimilar competition to existing products through new regulatory proposals intended to, or resulting in, changes to the scope of patent or data exclusivity rights and use of accelerated regulatory pathways for generic and biosimilar drug approvals. Such regulatory proposals, if enacted, could make prosecution of patents for new products more difficult and time consuming or could adversely affect the exclusivity period for our products, thereby materially and adversely affecting our financial results.

This new competitive environment and potential regulatory changes may further limit the exclusivity enjoyed by innovative products on the market and directly impact pricing and reimbursement levels, which may adversely affect our business and future results. See Item 4. Information on the Company B. Business Overview Competition and Item 4. Information on the Company B. Business Overview Regulation .

In addition, changes in tax laws or in their application with respect to matters such as tax rates, transfer pricing, dividends, controlled companies or a restriction in certain forms of tax relief, could affect our effective tax rate and our future results.

For information regarding risks related to changes in environmental rules and regulations, see Environmental liabilities and compliance costs may have a significant adverse effect on our results of operations below.

Risks Relating to Our Business

Generic versions of some of our products may be approved for sale in one or more of their major markets.

Many of our products are subject to aggressive generic competition, and additional products of the Group could become subject to generic competition in the future as product patents and/or exclusivities for several of our products have recently expired, or are about to expire. For example pediatric exclusivity for Aprovel® and Plavix® which contribute significantly to our net income will expire in the United States in March 2012 and May 2012, respectively, and the compound patent of Aprovel® will expire in most of the European Union in August 2012. Also, the U.S. market exclusivity of Eloxatin® will expire in August 2012, pursuant to settlement agreements. We expect this generic competition to continue and to implicate drug products with even relatively modest revenues.

The introduction of a generic version of a branded medicine typically results in a significant and rapid reduction in net sales for the branded product because generic manufacturers typically offer their unbranded versions at sharply lower prices. Accordingly, approval and market entry of a generic product often reduces the price that we receive for these products and/or the volume of the product that we would be able to sell and could materially and adversely affect our business, results of operations and financial condition. The extent of sales erosion also depends on the number of generic versions of our products that are actually marketed. For instance in 2011, there was only one generic product of enoxaparin sodium (Lovenox®) marketed in the United States. The introduction of a second generic on the U.S. market in early 2012 is likely to decrease our sales and revenues on this product.

Our long-term objectives may not be fully realized.

We have established a strategy focused on three pillars: increased innovation in R&D, adaptation of our structure for future opportunities and challenges and pursuit of external growth opportunities. We may not be able to fully realize our strategic objectives and, even if we are able to do so, these strategic objectives may not deliver the expected benefits.

For example, our strategy involves concentrating efforts around identified growth platforms and meeting significant growth objectives over 2012-2015. There is no guarantee that we will meet these objectives or that these platforms will grow in line with anticipated growth rates. A failure to continue to expand our business in targeted growth platforms could affect our business, results of operations or financial condition.

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As a further example, we are implementing a cost savings program across the Group and expect this new initiative, together with expected synergies from our recent acquisition of Genzyme, to generate additional incremental cost savings by 2015. We may fail to realize all the expected cost savings, which could materially and adversely affect our financial results.

We may fail to adequately renew our product portfolio whether through our own research and development or through acquisitions and strategic alliances.

To be successful in the highly competitive pharmaceutical industry, we must commit substantial resources each year to research and development in order to develop new products to take the place of products facing expiration of patent and regulatory data exclusivity or competition from new products that are perceived as being superior. In 2011, we spent 4,811 million on research and development, amounting to approximately 14.4% of our net sales.

Developing a product is a costly, lengthy and uncertain process. Also we may not be investing in the right technology platforms, leading therapeutic area, and products classes in order to build a robust pipeline and fulfill unmet medical needs. Fields of discovery and especially biotechnology are highly competitive and characterized by significant and rapid technological changes. Numerous companies are working on the same targets and a product considered as promising at the very beginning may become less attractive if a competitor showing the same mechanism of action reaches earlier the market.

The research and development process typically takes from 10 to 15 years from discovery to commercial product launch. This process is conducted in various stages in order to test, along with other features, the effectiveness and safety of a product. There can be no assurance that any of these compounds will be proven safe or effective. See Item 4. Information on the Company B. Business Overview Pharmaceutical Research & Development and Item 4. Information on the Company B. Business Overview Vaccines Research and Development . Accordingly, there is a substantial risk at each stage of development that we will not achieve our goals of safety and/or effectiveness including during the course of a development trial and that we will have to abandon a product in which we have invested substantial amounts and human resources, including in late stage development (Phase III). Decisions concerning the studies to be carried out can have a significant impact on the marketing strategy for a given product. Multiple in-depth studies can demonstrate that a product has additional benefits, facilitating the product s marketing, but such studies are expensive and time consuming and may delay the product s submission to health authorities for approval.

Our ongoing investments in new product launches and research and development for future products could therefore result in increased costs without a proportionate increase in revenues which may negatively affect our operating results. Each regulatory authority may also impose its own requirements in order to grant a license to market the product, including requiring local clinical studies, and may delay or refuse to grant approval, even though a product has already been approved in another country. Finally, obtaining regulatory marketing approval is not a guarantee that the product will achieve commercial success. Following each product marketing approval, the medical need served by the product and the corresponding reimbursement rate are evaluated by other governmental agencies which may in some cases require additional studies, including comparative studies, which may both effectively delay marketing of the new product and add to its development costs.

Also our success depends on our ability to educate patients and healthcare providers and provide them with innovative data about our products and their uses. If these education efforts are not effective, then we may not be able to increase the sales of our new products to the market.

On the same topic, for the research and development of drugs in rare diseases, we produce relatively small amounts of material at early stages. Even if a product candidate receives all necessary approvals for commercialization, we may not be able to successfully scale-up production of the product material at a reasonable cost or at all and we may not receive additional approvals in sufficient time to meet product demand.

As a complement to our portfolio of products, we pursue a strategy of selective acquisitions, in-licensing and partnerships in order to develop new growth opportunities. The implementation of this strategy depends on our ability to identify business development opportunities at a reasonable cost and under acceptable conditions of

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financing. Moreover, entering into these in-licensing or partnership agreements generally requires the payment of significant milestones well before the relevant products are placed on the market without any assurance that such investments will ultimately become profitable in the long term.

Because of the active competition among pharmaceutical groups for such business development opportunities, there can be no assurance of our success in completing these transactions when such opportunities are identified.

A substantial share of the revenue and income of the Group continues to depend on the performance of certain flagship products.

We generate a substantial share of our revenues from the sale of certain key products (see Item 5. Operating and Financial Review and Prospects Results of Operations Year ended December 31, 2011 compared with year ended December 31, 2010 Net Sales by Product Pharmaceuticals), which represented 37.6% of the Group s consolidated revenues in 2011. Among these products is Lantus®, which was the Group s leading product with revenues of 3,916 million in 2011, representing 11.7% of the Group s consolidated revenues for the year. Lantus® is a flagship product of the Diabetes division, one of the Group s growth platforms.

Sales of Cerezyme®, our enzyme-replacement product for patients with Gaucher disease which is also amongst our flagship products, totaled 441 million for the year ended December 31, 2011, below the usual level of sales due to important production disruptions since 2009 (see The manufacture of our products is technically complex, and supply interruptions, product recalls or inventory losses caused by unforeseen events may reduce sales, adversely affect our operating results and financial condition and delay the launch of new products. below). In addition the patient population with Gaucher disease is limited. Furthermore, changes in the methods for treating patients with such disease could limit growth, or result in a decline, in Cerezyme® sales.

In general, a reduction in sales of one or more of our flagship products or in their growth could affect our business, results of operations and financial condition.

We may lose market share to competing remedies or generic brands if they are perceived to be equivalent or superior products.

We are faced with intense competition from generic products and brand-name drugs. Doctors or patients may choose these products over ours if they perceive them to be safer, more reliable, more effective, easier to administer or less expensive, which could cause our revenues to decline and affect our results of operations.

For example, Cerezyme® and Fabrazyme® shortages due to manufacturing issues at our facility in Allston, Massachusetts (United-States) (see The manufacture of our products is technically complex, and supply interruptions, product recalls or inventory losses caused by unforeseen events may reduce sales, adversely affect our operating results and financial condition and delay the launch of new products. below) created, and continue to create, opportunities for our competitors and have resulted in a decrease in the number of patients using these products and a loss of our overall market share of Gaucher and Fabry patients, respectively. Even if we are able again to provide a full, sustainable product supply, there is no guarantee these patients will return to using our products.

Additionally, the market for our products could also be affected if a competitor s innovative drug in the same market were to become available as generic because a certain number of patients can be expected to switch to a lower-cost alternative therapy.

The diversification of the Group s business exposes us to additional risks.

We are implementing a strategy that includes pursuing external growth opportunities to meet the challenges that we have identified for the future. The inability to quickly or efficiently integrate newly acquired activities or businesses, such as Genzyme, the loss of key employees or integration costs that are higher than anticipated, could delay our growth objectives and prevent us from achieving expected synergies. For instance, challenges that we may face in our efforts to integrate Genzyme include, among others:

addressing manufacturing problems and supply constraints that have negatively affected Genzyme s business in recent years;

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ensuring continued compliance with a consent decree that Genzyme entered into with the FDA in May 2010 relating to a manufacturing facility in Allston, Massachusetts (United-States) (see Item 4. Information on the Company B. Business Overview Production and Raw Materials.);

the outcome of ongoing legal and other proceedings to which Genzyme is a party, including shareholder litigation and patent litigation;

preserving and developing Genzyme s goodwill in the genetic disease community; and

realizing the potential of the research and development pipeline.

If we fail to effectively integrate Genzyme or the integration takes longer than expected, we may not achieve the expected benefits of the transaction.

Moreover, we may miscalculate the risks associated with newly acquired activities or businesses at the time they are acquired or not have the means to evaluate them properly. It may take a considerable amount of time and be difficult to implement a risk analysis after the acquisition is completed due to lack of historical data. As a result, risk management and the coverage of such risks, particularly through insurance policies, may prove to be insufficient or ill-adapted.

While pursuing our objective to become a global and diversified leader within the health industry, we are exposed to a number of new risks inherent in sectors in which, in the past, we have been either less active or not present at all. As an example:

we have increased exposure to the animal health business. The contribution of our animal health business to the Group s income may be adversely affected by a number of risks including some which are specific to this business: *i.e.*, the outbreak of an epidemic or pandemic that could kill large numbers of animals, and the effect of reduced veterinary expenditures during an economic crisis (see The ongoing slowdown of global economic growth and the global financial crisis could have negative consequences for our business below).

the margins of consumer health and generic products are generally lower than those of the traditional branded prescription pharmaceutical business. Moreover, the periodic review of the effectiveness, safety and use of certain over-the-counter drug products by health authorities or lawmakers may result in modifications to the regulations that apply to certain components of such products, which may require them be withdrawn from the market and/or that their formulation be modified.

specialty products (such as those developed by Genzyme) that treat rare, life-threatening diseases that are used by a small number of patients are often expensive to develop compared to the market opportunity, and third-party payers trying to limit health-care expenses may become less willing to support their per-unit cost.

Moreover, losses that may be sustained or caused by these new businesses may differ, with regards to their nature, scope and level, from the types of product liability claims that we have handled in the past (see Product liability claims could adversely affect our business, results of operations and financial condition above), and thus our current risk management and insurance coverage may not be adapted to such losses. These risks could affect our business, results of operations or financial condition.

The globalization of the Group s business exposes us to increased risks.

Emerging markets have been identified as one of our growth platforms and are among the pillars of our overall strategy. Any difficulties in adapting to emerging markets and/or a significant decline in the anticipated growth rate in these regions could impair our ability to take advantage of these growth opportunities and could affect our business, results of operations or financial condition.

There is no guarantee that our efforts to expand sales in emerging markets will succeed. The significant expansion of our activities in emerging markets may further expose us to more volatile economic conditions, political instability, competition from companies that are already well established in these markets, the inability to adequately respond to the unique characteristics of these markets, particularly with respect to their regulatory frameworks, difficulties in recruiting qualified personnel, potential exchange controls, weaker intellectual

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property protection, higher crime levels (particularly with respect to counterfeit products (see Counterfeit versions of our products harm our business, below)), corruption and fraud, as we operate in many parts of the world where corruption exists to some degree.

Our existing policies and procedures, which are designed to help ensure that we, our employees and our agents comply with the U.S. Foreign Corrupt Practices Act (FCPA), the UK Bribery Act, and other anti-bribery laws, may not adequately protect us against liability under these laws for actions taken by our employees, agents and intermediaries with respect to our business. Failure to comply with domestic or international laws could result in various adverse consequences, including possible delay in the approval or refusal to approve a product, recalls, seizures, withdrawal of an approved product from the market, or the imposition of criminal or civil sanctions, including substantial monetary penalties.

Our products and manufacturing facilities are subject to significant government regulations and approvals, which are often costly and could result in adverse consequences to our business if we fail to comply with the regulations or maintain the approvals.

The industry in which we operate faces a changing regulatory environment and heightened public scrutiny worldwide, which simultaneously require greater assurances than ever as to the safety and efficacy of medications and health products on the one hand, and effectively provide reduced incentives for innovative pharmaceutical research on the other hand.

Health authorities, are increasingly focusing on product safety and on the risk/benefit profile of pharmaceuticals products. In particular, the FDA and the European Medicines Agency (EMA) have imposed increasingly burdensome requirements on pharmaceutical companies, particularly in terms of the volume of data needed to demonstrate a product s efficacy and safety. For the same reasons, the marketed products are subject to continual review, risk evaluations or comparative effectiveness studies even after regulatory approval. These requirements have resulted in increasing the costs associated with maintaining regulatory approvals and achieving reimbursement for our products.

Later discovery of previously undetected problems may result in marketing restrictions or the suspension or withdrawal of the product, as well as an increased risk of litigation for both pharmaceutical and animal health products. These post-regulatory approval reviews and data analyses can lead to the issuance of recommendations by government agencies, health professional and patient organizations or other specialized organizations regarding the use of products, which may result in a reduction in sales volume, such as, for example, a recommendation to limit the patient scope of a drug s indication. For instance in September 2011, the EMA defined a more restrictive indication for Multaq®, one of our cardiovascular products. Such reviews may result in the discovery of significant problems with respect to a competing product that is similar to one sold by the Group, which may in turn cast suspicion on the entire class to which these products belong and ultimately diminish the sales of the relevant product of the Group. When such issues arise, the contemplative nature of evidence-based health care and restrictions on what pharmaceutical manufacturers may say about their products are not always well suited to rapidly defending the Group or the public s legitimate interests in the face of the political and market pressures generated by social media and rapid news cycles, and this may result in unnecessary commercial harm, overly restrictive regulatory actions and erratic share price performance.

In addition, to the extent that new regulations raise the costs of obtaining and maintaining product authorization, or limit the economic value of a new product to its inventor, the growth prospects of our industry and of the Group are diminished. Also about 50% of our current research and development portfolio is constituted by biological products, that may bring in the future new therapeutic responses to current unmet medical needs but which may also lead to more technical constraints and costly investments from an industrial standpoint.

Moreover, we and certain of our third-party suppliers are also required to comply with applicable regulations, known as good manufacturing practices, which govern the manufacture of pharmaceutical products. To monitor our compliance with those applicable regulations, the FDA, the EMA and comparable agencies in other jurisdictions routinely conduct inspections of our facilities and may identify potential deficiencies which

might be expensive and time consuming to address. If we fail to adequately respond to a warning letter

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identifying a deficiency, or otherwise fail to comply with applicable regulatory requirements, we could be subject to enforcement, remedial and/or punitive actions by the FDA, the EMA or other regulatory authorities.

For example, in May 2010, Genzyme entered into a consent decree with the FDA relating to its Allston facility (see Item 4. Information on the Company B. Business Overview Production and Raw Materials.). Pursuant to the consent decree, in November 2010, Genzyme paid $175.0 million to the U.S. Federal Governement disgorgement of past profits. The consent decree also requires Genzyme to implement a plan to bring the Allston facility into compliance with applicable laws and regulations. Genzyme submitted a comprehensive remediation plan to FDA in April 2011. Remediation of the Allston facility in accordance with that plan is underway and is currently expected to continue for four more years, however, there is no guarantee that this timeframe will be respected.

We incurred substantial debt in connection with the acquisition of Genzyme which may limit our business flexibility compared to some of our peers

Our consolidated debt increased substantially in connection with our acquisition of Genzyme because we incurred debt to finance the acquisition price, and because our consolidated debt includes the debt incurred by Genzyme prior to the acquisition. Although we already achieved a partial deleverage by the end of 2011 (as of December 31, 2011, our debt, net of cash and cash equivalents amounted to 10.9 billion), we make significant debt service payments to our lenders and this could limit our ability to engage in new transactions which could have been part of our strategy.

We face uncertainties over the pricing and reimbursement of pharmaceutical products.

The commercial success of our existing products and our products candidates depends in part on the conditions under which our products are reimbursed. Pressure on pricing and reimbursement is strong due to:

- price controls imposed by governments in many countries;
- removal of a number of drugs from government reimbursement schemes (for instance products determined to be less cost-effective than alternatives);
- increased difficulty in obtaining and maintaining satisfactory drug reimbursement rates; and
- the tendency of governments and private health care providers to favor generic pharmaceuticals.

In addition to the pricing pressures they exert, governmental and private third-party payers and purchasers of pharmaceutical products may reduce volumes of sales by restricting access to formularies or otherwise discouraging physician prescriptions of our products. In the United States, health care reform law is increasing the government s role with respect to price, reimbursement and the coverage levels for healthcare-related expenses for the large government health care sector, imposed cost containment measures and imposed drug companies rebates to the government. Implementation of health care reform has affected and could still affect our revenues and/or margins (for further details concerning this law and a description of certain regulatory pricing systems that affect our Group see Item 4. Information on the Company

B. Business Overview Pricing & Reimbursement). Some states are also considering legislation that would control the prices of and access to drugs and we believe that federal and state legislatures and health agencies will continue to focus on healthcare reform implementation in the future.

We encounter similar cost containment issues in countries outside the United States. In certain countries, including countries in the EU and Canada, the coverage of prescription drugs, pricing and levels of reimbursement are subject to governmental control. For example, in Spain, recent direct price-related measures include price discount to all products launched more than 10 years ago, all genericized products needing to be at a minor (lower) price, and no more gradualism in price reductions of originator post generics introduction. Additionally, measures such as INN prescriptions, have been implemented. Another example, in Turkey Government has accelerated enforcement of drugs costs containment measures which include increased institutional discount applied on reimbursement prices and lower reference prices for reimbursement of Generics and originals with Generics as well as 20-year old drugs without Generics.

Due to the ongoing cost containment policies being pursued in many jurisdiction in which we operate, we are unable to predict the availability or amount of reimbursement for our product candidates.

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In addition, our operating results may also be affected by parallel imports, particularly within the European Union, whereby distributors engage in arbitrage based on national price differences to buy product on low cost markets for resale on higher cost markets.

The ongoing slowdown of global economic growth and the financial crisis could have negative consequences for our business[1].

Over the past several years, growth of the global pharmaceutical market has become increasingly tied to global economic growth. In this context, a substantial and lasting slowdown of the global economy or major national economies could negatively affect growth in the global pharmaceutical market and, as a result, adversely affect our business. This effect may be expected to be particularly strong in markets having significant co-pays or lacking a developed third-party payer system, as individual patients may delay or decrease out-of-pocket healthcare expenditures. Such a slowdown could also reduce the sources of funding for national social security systems, leading to heightened pressure on drug prices, increased substitution of generic drugs, and the exclusion of certain products from formularies.

Additionally, to the extent the slowing economic environment, as well as ongoing sovereign debt crisis affecting several European countries, may lead to financial difficulties or even the default or failure of major players including wholesalers or public sector buyers financed by insolvent States, the Group could experience disruptions in the distribution of its products as well as the adverse effects described below at We are subject to the risk of non-payment by our customers . Moreover, to the extent that the economic and financial crisis is directly affecting business, it may also lead to a disruption or delay in the performance of third parties on which we rely for parts of our business, including collaboration partners and suppliers (for more information see Item 5. Operating and Financial Review and Prospects Liquidity.). Such disruptions or delays could have a material and adverse effect on our business and results of operations. See We rely on third parties for the manufacture and supply of a substantial portion of our raw materials, active ingredients and medical devices; supply disruptions and/or quality concerns could adversely affect our operating results and financial condition , We rely on third parties for the marketing of some of our products and Fluctuations in currency exchange rates could adversely affect our results of operations and financial condition below.

Further, we believe our net sales may be negatively impacted by the continuing challenging global economic environment, as high unemployment levels and increases in co-pays may lead some patients to switch to generic products, delay treatments, skip doses or use less effective treatments to reduce their costs. Moreover, current economic conditions in the United States have resulted in an increase in the number of patients in the Medicaid program, under which sales of pharmaceuticals are subject to substantial rebates and, in many U.S. states, to formulary restrictions limiting access to brand-name drugs, including ours.

Our animal health business may also be negatively affected by the current slowdown in global economic growth (for instance tight credit conditions may limit the borrowing power of livestock producers, causing some to switch to lower-priced products).

The manufacture of our products is technically complex, and supply interruptions, product recalls or inventory losses caused by unforeseen events may reduce sales, adversely affect our operating results and financial condition and delay the launch of new products.

Many of our products are manufactured using technically complex processes requiring specialized facilities, highly specific raw materials and other production constraints. We must also be able to produce sufficient quantities of the products to satisfy demand. Our biologic products (including vaccines) in particular are subject to the risk of manufacturing stoppages or the risk of loss of inventory because of the difficulties inherent to the processing of biological materials and the potential unavailability of adequate amounts of raw materials meeting our standards. Additionally, specific conditions must be respected both by the Group and our customers for the storage and distribution of many of our products, *e.g.*, cold storage for certain vaccines and insulin-based products. The complexity of these processes, as well as strict internal and government standards for the manufacture of our products, subject us to risks. The occurrence or suspected occurrence of out-of-specification

[1] Information in this section is complementary to Note B.8.8. to our consolidated financial statements included at Item 18 of this annual report, with respect to information required by IFRS 7, and is covered by our independent registered public accounting firms report on the consolidated financial statements.

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production or storage can lead to lost inventories, and in some cases product recalls, with consequential reputational damage and the risk of product liability (see Product liability claims could adversely affect our business, results of operations and financial condition, above). The investigation and remediation of any identified problems can cause production delays, substantial expense, lost sales and the delay of new product launches and can adversely affect our operating results and financial condition.

Like many of our competitors, we have faced, and to a certain extent continue to face, significant manufacturing issues, most notably in our Genzyme subsidiary for the production of Cerezyme® and Fabrazyme®. In June 2009, Genzyme announced it had detected a virus that impairs cell growth in one of the bioreactors used in the Allston, Massachusetts facility to produce Cerezyme®. This contamination has had a material adverse effect on Cerezyme® and Fabrazyme® revenues. We will continue to work with minimal levels of inventory for Cerezyme® and Fabrazyme® until we are able to build inventory. However, there can be no guarantee that we will be able to return to pre-contamination supply levels of such products, nor can there be any guarantee that we will not face similar issues in the future or that we will successfully manage such issues when they arise.

We rely on third parties for the manufacture and supply of a substantial portion of our raw materials, active ingredients and medical devices; supply disruptions and/or quality concerns could adversely affect our operating results and financial condition.

Third parties supply us with a substantial portion of our raw materials, active ingredients and medical devices, which exposes us to the risk of a supply interruption in the event that these suppliers experience financial difficulties or are unable to manufacture a sufficient supply of our products meeting Group quality standards. It also increases the risk of quality issues, even with the most scrupulously selected suppliers.

If disruptions or quality concerns were to arise in the third-party supply of raw materials, active ingredients or medical devices, this could adversely affect our ability to sell our products in the quantities demanded by the market and could damage our reputation and relationships with our customers. See also The manufacture of our products is technically complex, and supply interruptions, product recalls or inventory losses caused by unforeseen events may reduce sales, adversely affect our operating results and financial condition and delay the launch of new products above. We may not have redundant manufacturing capacity for certain products particularly biologic products. For instance in summer 2011 a technical incident occurred in the filling line used for Apidra 3mL cartridges at our manufacturing site in Frankfurt and this has caused temporary shortages for Apidra 3mL cartridges. Also all of our bulk Cerezyme® products are produced solely at our Allston, Massachusetts facility. Even though we aim to have backup sources of supply whenever possible, including by manufacturing backup supplies of our principal active ingredients at a second or third facility when practicable, we cannot be certain they will be sufficient if our principal sources become unavailable. Switching sources and manufacturing facilities may require significant time.

Further, some raw materials essential to the manufacture of our products are not widely available from sources we consider reliable; for example, we have approved only a limited number of suppliers of heparins for use in the manufacture of Lovenox®. Heparin purchase prices can also fluctuate. See Item 4. Information on the Company B. Business Overview Production and Raw Materials for a description of these outsourcing arrangements. Any of these factors could adversely affect our business, operating results or financial condition.

We rely on third parties for the marketing of some of our products.

We market some of our products in collaboration with other pharmaceutical companies. For example, we currently have major collaborative arrangements with Bristol-Myers Squibb (BMS) for the marketing of Plavix® and Aprovel® in the United States and several other countries, with Warner Chilcott for the osteoporosis treatment Actonel®, and with Merck & Co., Inc. for the distribution of vaccines in Europe. See Item 4. Information on the Company B. Business Overview Pharmaceutical Products Main pharmaceutical products and Item 4. Information on the

Company B. Business Overview Vaccine Products for more information on our major alliances. When we market our products through collaboration arrangements, we are subject to the risk that certain decisions, such as the establishment of budgets and promotion strategies, are subject to the control of our collaboration partners, and that deadlocks may adversely affect the activities conducted through the collaboration arrangements. For example, our alliances with BMS are subject to the operational management of BMS in some countries, including the United States. Any conflicts that

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we may have with our partners during the course of these agreements or at the time of their renewal or renegotiation may affect the marketing of certain of our products and may cause a decline in our revenues and affect our results of operations.

Counterfeit versions of our products harm our business.

The drug supply has been increasingly challenged by the vulnerability of distribution channels to illegal counterfeiting and the presence of counterfeit products in a growing number of markets and over the Internet. Counterfeit products are frequently unsafe or ineffective, and can be potentially life-threatening. To distributors and users, counterfeit products may be visually indistinguishable from the authentic version. Reports of adverse reactions to counterfeit drugs or increased levels of counterfeiting could materially affect patient confidence in the authentic product, and harm the business of companies such as Sanofi. Additionally, it is possible that adverse events caused by unsafe counterfeit products will mistakenly be attributed to the authentic product. If a Group product was the subject of counterfeits, the Group could incur substantial reputational and financial harm. See Item 4. Information on the Company B. Business Overview Competition.

We are subject to the risk of non-payment by our customers.[1]

We run the risk of delayed payments or even non-payment by our customers, which consist principally of wholesalers, distributors, pharmacies, hospitals, clinics and government agencies. This risk is accentuated by the current worldwide financial crisis. The United States poses particular client credit risk issues, because of the concentrated distribution system in which approximately 62% of our consolidated U.S. pharmaceutical sales are accounted for by just three wholesalers. In addition, the Group s three main customers represent 17.4% of our gross total revenues. We are also exposed to large wholesalers in other markets, particularly in Europe. An inability of one or more of these wholesalers to honor their debts to us could adversely affect our financial condition (see Note D.34. to our consolidated financial statements included at Item 18 of this annual report).

Since the beginning of 2010, financial difficulties in some countries of southern Europe have increased especially in Greece and Portugal. Part of our customers in these countries are public or subsidized health systems. The deteriorating economic and credit conditions in these countries has led to longer payment terms. This trend may continue and we may need to reassess the recoverable amount of our debts in these countries during the coming financial years (for more information see Item 5. Operating and Financial Review and Prospects Liquidity.).

Our pension liabilities are affected by factors such as the performance of plan assets, interest rates, actuarial data and experience and changes in laws and regulations.

Our future funding obligations for our main defined-benefit pension plans depend on changes in the future performance of assets held in trust for these plans, the interest rates used to determine funding levels (or company liabilities), actuarial data and experience, inflation trends, the level of benefits provided for by the plans, as well as changes in laws and regulations. Adverse changes in those factors could increase our unfunded obligations under such plans, which would require more funds to be contributed and hence negatively affect our cash flow and results (see Note D.19.1 to our consolidated financial statements included at Item 18 of this annual report).

Impairment charges or write downs in our books and changes in accounting standards could have a significant adverse effect on the Group s results of operations and financial results.

New or revised accounting standards, rules and interpretations issued from time to time by the IASB (International Accounting Standards Board) could result in changes to the recognition of income and expense that may materially and adversely affect the Group s financial results.

1 Information in this section is complementary to Note B.8.8. to our consolidated financial statements included at Item 18 of this annual report, with respect to information required by IFRS 7, and is covered by our independent registered public accounting firms report on the consolidated financial statements and by Notes D.10. and D.34. to our consolidated financial statements included at Item 18 of this annual report.

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In addition, substantial value is allocated to intangible assets and goodwill resulting from business combinations, as disclosed at Note D.4. to our consolidated financial statements included in this annual report at Item 18, which could be substantially impaired upon indications of impairment (primarily relating to pharmacovigilance, patent litigation and the launch of competing products), with adverse effects on our financial condition and the value of our assets.

Also if any of our strategic equity investments decline in value and remain below cost for an extended duration, we may be required to write down our investment.

In addition the global financial crisis and in particular the ongoing sovereign debt crisis affecting certain European countries could also negatively affect the value of our assets (see Fluctuations in currency exchange rates could adversely affect our results of operations and financial condition below and The ongoing slowdown of global economic growth and the financial crisis could have negative consequences for our business above). For example, given the current level of investor confidence in the ability of the Greek State to avoid default, as a result of mark to market accounting standards, we recognized an impairment of 49 million on certain Greek bonds held by us in 2011.

We are increasingly dependent on information technologies and networks.

Our business depends on the use of information technologies, which means that certain key areas such as research and development, production and sales are to a large extent dependent on our information technology capabilities. We are commercializing some devices using new technologies which, in case of malfunctions could lead to a misuse causing a risk of damages to patients (see Product liability claims could adversely affect our business, results of operations and financial condition above). Our inability or the inability of our third-party service providers (for instance the accounting of some of our subsidiaries has been externalized) to implement adequate security and quality measures for data processing could lead to data deterioration or loss in the event of a system malfunction, or allow data to be stolen or corrupted in the event of a security breach, which could have a material adverse effect on our business, operating results and financial condition.

Natural disasters prevalent in certain regions in which we do business could affect our operations

Some of our production sites are located in areas exposed to natural disasters, such as earthquakes (in North Africa, Middle East, Asia, Pacific, Europe, Central and Latin Americas), floods (in Africa, Asia Pacific and Europe) and hurricanes. In the event of a major disaster we could experience severe destruction or interruption of our operations and production capacity. As a result, our operations could suffer serious harm which could have a material adverse effect on our business, financial condition and results of operations.

Environmental Risks of Our Industrial Activities

Risks from the handling of hazardous materials could adversely affect our results of operations.

Manufacturing activities, such as the chemical manufacturing of the active ingredients in our products and the related storage and transportation of raw materials, products and wastes, expose us to various risks, including:

fires and/or explosions;

storage tank leaks and ruptures; and

discharges or releases of toxic or hazardous substances.

These operating risks can cause personal injury, property damage and environmental contamination, and may result in:

the shutdown of affected facilities; and

the imposition of civil or criminal penalties.

The occurrence of any of these events may significantly reduce the productivity and profitability of a particular manufacturing facility and adversely affect our operating results.

Although we maintain property, business interruption and casualty insurance that we believe is in accordance with customary industry practices, we cannot assure you that this insurance will be adequate to cover fully all potential hazards incidental to our business.

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Environmental liabilities and compliance costs may have a significant adverse effect on our results of operations.

The environmental laws of various jurisdictions impose actual and potential obligations on our Group to remediate contaminated sites. These obligations may relate to sites:

- that we currently own or operate;
- that we formerly owned or operated; or
- where waste from our operations was disposed.

These environmental remediation obligations could significantly reduce our operating results. Sanofi accrues provisions for remediation when our management believes the need is probable and that it is reasonably possible to estimate the cost. See Item 4. Information on the Company B. Business Overview Health, Safety and Environment (HSE) for additional information regarding our environmental policies. In particular, our provisions for these obligations may be insufficient if the assumptions underlying these provisions prove incorrect or if we are held responsible for additional, currently undiscovered contamination. These judgments and estimates may later prove inaccurate, and any shortfalls could have a material adverse effect on our results of operations and financial condition.

Furthermore, we are or may become involved in claims, lawsuits and administrative proceedings relating to environmental matters. Some current and former Sanofi s subsidiaries have been named as potentially responsible parties or the equivalent under the U.S. Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended (also known as Superfund), and similar statutes in France, Germany, Italy, Brazil and elsewhere. As a matter of statutory or contractual obligation, we and/or our subsidiaries may retain responsibility for environmental liabilities at some of the sites of our predecessor companies, or our subsidiaries that we demerged, divested or may divest. We have disputes outstanding regarding certain sites no longer owned by the Group. An adverse outcome in such disputes might have a significant adverse effect on our operating results. See Note D.22.e) to the consolidated financial statements included at Item 18 of this annual report.

Environmental regulations are evolving (*i.e.*, in Europe, REACH, CLP/GHS, SEVESO, IPPC, the Waste Framework Directive, the Emission Trading Scheme Directive, the Water Framework Directive and the Directive on Taxation of Energy Products and Electricity and several other regulations aiming at preventing global warming). Stricter environmental, safety and health laws and enforcement policies could result in substantial costs and liabilities to our Group and could subject our handling, manufacture, use, reuse or disposal of substances or pollutants, site restoration and compliance costs to more rigorous scrutiny than is currently the case. Consequently, compliance with these laws could result in significant capital expenditures as well as other costs and liabilities, thereby adversely affecting our business, results of operations or financial condition. For more detailed information on environmental issues, see Item 4. Information on the Company B. Business Overview Health, Safety and Environment (HSE).

Risks Related to Financial Markets[1]

Fluctuations in currency exchange rates could adversely affect our results of operations and financial condition.

Because we sell our products in numerous countries, our results of operations and financial condition could be adversely affected by fluctuations in currency exchange rates. We are particularly sensitive to movements in exchange rates between the euro and the U.S. dollar, the British pound, the Japanese yen, and to currencies in emerging countries. In 2011, 29.8% of our net sales were realized in the United States. While we incur expenses in those currencies, the impact of currency exchange rates on these expenses does not fully offset the impact of currency exchange rates on our revenues. As a result, currency exchange rate movements can have a considerable impact on our earnings. When deemed appropriate and when technically feasible, we enter into transactions to hedge our exposure to foreign exchange risks. These efforts, when undertaken, may fail to offset the effect of

[1] Information in this section is complementary to Note B.8.8. to our consolidated financial statements included at Item 18 of this annual report, with respect to information required by IFRS 7, and is covered by our independent registered public accounting firms report on the consolidated financial statements.

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adverse currency exchange rate fluctuations on our results of operations or financial condition. In addition, in the specific context of the sovereign debt crisis affecting certain European countries, the alleged or actual disruption in the use of the euro as currency in one or more European Monetary Union countries and the associated fluctuations in currency exchange rates could have a material effect on our financial condition and earnings, the magnitude and consequences of which are unpredictable. For more information concerning our exchange rate exposure, see Item 11. Quantitative and Qualitative Disclosures about Market Risk.

In the context of the worldwide financial crisis, our liquidity may be constrained.

As of December 31, 2011, the Group s net debt amounted approximately to 10.9 billion, an amount which increased substantially with the acquisition of Genzyme in 2011. In addition to debt outstanding, the Group has contracted a number of credit lines and put into place commercial paper and medium term note programs with the aim of providing liquidity. See Item 11. Quantitative and Qualitative Disclosures about Market Risk. In the event of a market-wide liquidity crisis, the Group might be faced with reduced access to sources of financing, including under programs currently in place, or less favorable conditions.

Risks Relating to an Investment in our Shares or ADSs

Foreign exchange fluctuations may adversely affect the U.S. dollar value of our ADSs and dividends (if any).

Holders of ADSs face exchange rate risk. Our ADSs trade in U.S. dollars and our shares trade in euros. The value of the ADSs and our shares could fluctuate as the exchange rates between these currencies fluctuate. If and when we do pay dividends, they would be denominated in euros. Fluctuations in the exchange rate between the euro and the U.S. dollar will affect the U.S. dollar amounts received by owners of ADSs upon conversion by the depositary of cash dividends, if any. Moreover, these fluctuations may affect the U.S. dollar price of the ADSs on the New York Stock Exchange (NYSE), whether or not we pay dividends in addition to the amounts, if any, that a holder would receive upon our liquidation or upon the sale of assets, merger, tender offer or similar transactions denominated in euros or any foreign currency other than U.S. dollars.

Persons holding ADSs rather than shares may have difficulty exercising certain rights as a shareholder.

Holders of ADSs may have more difficulty exercising their rights as a shareholder than if they directly held shares. For example, if we offer new shares and they have the right to subscribe for a portion of them, the depositary is allowed, at its own discretion, to sell for their benefit that right to subscribe for new shares instead of making it available to them. Also, to exercise their voting rights, as holders of ADSs, they must instruct the depositary how to vote their shares. Because of this extra procedural step involving the depositary, the process for exercising voting rights will take longer for holders of ADSs than for holders of shares. ADSs for which the depositary does not receive timely voting instructions will not be voted at any meeting.

Our largest shareholders own a significant percentage of the share capital and voting rights of Sanofi.

As of December 31, 2011, L Oréal and Total held approximately 8.82% and 3.22% of our issued share capital, respectively, accounting for approximately 15.69% and approximately 5.52%, respectively, of the voting rights (excluding treasury shares) of Sanofi. See Item 7. Major Shareholders and Related Party Transactions A. Major Shareholders. Affiliates of each of these shareholders are currently serving on our Board of Directors. To the extent these shareholders continue to hold a large percentage of our share capital and voting rights, L Oréal and Total will remain in a position to exert heightened influence in the election of the directors and officers of Sanofi and in other corporate actions that require shareholders approval.

Sales of our shares may cause the market price of our shares or ADSs to decline.

Neither L Oréal nor Total is, to our knowledge, subject to any contractual restrictions on the sale of the shares each holds in our Company. Both of these shareholders have announced that they do not consider their stakes in our Company as strategic to them, and Total makes regular sales of its holdings on the financial market. Sales of large numbers of our shares, or a perception that such sales may occur, could adversely affect the market price for our shares and ADSs.

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Risks Relating to our Contingent Value Rights (CVRs)

In addition to the risks relating to our shares, CVR holders are subject to additional risks.

In connection with our acquisition of Genzyme, we issued CVRs under a CVR agreement entered into by and between us and American Stock Transfer & Trust Company, the trustee. A copy of the form of the CVR agreement is attached as exhibit 4.1 to our Registration Statement on Form F-4 (Registration No. 333-172638), as amended. Pursuant to the CVR agreement, each holder of a CVR is entitled to receive cash payments upon the achievement of certain milestones, based on U.S. regulatory approval of Lemtrada (alemtuzumab for treatment of multiple sclerosis), and on achievement of certain aggregate net sales thresholds. See Item 10. Additional Information C. Material Contracts The Contingent Value Rights Agreement.

CVR holders are subject to additional risks, including:

- an active public market for the CVRs may not develop or the CVRs may trade at low volumes, both of which could have an adverse effect on the resale price, if any, of the CVRs;
- because a public market for the CVRs has a limited history, the market price and trading volume of the CVRs may be volatile;
- if the milestones specified in the CVR agreement are not achieved for any reason within the time periods specified therein, and if net sales do not exceed the thresholds set forth in the CVR agreement for any reason within the time periods specified therein, no payment will be made under the CVRs and the CVRs will expire without value;
- since the U.S. federal income tax treatment of the CVRs is unclear, any part of any CVR payment could be treated as ordinary income and required to be included in income prior to the receipt of the CVR payment;
- any payments in respect of the CVRs are subordinated to the right of payment of certain of our indebtedness;
- we are not prohibited from acquiring the CVRs, whether in open market transactions, private transactions or otherwise, and on November 17, 2011, Sanofi publicly disclosed that it has obtained the necessary coporate authorizations to acquire any or all of the outstanding CVRs (for more information see Item 5. Operating and Financial Review and Prospectus Liquidity.);
- we may under certain circumstances purchase and cancel all outstanding CVRs; and
- while we have agreed to use diligent efforts, until the CVR agreement is terminated, to achieve each of the Lemtrada -related CVR milestones set forth in the CVR agreement, we are not required to take all possible actions to achieve these goals, and the failure to achieve such goals would have an adverse effect on the value, if any, of the CVRs.

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Item 4. Information on the Company

Introduction

We are a global pharmaceutical group engaged in the research, development, manufacture and marketing of healthcare products. In 2011, our net sales amounted to 33,389 million. We are the fifth largest pharmaceutical group in the world and the third largest pharmaceutical group in Europe (source: IMS sales 2011). Sanofi is the parent of a consolidated group of companies. A list of the principal subsidiaries included in this consolidation is shown at Note F. to our consolidated financial statements included at Item 18 of this annual report.

Our business includes three main activities: Pharmaceuticals, Human Vaccines through Sanofi Pasteur and Animal Health products through Merial Limited (Merial).

In our Pharmaceuticals activity, which generated net sales of 27,890 million in 2011, our major product categories are:

Diabetes: our main products are Lantus®, a long acting analog of human insulin which is the leading brand in the insulin market; Apidra®, a rapid-acting analog of human insulin; Insuman®, a range of human insulin solutions and suspensions; Amaryl®, an oral once-daily sulfonylurea and BGStar® and iBGStar , blood glucose meters first launched in Europe during the second quarter of 2011.

Rare Diseases: our principle products are enzyme replacement therapies: Cerezyme®, to treat Gaucher disease; Fabrazyme® to treat Fabry disease and Myozyme®/Lumizyme® to treat Pompe disease.

Oncology: our main products in the oncology market are Taxotere®, a taxane derivative representing a cornerstone therapy in several cancer types; Eloxatine®, a platinum agent, which is a key treatment for colorectal cancer; and Jevtana®, a new taxane derivative, indicated for patients with prostate cancer, launched in 2010 in the United States and in second quarter of 2011 in Europe.

Other flagship products: our thrombosis medicines include Plavix®, an anti-platelet agent indicated for a number of atherothrombotic conditions; and Lovenox®, a low molecular weight heparin indicated for prevention and treatment of deep vein thrombosis and for unstable angina and myocardial infarction. Our cardiovascular medicines include Multaq®, an anti-arrhythmic agent launched in 2009; and Aprovel®/CoAprovel®, major hypertension treatments. Our renal business includes Renagel®/Renvela® oral phosphate binders used in patients with chronic kidney disease on dialysis to treat high phosphorus levels. Our biosurgery business includes Synvisc® and Synvisc-One®, viscosupplements used to treat pain associated with osteoarthritis of certain joints.

The global pharmaceutical portfolio of Sanofi also comprises a wide range of other products in Consumer Health Care (CHC) and other prescription drugs including generics.

We are a world leader in the vaccines industry. Our net sales amounted to 3,469 million in 2011, with leading vaccines in five areas: pediatric combination vaccines, influenza vaccines, adult and adolescent booster vaccines, meningitis vaccines, and travel and endemics vaccines.

Our Animal Health activity is carried out through Merial, one of the world s leading animal healthcare companies, dedicated to the research, development, manufacture and delivery of innovative pharmaceuticals and vaccines used by veterinarians, farmers and pet owners providing a comprehensive range of products to enhance the health, well-being and performance of a wide range of animals (production and companion animals). Our net sales amounted to 2,030 million in 2011.

In the description below, the following should be kept in mind:

A drug can be referred to either by its international non-proprietary name (INN) or by its brand name, which is normally exclusive to the company that markets it. In most cases, our brand names, which may vary from country to country, are protected by trademark registrations. In general, we have chosen in this annual report to refer to our products by the brand names we use in France, except for Allegra® (sold in France as Telfast®), Tritace® (sold in France as Triatec®), Amaryl® (sold in France as Amarel®), and Ambien® CR (an extended-release formulation of zolpidem tartrate, not sold in France).

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For our pharmaceutical activity, except where otherwise stated, all market share percentages and rankings are based on full-year 2011 sales figures from IMS Health MIDAS (retail and hospital).

For our vaccines activity, market shares and rankings are based on our own estimates. These estimates have been made from public domain information collated from various sources, including statistical data collected by industry associations and information published by competitors.

We present our consolidated net sales for our leading products sold directly and through alliances. As regards the products sold through our alliance with Bristol-Myers Squibb (BMS), we also present the aggregate worldwide sales of Plavix® and Aprovel®, whether consolidated by Sanofi or by BMS. A definition of worldwide sales can be found in Item 5. Operating and Financial Review and Prospects Results of Operations .

A. History and Development of the Company

Sanofi was incorporated under the laws of France in 1994 as a *société anonyme*, a form of limited liability company, for a term of 99 years. We operate under the commercial name Sanofi (formerly sanofi-aventis). Our registered office is located at 54, rue La Boétie, 75008 Paris, France, and our main telephone number is +33 1 53 77 40 00. Our principal U.S. subsidiary s office is located at 55 Corporate Drive, Bridgewater, NJ 08807; telephone: +1 (908) 981-5000.

We are present in approximately 100 countries on five continents with 113,719 employees at year end 2011. Our legacy companies, Sanofi-Synthélabo (formed by the 1999 merger of Sanofi and Synthélabo into the current holding company) and Aventis (formed by the combination of Rhône-Poulenc and Hoechst also in 1999), bring to the Group more than a century of experience in the pharmaceutical industry.

Sanofi was founded in 1973 by Elf Aquitaine, a French oil company, when it took control of the Labaz group, a pharmaceutical company. Its first significant venture into the U.S. market was the acquisition of the prescription pharmaceuticals business of Sterling Winthrop an affiliate of Eastman Kodak in 1994.

Synthélabo was founded in 1970 through the merger of two French pharmaceutical laboratories, Laboratoires Dausse (founded in 1834) and Laboratoires Robert & Carrière (founded in 1899). In 1973, the French cosmetics group L Oréal acquired the majority of its share capital.

Hoechst traces its origins to the second half of the 19th century, to the time of the German industrial revolution and the emergence of the chemical industry. Traditionally active in pharmaceuticals, Hoechst strengthened its position in that industry by taking a controlling interest in Roussel-Uclaf in 1974 and the U.S. pharmaceutical company Marion Merrell in 1995.

Rhône-Poulenc was formed in 1928 from the merger of two French companies: a chemical company created by the Poulenc brothers and the Société Chimique des Usines du Rhône, which was founded in 1895. The company s activities in the first half of the 20th century focused on producing chemicals, textiles and pharmaceuticals. Rhône-Poulenc began to focus its activities on life sciences in the 1990s, which led to the successive purchases of Rorer, a U.S. pharmaceutical company acquired in two stages in 1990 and 1997, the remaining 49% of shares of Pasteur Mérieux Serums & Vaccins S.A. in 1994, and the U.K.-based pharmaceuticals company Fisons in 1995.

Sanofi-Synthélabo took control of Aventis in August 2004 and changed its registered name to sanofi-aventis . On December 31, 2004, Aventis merged with and into sanofi-aventis, with sanofi-aventis as the surviving company.

In 1994, Pasteur Mérieux Serums & Vaccins, the Group s vaccines division, together with the vaccines division of Merck & Co., Inc. formed Sanofi Pasteur MSD, creating the only European firm entirely dedicated to vaccines.

Merial was founded in 1997 as a combination of the animal health activities of Rhône-Poulenc and Merck. Merial was a joint venture in which we and Merck each held 50%. On September 17, 2009, we acquired Merck s entire interest in Merial. Merial became Sanofi s dedicated animal health division following the joint statement issued by Merck and Sanofi in March 2011 announcing the end of their agreement to create a new animal health joint venture by combining their respective animal health segments. See Note D.2. to our consolidated financial statements included at Item 18 of this annual report.

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Starting in 2009, Sanofi made a series of acquisitions to create or strengthen our regional CHC and generics platforms including:

The Prague-based branded generics group Zentiva was acquired by Sanofi through a tender offer completed on March 11, 2009;

On April 27, 2009, Sanofi acquired a 100% equity interest in Medley, the third largest pharmaceutical company in Brazil and a leading generics company in that country;

On February 9, 2010, Sanofi successfully completed its tender offer for all outstanding shares of common stock of Chattem, Inc., a leading U.S. consumer healthcare company. Immediately following the tender offer, Sanofi held approximately 97% of Chattem s outstanding shares, and acquired the remaining shares in a short form merger on March 10, 2010; and

On February 24, 2011, we acquired BMP Sunstone Corporation (a specialty pharmaceutical company with a proprietary portfolio of branded pharmaceutical and healthcare products in China) through a merger between BMP Sunstone and a wholly-owned subsidiary of ours.

On April 4, 2011, we acquired Genzyme Corporation, a leading biotechnology group headquartered in Cambridge, Massachusetts and specialized in the treatment of rare diseases, renal diseases, endocrinology, oncology and biosurgery. Immediately following the tender offer, Sanofi held over 90% of Genzyme s outstanding shares, and acquired the remaining shares in a short form merger on April 8, 2011. The agreement is described at Item 10. Additional Information C. Material Contracts .

As of the May 2011 General Meeting of Shareholders, the Group changed its name to Sanofi .

B. Business Overview

Strategy

Sanofi is a diversified, global healthcare leader offering solutions across areas of core historical strength and multiple growth platforms. Like other pharmaceutical companies, we have been facing competition from generics for several of our major products, in an environment subject to cost containment pressures from both third party payers and healthcare authorities. Starting in 2009, we have responded to these major challenges by implementing a new strategy with the objective of repositioning Sanofi for more stable and sustainable revenue and earnings growth. During that time we have transformed the Company by decreasing our reliance on existing blockbuster medicines (medicines with over $1 billion in global sales), optimizing our approach to Research & Development (R&D), increasing our diversification, and investing in 6 growth platforms (Emerging Markets[(1)], Diabetes Solutions, Human Vaccines, Consumer Health Care, Animal Health, and Innovative Products). Additionally, we became a global leader in rare genetic diseases through our acquisition of Genzyme in 2011.

We regularly review our strategy and are continuing to execute on this strategy along three prongs:

Increasing innovation in Research & Development (R&D)

We have conducted a complete review of our research and development portfolio since 2009, in order to improve the allocation of our resources. This review has led to a rationalization of our portfolio, focusing on high-value projects and reallocating part of our resources from internal infrastructure to partnerships and collaborations. We also redefined our decision-making processes so that commercial potential and the scope for value creation are better integrated into our development choices. We also redesigned our R&D footprint including increasing our presence in the Boston, MA area with its concentration of universities and innovative biotechnology companies. R&D is now based on an organizational structure focused on patient needs and encouraging entrepreneurship. This network-based organization, open to external opportunities, enables our R&D portfolio to more effectively capitalize on innovation, from a wide range of sources.

(1) We define Emerging Markets as the world excluding the United States, Canada, Western Europe (France, Germany, UK, Italy, Spain, Greece, Cyprus, Malta, Belgium, Luxemburg, Portugal, the Netherlands, Austria, Switzerland, Ireland, Finland, Norway, Iceland, Sweden and Denmark), Japan, Australia and New Zealand.

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In line with this policy, we signed new alliance and licensing agreements in 2011 designed to give us access to new technologies, and/or to broaden or strengthen our existing fields of research (including diabetes, oncology and vaccines). Finally, we have made progress on our objective of offering more products that add value for patients, with five New Molecular Entities (NMEs) submitted to regulatory agencies in 2011, and 18 potential new product launches possible before the end of 2015.

Adapting our structures to meet the opportunities and the challenges of the future

Since 2009, we have adapted our operating model, from being focused on the best-selling prescription drugs in our traditional markets, to a broader set of products and services reflecting the diversity of our activities and our geographical reach. In particular, we tailored our strategy, structure and offering to each region s needs, so as to deliver the most appropriate solution to each patient. The result is a dramatic shift in business mix from Top 15 products to key growth platforms. In 2008, 61 % of our sales originated from our top 15 products while in 2011, 65 % of our sales originated from Genzyme and our growth platforms. Moreover, 30 % of our 2011 sales were in emerging markets where we have enhanced our offerings in high growth market segments such as Generics and Consumer Health Care by completing 17 transactions and investing a total of approximately 3.7 billion in acquisitions over the last three years.

We also realigned our industrial capacity to reflect our expectation of changes in volumes and our analyses of growth opportunities. Combined with the streamlining of our R&D structures and keeping a tight control on SG&A expenses, this has helped enable us to successfully navigate through a period where multiple of our leading products faced the loss of patent exclusivity protection, despite an often tougher economic environment with new healthcare cost containment measures in many markets.

Exploring external growth opportunities

Business development remains an integral and disciplined pillar of our overall strategy, targeting acquisitions and alliances that create and/or strengthen platforms for long-term growth and create value for our shareholders. Since January 2009, we have invested a total of approximately 23 billion in external growth accounting for approximately 20% increase in 2011 consolidated sales. During 2011, we pursued this targeted policy actively, announcing 30 new transactions, including three acquisitions and 27 R&D alliances. We successfully completed our acquisition of Genzyme, a global leader in rare genetic diseases and an emerging leader in multiple sclerosis. We also strengthened our Emerging Markets growth platform with the acquisition of Universal Medicare, advancing our sustainable growth strategy in India and facilitating the creation of a Consumer Health Care platform in that country. Our U.S. vaccines operations were reinforced with the acquisition of Topaz Pharmaceuticals, which complements our pediatric offering.

In the years to come, we expect our sound financial position to provide us the potential to create value via external growth opportunities and to strengthen our diversification and growth platforms through new acquisitions and partnerships. We will remain financially disciplined with the aim of our business development activities to execute strategically important transactions and partnerships that secure a return on investment in excess of our cost of capital.

Pharmaceutical Products

Main Pharmaceutical Products

Within our Pharmaceuticals business, we focus on the following categories: diabetes, rare diseases, oncology, and other flagship products in anti-thrombotics, cardiovascular, renal and biosurgery fields.

The sections that follow provide additional information on the indications and market position of our key products. Our intellectual property rights over our pharmaceutical products are material to our operations and are described at Patents, Intellectual Property and Other Rights below. As disclosed in Item 8. Financial Information A. Consolidated Financial Statements and Other Financial Information Patents of this annual report, we are involved in significant litigation concerning the patent protection of a number of these products.

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The following table sets forth the net sales of our best-selling pharmaceutical products for the year ended December 31, 2011. These products are major contributors to public health.

Therapeutic Area / Product Name	2011 Net Sales (million)	Drug Category / Main Areas of Use
Diabetes		
Lantus® (insulin glargine)	3,916	Long-acting analog of human insulin
		Type 1 and 2 diabetes mellitus
Apidra® (insulin glulisine)	190	Rapid-acting analog of human insulin
		Type 1 and 2 diabetes mellitus
Amaryl® (glimepiride)	436	Sulfonylurea
		Type 2 diabetes mellitus
Insuman® (insulin)	132	Human insulin (rapid and intermediate acting)
		Type 1 and 2 diabetes mellitus
Rare Disease		
Cerezyme® (imiglucerase for injection)	441(1)	Enzyme replacement therapy
		Gaucher disease
Fabrazyme® (agalsidase beta)	109(1)	Enzyme replacement therapy
		Fabry disease
Myozyme®/Lumizyme® (alglucidase alpha)	308(1)	Enzyme replacement therapy
		Pompe disease
Oncology		
Taxotere® (docetaxel)	922	Cytotoxic agent
		Breast cancer
		Non small cell lung cancer
		Prostate cancer
		Gastric cancer
		Head and neck cancer
Eloxatine® (oxaliplatin)	1,071	Cytotoxic agent
		Colorectal cancer
Jevtana® (cabazitaxel)	188	Cytotoxic agent
		Prostate cancer
Other Flagship products		
Lovenox® (enoxaparin sodium)	2,111	Low molecular weight heparin
		Treatment and prevention of deep vein thrombosis
		Treatment of acute coronary syndromes
Plavix® (clopidogrel bisulfate)	2,040	Platelet adenosine disphosphate receptor antagonist
		Atherothrombosis
		Acute coronary syndrome with and without ST segment elevation
Aprovel® (irbesartan) / CoAprovel® (irbesartan & hydrochlorothiazide)	1,291	Angiotensin II receptor antagonist
		Hypertension
Multaq® (dronedarone)	261	Anti-arrhythmic drug
		Atrial Fibrillation

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Therapeutic Area / Product Name	2011 Net Sales (million)	Drug Category / Main Areas of Use
Renagel® (sevelamer hydrochloride) / Renvala® (sevelamer carbonate)	415(1)	Oral phosphate binders High phosphorus levels in patients with chronic kidney disease, or CKD, on dialysis
Synvisc® / Synvisc-One® (hylan G-F 20)	256(1)	Viscosupplements Pain associated with osteoarthritis of the knee
Others		
Stilnox® /Ambien®/Myslee® (zolpidem tartrate)	490	Hypnotic Sleep disorders
Allegra® (fexofenadine hydrochloride)	580(2)	Anti-histamine Allergic rhinitis Urticaria
Copaxone® (glatiramer acetate)	436	Non-interferon immunomodulating agent Multiple sclerosis
Tritace® (ramipril)	375	Angiotensin Converting Enzyme inhibitor Hypertension Congestive heart failure Nephropathy
Depakine® (sodium valproate)	388	Anti-epileptic Epilepsy
Xatral® (alfuzosin hydrochloride)	200	Uroselective alpha1-blocker Benign prostatic hypertrophy
Actonel® (risedronate sodium)	167	Biphosphonate Osteoporosis Paget s disease
Nasacort® (triamcinolone acetonide)	106	Local corticosteroid Allergic rhinitis

(1) Since date of acquisition
(2) Excluding Allegra® OTC sales.

Diabetes

The prevalence of diabetes is expected to increase significantly over the next 20 years, reflecting multiple socio-economic factors including sedentary lifestyles, excess weight and obesity, unhealthy diet and an aging population. Our principal diabetes products are Lantus®, a long-acting analog of human insulin; Apidra®, a rapid-acting analog of human insulin; Insuman®, a human insulin; and Amaryl®, a sulfonylurea. In 2011, in some European markets, we launched the BGStar® solution range of blood glucose meters for patients with diabetes, whether they are treated with insulin or not.

Lantus®

Lantus® (insulin glargine) is a long-acting analog of human insulin, offering improved pharmacokinetic and pharmacodynamic profiles compared to other basal insulins. Lantus® is indicated for once-daily subcutaneous administration in the treatment of adult patients with type 2 diabetes mellitus who require basal insulin for the control of hyperglycemia, and for adult and pediatric patients aged six years and above with type 1 diabetes mellitus.

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Lantus® is a well-established treatment with over 38 million patient-years exposure since 2000. The clinical trial experience with Lantus® covers over 100,000 patients.

Lantus® can be administered subcutaneously using syringes or specific pens including:

- Lantus® SoloSTAR® is a pre-filled disposable pen available in over 50 countries worldwide. It is the only disposable pen that combines a low injection force, up to 80 units per injection, and ease-of-use; and

- ClikSTAR® is a reusable insulin pen first approved in 2009 in the European Union and Canada. It is now available in more than 35 countries worldwide.

In September 2009, following four highly publicized but methodologically limited registry analyses, some of which created concern over a potential link between the use of Lantus® and an increased risk of cancer, we announced an action plan to provide methodologically robust research that will contribute to the scientific resolution of the debate over insulin safety, including insulin analogs and Lantus®. The research program encompasses both preclinical and clinical programs involving human insulin and insulin analogues, including insulin glargine; it is designed to generate more information on whether there is any association between cancer and insulin use, and to assess whether there is any difference in risk between different types of insulins. The plan is structured to yield short-term and longer-term results. Three epidemiological studies (two retrospective cohort studies and one case-control study) have been launched:

- the Northern European Study will compare the risk of cancer in adults prescribed insulin glargine versus those prescribed human insulin, and other types of insulin, and in all users of insulin combined. The results of the Northern European Database Study of Insulin and Cancer Risk are under review by health authorities and will be presented to scientific conferences in 2012. These results confirm Sanofi s confidence in the safety of Lantus®;

- the U.S. Study will compare the risk of breast, prostate and colon cancer (each considered separately) in glargine users versus human NPH insulin users. Study completion is for the end of the first half of 2012; and

- the International Study of Insulin and Cancer, being carried out in the United Kingdom, France and Canada, will assess the association of breast cancer with the use of insulins. The study results are expected by end 2012.

The ADA/ACS (American Diabetes Association / American Cancer Society) Consensus Report published on June 16, 2010 reasserted the inconclusiveness of any link between insulin and cancer.

In January 2011, the FDA updated its ongoing safety review of Lantus®. In addition to the analysis of the four registry analyses published in 2009, the FDA also reviewed results from a five-year diabetic retinopathy clinical trial in patients with type 2 Diabetes. Based on these data, the FDA has not concluded at this time that Lantus® increases the risk of cancer. FDA review remains ongoing.

In December 2011, results of new meta-analysis were presented at the World Diabetes Congress. This new meta-analysis of all published studies observational studies derived from databases as well as randomized controlled clinical trials and one case-control study has demonstrated no increased risk in people using Lantus® when compared to the users of human insulin.

The ADA and European Association for the Study of Diabetes (EASD) have maintained their 2008 treatment recommendations for type 2 diabetes. These guidelines further established basal insulins such as Lantus®, or a sulfonylurea such as Amaryl®, as two preferred second-line treatment options for people with diabetes who are unable to achieve glycemic control targets with lifestyle intervention and metformin alone. These treatment recommendations reinforce the timely use of basal insulin as a core therapy for type 2 diabetes.

Lantus® is the world number-one selling insulin brand in terms of both sales and units (source: IMS, 2011 sales) and is available in over 70 countries worldwide. The three leading countries for sales of Lantus® in 2011 were the United States, France and Japan.

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Apidra®

Apidra® (insulin glulisine) is a rapid-acting analog of human insulin. Apidra® is indicated for the treatment of adults with type 1 diabetes, or in type 2 diabetes for supplementary glycemic control. Apidra® has a more rapid onset and shorter duration of action than fast-acting human insulin and can be associated with long-acting insulins such as Lantus® for supplementary glycemic control at mealtime.

In addition, Apidra® is equally effective in adult diabetics ranging from lean to obese and offers patients greater flexibility of administration, either before or just after mealtime.

Apidra® can be administered subcutaneously using syringes or specific pens including the Apidra® SoloSTAR® disposable pen and the ClikSTAR® reusable pen.

Apidra® is available in over 60 countries worldwide.

Due to a technical incident on a manufacturing line, Apidra® faced a temporary shortage of Apidra® 3mL cartridges (including Apidra® SoloSTAR®) which impacted supplies in some markets. The production of Apidra® 3mL cartridges is expected to return to full capacity in the first half of 2012. Apidra® vials were not impacted.

Insuman®

Insuman® (human insulin) is a range of insulin solutions and suspensions for injection and is indicated for diabetes patients where treatment with insulin is required. Human insulin is produced by recombinant DNA technology in *Escherichia coli strains*.

Insuman® is supplied in vials, cartridges, pre-filled disposable pens (OptiSet® and SoloStar®) or reusable pens (ClickSTAR®) containing the active substance human insulin. The Insuman® range is comprised of rapid-acting insulin solutions (Insuman® Rapid and Insuman® Infusat) that contain soluble insulin, an intermediate-acting insulin suspension (Insuman® Basal) that contains isophane insulin, and combinations of fast- and intermediate-acting insulins in various proportions (Insuman® Comb). Insuman® is mostly sold in Germany.

Amaryl®/Amarel®/Solosa®

Amaryl® (glimepiride) is a latest-generation, orally administered once-daily sulfonylurea (a glucose-lowering agent) indicated as an adjunct to diet and exercise to improve glycemic control in patients with type 2 diabetes. Amaryl® reduces the body s blood sugar level in two ways: by helping the body to produce more insulin both at mealtime and between meals, and by decreasing insulin resistance.

The combination of metformin (which reduces hepatic glucose production and decreases insulin resistance) with a sulfonylurea such as Amaryl® is effective in combating the two causes of type 2 diabetes. It is one of the most prescribed combinations of diabetes drugs worldwide. Amaryl M®, a fixed-dose combination of Amaryl® plus metformin in a single presentation, was launched in 2007.

Our leading market for Amaryl® is Japan, where it is the best-selling oral anti-diabetes product by volume (source: IMS 2011 sales). A number of generics have received marketing authorization and have been launched in Europe and the United States. Generic became available in Japan in November 2010 but the impact on Amaryl® sales compared to the impact of generic sales generally observed in the U.S. or the EU has been more moderate.

BGStar® / iBGStar

Sanofi and its partner AgaMatrix are co-developing innovative solutions in diabetes care with the aim of simplifying the diabetes management experience for patients and healthcare providers. The blood glucose monitoring solutions will be exclusive to Sanofi and are designed to be synergistic with our Diabetes portfolio, with a positive effect on sales of Lantus® and other products expected.

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BGStar® and iBGStar are blood glucose meters that feature Dynamic Electrochemistry®, an innovative technology that extracts a spectrum of information from blood that is inaccessible to traditional electrochemical methods and compensates for many interfering factors that often distort blood glucose results.

These monitoring devices are an important step towards our vision of becoming the global leader in diabetes care by integrating innovative monitoring technology, therapeutic innovations, personalized services and support solutions. During 2011, the BGStar® and iBGStar were made commercially available in Germany, France, Switzerland, Spain, the Netherlands and Italy.

In December 2011, the FDA approved the iBGStar the first blood glucose meter that connects to the iPhone® allowing patients to view and analyze accurate, reliable information in real time .

The main compounds currently in Phase II or III clinical development in the Diabetes/Other Metabolic Disorders field are:

Lixisenatide (AVE0010 GLP-1: Glucagon-like peptide-1 agonist, type 2 diabetes mellitus; Phase IIIb; lixisenatide is in-licensed from Zealand Pharma A/S). The GETGOAL Phase III studies were finalized and demonstrated that lixisenatide was effective in lowering blood sugar and decreasing body weight with good safety and tolerability. These results were presented at international conferences (e.g. ADA, EASD, IDF). Lixisenatide was submitted in the fourth quarter of 2011 to EMA, Switzerland, Mexico, Brazil, Canada, Ukraine, South Africa and Australia. Additional Phase IIIb studies have been initiated.

Phase I studies on combination of lixisenatide and Lantus® have been successfully finalized. A proof-of-concept study to compare insulin glargine/ lixisenatide fixed ratio combination versus insulin glargine on glycemic control over 24 weeks has begun.

Preliminary Phase II results of **SAR236553**, co-developed with Regeneron (REGN727: anti-PCSK9 mAb), have been obtained. Treatment with SAR236553 leads to mean relative LDL-Cholesterol reduction of greater than 65% after 8-12 weeks of treatment in patients with high LDL-C at baseline.

The partnership with Metabolex on the GPR119 receptor agonist **SAR260093** has been terminated.

Oncology

Sanofi is present in the oncology field, primarily in chemotherapy, with three major products: Taxotere®, Eloxatine®, and Jevtana®, which was launched commercially in the United States in 2010 and in the second quarter of 2011 in Europe.

Taxotere®

Taxotere® (docetaxel), a taxoid class derivative, inhibits cancer cell division by essentially freezing the cell s internal skeleton, which is comprised of microtubules. Microtubules assemble and disassemble during a cell cycle. Taxotere® promotes their assembly and blocks their disassembly, thereby preventing many cancer cells from dividing and resulting in death in many cancer cells.

Taxotere® is available in more than 100 countries as an injectable solution. The single vial formulation (one vial IV route 20-80mg) was launched in the U.S. and in the European Union in 2010. It has gained approval for use in eleven indications in five different tumor types (breast, prostate, gastric, lung, and head and neck). Taxotere® is indicated for early stage and metastatic breast cancer, first-line and second-line metastatic Non-Small Cell Lung Cancer (NSCLC), androgen-independent (hormone-refractory) metastatic prostate cancer, advanced gastric adenocarcinoma (including adenocarcinoma of the gastroesophageal junction), and the induction treatment of patients with locally advanced squamous cell carcinoma of the head and neck.

The top four countries contributing to sales of Taxotere® in 2011 were the United States, Japan, France, and China. Generics of docetaxel were launched at the end of 2010 in Europe and in April 2011 in the U.S. Exclusivity for Taxotere® in Japan will be maintained through November 2013 (see Patents, Intellectual Property and Other Rights below).

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Eloxatin®

Eloxatin® (oxaliplatin) is a platinum-based cytotoxic agent. Eloxatin® combined with infusional (delivered through the bloodstream) administration of two other chemotherapy drugs, 5-fluorouracil/leucovorin (the FOLFOX regimen), is approved by the FDA for adjuvant treatment of people with stage III colon cancer who have had their primary (original) tumors surgically removed. This approval was based on evidence of an improvement in disease-free survival after four years.

Eloxatin® is in-licensed from Debiopharm and is marketed in more than 70 countries worldwide.

Following the end of the Eloxatin® European regulatory data exclusivity in April 2006, a number of oxaliplatin generics have been launched throughout Europe. With regard to the U.S. market, a number of oxaliplatin generics received final marketing authorization from the FDA and were marketed until June 30, 2010, when their manufacturers were ordered by the U.S. District Court for the District of New Jersey to cease selling their unauthorized Eloxatin® generic in the United States. Eloxatin U.S. market exclusivity is expected to be maintained through August 9, 2012. See Item 8. Financial Information A. Consolidated Financial Statements and other Financial Information Patents .

Jevtana®

Jevtana® (cabazitaxel) is a new taxane derivative approved in combination with prednisone for the treatment of patients with hormone-refractory metastatic prostate cancer previously treated with a docetaxel-containing treatment regimen. Jevtana® was the result of a 14-year research and development program to address the significant unmet medical need after taxane-based treatment progression.

The results of the TROPIC Phase III study demonstrated that cabazitaxel plus prednisone/prednisolone significantly improved overall survival versus the standard regimen of mitoxantrone plus prednisone/prednisolone in patients with metastatic hormone-refractory prostate cancer whose disease progressed following treatment with docetaxel-based chemotherapy. A combination of cabazitaxel and prednisone/prednisolone significantly reduced the risk of death by 28% with an improvement in median overall survival of 15.1 months vs. 12.7 months in the mitoxantrone combination arm.

Jevtana® was launched in the United States in July 2010. Jevtana® therapy is now covered by CMS (Committee for Medicare and Medicaid Services), and by most of the private insurance companies that pay for oncology care. In addition, the safety profile seen in clinical practice has been consistent with that seen in the pivotal TROPIC study.

In March 2011, Jevtana® received marketing authorization from the European Commission and was launched during the second quarter of 2011 in Germany and France. Jevtana® is now approved in 53 countries.

Sanofi has initiated a broad development program with Jevtana®. The clinical program is projected to evaluate Jevtana® in first- and second-line treatment of prostate cancer patients, second-line treatment of small-cell lung cancer patients, and patients with advanced gastric cancer.

The top four countries contributing to sales of Jevtana® in 2011 were the United States, Germany, Brazil and France.

The main compounds currently in Phase II or III clinical development in the Oncology field are:

Zaltrap®, also known as aflibercept, is an investigational angiogenesis inhibitor with a unique mechanism of action. This fusion protein binds all forms of Vascular Endothelial Growth Factor-A (VEGF-A), as well as VEGF-B and placental growth factor (PIGF), additional angiogenic growth factors that appear to play a role in tumor angiogenesis and inflammation. Zaltrap has been shown to bind VEGF-A, VEGF-B, and PlGF with higher affinity than their native receptors. Sanofi Oncology and Regeneron are collaborating on a broad oncology development program for Zaltrap. The Phase III clinical program was designed to evaluate Zaltrap in combination with common chemotherapy regimens

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in the treatment of patients with advanced cancers, including cancers where bevacizumab has not demonstrated efficacy. Patients who had previously received bevacizumab were also included in the clinical trials for certain second-line treatment settings. In June 2011, Sanofi announced the positive results from VELOUR, a multinational, randomized, double-blind trial comparing the FOLFIRI (irinotecan-5-fluorouracil-leucovorin) chemotherapy regimen in combination with either Zaltrap or placebo in the treatment of patients with mCRC. The study randomized 1,226 patients with mCRC who previously had been treated with an oxaliplatin-based regimen. About one-third of the participants received bevacizumab as part of their first-line therapy. The primary endpoint was an improvement in overall survival. Secondary endpoints included progression-free survival, response to treatment and safety. Results were first presented at the ESMO World Congress on Gastrointestinal Cancer on June 25, 2011. The abstract (#0-0024) was published in the June 2011 supplement to Annals of Oncology. The current development program also explores Zaltrap for the treatment of metastatic prostate cancer with VENICE: First-line treatment for androgen-independent (hormone-refractory) metastatic prostate cancer in combination with docetaxel and prednisone (Phase III). Final results are anticipated in 2012. The aflibercept dossier was accepted for review by the EMA at the end of 2011. A NDA was filed in February 2012.

Semuloparin is a novel ultra-low-molecular-weight heparin (ULMWH) characterized by a high anti-Xa and a residual anti-IIa activity. Semuloparin s binding feature is directly responsible for the prolonged half-life (16-20 hours). In the Phase III placebo-controlled SAVE-ONCO trial, whose results were presented at ASCO 2011, Semuloparin has been investigated for its use in the prophylaxis of venous thromboembolism (VTE) in 3,212 cancer patients receiving chemotherapy for locally advanced or metastatic solid tumors (lung, pancreas, stomach, colon/rectum, bladder or ovary). Overall, Semuloparin 20mg once daily administered subcutaneously over a mean treatment duration of 3.2 months, significantly reduced VTE or VTE related death by 64% and PE by 59% vs placebo. The treatment effect was consistent across the components of primary endpoint, DVT and PE, cancer type, stage and various levels of VTE risk. The incidence of major bleeding was similar in the two groups: 1.2% and 1.1% in the Semuloparin and placebo groups, respectively. Further study analyses by sub-groups have been presented in oral presentations at ESMO and ASH 2011. A new drug application (NDA) has been accepted for review by the FDA and the EMA end of October 2011. Semuloparin is expected to be the first anti-coagulant approved for the indication of VTE prophylaxis in cancer patients receiving chemotherapy.

BSI-201 (iniparib SAR240550) is an agent with novel mechanism of activity that is currently being studied in advanced squamous non-small cell lung cancer (Phase III) as well as ovarian and breast cancers (Phase II). While the initial dosing regimen was based on the putative PARP inhibitory activity, current efforts are aimed at elucidating the mechanism of action and exploring the maximal tolerated dose both as a single agent and in combination with chemotherapy.

Ombrabulin (AVE8062; combretastatin derivative, a new anti-vascular agent in-licensed from Ajinomoto; sarcoma; Phase III). Single agent and combination studies with platinums and taxanes alone or in combination have been conducted with ombrabulin. A Phase III study in soft tissue sarcoma in combination with cisplatin was initiated in 2008 and will terminate enrollment in 2012. Ombrabulin is also investigated in a Phase II trial in Non-Small-Cell Lung Cancer in combination with taxanes and platinum salts, which is over 90% enrolled and will report results in 2012, as well as in an ongoing Phase II trial in ovarian cancer.

SAR302503 (TG101348) was purchased from Targegen in 2009 and is being developed exclusively by Sanofi. SAR302503 is a selective oral, small molecule inhibitor of the JAK2 kinase. JAK2 and the JAK/stat pathway have been identified as key regulators of growth and differentiation of normal hematopoeitic cells, and are commonly dysregulated in multiple myeloproliferative disorders, including myelofibrosis (MF), polycythemia vera (PV), and essential thrombocytosis (ET). SAR302503 is now in Phase III, being investigated in the JAKARTA trial, a global Phase III trial of SAR302503 in primary and secondary myelofibrosis. The unique ability of SAR302503 to decrease allele burden will be further explored in the JAKARTA trial. In addition, a Phase II study in MF has recently completed accrual. Also ongoing is a Phase II trial in hydroxyurea-resistant PV and ET.

SAR245408 (XL147) was in-licensed from Exelixis, Inc. and is being developed by Sanofi. This phosphoinositide-3-kinase (PI3K) inhibitor is under evaluation in a Phase II study of monotherapy for

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the treatment of advanced or recurrent endometrial cancer. Combinations with paclitaxel/carboplatin, letrozole and trastuzumab are also being evaluated. Phase I trials of novel combinations with MSC1936369B (under a collaboration with Merck Serono, a division of Merck KGaA, Darmstadt, Germany) and MM121 (see below) have been initiated.

SAR245409 (XL765) was also in-licensed from Exelixis, Inc. and is being developed under an alliance by Sanofi. This oral agent is an inhibitor of phosphoinositide-3-kinase (PI3K) and also acts against the mammalian target of rapamycin (mTOR). A Phase I/II study in combination with letrozole for the treatment of metastatic hormone-receptor-positive breast cancer is ongoing and a Phase II trial in mantle cell lymphoma, follicular lymphoma and chronic lymphocytic leukemia has been initiated. Combinations with temozolomide, bendamustine and rituximab are also being evaluated.

SAR256212 (MM-121). Under an exclusive global collaboration and licensing agreement, Merrimack and Sanofi are co-developing SAR256212, a fully human monoclonal antibody targeting ErbB3. ErbB3 has been identified as a key node in tumor growth and survival. SAR256212 blocks Heregulin binding to ErbB3, and formation of pErbB3 and pAKT. Given SAR256212 s mode of action, it has the potential to be used in a wide number of tumors and settings. SAR256212 is in Phase II stage of development (Breast, Lung and Ovarian cancers), while a number of combinations with chemotherapy and targeted agents are being explored in the Phase I program. A companion diagnostic tool is being developed in parallel with the clinical program.

SAR3419 (Antibody Drug Conjugate (ADC) maytansin-loaded anti-CD19 mAb; B-cell malignancies: B-Non Hodgkin s Lymphomas (NHL), B-Acute Lymphoblastic Leukemias (ALL). License from IMMUNOGEN inc.). The clinical development program is entering Phase II stage in Diffuse Large B Cell Lymphoma (DLBCL, aggressive lymphoma type) with the aim of confirming the clinical benefit observed in patients during Phase I trials. Ongoing/Planned trials in unmet medical need subsets of patients are: one Phase II study as single agent and one study in combination with Rituximab (rituxan, anti CD20 mAb) in Relapsed/Refractory (R/R) DLBCL patients. A biomarker exploratory sub-study is associated to the clinical NHL program in order to evaluate drivers for anti tumor response. In parallel, preclinical experiments to identify potential synergistic combinations (hypothesis driven combinations and unbiased in vitro screens) are being performed. A second indication is developed in a setting of large medical need, with the start of one exploratory Phase II study in adult patients with R/R ALL.

Clorafabine (Clolar® / Evoltra®) (Genzyme) (Purine-nucleosid analog). A Phase III program is on going in the treatment of acute myeloid leukemia.

In 2011, we conducted several additional collaborations with other companies, universities and institutes to investigate novel oncology agents (see Pharmaceutical Research & Development Portfolio below).

Collaborations with Regeneron

We and Regeneron globally collaborate on the development and commercialization of Zaltrap®. Under the terms of our September 2003 collaboration agreement, as amended, we and Regeneron will share co-promotion rights and profits on sales, if any, of Zaltrap® outside of Japan for disease indications included in our collaboration. In Japan, Sanofi will develop and commercialize Zaltrap®, with Regeneron entitled to a royalty payment. Under the terms of the agreement, Sanofi is responsible for funding 100% of the development costs of Zaltrap®. Once Zaltrap® starts to be marketed, Regeneron will repay 50% of the development costs (originally paid by Sanofi) in accordance with a formula based on Regeneron s share of the profits. Sanofi may also be responsible for making milestone payments upon receipt of specified marketing approvals for Zaltrap® in the United States or the European Union and in Japan.

In November 2007, Sanofi signed additional agreements with Regeneron to discover, develop and commercialize fully-human therapeutic antibodies. These agreements were broadened, and their term extended, on November 10, 2009. Under the terms of the discovery agreement, Sanofi committed to fund the costs of Regeneron s antibody research program until 2017. Sanofi has an option to license for further development

those antibodies discovered by Regeneron which advance to IND. Upon exercise of the option, Sanofi is primarily responsible for funding the development and co-developing the antibody with Regeneron. Sanofi and Regeneron would also share co-promotion rights and profits on sales. Once a product begins to be marketed, Regeneron will repay out of its profits (provided they are sufficient) 50% of the development costs borne by Sanofi for all antibodies licensed by Sanofi. Sanofi may also be responsible for making milestone payments based upon aggregate sales of antibodies under the collaboration.

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Rare Diseases

The acquisition of Genzyme in April 2011 brought to the Group specific expertise in rare diseases, a sector where there are still many unmet needs, and expanded Sanofi s presence in the biotechnology sector.

Our Rare Disease business is focused on products for the treatment of rare genetic diseases and other chronic debilitating diseases, including lysosomal storage disorders, or LSDs, a group of metabolic disorders caused by enzyme deficiencies. Our principle rare disease products are enzyme replacement therapies: Cerezyme® (imiglucerase for injection) to treat Gaucher disease; Fabrazyme® (agalsidase beta) to treat Fabry disease and Myozyme® / Lumizyme® (alglucosidase alfa) to treat Pompe disease.

Cerezyme®

Cerezyme® (imiglucerase for injection) is an enzyme replacement therapy that is used to treat Gaucher disease, an inherited, potentially life-threatening LSD. It is estimated that there are approximately 10,000 Gaucher patients worldwide.

Cerezyme® is the only therapy with a 17-year history of reducing, relieving and reversing many of the symptoms and risks of Type 1 Gaucher disease. Cerezyme® is administered by intravenous infusion over 1-2 hours.

In June 2009, Genzyme interrupted production of Cerezyme® and Fabrazyme® at its Allston facility after identifying a virus in a bioreactor used for Cerezyme® production. Genzyme resumed Cerezyme® shipments in the fourth quarter of 2009. This interruption was followed by a second one in March 2010 resulting from a municipal electrical power failure that compounded issues with the facility s water system.

Genzyme communicated at the end of 2011 that, given current productivity and progress in the manufacturing recovery, we expect an improving supply outlook as the year progresses. We have begun communicating with the U.S. Gaucher community to inform them that, beginning in February 2012, current patients in the U.S. can be returned to normal dosing. Genzyme will also begin the process of returning additional regions globally back to normal supply. This process will begin in the second quarter of 2012 and continue gradually through the remainder of the year, to ensure that a ramp-up can be sustained. Regions outside of the U.S. will be maintained at their current allocation of Cerezyme®, as Genzyme assesses the timing of the return of additional regions to full supply. No regional allocation will be decreased to accommodate the U.S. ramp-up. We continue to make Cerezyme® available to patients as it is produced. However, since we have minimal inventory, any change to our manufacturing plans can have an immediate impact on our ability to provide product.

The principal markets for Cerezyme® are the United States, Latin America and Europe.

Fabrazyme®

Fabrazyme® (agalsidase beta) is an enzyme replacement therapy that is used to treat Fabry disease, an inherited, progressive and potentially life-threatening LSD. Fabry disease is estimated to affect between 5,000 and 10,000 people worldwide. Fabrazyme® is administered by intravenous infusion.

Fabrazyme® is available in over 30 countries, including the United States and Europe, and has been used in hundreds of patients.

Due to the June 2009 production interruption and low manufacturing productivity upon re-start of production, Fabrazyme® shipments decreased in the fourth quarter of 2009 and Genzyme began shipping Fabrazyme® at a rate equal to 30% of estimated product demand. Throughout 2011, Genzyme has maintained consistent supply of Fabrazyme® to current patients at a reduced dose. To return to normal supply levels of Fabrazyme® for existing and new patients, it will be necessary to utilize the additional capacity from Genzyme s new manufacturing facility in Framingham, Massachusetts, that was approved in January 2012 by the FDA and the EMA. Genzyme will begin the process of moving the most severely affected patients in Europe to full dose of Fabrazyme® during the first quarter of 2012. Beginning in March 2012 in the U.S., all patients currently on therapy are expected to be able to return to full dosing (1mg/kg). In addition, Genzyme will begin to transition

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new patients in the U.S. onto Fabrazyme® at full dosing (1mg/kg) levels. Beginning of March, Genzyme started shipping Fabrazyme® from Framingham. Globally, the return to normal supply levels of Fabrazyme® is expected to begin in the second quarter of 2012 and continue throughout the year as planned, as Genzyme works to obtain all global regulatory approvals throughout the year and to build inventory.

The principal markets for Fabrazyme® are the United States and Europe.

Myozyme® / Lumizyme®

Myozyme® / Lumizyme® (alglucosidase alfa) are enzyme replacement therapies used to treat Pompe disease, an inherited, progressive and often fatal LSD. We estimate that there are approximately 10,000 Pompe patients worldwide.

Myozyme® has been marketed since 2006 in the United States and the EU and is currently available in 48 markets worldwide. Lumizyme® is the first treatment approved in the United States specifically to treat patients with late-onset Pompe disease: Lumizyme® has been marketed since June 2010. Myozyme® and Lumizyme® are administered by intravenous infusion. Lumizyme® is used to treat Pompe disease in patients over 8 years of age without evidence of cardiac hypertrophy.

Both products are a recombinant form of the same human enzyme but are manufactured using different sized bioreactors.

The main compounds currently in Phase II or III clinical development in the Rare Diseases field are:

Eliglustat tartrate Substrate reduction therapy targeted for the treatment of Gaucher disease type 1. This product candidate is administered orally in capsule form and has the potential to transform the treatment experience of patients by providing a treatment alternative to bi-weekly infusions. The first three years of data from the Phase II trial of eliglustat tartrate showed clinically significant improvements in hematological, visceral and bone disease parameters in the range expected for enzyme replacement therapy. During 2011, the two pivotal Phase III registration studies completed enrollment and the third Phase III study closed screening. Its recruitment should be completed in 2012.

Other Flagship Products

Lovenox®/Clexane®

Lovenox® (enoxaparin sodium) is available in over 100 countries, it has been used to treat over 350 million patients since its launch.

Lovenox® has the broadest range of indications amongst low molecular weight heparins (LMWH). A comprehensive clinical development plan has demonstrated the efficacy and safety of Lovenox® in the prevention and treatment of venous thrombo-embolism (VTE) and in the management of the full spectrum of acute coronary syndromes (ACS).

In VTE management, Lovenox® is continuing to grow as a treatment for the prevention of VTE, mainly in acutely ill patients not undergoing surgery.

In 2008, new oral anticoagulants were launched for the prevention of VTE in orthopedic surgery and were approved in 2011 for stroke prevention in patients with atrial fibrillation, with the objective to replace vitamin K antagonists (e.g. warfarin). However, the impact has been limited on Lovenox® usage as prevention of VTE in orthopedic surgery is a small segment of Lovenox® usage and as stroke prevention in atrial fibrillation is not a Lovenox® approved indication.

In VTE prophylaxis in acutely ill medical patients, a major market segment for Lovenox®, two large clinical trials have compared new oral anti-coagulants to Lovenox®: extended prophylaxis using new oral anti-coagulants has not shown added benefit compared to short term prophylaxis using Lovenox®.

Competing generics of enoxaparin were launched respectively in July 2010 and in February 2012 in the U.S. An authorized generic is available in the U.S.. See Item 5. Operating and Financial Review and Prospects Impacts from generic competition .

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In 2011, Lovenox® was the leading anti-thrombotic in Germany, France, Italy, Spain, and the United Kingdom (source: IMS 2011 sales).

Plavix®/Iscover®

Plavix® (clopidogrel bisulfate), a platelet adenosine diphosphate (ADP) receptor antagonist with a rapid onset of action that selectively inhibits platelet aggregation induced by ADP, is indicated for long-term prevention of atherothrombotic events in patients with a history of recent myocardial infarction, recent ischemic stroke or established peripheral arterial disease. Plavix® is indicated for the secondary prevention of atherothrombosis regardless of the location of the arteries initially affected (heart, brain, lower limbs). This indication is supported by the results of the landmark CAPRIE trial, including almost 20,000 patients. CAPRIE demonstrated the superior efficacy of Plavix® over acetylsalicylic acid (ASA, the active ingredient of Aspirin®), with a comparable safety profile.

Following the significant results of several clinical trials, involving a total of almost 62,000 patients, Plavix® is now also indicated for the treatment of acute coronary syndrome (ACS) with and without ST segment elevation in combination with ASA.

Plavix® is also available in a 300 mg tablet that reinforces early use by simplifying its approved loading dose administration in patients with ACS.

In January 2011, on the basis of the ACTIVE A study results (7,554 patients), the EMA granted marketing authorization for Plavix® in combination with ASA for the prevention of atherothrombotic and thromboembolic events, including stroke, in patients with atrial fibrillation who have at least one risk factor for vascular events, are not suitable for treatment with Vitamin K antagonists (VKA), and have a low bleeding risk.

A Phase III mortality and shunt-related morbidity study in infants palliated with a systemic to pulmonary artery shunt was completed in 2010. Even though results did not support an indication in such infants, the FDA granted Sanofi an additional six month period of exclusivity to market Plavix® (clopidogrel bisulfate). Exclusivity for Plavix® in the U.S. is now scheduled to expire on May 17, 2012.

To further characterize patient responsiveness to Plavix® and provide the best guidance to healthcare professionals, a clinical program designed in close collaboration with the FDA has been completed by Sanofi and Bristol-Myers Squibb (BMS). Based on this program the label was updated worldwide in 2010, including new results on the pharmacological interaction of omeprazole with Plavix® and recent pharmaco-genomics data which have shown genomic variability of the response to Plavix® treatment (diminished effectiveness in poor metabolizers). This has been highlighted in the U.S. label with a boxed warning.

The extensive clinical development program for Plavix®, including all completed, ongoing and planned studies, is among the largest of its kind, involving more than 130,000 patients overall. Plavix® indications are incorporated into major scientific guidelines in North America, Europe and Japan. Over 115 million patients are estimated to have been treated with Plavix® since its launch in 1998, providing significant evidence of real-life efficacy and safety experience with this product.

CoPlavix® / DuoPlavin®, a fixed dose combination of clopidogrel bisulfate and acetylsalicylic acid (ASA), is indicated for the prevention of atherothrombotic events in adult patients with acute coronary syndrome who are already taking both clopidogrel and ASA. The combination has already been launched in several countries (including Australia, Germany, the Netherlands, Ireland, Spain, and Mexico).

The marketing of Plavix® / CoPlavix® / DuoPlavin® is organized through our alliance with BMS (see Alliance with BMS below). Sales of Plavix® in Japan are consolidated by Sanofi and are outside the scope of our alliance with BMS.

Plavix® is the leading anti-platelet in the U.S., Chinese and Japanese markets (source: IMS 2011 sales). In Europe, a number of generics have received marketing authorization and have been launched. Plavix® market

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share [(1)] by value was 29.1% in Western Europe and 27.2% in Germany (source: IMS 2011 sales). In Canada, generics were launched in December 2011. Plavix® U.S. market exclusivity is expected to be maintained through May 2012.

Aprovel®/Avapro ® /Karvea®

Aprovel® (irbesartan) is an anti-hypertensive belonging to the class of angiotensin II receptor antagonists. These highly effective and well tolerated antagonists act by blocking the effect of angiotensin II, the hormone responsible for blood vessel contraction, thereby enabling blood pressure to return to normal. In addition to Aprovel®/Avapro®/Karvea®, we also market CoAprovel®/Avalide®/Karvezide®, a fixed dose combination of irbesartan and hydrochlorothiazide (HCTZ), a diuretic that increases the excretion of water and sodium by the kidneys and provides an additional blood pressure lowering effect. These products achieve control of blood pressure in over 80% of patients, with a very good safety profile.

Aprovel® and CoAprovel® tablets are available in a wide range of dosages to fit the needs of patients with different levels of hypertension severity.

Aprovel® is indicated as a first-line treatment for hypertension and for the treatment of nephropathy in hypertensive patients with type 2 diabetes. CoAprovel® is indicated in patients whose blood pressure is not adequately controlled with a monotherapy, but also as initial therapy in patients who are likely to need multiple drugs to achieve their blood pressure goals (in the United States only).

Aprovel® and CoAprovel® are marketed in more than 80 countries. The marketing of Aprovel® and CoAprovel® is organized through an alliance with BMS (see Alliance with BMS below). In Japan, the product is licensed/sub-licensed to Shionogi Co. Ltd and Dainippon Sumitomo Pharma Co. Ltd, respectively. Aprovel® U.S. market exclusivity is expected to be maintained through March 2012.

Alliance with Bristol-Myers Squibb (BMS)

Plavix® and Aprovel® are marketed through a series of alliances with BMS. The alliance agreements include marketing and financial arrangements that vary depending on the country in which the products are marketed.

Three principal marketing arrangements are used in the BMS alliance:

co-marketing: each company markets the products independently under its own brand names;

exclusive marketing: one company has the exclusive right to market the products; and

co-promotion: the products are marketed through the alliance arrangements (either by contractual arrangements or by separate entities) under a single brand name.

Under the alliance arrangements, there are two territories, one under our operational management and the other under the operational management of BMS. The territory under our operational management consists of Europe and most of Africa and Asia, while the territory under the operational management of BMS consists of the rest of the world excluding Japan. In Japan, Aprovel® has been marketed jointly by Shionogi Pharmaceuticals and Dainippon Sumitomo Pharma Co. Ltd since June 2008. The BMS alliance does not cover rights to Plavix® in Japan; sales of Plavix® in Japan are consolidated by Sanofi.

In the territory under our operational management, the marketing arrangements are as follows:

we use the co-promotion system for most of the countries of Western Europe for Aprovel® and Plavix® and for certain Asian countries for Plavix®;

we use the co-marketing system in Germany, Spain and Greece for both Aprovel® and Plavix® and in Italy for Aprovel®; and

(1) *Plavix® market = oral platelet aggregants inhibitors.*

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we have the exclusive right to market Aprovel® and Plavix® in Eastern Europe, Africa and the Middle East, and we have the exclusive right to market Aprovel® in Asia, Scandinavia and Ireland.

In the territory under BMS operational management, the marketing arrangements are as follows:

we use the co-promotion system in the United States and Canada, where the products are sold through the alliances under the operational management of BMS;

we use the co-marketing system in Brazil, Mexico, Argentina and Australia for Plavix® and Aprovel® and in Colombia only for Plavix®; and

we have the exclusive right to market the products in certain other countries of Latin America.

In countries where the products are marketed by BMS on a co-marketing basis, or through alliances under the operational management of BMS, we often sell the active ingredients for the products to BMS or associated entities.

The financial impact of our principal alliances on our financial position and income is significant, and is described under Item 5. Operating and Financial Review and Prospects Financial Presentation of Alliances ; see also Item 3. Key Information D. Risk Factors Risks Relating to Our Business We rely on third parties for the marketing of some of our products for more information relating to risks in connection with our alliance agreements.

Multaq®

Multaq® (dronedarone) is the most extensively studied anti-arrhythmic drug (AAD) in Atrial Fibrillation (AF) and has demonstrated a unique cardiovascular (CV) outcome benefit in the ATHENA study in addition to effective rhythm control in the EURIDIS and ADONIS studies.

Multaq® is a multichannel blocker with both rhythm (prevention of atrial fibrillation recurrences) and rate (decrease of ventricular rate) controlling properties and additional effects (anti-hypertensive, vasodilatory). It is the first and only anti-arrhythmic drug to have shown a significant reduction in cardiovascular hospitalization and death in patients with paroxysmal and persistent Atrial Fibrillation/Atrial Flutter as seen in the ATHENA study.

The landmark ATHENA trial is the only double-blind anti-arrhythmic study in patients with AF to have assessed morbidity-mortality. The study enrolled a total of 4,628 patients. In this trial, the efficacy and safety of Multaq® was evaluated in patients with AF/AFL or a recent history of these conditions. Multaq® 400mg twice a day, in addition to standard therapy, was shown to significantly reduce the risk of first cardiovascular hospitalization or death by 24% ($p<0.001$) when compared to placebo, meeting the study s primary endpoint. In a secondary analysis of the ATHENA trial, Multaq® significantly reduced the total number of hospital days versus placebo.

Following reports in January 2011 of hepatocellular liver injury and hepatic failure in patients receiving Multaq®, including two post-marketing reports of acute hepatic failure requiring transplantation, Sanofi has collaborated with health authorities agencies to update prescribing information and include liver function monitoring. In Europe, EMA has then coordinated a review of all available data concerning the possible risks of liver injury associated with the use of Multaq® and their impact on its benefit-risk balance. The review was extended to include cardiovascular safety of Multaq® following premature termination of the PALLAS study (Permanent Atrial fibriLLAtion outcome Study) in July 2011.

The PALLAS study, using dronedarone on top of standard therapy, was a randomized, double-blind, parallel-group, placebo-controlled study comparing the efficacy of dronedarone 400 mg twice-daily to placebo in patients with permanent AF, a population different from the population with non-permanent AF for which Multaq® is currently approved. The study was discontinued in July 2011 following recommendation from the study s Operations Committee and the Data Monitoring Committee which observed a significant increase in cardiovascular events in the dronedarone arm. The decision to terminate the study was not related to any hepatic adverse event.

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The Committee for Medicinal Products for Human Use (CHMP) of the European Medicines Agency (EMA) confirmed in September 2011 that the benefits of Multaq® continue to outweigh the risks with a revised indication for the treatment of a limited, newly defined population of paroxysmal and persistent Atrial Fibrillation patients. Multaq® is indicated for the maintenance of sinus rhythm after successful cardioversion in adult clinically stable patients with paroxysmal or persistent atrial fibrillation. Due to its safety profile, Multaq® should only be prescribed after alternative treatment options have been considered and should not be given to patients with left ventricular systolic dysfunction or to patients with current or previous episodes of heart failure.

The FDA approved a label update in December 2011 to ensure its use in the appropriate patient population, specifically in patients in sinus rhythm with history of paroxysmal or persistent atrial fibrillation (AF) and reinforcing warnings and precautions for use.

Multaq® has a convenient fixed dose regimen of twice daily 400 mg tablets to be taken with morning and evening meals. Treatment with Multaq® does not require a loading dose and it can be initiated in an outpatient setting.

Multaq® has been launched in 39 countries. The three leading countries for sales of Multaq® in 2011 were the United States, Germany and Spain.

Renagel® and Renvela®

Renagel® (sevelamer hydrochloride) and Renvela® (sevelamer carbonate) are oral phosphate binders used by chronic kidney disease (CKD) patients on dialysis to treat a condition called hyperphosphatemia, or elevated phosphorus levels, which is associated with heart and bone disease. Renvela® is a second generation, buffered phosphate binder.

In the United States, there are an estimated 395,000 dialysis patients, approximately 90% of whom receive a phosphate binder. There are an estimated 350,000 dialysis patients in the EU and 65,000 in Brazil. In the EU, Renvela® is also approved to treat CKD patients not on dialysis but who have very high blood phosphorus levels.

The principal markets for Renagel® are the United States, the EU and Brazil. The principal markets for Renvela®, which was first marketed in 2008, are the United States and the EU (launched in 2010). In 2011, new launches took place in Singapore, Malaysia, Thailand, Israel, Columbia, Panama and Switzerland.

We market Renagel® and Renvela® directly to nephrologists through Genzyme s employee sales force and distribute these products through wholesalers and distributors. In Japan and several Pacific Rim countries, Renagel® is developed and marketed by Chugai Pharmaceutical Co., Ltd and its sublicensee, Kyowa Hakko Kirin Co., Ltd.

The top five countries contributing to the sales of our Renal portfolio in 2011 were the U.S., Italy, France, the UK, and Brazil.

Synvisc®/Synvisc-One®

Synvisc® and Synvisc-One® (hylan G-F 20) are viscosupplements used to treat pain associated with osteoarthritis of certain joints. Synvisc® is a triple-injection product and Synvisc-One® is our next-generation, single-injection product. The principal viscosupplementation market is treatment of pain associated with osteoarthritis of the knee.

The principal markets for Synvisc® are the U.S., the EU, and Japan (where launch took place in December 2010). The principal markets for Synvisc-One® are the United States and the EU, markets in which Synvisc-One® was first approved in 2009 and 2007, respectively.

We market Synvisc® and Synvisc-One® through Genzyme s employee sales force directly to physicians, hospitals, and pharmacies. We distribute these products directly and through independent distributors. In Japan, Synvisc® is marketed and distributed by Teijin Pharma Limited.

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The top five countries contributing to Synvisc® and Synvisc-One® sales in 2011 were the U.S., Japan, Canada, France, and Germany.

Other pharmaceutical products

Stilnox®/Ambien® /Myslee®

Stilnox® (zolpidem tartrate) is indicated in the short-term treatment of insomnia. Stilnox® rapidly induces sleep that is qualitatively close to natural sleep and devoid of certain side effects that are characteristic of the benzodiazepine class as a whole. Its action lasts for a minimum of six hours, and it is generally well tolerated, allowing the patient to awaken with a reduced risk of impaired attention, decreased alertness or memory lapses throughout the day.

We have developed a controlled release formulation of zolpidem tartrate, marketed only in the United States under the brand name Ambien® CR.

Stilnox® is marketed in over 100 countries. It was launched in Japan under the brand name Myslee® in December 2000. Myslee® has been co-promoted jointly with Astellas since 2006. Myslee® is the leading hypnotic in Japan (source: IMS 2011).

Generic zolpidem tartrate has been available in Europe since 2004. In the United States, generics of the immediate release formulation of Ambien® have been available since 2007. Ambien® CR generics entered the U.S. market in October 2010. In Japan, competing generics of Myslee® are likely to enter the market in 2012.

Allegra®/Telfast®

Allegra® (fexofenadine hydrochloride) is a long-lasting (12- and 24-hour) non-sedating prescription anti-histamine for the treatment of seasonal allergic rhinitis (hay fever) and for the treatment of uncomplicated hives. It offers patients significant relief from allergy symptoms without causing drowsiness.

We also market Allegra-D® 12 Hour and Allegra-D® 24 Hour, anti-histamine/decongestant combination products with an extended-release decongestant for effective non-drowsy relief of seasonal allergy symptoms, including nasal congestion. Generics of most forms of Allegra®/Tefast® have been approved in our major markets, with the notable exception of Japan.

In March 2011, in the U.S., Allegra® family moved to over-the-counter (OTC) use in adults and children two years of age and older (see Consumer Health Care below).

Allegra®/Telfast® is marketed in approximately 80 countries. The largest market for prescriptions of Allegra® is Japan. In Japan, competing generics of Allegra® may possibly enter the market in the second half of 2012 if the generic manufacturers get marketing approvals. Sanofi appealed at the IP High Court to defend two Allegra® use patents following their invalidation by the patent office (for more information see Item 8 Financial Information A. Consolidated Financial Statements and Other Financial Information Information on Legal or Arbitration Proceedings).

Copaxone®

Copaxone® (glatiramer acetate) is a non-interferon immunomodulating agent indicated for reducing the frequency of relapses in patients with relapsing-remitting multiple sclerosis. Copaxone® is available as a self-injectable pre-filled syringe storable at room temperature for up to one month.

This disease-modifying drug is characterized by an original and specific mode of action on multiple sclerosis. Clinical studies have shown that Copaxone® is more effective than placebo at two years, but also that it has a clinical efficacy over 15 years both in reducing relapses and progression of disability. A significant effect on lesions has also been confirmed by nuclear magnetic resonance imaging.

In 2009, the U.K. Medicine and Healthcare Regulatory Agency (MHRA) approved an expanded label for Copaxone® to include the treatment of patients with clinically isolated syndrome suggestive of multiple sclerosis.

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We have marketed Copaxone® outside the United States and Canada through our alliance with Teva. As of February 29, 2012 we no longer market or sell Copaxone®: on a country-by-country basis, we instead receive a payment of 6% on sales from Teva for a period of two years from the date of transfer (see Alliance with Teva below).

Alliance with Teva

We in-licensed Copaxone® from Teva and marketed it until 2012 through an agreement with Teva, which was originally entered into in 1995, and has been amended several times, most recently in 2005.

Under the agreement with Teva, marketing and financial arrangements vary depending on the country in which the products are marketed.

Sales and distribution rights were returned to Teva in 2008 for the United States and Canada.

Outside the United States and Canada, there were two principal marketing arrangements:

Exclusive marketing: we had the exclusive right to market the product. This system was used in a number of European countries (Portugal, Italy, Greece, Finland, Denmark, Sweden, Norway, Iceland, Ireland, Luxembourg, Poland, Lichtenstein, Switzerland), as well as in Australia and New Zealand.

Co-promotion: the product was marketed under a single brand name. We used the co-promotion system in Germany, the United Kingdom, France, the Netherlands, Austria, Belgium, the Czech Republic and Spain.

Under the terms of our agreement, the Copaxone® business has been transferred to Teva over a period running from the third quarter of 2009 to February 29, 2012 depending on the country. Following the transfer, Sanofi will receive from Teva a royalty of 6% for a period of two years, on a country-by-country basis. In September 2009, the Copaxone® business was transferred to Teva in Switzerland and Lichtenstein. In 2010, the Copaxone® business was transferred to Teva in Poland, in the Czech Republic and in the United Kingdom. In 2011, the Copaxone® business was transferred to Teva in Norway, Germany, Austria, Portugal, and Sweden. In January and February 2012 the Copaxone® business was transferred to Teva in Denmark, the Netherlands, Belgium, France, Greece, Cyprus, Ireland, Italy, Spain, Australia, and New Zealand.

Tritace ®/Triatec® /Delix®/Altace®

Tritace® (ramipril) is an angiotensin converting enzyme (ACE) inhibitor indicated for the treatment of hypertension, congestive heart failure following or in the absence of acute myocardial infarction, and nephropathy. Tritace® is the only ACE inhibitor approved for the prevention of stroke, myocardial infarction and death in high-risk patients and has the broadest spectrum of indications among ACE inhibitors for the treatment of cardiovascular diseases.

The combinations with diuretics (ramipril + hydrochlorothiazide) and calcium channel blockers (ramipril + felodipine) are available in Europe.

Tritace® is marketed in over 70 countries. A number of generics have received marketing authorization and have been launched since December 2001 in Europe.

Depakine®

Depakine® (sodium valproate) is a broad-spectrum anti-epileptic that has been prescribed for more than 40 years. Numerous clinical trials and long years of experience have shown that it is effective for all types of epileptic seizures and epileptic syndromes, and is generally well tolerated. Consequently, Depakine® remains a reference treatment for epilepsy worldwide.

Depakine® is also a mood stabilizer, registered in the treatment of manic episodes associated with bipolar disorder and, in numerous countries, in the prevention of mood episodes. Depakine® is recommended as a first

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line treatment in these indications by international guidelines such as the guidelines of the World Federation of Societies of Biological Psychiatry Guidelines 2009, the Canadian Network for Mood and Anxiety Treatments 2009, and the British Association for Psychopharmacology 2009.

We provide a wide range of formulations of Depakine® enabling it to be adapted to most types of patients: syrup, oral solution, injection, enteric-coated tablets, Depakine® Chrono (a sustained release formulation in tablets) and Depakine® Chronosphere (sustained release formulation of Depakine® packaged in stick packs, facilitating its use by children, the elderly and adults with difficulties swallowing).

Depakine® is marketed in over 100 countries.

Xatral®/Uroxatral®

Xatral® (alfuzosin hydrochloride) belongs to the class of alpha1-blockers. Capable of acting selectively on the lower urinary tract, it was the first alpha1-blocker indicated and marketed exclusively for the treatment of symptoms of benign prostatic hyperplasia (BPH). It is also the only alpha1-blocker indicated as an adjunctive therapy with catheterization for acute urinary retention, a painful and distressing complication of BPH.

Xatral® OD (extended release formulation) is active from the first dose, provides rapid and lasting symptom relief, and improves patient quality of life. Xatral® is the only alpha1-blocker showing no deleterious effect on ejaculation, as shown by the final results of the international ALF-LIFE trial. The once-daily formulation of Xatral® (branded Uroxatral® in the United States) has been registered in over 90 countries and is marketed worldwide, with the exception of Australia and Japan.

Generic alfuzosin became available in most European countries in 2009. Generics of the extended release formulation of alfuzosin became available in the U.S. in July 2011.

Actonel®/Optinate® /Acrel®

Actonel® (risedronate sodium) belongs to the bisphosphonate class that helps prevent osteoporotic fractures.

Actonel® is the only osteoporosis treatment that reduces the risk of both vertebral and non-vertebral fractures in as little as six months. Actonel® also provides reduced risk of fracture at all key osteoporotic sites: vertebral, hip and non-vertebral sites, studied as a composite endpoint (hip, wrist, humerus, clavicle, leg and pelvis).

Actonel® is available in various dosage strengths and combination forms to better suit patient needs. Depending on dosage form, Actonel® is indicated for the treatment of post-nstallment and other

3,175

192

6.05

3,080

175

5.68

Gross loans (tax equivalent)
661,419

28,571

4.32

588,866

25,638

4.35

Total interest-earnings assets
846,006

31,747

3.75

775,602

28,858

3.72

Noninterest-earning assets

Cash and cash equivalents
40,046

43,721

Premises and equipment, net
18,949

22,370

Other assets
79,765

48,431

Total nonearning assets
138,760

114,522

Total assets
$
984,766

$
890,124

LIABILITIES & STOCKHOLDERS' EQUITY						
Interest-bearing liabilities						
NOW accounts	130,262	115	0.09	119,202	89	0.07
Money market accounts	121,617	289	0.24	118,711	208	0.18
Savings deposits	124,480	14	0.01	123,233	13	0.01
Time deposits	204,947	939	0.46	195,358	917	0.47
Federal funds purchased and repurchase agreements	14,375	37	0.26	18,144	50	0.28
Advances from FHLB	86,686	746	0.86	64,370	529	0.82
Notes payable	18,971	562	2.96	23,387	645	2.76
Total interest-bearing liabilities	701,338	2,702	0.39	662,405	2,451	0.37
Noninterest-bearing liabilities						
Noninterest-bearing deposits	154,183			150,460		
Other liabilities	5,079			6,594		
Total noninterest-bearing liabilities	159,262			157,054		
Stockholders' equity	124,166			70,665		
Total liabilities and stockholders' equity	$984,766			$890,124		

Net interest income (tax equivalent)	$29,045	$26,407
Net interest income (tax equivalent) to total earning assets	3.43 %	3.40 %
Interest-bearing liabilities to earning assets	82.90%	85.41%

(1) Average balance and average rate on securities classified as available-for-sale is based on historical amortized cost balances.
(2) Interest income and average rate on tax exempt securities are reflected on a tax equivalent basis based upon a statutory federal income tax rate of 34%.
(3) In 2016 there was $37 in tax equivalent interest included in gross loans and $53 in 2015.
(4) Nonaccrual loans are included in the average balances; overdraft loans are excluded in the balances.
(5) Loan fees are included in the specific loan category.
(6) Average balances are derived from daily balances.

CENTRUE FINANCIAL CORPORATION
PART II: MANAGEMENT'S DISCUSSION AND ANALYSIS
(TABLE AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)

AVERAGE BALANCE SHEET
AND ANALYIS OF NET INTEREST INCOME

	For the Years Ended December 31,					
	2015			2014		
	Average Balance	Interest/Income Expense	Average Rate	Average Balance	Interest/Income Expense	Average Rate
ASSETS						
Interest-earning assets						
Interest-earning deposits	$2,488	$ 65	2.61 %	$3,480	$ 81	2.33 %
Securities						
Taxable	176,119	2,887	1.64	140,494	2,272	1.62
Non-taxable	6,071	248	4.08	6,055	352	5.82
Total securities (tax equivalent)	182,190	3,135	1.72	146,549	2,624	1.79
Federal funds sold	2,058	20	0.97	5,620	40	0.71
Loans						
Commercial	101,809	4,126	4.05	93,643	3,888	4.15
Real estate	483,977	21,337	4.41	476,430	20,935	4.39
Installment and other	3,080	175	5.68	2,698	166	6.14
Gross loans (tax equivalent)	588,866	25,638	4.35	572,771	24,989	4.36
Total interest-earnings assets	775,602	28,858	3.72	728,420	27,734	3.81
Noninterest-earning assets						
Cash and cash equivalents	43,721			58,761		
Premises and equipment, net	22,370			22,984		
Other assets	48,431			56,689		
Total nonearning assets	114,522			138,434		
Total assets	$890,124			$866,854		
LIABILITIES & STOCKHOLDERS' EQUITY						
Interest-bearing liabilities						
NOW accounts	119,202	89	0.07	117,203	101	0.09
Money market accounts	118,711	208	0.18	122,968	237	0.19
Savings deposits	123,233	13	0.01	117,599	12	0.01
Time deposits	195,358	917	0.47	247,690	1,690	0.68
Federal funds purchased and repurchase agreements	18,144	50	0.28	18,560	55	0.30
Advances from FHLB	64,370	529	0.82	26,466	450	1.70
Notes payable	23,387	645	2.76	31,138	955	3.07
Total interest-bearing liabilities	662,405	2,451	0.37	681,624	3,500	0.51
Noninterest-bearing liabilities						
Noninterest-bearing deposits	150,460			139,260		
Other liabilities	6,594			9,656		
Total noninterest-bearing liabilities	157,054			148,916		
Stockholders' equity	70,665			36,314		
Total liabilities and stockholders' equity	$890,124			$866,854		
Net interest income (tax equivalent)		$26,407			$24,234	
Net interest income (tax equivalent) to total earning assets			3.40 %			3.33 %
Interest-bearing liabilities to earning assets			85.41%			93.58%

(1) Average balance and average rate on securities classified as available-for-sale is based on historical amortized cost balances.
(2) Interest income and average rate on tax exempt securities are reflected on a tax equivalent basis based upon a statutory federal income tax rate of 34%.
(3) In 2015 there was $53 in tax equivalent interest included in gross loans and $55 in 2014.
(4) Nonaccrual loans are included in the average balances; overdraft loans are excluded in the balances.
(5) Loan fees are included in the specific loan category.
(6) Average balances are derived from daily balances.

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The Company's net interest income is affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities, referred to as "volume change". It is also affected by changes in yield earned on interest-earning assets and rates paid on interest-bearing deposits and other borrowed funds referred to as "rate change". The following table reflects the changes in net interest income stemming from changes in interest rates and from asset and liability volume, including mix. Any variance attributed jointly to volume and rate change is allocated to the volume and rate variances in proportion to the relationship of the absolute dollar amount of the change in each.

RATE/VOLUME ANALYSIS OF
NET INTEREST INCOME

	For the Years Ended December 31,					
	2016 Compared to 2015			2015 Compared to 2014		
	Volume	Rate	Net	Volume	Rate	Net
Interest income:						
Interest-earning deposits	$(68)	$121	$53	$(12)	$(4)	$(16)
Investment securities:						
Taxable	20	(2)	18	633	(18)	615
Non-taxable	(104)	(7)	(111)	166	(270)	(104)
Federal funds sold	(40)	36	(4)	(13)	(7)	(20)
Loans	2,830	103	2,933	993	(344)	649
Total interest income	2,638	251	2,889	1,767	(643)	1,124
Interest expense:						
NOW accounts	1	25	26	5	(17)	(12)
Money market accounts	(26)	107	81	(3)	(26)	(29)
Savings deposits	—	1	1	1	—	1
Time deposits	143	(121)	22	(314)	(459)	(773)
Federal funds purchased and repurchase agreements	$(11)	(2)	(13)	$—	(5)	(5)
Advances from FHLB	$179	38	217	$463	(384)	79
Notes payable	$(139)	56	(83)	$(247)	(63)	(310)
Total interest expense	147	104	251	(95)	(954)	(1,049)
Net interest income	$2,491	$147	$2,638	$1,862	$311	$2,173

Provision for Loan Losses

The amount of the provision for loan losses is based on management’s evaluations of the loan portfolio, with particular attention directed toward nonperforming, impaired and other potential problem loans. During these evaluations, consideration is also given to such factors as management's evaluation of specific loans, the level and composition of impaired loans, other nonperforming loans, other identified potential problem loans, historical loss experience, results of examinations by regulatory agencies, results of the independent asset quality review process, the market value of collateral, the estimate of discounted cash flows, the strength and availability of guarantees, concentrations of credits and various other factors, including concentration of credit risk in various industries and current economic conditions.

2016 compared to 2015.

The Company recorded $0.3 million of provision for loan losses during 2016 in comparison to $0.4 million recorded in the same period in 2015. The reduced need for provision charge during the period was driven by the following factors:

- No material migrations of performing loans to nonperforming status from year-end 2015 to year-end 2016;
- Charge-offs during the period were offset by recoveries, resulting in net recoveries for the year;
- Continued stabilization of collateral values.

Management continues to update collateral values and evaluate the level of specific allocations for impaired loans. As impaired loans have moved through the liquidation process, many of the previously established specific allocations have been charged off.

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2015 compared to 2014.
The 2015 provision for loan losses charged to operating expense totaled $0.4 million, a decrease of $6.8 million in comparison to $7.2 million recorded in the 2014 period. The largest part of the decrease was related to the bulk asset sale that was completed in late 2014 and increased the provision charge by $2.9 million. Additionally the provision level for 2014 was driven by more aggressive workout strategies as the Company made a significant improvement to asset quality during the year.
Noninterest Income
Noninterest income consists of a wide variety of fee-based revenues, including bank-related service charges on deposits, mortgage revenues and increases in cash surrender value on bank-owned life insurance.
2016 compared to 2015.
Noninterest income totaled $12.7 million for year ended December 31, 2016, compared to $12.4 million for the same period in 2015. Excluding gains related to the sale of OREO, securities, branches and other non-recurring gains, noninterest income decreased by $0.6 million or 4.8%. The decline from 2015 was across several categories such as: income from real estate, service charges and mortgage banking income and can be largely attributed to the three branch sales during the year.
2015 compared to 2014.
Noninterest income totaled $12.4 million for year ended December 31, 2015, compared to $12.8 million for the same period in 2014. Excluding gains related to the sale of OREO, securities and other non-recurring gains, noninterest income decreased by $0.6 million or 5.9%. The decline from 2014 can be attributed to a decrease in mortgage banking income along with a decline in service charge income.
Noninterest Expense
Noninterest expense is comprised primarily of compensation and employee benefits, occupancy and other operating expense.
2016 compared to 2015.
Noninterest expense for the year ended December 31, 2016 was $31.5 million which was $1.7 million lower than the year ended December 31, 2015. When excluding the OREO valuation adjustments and other infrequently occurring items, noninterest expense was $0.5 million, or 1.6%, below the comparable amount for 2015 driven by a reduction in FDIC premium expense, loan collection costs and OREO carrying costs. Partially offsetting these improvements were the costs of being a public registrant in 2016.
2015 compared to 2014.
Noninterest expense totaled $33.2 million for the year ended December 31, 2015, as compared to $34.2 million for the same period in 2014. This represented a decrease of $1.0 million or 2.9% in 2015 from 2014. Excluding OREO valuations adjustments and other non-recurring items, noninterest expense was $0.4 million, or 1.3%, higher in 2015 compared to 2014 driven by an increase in salaries and partially offset by a reduction in FDIC premium expense.
Applicable Income Taxes
In accordance with current income tax accounting guidance, the Company assessed whether a valuation allowance should be established against their deferred tax assets (DTAs) based on consideration of all available evidence using a “more likely than not” standard. The most significant portions of the deductible temporary differences relate to (1) net operating loss carryforwards and (2) the allowance for loan losses.
In assessing the need for a valuation allowance, both the positive and negative evidence about the realization of DTAs were evaluated. The ultimate realization of DTAs is based on the Company’s ability to carryback net operating losses to prior tax periods, tax planning strategies that are prudent and feasible, and the reversal of deductible temporary differences that can be offset by taxable temporary differences and future taxable income.
In 2010, the Company established a valuation allowance of $31.5 million against its DTAs because it concluded that, based upon the weight of all available evidence, it was “more likely than not” that the deferred tax asset would not be realized. The valuation allowance increased to $39.8 million at December 31, 2014 due mainly to increases in the net operating loss carryforwards each year from 2010 through 2014. The valuation allowance decreased to $38.2 million

before being reversed to zero at December 31, 2015 due to taxable income generated in 2015 which reduced the net operating loss carryforwards.

We evaluate the need for a deferred tax asset valuation allowance on an ongoing basis. For the years ended December 31, 2016 and December 31, 2015, management determined that is it “more likely than not” that the deferred tax asset will be realized. This conclusion was based on an analysis of both positive and negative evidence. Positive evidence included our return to profitability and positive three year cumulative pre-tax earnings as of December 31, 2015, significant improvement in asset quality and credit

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ratios, positive loan growth throughout 2015, future taxable income based on robust forecasting models including prudent and feasible tax planning strategies if needed, and the termination of the Company's Written Agreement by the Federal Reserve Bank of Chicago and the Illinois Department of Financial and Professional Regulation. Negative evidence included a pre-tax loss in 2014, no available taxes paid in open carryback years, and the fact that the banking industry is highly competitive and heavily regulated. Management determined that the positive evidence outweighed the negative and therefore the Company released the $38.2 million valuation allowance against the net deferred tax asset on December 31, 2015 resulting in an income tax benefit.

Interest Rate Sensitivity Management

The business of the Company and the composition of its balance sheet consist of investments in interest-earning assets (primarily loans and securities) which are funded for the most part by interest-bearing liabilities (deposits and borrowings). All of the financial instruments of the Company are held for investment rather than trading purposes. Such financial instruments have varying levels of sensitivity of economic value to changes in market rates of interest, but also sensitivity in coupon income for adjustable rate instruments and reinvestment income of maturing instruments. The operating income and net income of the Bank depends, to a substantial extent, on "rate differentials," i.e., the differences between the income the Bank receives from loans, securities, and other earning assets and the interest expense they pay to obtain deposits and other funding sources. These rates are highly sensitive to many factors that are beyond the control of the Bank, including general economic conditions and the policies of various governmental and regulatory authorities.

The Company measures its overall interest rate sensitivity through a multiple scenario analysis. The primary analysis measures the change in net interest income resulting from instantaneous hypothetical changes in interest rates. This analysis assesses the risk of changes in net interest income in the event of a sudden and sustained 100 to 300 basis point increase or decrease in market interest rates. Due to the current rate environment, this analysis was done in 2015 using a 100 basis point decrease in rates versus the normal 100 to 300 basis point decreases. Computations of the prospective effects of hypothetical interest rate changes are based on numerous assumptions including parallel shifts of market interest rates, loan and security prepayments, and deposit run-off rates and should not be relied upon as indicative of actual results. Actual values may differ from those projections set forth above, should market conditions vary from the assumptions used in preparing the analysis. Further, the computations do not contemplate actions the Company may undertake in response to changes in interest rates. The interest rates scenarios are used for analytical purposes and do not necessarily represent management's view of future market movements.

The tables below present the Company's projected changes in net interest income for December 31, 2016 and December 31, 2015 for the various rate shock levels.

	Change in Net Interest Income Over One Year Horizon			
	December 31, 2016		December 31, 2015	
	Change		Change	
	$	%	$	%
+ 300 bp	$1,567	5.12 %	$1,966	6.89 %
+ 200 bp	1,038	3.39	1,264	4.43
+ 100 bp	455	1.49	649	2.27
Base	—	—	—	—
- 100 bp	(1,690)	(5.53)	(1,550)	(5.43)

As shown above, the effect of an immediate 200 basis point increase in interest rates as of December 31, 2016 would increase the Company's net interest income by $1.0 million or 3.39%. The effect of an immediate 100 basis point decrease in rates would decrease the Company's net interest income by $1.7 million or 5.53%.

During 2015, management continued to position the balance sheet to generate a benefit to income in a rising interest rate environment. This was accomplished by allowing the fixed rate securities to run off and replacing them with adjustable rate securities. The loan portfolio had a lower amount of loans on which interest was not accruing at the end of the year, thus having a larger percentage of the total benefitting from rising interest rates. The primary factor increasing the benefit to the margin from rising interest rates was the greater percentage of funding coming from non-maturity deposits. These deposits tend to be less sensitive to rising interest rates as these are primarily transaction balances. This is somewhat related to the general industry trend of an influx of funds from money market mutual funds which will likely be less secure funding. This makes it necessary to invest these funds focusing on less volatile assets. With the influx of deposits into non-maturity accounts there was reduced dependence on time deposits and from wholesale funding. Time deposits and wholesale funding tend to have the highest sensitivity to rising interest rates and our reduced concentration of this type of funding allows greater benefit to the margin from rising interest rates.

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PART II: MANAGEMENT'S DISCUSSION AND ANALYSIS
(TABLE AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)

Financial Condition
General
Following are highlights of the December 31, 2016 balance sheet when compared to December 31, 2015:
Loans. The Company offers a broad range of products, including commercial; agricultural production and agricultural real estate; construction, land and development; commercial real estate, 1-4 family mortgages; and consumer loans, designed to meet the credit needs of its borrowers. The Company’s loans are diversified by borrower and industry group.
Outstanding loans totaled $685.8 million at December 31, 2016 compared to $633.5 million at December 31, 2015, representing an increase of $52.3 million or 8.3%. This increase is primarily due to a combination of new organic loan growth and normal seasonal line draws offset by $13.1 million of loans sold with branch sales during the year. See Note 19. Business Acquisitions and Divestitures for additional disclosure related to the branch sales.
As of December 31, 2016 and December 31, 2015, commitments of the Bank under standby letters of credit and unused lines of credit totaled approximately $125.9 million and $151.8 million.
STATED LOAN MATURITIES (1)

	Within 1 Year	1 to 5 Years	After 5 Years	Total
Commercial	$42,630	$25,396	$12,261	$80,287
Agricultural & AGRE	17,511	13,075	18,535	49,121
Construction, land & development	7,365	16,066	5,340	28,771
Commerical RE	44,800	261,882	132,644	439,326
1-4 mortgages	12,258	29,907	42,987	85,152
Consumer	514	2,196	408	3,118
Total	$125,078	$348,522	$212,175	$685,775

(1) Maturities based upon contractual maturity dates
The maturities presented above are based upon contractual maturities. Many of these loans are made on a short-term basis with the possibility of renewal at time of maturity.
Rate sensitivities of the total loan portfolio, net of unearned income, at December 31, 2016 were as follows:
LOAN REPRICING

	Within 1 Year	1 to 5 Years	After 5 Years	Total
Fixed rate	$50,442	$242,831	$26,445	$319,718
Variable rate	73,433	105,424	185,588	364,445
Nonaccrual	1,203	267	142	1,612
Total	$125,078	$348,522	$212,175	$685,775

Nonperforming Assets
The Company’s financial statements are prepared on the accrual basis of accounting, including the recognition of interest income on its loan portfolio, unless a loan is placed on nonaccrual status. Loans are placed on nonaccrual status when there are serious doubts regarding the collectability of all principal and interest due under the terms of the loans. If a loan is placed on nonaccrual status, the loan does not generate current period income for the Company and any amounts received are generally applied first to principal and then to interest. A loan is generally transferred to nonaccrual status if it is not in the process of collection and is delinquent in payment of either principal or interest beyond 90 days.

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The classification of a loan as nonaccrual does not necessarily indicate that the principal is uncollectible, in whole or in part. The Bank makes a determination as to collectability on a case-by-case basis and considers both the adequacy of the collateral and the other resources of the borrower in determining the steps to be taken to collect nonaccrual loans. The final determination as to the steps taken is made based upon the specific facts of each situation. Alternatives that are typically considered to collect nonaccrual loans are foreclosure, collection under guarantees, loan restructuring, or judicial collection actions.

Other nonperforming assets consist of real estate acquired through loan foreclosures or other workout situations and other assets acquired through repossessions.

Each of the Company’s commercial loans is assigned a risk rating at origination based upon an internally developed grading system. A separate credit administration department also reviews selected grade assignments on a quarterly basis. Management continuously monitors nonperforming, impaired, and past due loans in an effort to prevent further deterioration of these loans. The Company has engaged a third-party loan review firm to assist with the Company's loan review function.

The following table sets forth a summary of nonperforming assets:

	December 31,			
	2016	2015	2014	2013
Nonaccrual loans (including TDRs)	$1,612	$6,007	$7,749	$28,871
TDRs still accruing interest	20	—	—	181
Loans 90 days past due and still accruing interest	—	—	—	—
Total nonperforming loans	$1,632	$6,007	$7,749	$29,052
Other real estate owned	5,042	8,401	10,256	23,318
Total nonperforming assets	$6,674	$14,408	$18,005	$52,370
Nonperforming loans to total end of period loans	0.24 %	0.93 %	1.40 %	5.13 %
Nonperforming assets to total end of period loans	0.97	2.23	3.25	9.25
Nonperforming assets to total end of period assets	0.68	1.50	2.20	5.93

The Company’s level of nonperforming assets has declined significantly over the past three years mainly due to the sale of $35.2 million of troubled assets through the bulk asset sale completed on December 5, 2014 which included the sale of $9.5 million in nonaccrual loans and $7.7 million in OREO. Total nonperforming assets declined $7.7 million to $6.7 million, or 0.68% of total assets, at December 31, 2016 from $14.4 million at December 31, 2015. Total nonperforming assets included $0.1 million in troubled debt restructures, $5.0 million of foreclosed assets and repossessed real estate, and $1.6 million of nonaccrual loans compared to $8.4 million of foreclosed assets, $0.2 million in troubled debt restructures and $5.8 million of nonaccrual loans at December 31, 2015.

Nonperforming Loans

Nonperforming loans (nonaccrual, 90 days past due and troubled debt restructures) decreased $4.4 million from December 31, 2015 to December 31, 2016, largely due to successful workout strategies.

The level of nonperforming loans to end of period loans was 0.24% as of December 31, 2016 as compared to 0.93% as of December 31, 2015. As a result of the decrease in the nonperforming loans, the allowance to nonperforming loan coverage ratio increased to 545.59% for year ended December 31, 2016 from 143.02% for the year ended December 31, 2015.

Other Real Estate Owned

Other real estate owned (OREO) properties have been slow to move in the current economic environment. OREO was $5.0 million as of December 31, 2016 compared to $8.4 million as of December 31, 2015. During 2016, the Company transferred $0.04 million of foreclosed or repossessed real estate from the loan portfolio. OREO properties with a carrying value of $3.9 million were written down to their fair value of $3.8 million, resulting in a charge to earnings of $0.1 million. This compares to 2015 when OREO properties with a carrying value of $5.2 million were written down

to their fair value of $4.9 million, which resulted in a charge to earnings of $0.3 million during the year.

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PART II: MANAGEMENT'S DISCUSSION AND ANALYSIS
(TABLE AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)

The following table sets forth a summary of other real estate owned at December 31, 2016 and December 31, 2015:

	December 31, 2016 Net Book Carrying Value	December 31, 2015 Net Book Carrying Value
Developed property	$ 2,897	$ 4,508
Vacant land or unsold lots	2,145	3,893
Total other real estate owned	$ 5,042	$ 8,401

Other Potential Problem Loans

The Company has other potential problem loans that are currently performing, but where some concerns exist regarding the nature of the borrowers' projects in our current economic environment. As of December 31, 2016, management identified $1.3 million of loans that are currently performing but due to the economic environment facing these borrowers were classified by management as impaired. Impaired loans that are performing account for 44.18% of the loans deemed impaired during 2016. The Company proactively reviews loans for potential impairment regardless of the payment or performance status. This approach results in some relationships being classified as impaired but still performing.

Allowance for Loan Losses

At December 31, 2016, the allowance for loan losses was $8.9 million, or 1.30% of total loans, as compared to $8.6 million, or 1.33% of total loans, at December 31, 2015. The Company recorded $0.3 million of provision to the allowance for loan losses for the year ended December 31, 2016 largely due to net loan growth.

Activity in the Allowance for years ended December 31, 2016 and December 31, 2015 was as follows.

	December 31, 2016	December 31, 2015
Beginning Balance	$ 8,591	$ 7,981
Net recoveries	13	235
Provision	300	375
Ending Balance	$ 8,904	$ 8,591

The components of the Allowance for Loan Losses ("Allowance") at December 31, 2016 and December 31, 2015 were as follows.

	December 31, 2016	December 31, 2015
Allowance for loan losses:		
Loans individually evaluated for impairment	$ 1,133	$ 1,594
Loans collectively evaluated for impairment	7,771	6,997
Ending Balance	$ 8,904	$ 8,591

The general component of the Allowance covers loans that are collectively evaluated for impairment. The general component also includes loans that are not individually identified for impairment evaluation, as well as those loans that are individually evaluated but are not considered impaired. The general component is based on historical loss experience adjusted for factors. These factors include consideration of the following: levels of and trends in charge-offs and recoveries; migration of loans to the classification of special mention, substandard or doubtful; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability and depth of lending management and other relevant staff, national and local economic trends and conditions; industry conditions; and effects of changes in credit concentration.

The establishment of the Allowance involves a high degree of judgment and includes a level of imprecision given the difficulty of identifying all of the factors impacting loan repayment and the timing of when losses occur.
Net loan charge-offs for 2016 resulted in a net recovery of $0.01 million compared with a net recovery of $0.2 million in the same period of 2015. Management believes losses are being recognized in our portfolio through charge-offs as they are confirmed.

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Of the $8.9 million allowance for loan losses at December 31, 2016, $5.2 million, or 58.43%, was allocated to commercial real estate loans. Management monitors these collateral dependent real estate loans periodically to analyze the adequacy of the cash flows to support the debt levels and obtains updated appraisals to determine the collateral's fair value for impairment analysis.

Management continues to diligently monitor the loan portfolio, paying particular attention to borrowers with land development, residential and commercial real estate, and commercial development exposures. Should the economic climate deteriorate from current levels, more borrowers may experience repayment difficulty, and the level of nonperforming loans, charge-offs and delinquencies could rise, potentially requiring increases in the provision for loan losses. Management believes that the allowance for loan losses at December 31, 2016 was adequate to absorb probable incurred credit losses inherent in the loan portfolio.

The following table presents a ratio analysis of the Company's allowance for loan losses:

ALLOWANCE FOR LOAN LOSS RATIOS

	Years Ended December 31,			
	2016	2015	2014	2013
Net loan charge-offs to total average loans [1]	NM	(0.04)%	1.90 %	1.92 %
Provision for loan losses to average loans	0.05	0.06	1.26	0.61
Allowance for loan losses to total end of period loans	1.30	1.33	1.44	2.06
Allowance for loan losses to total nonperforming loans	545.59	143.02	102.99	40.06

(1) (NM) Not meaningful.

Securities. The primary strategic objective of the Company's $165.9 million securities - available-for-sale from December 31, 2016, which excludes restricted securities, is to minimize interest rate risk, maintain sufficient liquidity, and maximize return. In managing the securities portfolio, the Company minimizes any credit risk and avoids investments in sophisticated and complex investment products. The portfolio includes several callable agency debentures, adjustable rate mortgage pass-throughs, municipal bonds and collateralized mortgage obligations. Collateralized mortgage obligations currently owned are guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. Neither the Company nor the Bank hold any securities containing sub-prime mortgages or Fannie Mae or Freddie Mac equities. The Company does not have any securities classified as trading or held-to-maturity.

The Company's financial planning anticipates income streams generated by the securities portfolio based on normal maturity and reinvestment. Securities classified as available-for-sale, carried at fair value, were $165.9 million at December 31, 2016 compared to $171.4 million at December 31, 2015. The Company also holds Federal Reserve Board and Federal Home Loan Bank stock which are classified as restricted securities of $9.9 million at December 31, 2016 and $9.1 million at December 31, 2015.

Deposits. Deposits are attracted through the offering of a broad variety of deposit instruments, including checking accounts, money market accounts, regular savings accounts, term certificate accounts (including "jumbo" certificates in denominations of $100,000 or more), and retirement savings plans. The Company's average balance of total deposits was $735.5 million for 2016, representing an increase of $28.5 million or 4.03% compared with the average balance of total deposits for 2015 of $707.0 million as organic deposits grew and brokered deposit relationships were established to replace the $51.7 million of deposits sold as part of the branch sales during the year.

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The following table sets forth certain information regarding the Bank’s average deposits:

	2016			2015		
	Average Amount	% of Total	Average Rate Paid	Average Amount	% of Total	Average Rate Paid
Demand deposit accounts:						
Interest bearing	$130,262	17.71 %	0.09 %	$119,202	16.86 %	0.07 %
Non-interest bearing	154,183	20.96	—	150,460	21.29	—
Money market accounts	121,617	16.54	0.24	118,711	16.79	0.18
Savings accounts	124,480	16.92	0.01	123,233	17.43	0.01
Time, less than $100,000	100,297	13.64	0.21	123,097	17.41	0.23
Time, $100,000 or more	104,650	14.23	0.70	72,261	10.22	0.88
	$735,489	100.00%	0.18 %	$706,964	100.00%	0.17 %

For the year ended December 31, 2016, average time deposits over $100,000 represented 14.23% of total average deposits, compared with 10.22% of total average deposits for the year ended December 31, 2015. The Company’s large denomination time deposits are generally from customers within the local market areas and provide a greater degree of stability than is typically associated with brokered deposit customers with limited business relationships.

The following table sets forth the remaining maturities for time deposits of $250,000 or more at December 31, 2016:

TIME DEPOSITS OF $250,000 OR MORE

Maturity period:	
Three months or less	$38,587
Over three months through six months	8,035
Over six months through one year	8,023
Over one year	8,960
Total	$63,605

Brokered deposits account for $44.2 million of the total from the table above and maturities at December 31, 2016 are as follows:

BROKERED TIME DEPOSITS OF $100,000 OR MORE

Maturity period:	
Three months or less	$30,000
Over three months through six months	5,297
Over six months through one year	5,000
Over one year	3,924
Total	$44,221

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Return on Equity and Assets

The following table presents various ratios for the Company:

RETURN ON EQUITY AND ASSETS

	Years Ended December 31,	
	2016	2015
Return on average assets	0.64 %	4.79 %
Return on average equity	5.09	60.29
Average equity to average assets	12.61	7.94

Liquidity

The Company manages its liquidity position with the objective of maintaining sufficient funds to respond to the needs of depositors and borrowers and to take advantage of earnings enhancement opportunities. In addition to the normal inflow of funds from core-deposit growth together with repayments and maturities of loans and investments, the Company utilizes other short-term funding sources such as brokered time and non-maturing deposits, securities sold under agreements to repurchase, overnight federal funds purchased from correspondent banks and the acceptance of short-term deposits from public entities, and Federal Home Loan Bank advances.

The Company monitors and manages its liquidity position on several bases, which vary depending upon the time period. As the time period is expanded, other data is factored in, including estimated loan funding requirements, estimated loan payoffs, investment portfolio maturities or calls, and anticipated depository buildups or runoffs.

The Company classifies all of its securities as available-for-sale, thereby maintaining significant liquidity. The Company’s liquidity position is further enhanced by structuring its loan portfolio interest payments as monthly and by the significant representation of retail credit and residential mortgage loans in the Company’s loan portfolio, resulting in a steady stream of loan repayments. In managing its investment portfolio, the Company provides for staggered maturities so that cash flows are provided as such investments mature.

The Company’s cash flows are comprised of three classifications: cash flows from operating activities, cash flows from investing activities, and cash flows from financing activities. Cash flows provided by financing activities offset by cash flows used in operating activities and investing activities resulted in a net decrease in cash and cash equivalents of $5.1 million from December 31, 2015 to December 31, 2016.

During 2016, the Company experienced a positive net cash flow of $63.9 million in financing activities primarily due to the growth in deposits. In contrast, net cash outflows of $79.7 million were used by investing activities due to the purchase of available for sale securities and an overall increase in net loans. Net cash provided by operating activities was $10.7 million.

The Bank’s securities portfolio, federal funds sold, and cash and due from bank deposit balances serve as the primary sources of liquidity for the Company. At December 31, 2016, 10.83% of the Bank’s interest-bearing deposits were in the form of time deposits of $100,000 and over. Management believes these deposits to be a stable source of funds. However, if a large number of these time deposits matured at approximately the same time and were not renewed, the Bank’s liquidity could be adversely affected. Currently, the maturities of the large time deposits are spread throughout the year, with 60.67% maturing in the first quarter of 2017, 12.63% maturing in the second quarter of 2017, 12.61% maturing in the third and fourth quarter of 2017, and the remaining 14.09% maturing thereafter. The Bank monitors those maturities in an effort to minimize any adverse effect on liquidity.

At December 31, 2016, borrowings included $10.0 million for Centrue Statutory Trust II. The principal source of debt service payments for this obligation is from the net proceeds of the Company’s recent capital financing. Borrowings held at the Bank include $85.0 million in FHLB advances and $11.2 million in securities sold under agreements to repurchase; the debt service for the Bank’s borrowings is provided by operating cash flows from the Bank.

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(TABLE AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)

Contractual Obligations

The Company has entered into contractual obligations and commitments and off-balance sheet financial instruments. The following tables summarize the Company's contractual cash obligations and other commitments and off balance sheet instruments as of December 31, 2016:

	Payments Due by Period				
	Within 1 Year	1-3 Years	4-5 Years	After 5 Years	Total
Contractual Obligations					
Certificates of deposit	$162,545	$35,041	$3,586	$—	$201,172
Operating leases	282	412	98	—	792
Series B mandatory redeemable preferred stock	—	268	—	—	268
Subordinated debentures	—	—	—	20,620	20,620
FHLB advances	60,000	16,000	—	—	76,000
Total contractual cash obligations	$222,827	$51,721	$3,684	$20,620	$298,852

Commitments, Contingencies, and Off-Balance Sheet Financial Instruments

Some financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, often including obtaining collateral at exercise of the commitment. At December 31, 2016, the Company had $124.1 million in outstanding loan commitments including outstanding commitments for various lines of credit and $1.8 million of standby letters of credit. See Note 15 of the Notes to the Consolidated Financial Statements for additional information on loan commitments and standby letters of credit.

Capital Resources

Stockholders' Equity

Stockholders' equity at December 31, 2016 was $126.9 million, an increase of $5.6 million from $121.3 million at December 31, 2015. The change in stockholders' equity during 2016 was the result of net income partially offset by a decrease in accumulated other comprehensive income related to the unrealized losses on the securities portfolio. Average equity as a percentage of average assets was 12.61% at December 31, 2016 compared to 7.94% at December 31, 2015. Book value per common share equaled $19.08 at December 31, 2016, an increase from $18.21 reported at the end of 2015.

Regulatory Capital Measurements

The Company and the Bank ("Regulated Companies") are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum regulatory capital requirements can initiate certain mandatory, and possibly additional discretionary actions by these regulators that, if undertaken, could have a direct material effect on the Company's Consolidated Financial Statements. Under regulatory capital adequacy guidelines and the regulatory framework for prompt corrective action, the Regulated Companies must meet specific regulatory capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. Their regulatory capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure regulatory capital adequacy require the Regulated Companies to maintain minimum amounts and ratios (set forth in the table below) of total, common equity Tier 1 ("CET1") and Tier 1 capital to risk-weighted assets; and of Tier 1 Capital to average assets. Tier 1 Capital includes common stockholders' equity, qualifying preferred stock and Trust Preferred securities, less goodwill and certain other deductions (including the unrealized net gains and losses, after applicable taxes, on available-for-sale securities carried

at fair value). CET1 is a subset of Tier 1 capital and is limited to common equity (plus related surplus), retained earnings, accumulated other comprehensive income and certain other items. Other instruments that have historically qualified for Tier 1 treatment, including non-cumulative perpetual preferred stock, are consigned to a category known as Additional Tier 1 capital and must be phased out over a period of nine years beginning in 2014. The rules permit bank holding companies with less than $15 billion in assets (such as us) to continue to include trust preferred securities and non-cumulative perpetual preferred stock issued before May 19, 2010 in Tier 1 capital, but not CET1.Total Capital includes Tier 1

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PART II: MANAGEMENT'S DISCUSSION AND ANALYSIS
(TABLE AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)

Capital plus preferred stock not qualifying as Tier 1 Capital, mandatory convertible debt, subordinated debt and the allowance for loan and lease losses, subject to limitations by the guidelines.

On July 2, 2013, the Federal Reserve Board and the FDIC approved rules that implement the “Basel III” regulatory capital reforms, as well as certain changes required by the Dodd-Frank Act. The rules include a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets, which is in addition to the Tier 1 and Tier 2 risk-based capital requirements. The capital conservation buffer will be phased in over four years beginning on January 1, 2016, with a maximum buffer of 0.625% of risk-weighted assets for 2016, 1.25% for 2017, 1.875% for 2018, and 2.5% for 2019 and thereafter. Failure to maintain the required capital conservation buffer will result in limitations on capital distributions and on discretionary bonuses to executive officers. Regulatory capital ratios shown for December 31, 2016 are in excess of the Basel III 2016 phase-in level in regards to the capital conservation buffer.

Basel III also introduced changes to risk-weightings and treatment of Accumulated Other Comprehensive Income (AOCI). In 2015, the Bank made a one-time available election to opt-out of the impact of certain unrealized capital gains and losses in AOCI being included in regulatory capital. There is no opportunity to change methodology in future periods.

On March 31, 2015, the Company completed a common stock offering and capital infusion into the Bank. See Note 1 to the Audited Financial Statements for additional disclosure.

As reflected in the following table, Centrue Bank was considered “well-capitalized” under regulatory defined capital ratios as of December 31, 2016.

	Actual		To Be Adequately Capitalized		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2016						
Total capital (to risk-weighted assets)						
Centrue Financial	$118,841	15.0%	N/A	N/A	N/A	N/A
Centrue Bank	115,455	14.5	63,556	8.0	79,445	10.0
Common equity tier I (to risk-weighted assets)						
Centrue Financial	$109,434	13.8	N/A	N/A	N/A	N/A
Centrue Bank	106,551	13.4	35,750	4.5	51,639	6.5
Tier I capital (to risk-weighted assets)						
Centrue Financial	$109,937	13.8	N/A	N/A	N/A	N/A
Centrue Bank	106,551	13.4	47,667	6.0	63,556	8.0
Tier I leverage ratio (to average assets)						
Centrue Financial	$109,937	11.5	N/A	N/A	N/A	N/A
Centrue Bank	106,551	11.1	38,251	4.0	47,814	5.0

Impact of Inflation, Changing Prices, and Monetary Policies

The financial statements and related financial data concerning the Company have been prepared in accordance with accounting principles generally accepted in the United States of America which require the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation. The primary effect of inflation on the operations of the Company is reflected in increased operating costs. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, changes in interest rates have a more significant effect on the

performance of a financial institution than do the effects of changes in the general rate of inflation and changes in prices. Interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. Interest rates are highly sensitive to many factors which are beyond the control of the Company, including the influence of domestic and foreign economic conditions and the monetary and fiscal policies of the United States government and federal agencies, particularly the Federal Reserve-Chicago.

Recent Accounting Developments

See Note 1 to the Consolidated Financial Statements for information concerning recent accounting developments.

CENTRUE FINANCIAL CORPORATION
PART II
(TABLE AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The discussion under the captions "Interest Rate Sensitivity Management" contained in Item 7 of the Form 10-K is incorporated herein by this reference.

Item 8. Financial Statements and Supplementary Data

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Centrue Financial Corporation
Ottawa, Illinois

We have audited the accompanying consolidated balance sheets of Centrue Financial Corporation as of December 31, 2016 and 2015, and the related consolidated statements of income and comprehensive income, of stockholders' equity, and cash flows for each of the two years in the period ended December 31, 2016. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2016 and 2015, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

/s/ Crowe Horwath LLP
Crowe Horwath LLP
Oak Brook, Illinois
March 2, 2017

CENTRUE FINANCIAL CORPORATION
PART II
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2016 AND 2015 (IN THOUSANDS, EXCEPT FOR PAR VALUE AND SHARE DATA)

	December 31, 2016	December 31, 2015
ASSETS		
Cash and cash equivalents	$ 22,507	$ 27,655
Securities available-for-sale	165,927	171,440
Restricted securities	9,860	9,116
Loans held for sale	—	735
Loans, net of allowance for loan loss: 2016 - $8,904; 2015 - $8,591	676,871	624,956
Branch assets held for sale	—	16,673
Bank-owned life insurance	35,986	35,103
Mortgage servicing rights	2,033	2,129
Premises and equipment, net	16,371	16,852
Intangible assets, net	—	880
Other real estate owned, net	5,042	8,401
Deferred tax assets, net	35,035	38,180
Other assets	8,147	9,098
Total assets	$ 977,779	$ 961,218
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Deposits:		
Non-interest-bearing	$ 152,524	$ 164,137
Interest-bearing	587,522	554,367
Total deposits	740,046	718,504
Federal funds purchased and securities sold under agreements to repurchase	11,168	18,730
Federal Home Loan Bank advances	85,000	76,000
Series B mandatory redeemable preferred stock	209	268
Subordinated debentures	10,310	20,620
Other liabilities	4,117	5,815
Total liabilities	850,850	839,937
Commitments and contingent liabilities	—	—
Stockholders' equity		
Series D Fixed Rate, Non-Cumulative Perpetual Preferred Stock, 2,636 shares authorized and issued 2016 and 2015; aggregate liquidation preference of $2,636	2,636	2,636
Common stock, $0.01 par value; 215,000,000 shares authorized; 6,581,544 shares issued at December 31, 2016 and December 31, 2015	66	66
Surplus	140,664	140,609
Retained earnings (deficit)	3,029	(2,958)
Accumulated other comprehensive loss	(3,340)	(2,946)
	143,055	137,407
Treasury stock, at cost, 67,850 shares at December 31, 2016 and December 31, 2015[1]	(16,126)	(16,126)
Total stockholders' equity	126,929	121,281

Total liabilities and stockholders' equity	$ 977,779	$ 961,218

(1) Share and per share amounts have been adjusted to reflect the Company's 1:30 reverse stock split effective May 29, 2015.
See Accompanying Notes to Consolidated Financial Statements

CENTRUE FINANCIAL CORPORATION
PART II
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
YEARS ENDED DECEMBER 31, 2016 AND 2015 (IN THOUSANDS)

	2016	2015
Interest income		
Loans	$28,558	$25,619
Securities		
Taxable	2,905	2,887
Exempt from federal income taxes	91	164
Federal funds sold and other	134	85
Total interest income	31,688	28,755
Interest expense		
Deposits	1,357	1,227
Federal funds purchased and securities sold under agreements to repurchase	37	50
Federal Home Loan Bank advances	746	529
Series B mandatory redeemable preferred stock	14	16
Subordinated debentures	548	545
Notes payable	—	84
Total interest expense	2,702	2,451
Net interest income	28,986	26,304
Provision for loan losses	300	375
Net interest income after provision for loan losses	28,686	25,929
Noninterest income		
Service charges	3,927	4,051
Mortgage banking income	1,175	1,240
Electronic banking services	2,536	2,545
Bank-owned life insurance	883	909
Securities gains, net	142	339
Income from real estate	330	619
Gain on sale of OREO	130	161
Gain on sale of branches	1,877	—
Gain on sale of other assets	102	—
Gain on extinguishment of debt	1,000	1,750
Other income	644	814
	12,746	12,428

(Continued)

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CENTRUE FINANCIAL CORPORATION
PART II
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
YEARS ENDED DECEMBER 31, 2016 AND 2015 (IN THOUSANDS)

	2016	2015
Noninterest expense		
Salaries and employee benefits	16,748	16,805
Occupancy, net	2,679	2,840
Furniture and equipment	1,093	1,028
Marketing	244	378
Supplies and printing	228	222
Telephone	831	816
Data processing	1,809	1,661
FDIC insurance	450	1,166
Loan processing and collection costs	390	705
OREO carrying costs	473	799
OREO valuation adjustment	137	291
Amortization of intangible assets	880	951
Other expenses	5,552	5,577
	31,514	33,239
Income before income taxes	$9,918	$5,118
Income tax expense (benefit)	3,602	(37,484)
Net income	$6,316	$42,602
Preferred stock dividends	329	1,484
Discount on redemption of preferred stock	—	(13,668)
Net income for common stockholders	$5,987	$54,786
Basic earnings per common share [(1)]	$0.92	$11.08
Diluted earnings per common share [(1)]	$0.92	$11.08
Total comprehensive income:		
Net income	$6,316	$42,602
Change in unrealized gains (losses) on securities available for sale	(503)	(1,127)
Reclassification adjustment for losses (gains) recognized in income	(142)	(339)
Net unrealized gains (loss)	(645)	(1,466)
Tax effect	(251)	(571)
Other comprehensive income (loss)	(394)	(895)
Total comprehensive income	$5,922	$41,707

(1) Share and per share amounts have been adjusted to reflect the Company's 1:30 reverse stock split effective May 29, 2015.
See Accompanying Notes to Consolidated Financial Statements

CENTRUE FINANCIAL CORPORATION
PART II
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2016 AND 2015 (IN THOUSANDS)

	Series C Preferred Stock	Series D Preferred Stock	Common Stock	Surplus	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Treasury Stock [1]	Total
Balance, January 1, 2015	$32,668	$2,636	$ 2	$78,955	$ (58,750)	$ (2,051)	$(23,132)	$30,328
Net proceeds from common stock offering - see Note 1	—	—	64	68,184	—	—	—	68,248
Preferred stock dividends	—	—	—	—	(478)	—	—	(478)
Deferred compensation distribution (1,003 shares)	—	—	—	(224)	—	—	239	15
Redemption of preferred stock - see Note 1	(32,668)	—	—	—	13,668	—	—	(19,000)
Restricted stock awards (40,443 shares)	—	—	—	(6,306)	—	—	6,767	461
Net income	—	—	—	—	42,602	—	—	42,602
Total comprehensive income	—	—	—	—	—	(895)	—	(895)
Balance, December 31, 2015 [1]	$—	$2,636	$ 66	$140,609	$ (2,958)	$ (2,946)	$(16,126)	$121,281
Preferred stock dividends	—	—	—	—	(329)			(329)
Forfeited stock options	—	—	—	(69)	—	—	—	(69)
Restricted stock unit expense	—	—	—	124	—	—	—	124
Net income	—	—	—	—	6,316	—	—	6,316
Total comprehensive income	—	—	—	—	—	(394)	—	(394)
Balance, December 31, 2016	$—	$2,636	$ 66	$140,664	$ 3,029	$ (3,340)	$(16,126)	$126,929

(1) Share and per share amounts have been adjusted to reflect the Company's 1:30 reverse stock split effective May 29, 2015.

See Accompanying Notes to Consolidated Financial Statements

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CENTRUE FINANCIAL CORPORATION
PART II
CONSOLIDATED STATEMENT OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2016 AND 2015 (IN THOUSANDS)

	2016	2015
Cash flows from operating activities		
Net income	$6,316	$42,602
Adjustments to reconcile net income		
to net cash provided by operating activities		
Depreciation	1,115	1,199
Amortization of intangible assets	880	951
Amortization of mortgage servicing rights, net	304	341
Amortization of bond premiums, net	1,649	1,396
Income tax valuation adjustment	—	(39,759)
Share based compensation	124	461
Provision for loan losses	300	375
Provision for deferred income taxes	3,388	1,579
Earnings on bank-owned life insurance	(883)	(909)
OREO valuation adjustment	137	291
Securities gains, net	(142)	(339)
Gain on sale of OREO	(130)	(161)
Gain on extinguishment of debt	(1,000)	(1,750)
Gain on sale of branches	(1,877)	—
Gain on sale of other assets	(102)	—
Proceeds from sales of loans held for sale	28,939	32,631
Origination of loans held for sale	(27,421)	(28,328)
Gain on sale of loans	(783)	(828)
Change in assets and liabilities		
(Increase) decrease in other assets	122	338
Increase (decrease) in other liabilities	(281)	(3,624)
Net cash (used in) provided by operating activities	10,655	6,466
Cash flows from investing activities		
Proceeds from paydowns of securities available for sale	42,102	31,928
Proceeds from calls and maturities of securities available for sale	13,690	5,965
Proceeds from sales of securities available for sale	41,661	91,409
Purchases of securities available for sale	(94,035)	(167,840)
Redemption of Federal Reserve Bank stock	310	179
Purchase of Federal Home Loan Bank stock	—	(2,028)
Purchase of Federal Reserve Bank stock	(1,054)	(1,165)
Net increase in loans	(53,865)	(95,774)
Purchase of premises and equipment	(549)	(574)
Proceeds from sales of OREO	3,452	1,933
Sale of branches, net of premium received	(31,444)	—
Net cash (used in) provided by investing activities	(79,732)	(135,967)

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CENTRUE FINANCIAL CORPORATION
PART II
CONSOLIDATED STATEMENT OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2016 AND 2015 (IN THOUSANDS)

	2016	2015
Cash flows from financing activities		
Net increase in deposits [1]	71,879	19,680
Net decrease in federal funds purchased and securities sold under agreements to repurchase	(7,562)	(7,961)
Net proceeds of advances from the Federal Home Loan Bank	9,000	56,000
Repayment of notes payable	—	(8,500)
Repurchase of subordinated debentures	(9,000)	—
Net proceeds from the issuance of common stock	—	68,248
Redemption of Series B Mandatory Redeemable Preferred Stock	(59)	—
Redemption of Series C Cumulative Perpetual Preferred Stock	—	(19,000)
Dividends paid on preferred stock	(329)	(478)
Net cash provided by (used in) financing activities	63,929	107,989
Net increase (decrease) in cash and cash equivalents	(5,148)	(21,512)
Cash and cash equivalents		
Beginning of period	27,655	49,167
End of period	$22,507	$27,655
Supplemental disclosures of cash flow information		
Cash payments for		
Interest	$2,650	$7,358
Income taxes	270	121
Transfers from loans to other real estate owned	43	292
Transfer from loan portfolio and sold in secondary market	—	3,848
Loan transfers to branch assets held for sale	1,607	11,524
Premises and equipment transferred to branch assets held for sale	—	5,149

[1] Deposits impacted by branch sales during 2016. See Note 19 for additional information.

CENTRUE FINANCIAL CORPORATION
PART II: NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(TABLE AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)

Note 1. Summary of Significant Accounting Policies

Centrue Financial Corporation is a bank holding company organized under the laws of the State of Delaware. When we use the terms “Centrue,” the “Company,” “we,” “us,” and “our,” we mean Centrue Financial Corporation, a Delaware Corporation, and its consolidated subsidiary. When we use the term the “Bank,” we are referring to our wholly owned banking subsidiary, Centrue Bank. The Company and the Bank provide a full range of banking services to individual and corporate customers located in markets extending from the far western and southern suburbs of the Chicago metropolitan area across Central Illinois down to the metropolitan St. Louis area. These services include demand, time, and savings deposits; business and consumer lending; and mortgage banking. The Company is subject to competition from other financial institutions and nonfinancial institutions providing financial services. Additionally, the Company and the Bank are subject to regulations of certain regulatory agencies and undergo periodic examinations by those regulatory agencies.

Principles of Consolidation

The consolidated financial statements include the accounts and results of operations of the Company and its subsidiary after elimination of all significant intercompany accounts and transactions.

Use of Estimates

The accounting and reporting policies of the Company and its subsidiaries conform to U.S. generally accepted accounting principles ("GAAP") and general practice within the banking industry. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Basis of Presentation

The accounting and reporting policies of the Company conform to generally accepted accounting principles in the United States of America. The Company’s December 31, 2016 and 2015 financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair presentation of its financial position and results of operations for the periods presented. All such adjustments are of a normal and recurring nature.

Reverse Stock Split

Common shares and per share amounts for all periods shown have been restated to reflect the impact of the 1:30 reverse stock split the Company completed effective May 29, 2015.

Cash flows

Cash and cash equivalents includes cash, deposits with other financial institutions with maturities under 90 days, and federal funds sold. Net cash flows are reported for customer loan and deposit transactions, repurchase agreements, FHLB advances and federal funds purchased.

Securities

Available-for-sale. Securities classified as available-for-sale are those securities that the Company intends to hold for an indefinite period of time, but not necessarily to maturity. Available-for-sale securities are carried at fair value with unrealized gains and losses, net of related deferred income taxes, recorded in stockholders’ equity as a separate component of other comprehensive income. Any decision to sell a security classified as available-for-sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of the Company’s assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors. Purchases and sales of securities are recognized on a trade date basis. Realized securities gains or losses are reported in securities gains (losses), net in the Consolidated Statement of Income. The cost of securities sold is based on the specific identification method. On a quarterly basis, the Company makes an assessment to determine whether there have been any events or circumstances to indicate that a security for which there is an unrealized loss is impaired on an other-than-temporary (“OTTI”) basis. In evaluating other-than-temporary impairment, the Company considers many factors including the severity and duration of the impairment; the financial condition and near-term prospects of the

issuer, which for debt securities considers external credit ratings and recent downgrades; whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. Securities for which there is an unrealized loss that is deemed to be OTTI are written down to fair value with the write-down recorded as a realized loss and included in net impairment on securities, but only to the extent the impairment is related to credit losses. The amount of the impairment related to other factors is recognized in other comprehensive income unless management intends to sell the security or believes it is more likely than not that it will be required to sell the security prior to full recovery.

CENTRUE FINANCIAL CORPORATION
PART II: NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(TABLE AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)

Interest income is reported net of amortization of premiums and accretion of discounts. Amortization of purchase premium or discount is included in interest income. Premiums and discounts on securities are amortized over the level-yield method without anticipating prepayments except for mortgage backed securities where prepayments are anticipated.

Restricted Securities. Federal Home Loan Bank stock and Federal Reserve Bank stock are carried at cost and are included in restricted stock. The Corporation is required to maintain these equity securities as a member of both the Federal Home Loan Bank and the Federal Reserve System, and in amounts as required by these institutions. These equity securities are “restricted” in that they can only be sold back to the respective institutions or another member institution at par. Therefore, they are less liquid than other tradable equity securities and no impairment has been recorded during 2016 and 2015. Both cash and stock dividends are reported as income.

Loans Held for Sale

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings. Mortgage loans held for sale are sold with either servicing rights retained or servicing rights released. When retaining the servicing rights, the carrying value of mortgage loans sold is reduced by the cost allocated to the servicing right. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold. When selling service released, the gain or loss is determined by comparing the selling price to the value of the mortgage sold.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding; net of purchase premiums and discounts, deferred loan fees and costs, and an allowance for loan losses. Interest income on loans is accrued based on principal amounts outstanding. Loan and lease origination fees, fees for commitments that are expected to be exercised and certain direct loan origination costs are deferred and the net amount amortized over the estimated life of the related loans or commitments as a yield adjustment. Other credit-related fees are recognized as fee income when earned.

Nonaccrual Loans. Generally, commercial loans and loans secured by real estate are designated as nonaccrual: (a) when either principal or interest payments are 90 or more past due based on contractual terms unless the loan is sufficiently collateralized such that full repayment of both principal and interest is expected and is in the process of collection; or (b) when an individual analysis of a borrower’s creditworthiness indicates a credit should be placed on nonaccrual status. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Future interest income may only be recorded on a cash basis after recovery of principal is reasonably assured. Nonaccrual loans are returned to accrual status when the financial position of the borrower and other relevant factors indicate there is no longer doubt as to such collectability.

Charged-Off Loans. Commercial loans and loans secured by real estate are generally charged-off when deemed uncollectible. A loss is recorded at that time if the net realizable value of the real estate can be quantified and it is less than the associated principal and interest. Consumer loans that are not secured by real estate are subject to mandatory charge-off at a specified delinquency date and are usually not classified as non-accrual prior to being charged-off. Consumer loans, which include installment, automobile, and single payment loans are generally charged-off in full no later than the end of the month in which the loan becomes 120 days past due.

90-Day Past Due Loans. 90 days or more past due loans are loans for which principal or interest payments become 90 days or more past due but that still accrue interest since they are loans that are well secured and in the process of collection.

Allowance for Loan Losses. The allowance for loan losses is a valuation allowance for probable incurred credit losses. Credit exposures deemed to be uncollectible are charged-off against the allowance, while recoveries of amounts previously charged-off are credited to the allowance. Management estimates the allowance balance required using past

loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off.

Additions to the allowance for loan losses are charged to operating expense through the provision for loan losses. The amount charged to operating expense in any given year is dependent upon a number of factors including historic loan growth and changes in the composition of the loan portfolio, net charge-off levels, and the Company's assessment of the allowance for loan losses.

The allowance for loan losses consists of specific and general components. The specific component is established for expected losses on individual loans classified as impaired. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all contractual principal and interest due according to the terms of the loan

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agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or the value of the underlying collateral. The Company evaluates the collectability of both principal and interest when assessing the need for loss accrual.

Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on case-by-case basis, taking into consideration all the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

The specific reserves component of the allowance for loan losses is based on a regular analysis of impaired loans exceeding a fixed dollar amount where the internal credit rating is at or below a predetermined classification. If the estimated fair value of the loan is less than the recorded book value, a valuation allowance is established as a component of the allowance for loan losses.

In cases where a borrower experiences financial difficulties and the Company makes certain concessionary modifications to contractual terms, the loan is classified as a troubled debt restructured loan. Loans restructured at a rate equal to or greater than that of a new loan with comparable risk at the time the contract is modified may be excluded from restructured loans in the calendar years subsequent to the restructuring if they are in compliance with modified terms. Generally, a nonaccrual loan that is a troubled debt restructuring remains on nonaccrual until such time that repayment of the remaining principal and interest is not in doubt, and the borrower has a period of satisfactory repayment performance. Troubled debt restructurings (TDRs) are individually evaluated for impairment and included in the separately identified impairment disclosures. TDRs are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a TDR is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral.

For TDRs that subsequently default, the Company determines the amount of the allowance on that loan in accordance with the accounting policy for the allowance for loan losses on loans individually identified as impaired. The Company incorporates recent historical experience related to TDRs including the performance of TDRs that subsequently default into the calculation of the allowance by loan portfolio segment.

The general component covers loans that are collectively evaluated for impairment. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not included in the separately identified impairment disclosures. The general allowance component also includes loans that are not individually identified for impairment evaluation, as well as those loans that are individually evaluated but are not considered impaired. The general component is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans (including TDRs); levels of and trends in charge-offs and recoveries; migration of loans to the classification of special mention, substandard, or doubtful; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentration.

The establishment of the allowance for loan losses involves a high degree of judgment and includes a level of imprecision given the difficulty of identifying all of the factors impacting loan repayment and the timing of when losses actually occur.

Management considers the following when assessing the risk in the loan portfolio:

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Commercial loans are dependent on the strength of the industries of the related borrowers and the success of their businesses. Commercial loans are advances for equipment purchases or to provide working capital or meet other financing needs of business enterprises. These loans may be secured by accounts receivable, inventory, equipment or other business assets. At the time of origination, financial information is obtained from the borrower to evaluate ability to repay the loans and periodically obtained during the life of the loan.

- Agriculture and Agriculture Real Estate are subject to adverse market conditions including changes in local or foreign demand, weather related reduction in output, impact on storage, distribution or use. Increasing commodity prices leading to higher production costs, distribution or exporting.
- Commercial real estate loans and Construction loans are dependent on the industries tied to these loans as well as the local commercial real estate market. The loans are secured by the real estate, and appraisals are obtained to support the loan amount. An evaluation of the project's cash flows is performed to evaluate the borrower's ability to repay the loan at the time of origination and periodically updated during the life of the loan.

CENTRUE FINANCIAL CORPORATION
PART II: NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(TABLE AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)

- 1-4 family residential real estate and home equity loans are affected by the local residential real estate market, the local economy, and, for variable rate mortgages, movement in indices tied to these loans. At the time of origination the Bank evaluates the borrower's repayment ability through a review of credit scores and debt to income ratios. Appraisals are obtained to support the loan amount.
- Consumer loans are subject to adverse employment conditions in the local economy which may lead to higher default rates. Decreases in the value of underlying collateral effect the amount collected if a borrower defaults.

Loan Commitments and Related Financial Instruments

Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Concentration of Credit Risk

The Bank generates loans throughout its foot print, with lending activities primarily focused on Cook, LaSalle, Kane, Kankakee, Kendall and Will Counties in Illinois and St. Louis County in Missouri. The Bank engages in all traditional aspects of community lending with focuses on: (i) owner occupied commercial real estate, (ii) investor commercial real estate, (iii) residential lending, (iv) commercial lending, (v) multifamily real estate, and (vi) agricultural lending.

Mortgage Servicing Rights

Servicing rights are recognized separately when they are acquired through sales of loans. When mortgage loans are sold, servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on market prices for comparable mortgage servicing contracts, when available or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing rights are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual grouping, to the extent that fair value is less than the carrying amount. If the Company later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase to income. Changes in valuation allowances are reported with noninterest expense in the other expense line on the income statement. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Servicing fee income which is reported on the income statement as mortgage banking income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal; or a fixed amount per loan and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income. Servicing fees totaled $459 thousand and $492 thousand for years ended December 31, 2016 and 2015, respectively.

Premises and Equipment

Premises, furniture and equipment, and leasehold improvements are stated at cost less accumulated depreciation and land is carried at cost. Depreciation expense is determined by the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized on a straight-line basis over the shorter of the life of the asset or the lease term. Rates of depreciation are generally based on the following useful lives: buildings, 25 to 40 years; building improvements, typically 3 to 15 years but longer under limited circumstances; and furniture and equipment, 3 to 10 years. Gains and losses on dispositions are included in gains on sale of other assets in noninterest income on the Consolidated Statement of Income. Maintenance and repairs are charged to operating expenses as incurred, while

improvements that extend the useful life of assets are capitalized and depreciated over the estimated remaining life. Long-lived depreciable assets are evaluated periodically for impairment when events or changes in circumstances indicate the carrying amount may not be recoverable. Impairment exists when the expected undiscounted future cash flows of a long-lived asset are less than its carrying value. In that event, the Company recognizes a loss for the difference between the carrying amount and the estimated fair value of the asset based on a quoted market price, if applicable, or a discounted cash flow analysis. Impairment losses are recorded in other noninterest expense on the Consolidated Statement of Income.

Other Real Estate Owned

Other real estate owned includes properties acquired in partial or total satisfaction of certain loans. Properties are initially recorded at fair value, which represents the estimated sales price of the properties on the date acquired less estimated selling costs, establishing a new cost basis. Any write-downs in the carrying value of a property at the time of acquisition are charged against the allowance

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for loan losses. Management periodically reviews the carrying value of other real estate owned. Any write-downs of the properties subsequent to acquisition, as well as gains or losses on disposition and income or expense from the operations of other real estate owned, are recognized in operating results in the period they are realized.

Earnings Per Share

Basic earnings per common share is net income for common stockholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable under stock options using the treasury stock method. Earnings and dividends per share are restated for all stock splits through the date of issuance of the financial statements.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Company, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Bank-Owned Life Insurance (“BOLI”)

BOLI represents life insurance policies on the lives of certain current and former Company officers and directors for which the Company is the sole beneficiary. These policies are recorded as an asset on the Consolidated Balance Sheets at their cash surrender value adjusted for other charges or other amounts due that are probable at settlement. The change in cash surrender value and insurance proceeds received are recorded as bank-owned life insurance income on the Consolidated Statement of Income in noninterest income. Management performs a monthly analysis to determine the current cash surrender value and adjusts the value accordingly.

Intangible Assets

Intangible assets represent purchased assets that also lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset, or liability. Identified intangible assets that have a finite useful life are amortized over that life in a manner that reflects the estimated decline in the economic value of the identified intangible asset. Identified intangible assets that have a finite useful life are periodically reviewed to determine whether there have been any events or circumstances to indicate that the recorded amount is not recoverable from projected undiscounted net operating cash flows. If the projected undiscounted net operating cash flows are less than the carrying amount, a loss is recognized to reduce the carrying amount to fair value, and, when appropriate, the amortization period is also reduced. Unamortized intangible assets associated with disposed assets are included in the determination of gain or loss on the sale of the disposed assets.

Intangible assets consist of core deposit and acquired customer relationship intangible assets arising from whole bank and branch company acquisitions. They are initially measured at fair value and then are amortized over ten years using an accelerated method. Management reviews intangible assets at least annually for impairment and any such impairment will be recognized in the period identified. During 2016, the Company's core deposit intangible became fully amortized.

Repurchase agreements

Substantially all repurchase agreement liabilities represent amounts advanced by various customers. Securities are pledged to cover these liabilities, which are not covered by federal deposit insurance.

Mortgage Banking Derivatives

Commitments to fund mortgage loans (interest rate locks) to be sold into the secondary market and forward commitments for the future delivery of these mortgage loans are accounted for as free standing derivatives.

Fair values of these mortgage derivatives are estimated based on changes in mortgage interest rates from the date the interest on the loan is locked. The Company enters into forward commitments for the future delivery of mortgage loans when interest rate locks are entered into, in order to hedge the change in interest rates resulting from its

commitments to fund the loans. Changes in the fair values of these derivatives are included in net gains on sales of loans.

Income Taxes

The Company files income tax returns in the U.S. federal jurisdiction and in Illinois and Missouri. The provision for income taxes is based on income in the financial statements, rather than amounts reported on the Company's income tax return. Changes in enacted tax rates and laws are reflected in the financial statements in the periods they occur. The Company recognizes interest related to income tax matters as interest expense and penalties related to income tax matters as other expense.

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Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in years in which those temporary differences are expected to be recovered or settled. A valuation allowance is established for any deferred tax asset for which recovery or settlement is unlikely. The effect on deferred tax assets and liabilities of a change in tax rates is recognized as income or expense in the period that includes the enactment date.

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

Stock-Based Compensation

Compensation cost is recognized for stock options and restricted stock awards issued to employees, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of the stock options, while the market price of the Company’s common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Fair Value of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates. See Note 4 for additional information.

Stockholders’ Equity

Capital Event

On March 31, 2015, the Company completed the issuance of $76.0 million of new common stock in a private placement offering, $68.2 million of net proceeds after issuance and registration costs of $7.8 million. A total of 6.3 million shares were sold in the offering at a price of $12.00 per share. In conjunction with the stock offering the Company used the proceeds in part to pay $4.9 million in accrued but unpaid interest on its subordinated debentures, redeemed all $32.7 million of Series C Preferred Stock for $19.0 million, settled $10.3 million in notes payable with another financial institution for $8.5 million and made a $36.0 million capital contribution into Centrue Bank. The remaining proceeds will be used for general corporate purposes.

Preferred Stock

The Company’s Certificate of Incorporation authorizes its board of directors to fix or alter the rights, preferences, privileges, and restrictions of 200,000 shares of preferred stock.

The Company has the following classes of preferred stock issued or authorized:

Series B Mandatory Redeemable Preferred Stock: The Company has authorized 1,092 shares of Series B Mandatory Redeemable Preferred Stock. There were 209 shares of Series B Mandatory Redeemable Preferred Stock issued and outstanding at December 31, 2016 and 268 shares issued and outstanding at December 31, 2015 which are shown in other liabilities. Preferential cumulative cash dividends are payable quarterly at an annual rate of $60.00 per share. Dividends accrue on each share of Series B Preferred Stock from the date of issuance and from day to day, thereafter, whether or not earned or declared.

Each original holder of Series B Preferred Stock (or upon such holder’s death, their executor or personal representatives) will have the option, exercisable at their sole discretion, to sell, and the Company be obligated to redeem such holder’s shares of Series B Preferred Stock. The per share price payable by the Company for such shares of Series B Preferred Stock will be equal to $1,000 per share, plus any accrued but unpaid dividends. Upon dissolution, wind up, or liquidation of the Company, voluntary or otherwise, holders of Series B Preferred Stock will

be entitled to receive, out of the assets of the Company available for distribution to stockholders, the amount of $1,000 per share, plus any accrued but unpaid dividends, before any payment or distribution may be made on shares of common stock or any other securities issued by the Company that rank junior to the Series B Preferred Stock. There were no dividends in arrears at December 31, 2016 or December 31, 2015.

Series C Fixed Rate Cumulative Perpetual Preferred Stock: The Company has no Series C Fixed Rate Cumulative Perpetual Preferred Stock authorized, issued and outstanding or dividend in arrears at December 31, 2016 or December 31, 2015. On March 31, 2015 the Company redeemed all 32,668 shares outstanding of Series C Fixed Rate Cumulative Perpetual Preferred Stock and dividends in arrears for $19.0 million as part of its capital event.

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Series D Fixed Rate Non-Voting Non-Cumulative Preferred Stock (“Series D”): The Company authorized and issued 2,636 shares of Series D preferred stock with a liquidation preference of $1,000 per share during 2014. The stock pays non-cumulative dividends of 12.5% per annum.

Dividend Restrictions

Banking regulations require the maintenance of certain regulatory capital levels and may limit the amount of dividends that may be paid by the subsidiary bank to the holding company or by the holding company to stockholders.

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the financial statements.

Comprehensive Income

Comprehensive income is the total of reported net income and all other revenues, expenses, gains, and losses that bypass reported net income under GAAP. As of December 31, 2016, the Company included unrealized gains or losses on securities available-for-sale in other comprehensive income.

Treasury Stock

Treasury stock acquired is recorded at cost and is carried as a reduction of stockholders’ equity in the Consolidated Balance Sheets. Treasury stock issued is valued based on the “last in, first out” inventory method. The difference between the consideration received upon issuance and the carrying value is charged or credited to surplus.

Reclassifications

Certain prior year account balances, with no effect on net income or stockholders’ equity, have been reclassified to be consistent with the classifications adopted as of and for the period ended December 31, 2016.

Recent Accounting Pronouncements

In August 2016, the FASB issued amended guidance (ASU 2016-15) to clarify the classification of certain items with an entity’s statements of cash flows. These items include debt prepayment or extinguishment costs, settlement of zero-coupon debt instruments, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of BOLI policies, distributions received from equity method investees, and beneficial interests in securitization transactions. The amended guidance also specifies how to address classification of cash receipts and payments that have aspects of more than one class of cash flows. The amended guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017, with early adoption permitted, and is to be applied on a retrospective basis unless it is impractical to do so. Management is currently in the process of evaluating the impact of the amended guidance on its Consolidated Financial Statements.

In June 2016 the FASB issued accounting standards update 2016-13 Financial Instruments - Credit Losses, commonly referred to as CECL. The provisions of the update eliminate the probable initial recognition threshold under current GAAP which requires reserves to be based on an incurred loss methodology. Under CECL reserves required for financial assets measured at amortized cost will reflect an organization’s estimate of all expected credit losses over the contractual term of the financial asset and thereby require the use of reasonable and supportable forecasts to estimate future credit losses. Because CECL encompasses all financial assets carried at amortized cost, the requirement that reserves be established based on an organization’s reasonable and supportable estimate of expected credit losses extends to held to maturity (HTM) debt securities. Under the provisions of the update credit losses recognized on available for sale (AFS) debt securities will be presented as an allowance as opposed to a write-down. In addition, CECL will modify the accounting for purchased loans, with credit deterioration since origination, so that reserves are established at the date of acquisition for purchased loans. Under current GAAP a purchased loan’s contractual balance is adjusted to fair value through a credit discount and no reserve is recorded on the purchased loan upon acquisition. Since under CECL reserves will be established for purchased loans at the time of acquisition the accounting for purchased loans is made more comparable to the accounting for originated loans. Finally, increased disclosure

requirements under CECL oblige organizations to present the currently required credit quality disclosures disaggregated by the year of origination or vintage. FASB expects that the evaluation of underwriting standards and credit quality trends by financial statement users will be enhanced with the additional vintage disclosures. For public business entities that are SEC filers the amendments of the update are effective beginning January 1, 2020. Management is in the process of evaluating the impact of CECL on the Company's financial position, results of operations and cash flows as well as its required disclosures.

In March 2016, the FASB issued an update (ASU No. 2016-09, Stock Compensation: Improvements to Employee Share-Based Payment Accounting.) The guidance in this update affects any entity that issues share-based payment awards to its employees

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and is intended to simplify several aspects of the accounting for share-based payment awards including income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The amendments in this update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. Early adoption is permitted. The adoption of this standard is not expected to have a material effect on the Company's results of operations or financial position.

In February 2016, the FASB issued an update (ASU No. 2016-02, Leases) creating FASB Topic 842, Leases. The guidance is intended to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and requiring more disclosures related to leasing transactions. The amendments in this update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2018. Early adoption is permitted. Management is currently evaluating the impact on the consolidated financial statements and related disclosures.

Note 2. Securities

The following table summarizes the fair value of available-for-sale securities, the related gross unrealized gains and losses recognized in accumulated other comprehensive income, and the amortized cost as follows:

	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agencies	$12,680	$ —	$ (609)	$12,071
States and political subdivisions	9,127	2	(64)	9,065
U.S. government agency residential mortgage-backed securities	128,550	90	(1,327)	127,313
Collateralized residential mortgage obligations:				
Agency	14,566	—	(110)	14,456
Equity securities	2,689	354	(21)	3,022
	$167,612	$ 446	$ (2,131)	$165,927

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agencies	$14,629	$ 13	$ (35)	$14,607
States and political subdivisions	10,190	16	(25)	10,181
U.S. government agency residential mortgage-backed securities	127,039	7	(1,017)	126,029
Collateralized residential mortgage obligations:				
Agency	17,990	—	(157)	17,833
Equity securities	2,632	158	—	2,790
	$172,480	$ 194	$ (1,234)	$171,440

The amounts below include the activity for available-for-sale securities related to sales, maturities and calls:

	2016	2015
Proceeds from calls and maturities	$13,690	$5,965
Proceeds from sales	41,661	91,409
Realized gains	162	519
Realized losses	(20)	(180)

Net impairment loss recognized in earnings	—	—

The amortized cost and fair value of the investment securities portfolio are shown below by contractual maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

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	December 31, 2016	
	Amortized Cost	Fair Value
Due in one year or less	$382	$382
Due after one year through five years	6,840	6,816
Due after five years through ten years	14,585	13,938
Due after ten years	—	—
U.S. government agency residential mortgage-backed securities	128,550	127,313
Collateralized residential mortgage obligations	14,566	14,456
Equity	2,689	3,022
	$167,612	$165,927

Securities with carrying values of approximately $116.9 million at December 31, 2016 and $114.9 million at December 31, 2015 were pledged to secure public deposits and securities sold under agreements to repurchase and for other purposes as required or permitted by law. At December 31, 2016 and 2015 there were no holdings of securities of any one issuer, other than the U.S. Government agencies, in an amount greater than 10% of stockholders' equity. The Company does not have any securities classified as trading or held-to-maturity.

Securities with unrealized losses not recognized in income are as follows presented by length of time individual securities have been in a continuous unrealized loss position:

	December 31, 2016					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government agencies	$12,071	$ (609)	$—	$ —	$12,071	$ (609)
States and political subdivisions	$5,691	$ (64)	$—	$ —	$5,691	$ (64)
U.S. government agency residential mortgage-backed securities	92,400	(1,178)	9,379	(149)	101,779	(1,327)
Collateralized residential mortgage obligations: Agency	12,559	(110)	—	—	12,559	(110)
Equity securities	2,568	(21)	—	—	2,568	(21)
Total temporarily impaired	$125,289	$ (1,982)	$9,379	$ (149)	$134,668	$ (2,131)

	December 31, 2015					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government agencies	$10,394	$ (35)	$ —	$ —	$10,394	$ (35)
States and political subdivisions	6,057	(25)	—	—	6,057	(25)
U.S. government agency residential mortgage-backed securities	124,411	(1,017)	—	—	124,411	(1,017)
Collateralized residential mortgage obligations: Agency	17,833	(157)	—	—	17,833	(157)
Total temporarily impaired	$158,695	$ (1,234)	$ —	$ —	$158,695	$ (1,234)

Unrealized losses on agency bonds have not been recognized into income because the issuer(s) bonds are of high credit quality (rated AA or higher at the time of purchase), management does not intend to sell and it is not more

likely than not that management would be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates. The fair value is expected to recover as the bonds(s) approach maturity.

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As of December 31, 2016, the Company's security portfolio consisted of 66 securities, 49 of which were in an unrealized loss position. The majority of unrealized losses are related to the Company's mortgage-backed, as discussed below:

At December 31, 2016, 100.00% of the mortgage-backed securities held by the Company were issued by U.S. government-sponsored enterprises and agencies, primarily Fannie Mae and Freddie Mac, institutions which the government has affirmed its commitment to support. Because the decline in fair value is attributable to changes in interest rates and illiquidity, and not credit quality, and because the Company does not intend to sell these mortgage-backed securities and it is likely that it will not be required to sell the securities before their anticipated recovery, the Company does not consider these securities to be other-than-temporarily impaired at December 31, 2016.

At December 31, 2015, the Company's security portfolio consisted of 59 securities, 46 of which were in an unrealized loss position. The 100.00% of unrealized losses are related to the Company's mortgage-backed securities and were issued by U.S. government-sponsored enterprises and agencies, primarily Fannie Mae and Freddie Mac, institutions which the government has affirmed its commitment to support. Because the decline in fair value is attributable to changes in interest rates and illiquidity, and not credit quality, and because the Company does not intend to sell these mortgage-backed securities and it is likely that it will not be required to sell the securities before their anticipated recovery, the Company does not consider these securities to be other-than-temporarily impaired at December 31, 2015.

Note 3. Loans

The major classifications of loans follow:

	Aggregate Principal Amount	
	December 31, 2016	December 31, 2015
Commercial	$80,287	67,360
Agricultural & AGRE	49,121	50,121
Construction, land & development	28,771	26,016
Commercial RE	439,326	391,918
1-4 family mortgages	85,152	95,227
Consumer	3,118	2,905
Total Loans	$685,775	633,547
Allowance for loan losses	(8,904)	(8,591)
Loans, net	$676,871	624,956

The Company sold three branches during 2016. Loans totaling $11.5 million had been identified to be included in this sale and had been excluded from the December 31, 2015 amounts in the table above. See Note 19 for further information.

The credit quality indicator utilized by the Company to internally analyze the loan portfolio is the internal risk rating. Internal risk ratings of 0 to 5 are considered pass credits, a risk rating of a 6 is special mention, a risk rating of a 7 is substandard, and a risk rating of an 8 is doubtful. Loans classified as pass credits have no well defined weaknesses and are performing as agreed. Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are

characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

The following table presents the commercial loan portfolio by internal risk rating:

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December 31, 2016

	Commercial				Commercial Real Estate		
Internal Risk Rating	Closed-end	Lines of Credit	Agriculture & AG RE	Construction, Land & Development	Owner-Occupied	Non-Owner Occupied	Total
Pass	$24,984	$53,256	$ 49,121	$ 28,652	$194,458	$ 236,423	$586,894
Special Mention	687	764	—	—	1,390	3,824	6,665
Substandard	175	421	—	119	151	3,080	3,946
Doubtful	—	—	—	—	—	—	—
Total	$25,846	$54,441	$ 49,121	$ 28,771	$195,999	$ 243,327	$597,505

December 31, 2015

	Commercial				Commercial Real Estate		
Internal Risk Rating	Closed-end	Lines of Credit	Agriculture & AG RE	Construction, Land & Development	Owner-Occupied	Non-Owner Occupied	Total
Pass	$24,303	$42,374	$ 50,121	$ 25,825	$164,538	$ 203,679	$510,840
Special Mention	304	250	—	64	7,701	11,512	19,831
Substandard	129	—	—	127	412	4,076	4,744
Doubtful	—	—	—	—	—	—	—
Total	$24,736	$42,624	$ 50,121	$ 26,016	$172,651	$ 219,267	$535,415

The following table presents the retail residential loan portfolio by internal risk rating:

	Residential -- 1-4 family		
	Senior Lien	Jr. Lien & Lines of Credit	Total
December 31, 2016			
Unrated	$42,772	$37,561	$80,333
Special mention	89	13	102
Substandard	3,969	748	4,717
Doubtful	—	—	—
Total	$46,830	$38,322	$85,152

	Residential -- 1-4 family		
	Senior Lien	Jr. Lien & Lines of Credit	Total
December 31, 2015			
Unrated	$48,319	$41,380	$89,699
Special mention	4,011	168	4,179
Substandard	1,036	313	1,349

Doubtful	—	—	—
Total	$53,366	$41,861	$95,227

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The retail residential loan portfolio is generally unrated. Delinquency is a typical factor in adversely risk rating a credit to a special mention or substandard.
An analysis of activity in the allowance for loan losses follows:

	Commercial	Agriculture & AG RE	Construction, Land & Development	Commercial RE	1-4 Family Residential	Consumer	Total
December 31, 2016							
Beginning Balance	$ 648	$ 97	$ 523	$ 5,681	$ 1,628	$ 14	$8,591
Charge-offs	(38)	—	—	(754)	(237)	(4)	(1,033)
Recoveries	252	86	32	540	133	3	1,046
Provision	369	(63)	90	(299)	212	(9)	300
Ending Balance	$ 1,231	$ 120	$ 645	$ 5,168	$ 1,736	$ 4	$8,904

	Commercial	Agriculture & AG RE	Construction, Land & Development	Commercial RE	1-4 Family Residential	Consumer	Total
December 31, 2015							
Beginning Balance	$ 1,117	$ 69	$ 711	$ 3,999	$ 2,075	$ 10	$7,981
Charge-offs	(384)	—	(4)	(702)	(667)	(6)	(1,763)
Recoveries	197	3	52	1,663	52	31	1,998
Provision	(282)	25	(236)	721	168	(21)	375
Ending Balance	$ 648	$ 97	$ 523	$ 5,681	$ 1,628	$ 14	$8,591

The following is an analysis on the balance in the allowance for loan losses and the recorded investment in impaired loans by portfolio segment based on impairment method as of December 31, 2016 and December 31, 2015:

December 31, 2016	Commercial	Agriculture & AG RE	Construction, Land & Development	Commercial RE	1-4 Family Residential	Consumer	Total
Allowance for loan losses:							
Loans individually evaluated for impairment	$ 493	$ —	$ 60	$ 92	$ 488	$ —	$1,133
Loans collectively evaluated for impairment	738	120	585	5,076	1,248	4	7,771
Total ending allowance balance:	$ 1,231	$ 120	$ 645	$ 5,168	$ 1,736	$ 4	$8,904
Loan balances:							
Loans individually evaluated for impairment	$ 598	$ —	$ 129	$ 451	$ 1,709	$ —	$2,887
Loans collectively evaluated for impairment	79,689	49,121	28,642	438,875	83,443	3,118	682,888
Loans with an allowance recorded:	$ 80,287	$ 49,121	$ 28,771	$ 439,326	$ 85,152	$ 3,118	$685,775

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December 31, 2015	Commercial	Agriculture & AG RE	Construction, Land & Development	Commercial RE	1-4 Family Residential	Consumer	Total
Allowance for loan losses:							
Loans individually evaluated for impairment	$ 80	$ —	$ 10	$ 1,178	$ 325	$ 1	$ 1,594
Loans collectively evaluated for impairment	568	97	513	4,503	1,303	13	6,997
Total ending allowance balance:	$ 648	$ 97	$ 523	$ 5,681	$ 1,628	$ 14	$ 8,591
Loan balances:							
Loans individually evaluated for impairment	$ 129	$ —	$ 127	$ 4,488	$ 1,348	$ 1	$ 6,093
Loans collectively evaluated for impairment	67,231	50,121	25,889	387,430	93,879	2,904	627,454
Loans with an allowance recorded:	$ 67,360	$ 50,121	$ 26,016	$ 391,918	$ 95,227	$ 2,905	$ 633,547

Troubled Debt Restructurings:

The Company had troubled debt restructurings (“TDRs”) of $0.15 million and $0.24 million as of December 31, 2016 and December 31, 2015, respectively. Specific reserves were immaterial at December 31, 2016 and December 31, 2015. At December 31, 2016, nonaccrual TDR loans were $0.13 million, as compared to $0.24 million at December 31, 2015. At December 31, 2016 there were $0.02 million of loans on accrual status, while there were none on accrual status at December 31, 2015. The Company had no commitments to lend additional amounts to a customer with an outstanding loan that is classified as TDR as of December 31, 2016 and December 31, 2015.

In the course of a year the terms of certain loans may be modified as troubled debt restructurings. The modification of the terms of such loans may include one or a combination of the following: a reduction of the stated interest rate of the loan to a below market rate or the payment modification to interest only. A modification involving a reduction of the stated interest rate of the loan would be for periods ranging from 6 months to 16 months. During the year ended December 31, 2016, there was one TDR loan added in the amount of $0.02 million compared to the year ended December 31, 2015 in which three loans were added as TDRs in the amount of $0.2 million.

The following tables present loans by class modified as troubled debt restructurings that occurred during the years ending December 31, 2016 and 2015:

	For the Twelve Months Ended December 31, 2016		
	Number of Loans	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
1-4 family residential			
Senior lien	1	$ 20	$ 20
Total	1	$ 20	$ 20

The troubled debt restructurings described above did not have a material impact to the allowance for loan losses and did not result in any additional charge-off’s during the year ended December 31, 2016.

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	For the Twelve Months Ended December 31, 2015		
	Number of Loans	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
1-4 family residential			
Senior lien	3	$ 241	$ 241
Total	3	$ 241	$ 241

The troubled debt restructurings described above did not have a material impact to the allowance for loan losses and did not result in any additional charge-off's during the year ended December 31, 2015.

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms. In the years ended December 31, 2016 and December 31, 2015 there were no loans modified as troubled debt restructurings for which there was a payment default within twelve months following the modification.

The Company evaluates loan modifications to determine if the modification constitutes a troubled debt restructure. A loan modification constitutes a troubled debt restructure if the borrower is experiencing financial difficulty and the Company grants a concession it would not otherwise consider. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its loans with the Company's debt in the foreseeable future without the modification. This evaluation is performed under the Company's internal underwriting guidelines. TDRs are separately identified for impairment disclosures. If a loan is considered to be collateral dependent loan, the TDR is reported, net, at the fair value of the collateral.

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The following tables present data on impaired loans:

December 31, 2016	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
Loans with no related allowance recorded:						
Commercial						
Closed-end	$ —	$ —	$ —	$ —	$ —	$ —
Line of credit	—	—	—	—	—	—
Agricultural & AG RE	—	—	—	85	—	—
Construction, land & development	57	235	—	19	—	—
CRE - all other						
Owner occupied	134	134	—	9	7	9
Non-owner occupied	—	—	—	—	—	—
1-4 family residential						
Senior lien	331	349	—	180	—	—
Jr. lien & lines of credit	433	433	—	116	7	7
Consumer	—	—	—	—	—	—
Subtotal	955	1,151	—	409	14	16
Loans with an allowance recorded:						
Commercial						
Closed-end	$ 175	$ 175	$ 110	$ 135	$ 4	$ 4
Line of credit	423	422	383	293	26	25
Agricultural & AG RE	—	—	—	80	—	—
Construction, land & development	72	72	60	84	4	1
CRE - all other						
Owner occupied	17	17	17	313	—	—
Non-owner occupied	300	300	75	1,110	—	—
1-4 family residential						
Senior lien	629	629	298	862	19	19
Jr. lien & lines of credit	316	316	190	349	14	14
Consumer	—	—	—	1	—	—
Subtotal	1,932	1,931	1,133	3,227	67	63
Total	$ 2,887	$ 3,082	$ 1,133	$ 3,636	$ 81	$ 79

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December 31, 2015	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
Loans with no related allowance recorded:						
Commercial						
Closed-end	$ 2	$ 2	$ —	$ 15	$ 1	$ 1
Line of credit	—	—	—	—	—	—
Agricultural & AG RE	—	—	—	—	—	—
Construction, land & development	—	—	—	299	—	—
CRE - all other						
Owner occupied	6	6	—	78	—	—
Non-owner occupied	—	—	—	—	—	—
1-4 family residential						
Senior lien	176	176	—	277	—	—
Jr. lien & lines of credit	71	71	—	88	3	3
Consumer	—	—	—	—	—	—
Subtotal	255	255	—	757	4	4
Loans with an allowance recorded:						
Commercial						
Closed-end	$ 127	$ 127	$ 80	$ 199	$ 2	$ 2
Line of credit	—	—	—	—	—	—
Agricultural & AG RE	—	—	—	—	—	—
Construction, land & development	127	419	10	120	—	—
CRE - all other						
Owner occupied	406	541	100	586	11	9
Non-owner occupied	4,076	4,955	1,078	4,101	17	17
1-4 family residential						
Senior lien	859	984	215	1,003	14	10
Jr. lien & lines of credit	242	242	110	230	5	5
Consumer	1	—	1	—	—	—
Subtotal	5,838	7,268	1,594	6,239	49	43
Total	$ 6,093	$ 7,523	$ 1,594	$ 6,996	$ 53	$ 47

The Company determined that there were $1.3 million of loans that were classified as impaired but were considered to be performing (i.e., loans which are accruing interest) loans at December 31, 2016 compared to $0.1 million at December 31, 2015.

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The following table represents activity related to loan portfolio aging:

December 31, 2016	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days Past Due or Nonaccrual	Total Past Due	Current	Total Loans
Commercial						
Closed-end	$20	$—	$ 122	$142	$25,704	$25,846
Line of credit	—	—	—	—	54,441	54,441
Agricultural & AG RE	—	—	—	—	49,121	49,121
Construction, land & development	133	—	57	190	28,581	28,771
CRE - all other						
Owner occupied	—	—	151	151	195,848	195,999
Non-owner occupied	588	—	—	588	242,739	243,327
1-4 family residential						
Senior lien	664	152	577	1,393	45,437	46,830
Jr. lien & lines of credit	432	19	705	1,156	37,166	38,322
Consumer	—	—	—	—	3,118	3,118
Total	$1,837	$171	$ 1,612	$3,620	$682,155	$685,775

December 31, 2015	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days Past Due or Nonaccrual	Total Past Due	Current	Total Loans
Commercial						
Closed-end	$58	$—	$ 130	$188	$24,548	$24,736
Line of credit	—	—	—	—	42,624	42,624
Agricultural & AG RE	—	—	—	—	50,121	50,121
Construction, land & development	—	—	127	127	25,889	26,016
CRE - all other						
Owner occupied	985	—	412	1,397	171,254	172,651
Non-owner occupied	—	—	4,076	4,076	215,191	219,267
1-4 family residential						
Senior lien	1,481	21	994	2,496	50,870	53,366
Jr. lien & lines of credit	230	258	268	756	41,105	41,861
Consumer	1	1	—	2	2,903	2,905
Total	$2,755	$280	$ 6,007	$9,042	$624,505	$633,547

Nonperforming loans include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. There were no loans past due over 90 days and still accruing interest at the years ending December 31, 2016 and December 31, 2015.

Loans made to executive officers, directors, and their affiliates during 2016 were as follows:

Beginning balance	$46

New loans, extensions, and modification	343
Repayments	(17)
Effect of changes in composition of related parties	—
Ending balance	$372

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Note 4. Fair Value

The Company measures, monitors, and discloses certain of its assets and liabilities on a fair value basis. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The Company maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. Fair value guidance establishes a fair value hierarchy that prioritizes the inputs used to measure fair value into three broad levels based on the reliability of the input assumptions. The hierarchy gives the highest priority to level 1 measurements and the lowest priority to level 3 measurements and the categorization of where an asset or liability falls within the hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The three levels of the fair value hierarchy are defined as follows:

Level 1 - Unadjusted quoted prices for identical assets or liabilities traded in active markets.

Level 2 - Observable inputs other than level 1 prices, such as quoted prices for similar instruments; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The Company used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

Securities

Available for Sale Securities. The fair value of securities available for sale is determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). If the securities could not be priced using quoted market prices, observable market activity or comparable trades, the financial market was considered not active and the assets were classified as Level 3.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table summarizes, by measurement hierarchy, the various assets and liabilities of the Company that are measured at fair value on a recurring basis:

	Carrying Amount	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2016				
U.S. government agencies	$12,071	$ —	$ 12,071	$ —
State and political subdivisions	9,065	—	6,398	2,667
U.S. government agency residential mortgage-backed securities	127,313	—	127,313	—
Collateralized mortgage obligations:				
Agency	14,456	—	14,456	—
Equities	3,022	—	3,022	—
Available-for-sale securities	$165,927	$ —	$ 163,260	$ 2,667

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	Carrying Amount	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2015				
U.S. government agencies	$14,607	$ —	$ 14,607	$ —
State and political subdivisions	10,181	—	5,160	5,021
U.S. government agency residential mortgage-backed securities	126,029	—	126,029	—
Collateralized mortgage obligations:				
Agency	17,833	—	17,833	—
Equities	2,790	—	2,790	—
Available-for-sale securities	$171,440	$ —	$ 166,419	$ 5,021

There were no transfers between Level 1 and Level 2 during 2016 or 2015.

Assets and Liabilities Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs

For the period ended December 31, 2016, the Company had $2.7 million of local school district bonds that are measured at fair value on a recurring basis using unobservable inputs. The Company utilizes non binding broker quotes for the fair value determination of these school district bonds. These bonds had a fair value of $5.0 million for the period ended December 31, 2015 and during 2016 had maturities of $2.3 million. These school district bond balances are the only assets of the Company that are measured at fair value on a recurring basis using significant unobservable inputs. There currently are no liabilities of the Company that are measured at fair value on a recurring basis using significant unobservable inputs.

Assets Measured at Fair Value on a Non-Recurring Basis

The following table summarizes, by measurement hierarchy, financial assets of the Company that are measured at fair value on a non-recurring basis.

	Carrying Amount	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2016				
Impaired loans				
Commercial				
Closed-end	$ 25	$ —	$ —	$ 25
Lines of credit	39	—	—	39
CRE - construction, land & development	12	—	—	12
1-4 family residential				

Senior lien	140	—	—	140
OREO property				
CRE - construction, land & development	1,867	—	—	1,867
Non-owner occupied	476	—	—	476
1-4 family residential				
Senior lien	163	—	—	163

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	Carrying Amount	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2015				
Impaired loans				
1-4 family residential				
Senior lien	572	—	—	572
OREO property				
CRE - construction, land & development	1,140	—	—	1,140
CRE - all other				
Non-owner occupied	468	—	—	468
1-4 family residential				
Senior lien	131	—	—	131

At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive specific allocations of the allowance for loan losses. For collateral dependent loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach.

Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower’s financial statements, or aging reports, adjusted or discounted based on management’s historical knowledge, changes in market conditions from the time of the valuation, and management’s expertise and knowledge of the client and client’s business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Impaired loans had a net carrying amount of $0.2 million with a specific loan loss allocation of $0.6 million at December 31, 2016, resulting in an additional provision for loan losses of $0.6 million for the twelve month period. In 2015 impaired loans had a net carrying amount of $0.6 million with a specific loan loss allocation of $0.3 million during 2015, resulting in an additional provision for loan losses of $0.1 million for the year ended December 31, 2015. The majority of our impaired loans are collateralized by real estate.

Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. Any write-downs in the carrying value of a property at the time of acquisition are charged against the allowance for loan losses. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Management periodically reviews the carrying value of other real estate owned. Any write-downs of the properties subsequent to acquisition, as well as gains or losses on disposition and income or expense from the operations of other real estate owned, are recognized in operating results in the period they are realized. Fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

OREO properties measured at fair value, less costs to sell, had a net carrying amount of $2.5 million which is made up of the outstanding balance of $3.7 million, net of a valuation allowance of $1.2 million at December 31, 2016. This compares to 2015 when OREO properties with an outstanding balance of $2.9 million was written down to a fair value of $1.7 million.

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2016 and December 31, 2015:

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December 31, 2016	Fair Value	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Impaired loans		Sales comparison approach	Adjustment for differences between comparable sales	
Commercial				
Closed-end	$ 25			20% - 100% (36%)
Lines of credit	39			20% - 100% (89%)
CRE - construction, land & development	12			10% - 85% (80%)
1-4 family residential				
Senior lien	140			10% - 60% (57%)
OREO property		Sales comparison approach	Adjustment for differences between comparable sales	
CRE - construction, land & development	1,867			5% - 80% (30%)
CRE - all other				
Non-owner occupied	476			5% - 50% (15%)
1-4 family residential				
Senior lien	163			6% - 65% (37%)

December 31, 2015	Fair Value	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Impaired loans		Sales comparison approach	Adjustment for differences between comparable sales	
1-4 family residential				
Senior lien	572			10% - 60% (17%)
OREO property		Sales comparison approach	Adjustment for differences between comparable sales	
CRE - construction, land & development	$1,140			5% - 70% (27%)
CRE - all other				
Non-owner occupied	468			5% - 50% (16%)
1-4 family residential				
Senior lien	131			6% - 55% (30%)

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

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		Fair Value measurements at December 31, 2016 Using			
	Carrying Value	Level 1	Level 2	Level 3	Total
Financial assets					
Cash and cash equivalents	$22,507	$22,507	$—	$ —	$22,507
Securities	165,927	—	163,260	2,667	165,927
Restricted securities	9,860	—	—	—	NA
Net loans	676,871	—	—	677,832	677,832
Accrued interest receivable	2,750	—	511	2,239	2,750
Financial liabilities					
Deposits	$740,046	$—	$740,106	$ —	$740,106
Federal funds purchased and securities sold under agreements to repurchase	11,168	—	11,168	—	11,168
Federal Home Loan Bank advances	85,000	—	85,039	—	85,039
Subordinated debentures	10,310	—	—	9,525	9,525
Series B mandatorily redeemable preferred stock	209	—	211	—	211
Accrued interest payable	286	—	272	14	286

		Fair Value measurements at December 31, 2015 Using			
	Carrying Value	Level 1	Level 2	Level 3	Total
Financial assets					
Cash and cash equivalents	$27,655	$27,655	$—	$ —	$27,655
Securities	171,440	—	166,419	5,021	171,440
Restricted securities	9,116	—	—	—	NA
Loans held for sale	735	—	760	—	760
Net loans	624,956	—	—	629,017	629,017
Accrued interest receivable	3,012	—	402	2,610	3,012
Financial liabilities					
Deposits	$718,504	$—	$718,689	$ —	$718,689
Federal funds purchased and securities sold under agreements to repurchase	18,730	—	18,730	—	18,730
Federal Home Loan Bank advances	76,000	—	76,271	—	76,271
Notes payable	—	—	—	—	—
Subordinated debentures	20,620	—	—	13,933	13,933
Series B mandatorily redeemable preferred stock	268	—	273	—	273
Accrued interest payable	235	—	169	66	235

Other assets and liabilities of the Company that are not defined as financial instruments are not included in the above disclosures, such as property and equipment. In addition, nonfinancial instruments typically not recognized in financial statements nevertheless may have value but are not included in the above disclosures. These include, among other items, the estimated earning potential of core deposit accounts, the earnings potential of loan servicing rights, the earnings potential of the trust operations, customer goodwill and similar items.

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The methods and assumptions, not previously presented, used to estimate fair values are described as follows:
(a) Cash and Cash Equivalents
The carrying amounts of cash and short-term instruments approximate fair values and are classified as either Level 1 or Level 2. As of December 31, 2016 and December 31, 2015; $22.5 million and $27.7 million was classified as Level 1.
(b) Restricted securities
It is not practical to determine the fair value of restricted securities due to the restrictions placed on its transferability.
(c) Loans
Fair values of loans, excluding loans held for sale, are estimated as follows: Fair values for loans are estimated using discounted cash flow analysis, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value as described previously. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.
The fair value of loans held for sale is estimated based upon binding contracts and quotes from third party investors resulting in a Level 2 classification.
(d) Deposits
The fair values disclosed for demand deposits (e.g., interest and non-interest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) resulting in a Level 2. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.
(e) Short-term Borrowings
The carrying amounts of federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings, generally maturing within ninety days, approximate their fair values resulting in a Level 2 classification.
(f) Other Borrowings
The fair values of the Company’s long-term borrowings are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification.
The fair values of the Company’s Subordinated Debentures are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 3 classification.
(g) Accrued Interest Receivable/Payable
The carrying amounts of accrued interest approximate fair value resulting in a Level 2 or Level 3 classification which is consistent with the underlying asset/liability they are associated with.
(h) Off-balance Sheet Instruments
Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties’ credit standing. The fair value of commitments is not material.
Note 5. Loan Sales and Servicing
Loans held for sale at year end related to our secondary mortgage market activities, located in the "Loans held for sale" section of our balance sheet. There were no loans held for sale at December 31, 2016 and $0.7 million at December 31, 2015.
Mortgage loans serviced for others are not included in the accompanying consolidated balance sheet. The unpaid principal balances of these loans are summarized as follows:

	December 31,	
	2016	2015
Federal Home Loan Mortgage Corporation	$13,674	$17,614
Federal National Mortgage Association	252,702	266,307

Total Mortgage Loans Serviced	$266,376	$283,921

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Custodial escrow balances maintained in connection with serviced loans were $2.47 million and $2.36 million at year-end 2016 and 2015.
Following is an analysis of the changes in originated mortgage servicing rights:

	Years Ended December 31,	
	2016	2015
Balance at beginning of year	$2,129	$2,240
Originated mortgage servicing rights	208	230
Amortization	(304)	(341)
Balance at end of year	$2,033	$2,129

Mortgage servicing rights are reported on the Consolidated Balance Sheets. Management periodically evaluates mortgage servicing rights for impairment. For purposes of measuring impairment, servicing assets are stratified by loan type. Impairment is recognized if the carrying value of servicing assets exceeds the fair value of the stratum. The fair value of capitalized mortgage servicing rights was $2.1 million and $2.2 million at December 31, 2016 and 2015, respectively. Fair value was determined using discount rates ranging from 10.50% to 16.50% and prepayment speeds ranging from 12.17% to 14.25% depending on the stratification of the specific right in 2016. The discount rates used in 2015 ranged from 10.50% to 16.50% and the prepayment speeds used were between 14.80% and 15.72%.

Estimated amortization expense for each of the next five years is as follows:

2017	$379
2018	245
2019	219
2020	206
2021	207
	$1,256

There were no repurchases required in 2016 and 2015. At December 31, 2016, management believes any recourse obligations to be immaterial.
Note 6. Premises and Equipment
Premises and equipment consisted of:

	December 31,	
	2016	2015
Land	$8,345	$8,315
Buildings	14,117	14,118
Furniture and equipment	9,486	13,188
Work in Process	2	84
	31,950	35,705
Less accumulated depreciation	15,579	18,853
	$16,371	$16,852

Depreciation expense on premises and equipment totaled $1.1 million in 2016 and $1.2 million in 2015.
The Company entered into agreements to sell three branches during 2016 and completed those sales during the second quarter of 2016. At December 31, 2015 a total of $5.1 million of Premises and Equipment to be included in the sales was transferred to branch assets held for sale and was excluded from the amounts reported above. See Note 19 for

further information.

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Note 7. Deposits

Time certificate of deposits in denominations of $250 thousand or more were $63.6 million and $35.2 million at December 31, 2016 and December 31, 2015.

At December 31, 2016, the scheduled maturities of time deposits are as follows:

2017	$162,545
2018	26,387
2019	8,654
2020	2,183
2021	1,403
	$201,172

At December 31, 2016 and 2015, brokered deposits account for $79.9 million and $21.3 million, respectively. Deposits from principal officers, directors and their affiliates at year end 2016 and 2015 were $0.79 million and $0.78 million.

Note 8. Securities Sold Under Agreements To Repurchase

Securities sold under agreements to repurchase are financing arrangements that generally mature within 90 days. Repurchase agreements are secured by U.S. Agency residential mortgage-backed securities and, if required, are held in third party pledge accounts. At maturity, the securities underlying the agreements are returned to the Company. Securities sold under agreements to repurchase had a carrying value of $11.2 million at December 31, 2016 and $18.7 million at year-end 2015. The securities underlying the agreements remain in the respective asset accounts. As of December 31, 2016, the Company had no counterparties with amounts at risk under repurchase agreements that exceeded 10% of stockholders' equity.

	2016	2015
Average daily balance during the period	$14,347	$18,144
Average interest rate during the period	0.25 %	0.27 %
Maximum month end balance during the period	$18,695	$20,832
Weighted average interest rate at period-end	0.19 %	0.26 %

At December 31, 2016, securities sold under agreements to repurchase are secured by $25.4 million of U.S. government agency residential mortgage-backed securities. The contractual maturity of these agreements are overnight and continuous. At December 31, 2015, securities sold under agreements to repurchase are secured by $25.3 million of U.S. government agency residential mortgage-backed securities. The contractual maturity of these agreements are overnight and continuous. The fair value of securities pledged to secure repurchase agreements may decline. The Company manages this risk by having a policy to pledge securities valued at 15% above the gross outstanding balance of repurchase agreements.

Note 9. Borrowed Funds and Debt Obligations

At December 31, 2016 and December 31, 2015 no FHLB advances had any call provisions. The Company maintains a collateral pledge agreement covering secured advances whereby the Company had $191.1 million collateral credited to the Company by the FHLB at December 31, 2016. The Company has pledged $335.5 million of first mortgage loans on property free of all other pledges, liens, and encumbrances (not more than 90 days delinquent). The Company had two variable rate advances at December 31, 2016 both with a year-end rate of 0.445%. The Company had no variable rate advances at year-end 2015. The remaining advances are at fixed rates ranging from 0.70% to 2.46% at December 31, 2016 and 0.21% to 3.64% at year-end 2015.

The scheduled maturities of advances from the FHLB are as follows:

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	December 31, 2016		December 31, 2015	
Year	Average Interest Rate	Amount	Average Interest Rate	Amount
2016	— %	$—	0.70%	$60,000
2017	0.93	21,000	1.14	11,000
2018	0.44	49,000	3.64	5,000
2019	0.45	10,000	—	—
2020	—	—	—	—
2021	2.46	5,000	—	—
	0.79%	$85,000	0.96%	$76,000

Of the $21.0 million of FHLB advances with maturities in 2017 at December 31, 2016, $10.0 million has matured and been renewed.

During the period ended December 31, 2015, in connection with the settlement of obligations involving another financial institution, the Company recognized a gain of $1.8 million representing the difference between the fair value of the consideration issued in the settlement transaction and the carrying value of the amounts due to another financial institution. As a result, the gain has been included as ‘‘Gain on extinguishment of debt’’ within income from continuing operations in the accompanying Consolidated Statements of Income for the period ended December 31, 2015.

Information concerning borrowed funds is as follows:

	2016		2015	
Advances from the Federal Home Loan Bank				
Maximum month-end balance during the period	$111,000		$110,000	
Average balance during the period	86,686		64,370	
Weighted average interest rate for the period	0.86	%	0.82	%
Weighted average interest rate at period end	0.79	%	0.96	%
Notes Payable				
Maximum month-end balance during the period	$—		$10,250	
Average balance during the period	—		2,499	
Weighted average interest rate for the period	—	%	3.36	%
Weighted average interest rate at period end	—	%	—	%

Note 10. Subordinated Debentures

The Company had two $10.0 million trust preferred issuances that were issued in April 2004 and April 2007 in cumulative trust preferred securities through special-purpose trusts Centrue Statutory Trust II (Trust II) and Centrue Statutory Trust III (Trust III). The proceeds of the offerings were invested by the trusts in junior subordinated deferrable interest debentures of Trust II and Trust III totaling $20.6 million. Trust II is a wholly-owned subsidiary of the Company, and their sole assets are the junior subordinated deferrable interest debentures. On October 27, 2016 the Company redeemed its Trust III issuance for $9.3 million plus accrued interest. This transaction created a gain on debt extinguishment of $1.0 million during the period. The Company had $10.3 million in trust preferred (Trust II) issuances outstanding at December 31, 2016.

Distributions are cumulative and are payable quarterly at a variable rates per annum of the stated liquidation amount of $1,000 per preferred security. Trust II has a rate of 2.65% over the LIBOR rate of 0.9932% for total rate of 3.64%

at December 31, 2016 and 3.18% at December 31, 2015. Trust III had a rate of 1.65% over the LIBOR rate of 0.84560% for a total rate of 2.50% at the time of redemption and 1.98% at December 31, 2015. Interest expense on the trust preferred securities was $0.5 million for the years ended December 31, 2016 and December 31, 2015. All interest was accrued as of December 31, 2016 and December 31, 2015 and was immaterial.

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During the third quarter of 2009, the Company began deferring the interest payments on these instruments. The permitted five year default period expired in the third quarter of 2014 resulting in the Company being in default on these debentures. On March 31, 2015, the accrued interest was made current on each trust preferred security through the most recent quarterly due date and were fully reinstated out of default status. The obligations of the trust are fully and unconditionally guaranteed, on a subordinated basis, by the Company. See Note 1 for additional disclosure related to the deferred interest.

The trust preferred securities for the Trust II are redeemable upon the maturity of the debentures on April 22, 2034, or to the extent of any earlier redemption of any debentures by the Company, and are callable beginning April 22, 2009. Holders of the capital securities have no voting rights, are unsecured, and rank junior in priority of payment to all of the Company’s indebtedness and senior to the Company’s capital stock. For regulatory purposes, the trust preferred securities qualify as Tier 1 capital subject to certain provisions.

In accordance with accounting guidelines, the trusts are not consolidated with the Company’s consolidated financial statements, but rather the subordinated debentures are shown as a liability and the Company’s investment in the common stock for Trust II of $0.3 million is included in other assets.

Note 11. Income Taxes

Income tax expense (benefit) consisted of:

	Years Ended December 31,	
	2016	2015
Federal		
Current	$214	$126
Deferred	2,706	(126)
	2,920	—
State		
Current	—	—
Deferred	682	—
	682	—
Change in valuation allowance	—	(37,484)
	$3,602	$(37,484)

The Company's income tax expense differed from the statutory federal rate of 34% as follows:

	Years Ended December 31,	
	2016	2015
Expected income taxes	$3,372	$1,740
Income tax effect of		
Valuation allowance reversal	—	(39,759)
Interest earned on tax-free investments and loans	(39)	(67)
Nondeductible interest expense incurred to carry tax-free investments and loans	1	1
State income taxes, net of federal tax benefit	450	191
Earnings on Bank-owned life insurance	(428)	(304)
Bank-owned life insurance substitution gain	208	—
Nondeductible meals and health club dues	37	33
Section 382 limitations	—	370
Impact of state apportionment change	(10)	193

Other	11	118
Total income tax expense (benefit)	$3,602	$(37,484)

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The significant components of deferred income tax assets and liabilities consisted of:

	December 31, 2016	December 31, 2015
Deferred tax assets		
Allowance for loan losses	$ 3,465	$ 3,342
Deferred compensation, other	108	74
Stock based expense	66	87
Net operating loss carryforwards	30,166	34,180
Securities available-for-sale	655	405
Deferred tax credits	1,068	823
OREO valuation allowance	942	1,059
Depreciation	196	—
Donation carryforward	—	5
Capital loss carryforward	—	4
Other	204	246
Total deferred tax assets	36,870	40,225
Deferred tax liabilities		
Depreciation	$ —	$ (58)
Adjustments arising from acquisitions	(30)	(146)
Mortgage servicing rights	(791)	(828)
Federal Home Loan Bank dividend received in stock	(450)	(450)
Deferred loan fees & costs	(385)	(399)
Prepaid expenses	(179)	(164)
Total deferred tax liabilities	(1,835)	(2,045)
Valuation allowance	—	—
Net deferred tax assets	$ 35,035	$ 38,180

In accordance with current income tax accounting guidance, the Company assessed whether a valuation allowance should be established against their deferred tax assets (DTAs) based on consideration of all available evidence using a “more likely than not” standard. The most significant portions of the deductible temporary differences relate to (1) net operating loss carryforwards and (2) the allowance for loan losses.

In assessing the need for a valuation allowance, both the positive and negative evidence about the realization of DTAs were evaluated. The ultimate realization of DTAs is based on the Company’s ability to carryback net operating losses to prior tax periods, tax planning strategies that are prudent and feasible, the reversal of deductible temporary differences that can be offset by taxable temporary differences and future taxable income.

After evaluating all of the factors previously summarized and considering the weight of the positive evidence compared to the negative evidence, the Company determined that no valuation adjustment was necessary as of December 31, 2016. The Company also concluded it was more likely than not that it will utilize the net deferred tax assets as of December 31, 2015. Therefore, it reversed the $38.2 million valuation allowance on the net deferred tax assets in the fourth quarter of 2015. The factors leading to this conclusion are positive three year cumulative pre-tax earnings as of December 31, 2015; significantly improved asset quality and capital position; positive loan growth throughout 2015, availability of prudent and feasible tax planning strategies, and future taxable income strategies.

At December 31, 2016 and 2015, federal net operating loss carry forwards includes $1.3 million and $1.4 million, respectively, related to the Illinois Community Bancorp Inc. acquisition. The federal NOL carry forward expires in 2021 thru 2024, and can be used at a rate of $0.16 million per year based on Section 382 limitations. The rest of the federal NOL carry forward represents losses of $9.8 million, $20.1 million, $6.3 million, $29.9 million and $9.2

million generated in 2010, 2011, 2012, 2013 and 2014, respectively, which will begin to expire in 2030. At December 31, 2016, net operating loss carry forwards also includes $23.3 million, $25.5 million, $14.7 million, $4.6 million, $22.9 million and $6.7 million in state of Illinois loss carry forwards generated in 2010, 2011, 2012, 2013 and 2014, respectively, that have a twelve year carry forward period. New tax laws in Illinois have deferred carry forwards for the years 2011 through 2013; therefore, they will begin to expire after 2023.

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The Company does not have any material uncertain tax positions or unrecognized tax benefits for additional disclosure in the consolidated financial statements. The Company does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months.

The deferred tax credits represent $1.1 million in Alternative Minimum Tax credit carry forwards generated in 2007, 2008, 2015 and 2016. These credits can be carried forward indefinitely. Donation carry forwards of $0.6 million generated in 2010 through 2016 were converted to NOL carryforwards, which extended their expiration periods.

During 2016 and 2015, no interest or penalties were recorded in the income statement. There were no amounts accrued for interest and penalties at December 31, 2016 and December 31, 2015.

The Company is no longer subject to examination by federal or state taxing authorities for tax years prior to 2013.

Note 12. Benefit Plans

The Company has a 401(k) salary reduction plan (the 401(k) plan) covering substantially all employees. Eligible employees may elect to make tax deferred and/or Roth after-tax contributions up to annual IRS contribution limits subject to the results of plan testing. In 2016, the Plan adopted a "safe harbor" status. Eligible participants received a 100% Company match on the first 3% of eligible compensation deferred and a 50% Company match on deferrals of the next 2% of eligible compensation deferred for a maximum Company match of 4%. A special true-up Company contribution was made in January 2017 to account for non-cash eligible compensation items, participant front-loading/back-loading and any other eligible compensation not captured during the year. The Company expensed $0.5 million for 2016. In 2015, the Company accrued 2% of employee eligible wages for employees who met certain eligibility requirements at December 31, 2015, resulting in an accrual of $0.3 million at December 31, 2015. This amount was posted to participant accounts in February 2016.

The Company also entered into certain non-qualified deferred compensation agreements with members of the senior management team. The Company may make discretionary matching contributions with respect to a portion of the participant’s deferral. Additionally, the Company continues its non-qualified deferred compensation plan for the directors. These agreements, which are subject to the rules of Internal Revenue Code Section 409A, relate to the voluntary deferral of compensation received. The accrued liability for both deferral plans as of December 31, 2016 was $0.71 million and at December 31, 2015 was $0.03 million. There was no Company match for the employee deferred compensation plan in 2016 and 2015 and none is projected for 2017. In conjunction with the March 31, 2015 recapitalization which triggered certain change of control provisions, three executives had full balance payouts and two directors had partial balance payouts for aggregate payouts of $38,010 and $16,850, respectively.

Note 13. Share Based Compensation

In April 2003, the Company adopted the 2003 Option Plan. Under the 2003 Option Plan, as amended on April 24, 2007, nonqualified options, incentive stock options, restricted stock and/or stock appreciation rights may be granted to employees and outside directors of the Company and its subsidiaries to purchase the Company's common stock at an exercise price to be determined by the executive and compensation committee. Pursuant to the 2003 Option Plan, 19,000 shares of the Company's unissued common stock had been reserved and were available for issuance upon the exercise of options and rights granted under the 2003 Option Plan. The granted options have an exercise period of seven to ten years from the date of grant.

In May 2015, the Company adopted the 2015 Stock Compensation Plan. Under the 2015 Stock Compensation Plan nonqualified options, incentive stock options, restricted stock and/or stock appreciation rights may be granted to employees and outside directors of the Company and its subsidiaries to purchase the Company's common stock at an exercise price to be determined by the compensation committee. A total of 430,000 shares have been made available under the 2015 Stock Compensation Plan. There are currently 356,236 shares available .

There were 33,321 units of restricted stock granted in May of 2016 from the 2015 Stock Compensation Plan. The restricted stock units were granted using the last sale price as quoted on the NASDAQ Stock Market on the date of grant of $16.72 per unit. The awarded shares are scheduled to vest over three years in which two-thirds will vest on May 10, 2018 and the remaining one-third will vest on May 10, 2019.

The Company awarded 40,443 shares of restricted stock in November 2015 that were available under the restricted portion of the plan. The restricted shares were issued out of treasury shares with an aggregate grant date fair value of $0.7 million. The awards were granted using the last sale price as quoted on the NASDAQ Stock Market on the date of grant of $17.75. The awarded shares vested immediately but are subject to a holding period in which the shares may not be sold, assigned, transferred, pledged or otherwise encumbered.

There was no compensation cost charged against income for the stock options portion of the Equity Incentive Plan for the years ended December 31, 2016 and December 31, 2015. There was $0.1 million and $0.5 million of compensation cost charged against

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income for the restricted stock portion of the equity incentive plan for the year ended December 31, 2016 and December 31, 2015, respectively.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses the assumptions noted in the table below. Expected volatilities are based on historical volatilities of the Company's common stock prior to its de-registration. The Company uses historical data to estimate option exercise and post-vesting termination behavior. (Employee and management options are tracked separately.) The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. There were no options granted in December 31, 2016 and in December 31, 2015.

A status summary of the option plan as of December 31, 2016 and changes during the period ended on that date are presented below:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life	Aggregate Intrinsic Value
Outstanding at January 1, 2015	3,156	$ 338.72		
Granted	—	—		
Exercised	—	—		
Forfeited	(2,824)	310.57		
Outstanding at end of period	332	$ 578.10	0.3 years	$ —
Vested or expected to vest	332	$ 578.10	0.3 years	$ —
Options exercisable at period end	332	$ 578.10	0.3 years	$ —

Options outstanding at December 31, 2016 and year-end 2015 were as follows:

	Outstanding		Exercisable	
Range of Exercise Prices	Number	Weighted Average Remaining Contractual Life	Number	Weighted Average Exercise Price
December 31, 2016:				
$390.01 - $578.10	332	0.3 years	332	578.10
	332	0.3 years	332	$ 578.10
December 31, 2015:				
$157.20 - $390.00	2,160	0.2 years	2,160	$ 228.33
390.01 - 578.10	996	0.9 years	996	578.10
	3,156	0.4 years	3,156	$ 338.72

As of December 31, 2016 and December 31, 2015, there was no unrecognized compensation cost related to non-vested stock options granted under the 2003 Option Plan. As of December 31, 2016, there was $0.4 million of total unrecognized compensation costs related to non-vested shares granted under the 2015 Stock Compensation Plan.

Note 14. Regulatory Matters

The Company and the Bank ("Regulated Companies") are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum regulatory capital requirements can initiate certain mandatory, and possibly additional discretionary actions by these regulators that, if undertaken, could have a direct material effect on the Company's Consolidated Financial Statements. Under regulatory capital adequacy guidelines and the regulatory framework for prompt corrective action, the Regulated Companies must meet specific

regulatory capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. Their regulatory capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

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Quantitative measures established by regulation to ensure regulatory capital adequacy require the Regulated Companies to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital to risk-weighted assets, and of Tier 1 Capital to average assets. Tier 1 Capital includes common stockholders' equity, qualifying preferred stock and Trust Preferred securities, less goodwill and certain other deductions (including the unrealized net gains and losses, after applicable taxes, on available-for-sale securities carried at fair value). Total Capital includes Tier 1 Capital plus preferred stock not qualifying as Tier 1 Capital, mandatory convertible debt, subordinated debt and the allowance for loan and lease losses, subject to limitations by the guidelines.
On July 2, 2013, the Federal Reserve Board and the FDIC approved rules that implement the "Basel III" regulatory capital reforms, as well as certain changes required by the Dodd-Frank Act. The rules include a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets, which is in addition to the Tier 1 and Tier 2 risk-based capital requirements. The capital conservation buffer will be phased in over four years beginning on January 1, 2016, with a maximum buffer of 0.625% of risk-weighted assets for 2016, 1.25% for 2017, 1.875% for 2018, and 2.5% for 2019 and thereafter. Failure to maintain the required capital conservation buffer will result in limitations on capital distributions and on discretionary bonuses to executive officers. Regulatory capital ratios shown for December 31, 2016 are in excess of the Basel III 2016 phase-in level for the capital conservation buffer.
Basel III also introduced changes to risk-weightings and treatment of Accumulated Other Comprehensive Income (AOCI). In 2015, the Bank made a one-time available election to opt-out of the impact of certain unrealized capital gains and losses in AOCI being included in regulatory capital. There is no opportunity to change methodology in future periods.

On March 31, 2015, the Company completed a common stock offering and capital infusion into the Bank. See Note 1 for additional disclosure.

	Actual		To Be Adequately Capitalized		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2016						
Total capital (to risk-weighted assets)						
Centrue Financial	$118,841	15.0%	N/A	N/A	N/A	N/A
Centrue Bank	115,455	14.5	63,556	8.0	79,445	10.0
Common equity tier I (to risk-weighted assets)						
Centrue Financial	$109,434	13.8	N/A	N/A	N/A	N/A
Centrue Bank	106,551	13.4	35,750	4.5	51,639	6.5
Tier I capital (to risk-weighted assets)						
Centrue Financial	$109,937	13.8	N/A	N/A	N/A	N/A
Centrue Bank	106,551	13.4	47,667	6.0	63,556	8.0
Tier I leverage ratio (to average assets)						
Centrue Financial	$109,937	11.5	N/A	N/A	N/A	N/A
Centrue Bank	106,551	11.1	38,251	4.0	47,814	5.0

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	Actual		To Be Adequately Capitalized		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2015						
Total capital (to risk-weighted assets)						
Centrue Financial	$118,359	15.6%	N/A	N/A	N/A	N/A
Centrue Bank	117,807	15.6	60,463	8.0	75,579	10.0
Common equity tier I (to risk-weighted assets)						
Centrue Financial	107,678	14.2	N/A	N/A	N/A	N/A
Centrue Bank	109,216	14.5	34,011	4.5	49,126	6.5
Tier I capital (to risk-weighted assets)						
Centrue Financial	$109,768	14.5	N/A	N/A	N/A	N/A
Centrue Bank	109,216	14.5	45,347	6.0	60,463	8.0
Tier I leverage ratio (to average assets)						
Centrue Financial	$109,768	12.1	N/A	N/A	N/A	N/A
Centrue Bank	109,216	12.0	36,505	4.0	45,631	5.0

On December 18, 2009, the Bank entered into an Agreement with the Federal Reserve Bank-Chicago and the IDFPR. The Agreement describes commitments made by the Bank to address and strengthen banking practices relating to credit risk management practices; improving loan underwriting and loan administration; improving asset quality by enhancing the Bank’s position on problem loans through repayment, additional collateral or other means; reviewing and revising as necessary the Bank’s allowance for loan and lease losses policy; maintaining sufficient regulatory capital at the Bank, implementing an earnings plan and comprehensive budget to improve and sustain the Bank’s earnings; and improving the Bank’s liquidity position and funds management practices.

The Agreement was terminated on February 16, 2016.

Note 15. Commitments, Contingencies, and Credit Risk

In the normal course of business, the Company enters into a variety of financial instruments with off-balance sheet risk to meet the financing needs of its customers, to reduce its exposure to fluctuations in interest rates, and to conduct lending activities. These instruments principally include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the Consolidated Balance Sheets. Financial instruments whose contract amounts represent credit risk are as follows:

	Standby Letters of Credit	Variable Rate Commitments	Fixed Rate Commitments	Total Commitments	Range of Rates on Fixed Rate Commitments
Commitments					
December 31, 2016	$ 1,809	$ 89,680	$ 34,460	$ 125,949	2.60% - 18.00%
December 31, 2015	1,970	120,173	29,681	151,824	2.60% - 18.00%

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total

commitment amounts do not necessarily represent future cash requirements. For commitments to extend credit, the Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained is based on management's credit evaluation of the customer. Collateral held varies, but may include accounts receivable; inventory; property, plant, and equipment; and income producing commercial properties.

In the event of a customer’s nonperformance, the Company’s credit loss exposure is equal to the contractual amount of those commitments. The credit risk is essentially the same as that involved in extending loans to customers and is subject to normal credit policies. The Company uses the same credit policies in making credit commitments as it does for on-balance sheet instruments, with such exposure to credit loss minimized due to various collateral requirements in place.

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Unsecured standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loan commitments to customers.

The Company leases certain branch properties under operating leases. Rent expense was $0.32 million and $0.31 million for the years-ended December 31, 2016 and December 31, 2015, respectively. Rent commitments, before considering renewal options that generally are present, were as follows:

2017	$315
2018	266
2019	154
2020	—
Total	$735

Note 16. Condensed Financial Information - Parent Company Only

The following represents the condensed financial statements of Centrue Financial Corporation, the Parent Company.

Balance Sheets (Parent Company Only)

	December 31,	
	2016	2015
ASSETS		
Cash and cash equivalents	$3,479	$741
Securities available-for-sale	27	27
Investment in subsidiary	128,096	135,576
Other assets	6,051	6,075
	$137,653	$142,419
LIABILITIES AND STOCKHOLDERS' EQUITY		
Series B mandatory redeemable preferred stock	$209	$268
Subordinated debentures	10,310	20,620
Other liabilities	205	250
	10,724	21,138
Stockholders' equity	126,929	121,281
	$137,653	$142,419

Income Statements (Parent Company Only)

	Years Ended December 31,	
	2016	2015
Dividends from subsidiary	$—	$—
Interest income	16	16
Other income	1,109	1,754
Interest expense	563	645
Other expense	693	1,055
Income tax benefit	(51)	(6,068)
Equity in undistributed earnings of subsidiaries	6,396	36,464
Net income	6,316	42,602
Preferred stock dividends	—	1,484
Discount on redemption of preferred stock	—	(13,668)
Net income for common stockholders	$6,316	$54,786

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Statements of Cash Flows (Parent Company Only)

	Years Ended December 31,	
	2016	2015
Cash flows from operating activities		
Net income	$6,316	$42,602
Adjustments to reconcile net income to net cash provided by operating activities		
Undistributed earnings of subsidiary	(6,396)	(36,464)
Share based compensation	124	461
Forfeited stock options	(70)	—
Gain from extinguishment of debt	(1,000)	(1,750)
(Increase) decrease in other assets	24	(4,271)
Decrease in other liabilities	(45)	(4,871)
Net cash used in operating activities	(1,047)	(4,293)
Cash flows from investing activities		
Capital infusion to subsidiary	$—	$(36,000)
Proceeds from repurchase of subsidiary common stock	9,000	—
Net cash provided by (used in) investing activities	9,000	(36,000)
Cash flows from financing activities		
Repayment of notes payable	$—	$(8,500)
Proceeds from issuance of common stock	4,173	68,248
Repurchase of subordinated debentures	(9,000)	—
Redemption of Series C Cumulative Perpetual Preferred Stock	—	(19,000)
Redemption of mandatory redeemable preferred stock	(59)	—
Dividends paid on preferred stock	(329)	(478)
Net cash provided by (used in) financing activities	(5,215)	40,270
Net decrease in cash and cash equivalents	$2,738	$(23)
Cash and cash equivalents		
Beginning of period	741	764
End of period	$3,479	$741

Note 17. Earnings Per Share

A reconciliation of the numerators and denominators for earnings per common share computations for the years ended December 31, 2016 and 2015 is presented below. Common shares, options and per share amounts for both periods shown have been restated to reflect the impact of the reverse stock split the Company completed effective May 29th, 2015. Options to purchase 332 and 3,156 shares of common stock were outstanding for December 31, 2016 and 2015, respectively; but were not included in the computation of diluted earnings per share because the exercise price was greater than the average market price and, therefore, were anti-dilutive. Of the 33,321 shares of restricted stock units issued in 2016, 3,415 shares were considered dilutive at December 31, 2016. As of December 31, 2015, there were no shares considered dilutive.

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	2016	2015
Basic Earnings Per Common Share		
Net income	$ 6,316	$ 42,602
Preferred stock dividends	(329)	(1,484)
Discount on redemption of preferred stock	—	13,668
Net income for common shareholders	$ 5,987	$ 54,786
Weighted average common shares outstanding	6,513,694	4,945,073
Basic earnings per common share	$ 0.92	$ 11.08
Diluted Earnings Per Common Share		
Weighted average common shares outstanding	6,513,694	4,945,073
Add: dilutive effect of restricted stock units	3,415	—
Weighted average common and dilutive potential shares outstanding	6,517,109	4,945,073
Diluted earnings per common share	$ 0.92	$ 11.08

Note 18. Quarterly Financial Data (Unaudited)

	Interest Income	Net Interest Income	Net Income	Earnings Per Share	
				Basic	Diluted
2016					
First Quarter	$ 7,913	$ 7,262	$ 918	$ 0.13	$ 0.13
Second Quarter	7,862	7,216	2,128	0.31	0.31
Third Quarter	7,928	7,216	1,055	0.15	0.15
Fourth Quarter	7,985	7,292	2,215	0.33	0.33
2015					
First Quarter	$ 6,734	$ 6,040	$ 1,867	$ 65.60	$ 65.60
Second Quarter	7,007	6,446	1,053	0.16	0.16
Third Quarter	7,336	6,737	1,088	0.11	0.11
Fourth Quarter	7,678	7,081	38,594	5.92	5.92

Note 19. Business Acquisitions and Divestitures

On June 17, 2016, Centrue Bank completed the sales of its Fairview Heights, Aviston and St. Rose, Illinois branches. The sales resulted in a reduction of $51.7 million of deposits, $13.1 million of loans and $5.1 million of fixed assets. These transactions generated a net after tax gain of $1.1 million.

Note 20. Subsequent Events

On January 26, 2017, the Company announced the signing of a definitive agreement with Midland States Bancorp, Inc. ("Midland") under which Midland will acquire Centrue for estimated total consideration of $175.1 million, or $26.75 per share of Centrue common stock. The transaction is expected to close in mid-2017, subject to regulatory approvals, the approval of Centrue's and Midland's shareholders and the satisfaction of customary closing conditions.

CENTRUE FINANCIAL CORPORATION
PART II

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

As of the end of the period covered by this report, the Company carried out an evaluation under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended). Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective in timely alerting them to material information relating to the Company required to be included in the Company's periodic filings with the Securities and Exchange Commission. It should be noted that in designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. The Company has designed its disclosure controls and procedures to reach a level of reasonable assurance of achieving the desired control objectives and, based on the evaluation described above, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective at reaching that level of reasonable assurance.

There was no change in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended) during the Company's most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information

None.

CENTRUE FINANCIAL CORPORATION
PART III

Item 10. Directors, Executive Officers and Corporate Governance

Name (Age)	
Bradley E. Cooper (50) Director since 2015	Mr. Cooper has been a director since June 2015. Mr. Cooper is a member of the Corporate Governance and Nominating Committee. He is a founding partner of Capital Z Partners, a private equity firm focused on investing in the financial services sector. Prior to founding a predecessor of Capital Z Partners Management, LLC ("CZPM") in 1990, Mr. Cooper was an investment banker in the Financial Institutions Group of Salomon Brothers. Mr. Cooper currently serves as a director of several CZPM portfolio companies. His qualifications to serve as a Director of the Company and a member of the Corporate Governance and Nominating Committee include his extensive experience as an investor in the financial services industry. Further, Mr. Cooper has developed an extensive network of contacts throughout the industry. He regularly speaks at industry conferences as an expert on acquisitions and investments in financial services companies.
Randall E. Ganim (63) Director since 2006	Director of Centrue Financial Corporation and Centrue Bank. He serves as a member of the Audit and Executive Committees. Retired. Formerly, CPA/Partner/Principal, CliftonLarsonAllen, LLP; formerly CPA/President/ Principal, Ganim, Meder, Childers & Hoering, P.C. As a Certified Public Accountant and business owner, Mr. Gamin's professional qualifications meet the Securities and Exchange Commission's (the "SEC's") definition of a "financial expert," while his local roots in one of the Company's key market areas provide him with a unique perspective on business development efforts.
Richard C. Peterson (66) Director since 2011	Director of Centrue Financial Corporation and Centrue Bank. He serves as a member and chairman of the Compensation Committee and member of the Audit Committee. Principal, RCP Consulting 1999 through present. Formerly, Chief Executive Officer, Newport Capital Bancorp, LLC from 2012 to 2013; formerly, Managing Principal and Co-Founder of Hermitage Capital Partners from 2009 to 2010; and Executive Vice President and Head of Community Banking, Banco Popular North America from 2000 to 2008. With 30 plus years of executive leadership within high profile banking organizations, Mr. Peterson's qualifications and experience includes managing and co-founding a start-up private equity venture formed to acquire, re-capitalize and aggregate troubled community banks in the Chicago market which allows him to serve as a critical resource to the organization. In addition his leadership experience in retail banking and in increasing net income allows him to provide guidance on the Company's customer acquisition and retention strategies.
Dennis O. Battles (70) Director since 2012	Director and Chairman of the Board of Centrue Financial Corporation and Centrue Bank. He also serves as a member and chairman of the Executive Committee and a member of the Compensation and Corporate Governance and Nominating Committees. With 30 plus years of banking experience, Mr. Battles retired from an executive position at US Bank in 2007. Prior to his retirement, he headed Corporate Banking for US Bank. In this position, he was accountable for corporate lending across the United States along with attendant corporate products including Treasury Management, International Banking, Foreign Exchange and Trading, Government Banking and Commercial Customer Service. Prior to its merger with US Bank, Mr. Battles was chief credit officer for Mercantile Bancorporation in St. Louis where he also held positions in Mergers and Acquisitions, Strategic Planning and regional/community banking. Mr. Battles' qualifications and experience include more than 30 years of executive bank management experience, including serving as chief credit officer and head of corporate lending and managing responsibility for

	merger and acquisition activity and strategic planning, and allow him to provide critical insight and leadership on the Company's highest level operating and strategic business decisions.
Derek J. Ferber (31) Director since 2015	Director of Centrue Financial Corporation since June 2015. He is a member of the Compensation Committee. Mr. Ferber has been in the financial industry since 2007. He is currently a senior analyst with FJ Capital Management. Prior to joining FJ Capital, Mr. Ferber was an equity research associate with Stifel, Nicolaus & Company, focusing on the financial institutions sector. His qualifications to serve as a director and a member of the Compensation Committee is based on his extensive financial expertise in the financial institutions sector and past board service.

David J. Butler (62) Director since 2015	Director of Centrue Financial Corporation and Centrue Bank since June 2015. He is a member and chairman of the Audit Committee. He also serves on the Corporate Governance and Nominating Committee. In 2014 he retired from his position as Audit Partner at KPMG LLP. Mr. Butler joined KPMG LLP in 1975. While there he served as the partner in charge of the St. Louis office financial services practice, Audit Partner in the Chicago office and Regional Professional Practice Partner. His qualifications to serve as a Director of the Company and a member of the Audit Committee include his strong audit experiences at KPMG LLP. Mr. Butler specialized in audit and risk advisory services for major financial services companies as well as risk management and professional practice issues. He also served on KPMG LLP's Issue Council and Audit Leadership Team. Mr. Butler's professional qualifications meet the Securities and Exchange Commission's (the SEC's") definition of a "financial expert."
Kurt R. Stevenson (50) Director since 2011	Director, President and Chief Executive Officer of Centrue Financial Corporation and Centrue Bank. He also serves on the Executive Committee. As the CEO of the Company, Mr. Stevenson's qualifications and experience includes nearly 25 years of progressive experience with the Company. As the liaison between the board and management, Mr. Stevenson's leadership role within the organization allows him to provide the board with critical insight and perspective on key strategic business initiatives. Mr. Stevenson served as Chief Financial Officer of Centrue Financial Corporation and Centrue Bank from 2000 to 2011.
Scott C. Sullivan (62) Director since 1996	Mr. Sullivan has been a director of Centrue Financial Corporation and Centrue Bank since 1996. Prior to that time he served as a director of Prairie Bancorp, Inc. He is a member and chairman of the Corporate Governance and Nominating Committee and member of the Compensation and Executive Committees. Mr. Sullivan holds a B.A. in Finance from the University of Notre Dame and a law degree from its law school. He is a licensed attorney and a senior partner of the law firm of WilliamsMcCarthy LLP where he concentrates his practice in corporate law and commercial litigation. He currently serves as a trustee of the Smith Charitable Foundation. Mr. Sullivan's professional qualifications and expertise allow him to provide important insight and guidance to the board and management with respect to complex matters facing the Corporation and the Bank.

Separation of the Chairman and Chief Executive Officer Roles and Board Oversight of Risk

The chairman and chief executive officer roles are currently separate. While the Company's by-laws permit the chairman and the chief executive officer to be the same person, we believe separation of these roles provides important checks and balances for the CEO role and those areas reporting to the board. The board has delegated to the Audit Committee the responsibility of implementing internal audit controls and maintaining the safety, soundness and integrity of the institution by properly mitigating and managing risk. On a daily basis, these duties are the responsibilities of the chief risk officer. This individual has a direct reporting relationship to the chairman of the Audit Committee who, in turn, provides regular updates to the full board. In addition, the board receives regular updates from key business leaders in the organization on critical business issues as part of the board's oversight function. From a leadership perspective, the board does interact periodically with key members of management through their participation in various board committee meetings. However, most routine matters are delegated to the CEO.

Board Committees and Meetings

Our board of directors met nine (9) times during 2016. During 2016 all directors attended at least seventy seven percent (77%) of the meetings of the board and the committees on which they served. Our board of directors has standing audit, compensation, corporate governance and nominating, and executive committees. Our board of directors has determined that the independent directors are Messrs. Battles, Butler, Cooper, Ferber, Ganim, Peterson, and Sullivan. Mr. Stevenson, our president and chief executive officer is a non-independent director.

The members of the board committees are:

Audit Committee	Corporate Governance and Nominating Committee
David J. Butler, Chairman	Scott C. Sullivan, Chairman
Randall E. Ganim	Dennis O. Battles
Richard C. Peterson	David J. Butler
	Bradley E. Cooper

Compensation Committee	Executive Committee
Richard C. Peterson, Chairman	Dennis O. Battles, Chairman
Dennis O. Battles	Randall E. Ganim
Derek J. Ferber	Kurt R. Stevenson
Scott C. Sullivan	Scott C. Sullivan

All of our directors will hold office for the terms to which they were elected, or until their respective successors are duly elected and qualified. No member of the board of directors is related to any other member of the board of directors.

Audit Committee

The Audit Committee is responsible for assisting the board of directors with oversight of (1) the integrity of our financial statements, (2) our compliance with legal and regulatory requirements, (3) the independent auditor's qualifications and independence and (4) the performance of our internal accounting function and independent auditors. The audit committee has the direct authority and responsibility to select, evaluate and, where appropriate, replace the independent auditors. The members of the audit committee are Messrs. Butler (Chairman), Ganim and Peterson. Each member of the compensation committee is independent. The committee met five times during 2016. The audit committee has a charter which is available on the Company’s website at www.centrue.com.

Compensation Committee

The members of the Compensation Committee are Messrs. Peterson (Chairman), Battles, Ferber and Sullivan. Each member of the Compensation Committee is independent. The committee met five times during 2016. The Compensation Committee has a charter which is available on the Company’s website at www.centrue.com.

The Compensation Committee is organized, and its members appointed, by the board of directors to carry out the responsibilities of the board of directors relating to the effective administration of the Company’s executive compensation and benefits programs, as well as the general oversight of the Company’s compensation program for all Company employees. The committee responsibilities include reviewing the performance of the CEO and compensation matters for our executive officers, except for those compensation matters for executive officers other than the chief executive officer delegated to the chief executive officer. The committee is responsible for providing oversight to ensure that the Company’s compensation, incentives and benefits are competitive and are aligned with Company goals so that such goals can be successfully achieved.

Items of daily management and decisions relating to company-wide compensation and benefits are delegated to Company management to the extent that it does not result in decisions that may materially benefit named executive officers in comparison with the overall employee population. The Company’s chief executive officer may implement salary changes for named executive officers within budgetary parameters, as delegated by the committee. The committee periodically reviews such information to ensure levels are reasonable and not excessive.

The Compensation Committee also periodically reviews director compensation. This oversight may be done in conjunction with or as delegated to the corporate governance committee or the full board of directors.

Corporate Governance and Nominating Committee

The members of the Corporate Governance and Nominating Committee are Messrs. Sullivan (Chairman), Battles, Butler and Cooper. Each member of the Corporate Governance and Nominating Committee is independent. This committee identifies individuals to become board members and selects, or recommends for the board's selection, director nominees to be presented for stockholder approval at the annual meeting of stockholders or to fill any vacancies. The Corporate Governance and Nominating Committee met two times during 2016.

Our board of directors has adopted a written charter for the Corporate Governance and Nominating Committee. The charter and principles are available on the Company's website at www.centrue.com.

The Corporate Governance and Nominating Committee will consider director nominees recommended by stockholders. A stockholder who wishes to recommend a person or persons for consideration as a nominee for election to the board of directors

must send a written notice by mail, c/o Corporate Governance and Nominating Committee, Centrue Financial Corporation, 122 West Madison Street, Ottawa, Illinois 61350 that sets forth: (1) the name, address (business and residence), date of birth and principal occupation or employment (present and for the past five years) of each person whom the stockholder proposes to be considered as a nominee; and (2) the number of shares of the common stock beneficially owned by the proposed nominee and the stockholder making the recommendation.

We may require any proposed nominee to furnish additional information as may be reasonably required to determine the qualifications of such proposed nominee to serve as a director of Centrue Financial Corporation. Stockholder recommendations will be considered only if received no less than 120 days or no more than 150 days before the one year anniversary of the date of the proxy statement sent to stockholders in connection with the previous year's annual meeting of stockholders. The Corporate Governance and Nominating Committee will consider any nominee recommended by a stockholder in accordance with the preceding paragraph under the same criteria as any other potential nominee.

While the Corporate Governance and Nominating Committee seeks board members from diverse professional backgrounds who combine a broad spectrum of experience and expertise with a reputation for integrity, the Company does not have a formal written diversity policy for director nominations. Directors should have experience in positions with a high degree of responsibility, be leaders in the companies or institutions with which they are affiliated and be selected based upon contributions they can make to the board in performing its oversight responsibilities. The Corporate Governance and Nominating Committee uses a subjective process for identifying and evaluating nominees for director, based on the information available to, and the subjective judgments of, the members of the Corporate Governance and Nominating Committee and our then current needs. We do not believe there would be any difference in the manner in which the committee evaluates nominees based on whether the nominee is recommended by a stockholder or not.

Executive Committee

Our board of directors has an Executive Committee of four directors. Messrs. Battles (Chairman), Ganim, Stevenson and Sullivan are the current members of the committee. The committee may act between board meetings as deemed necessary. The committee met once in 2016.

Code of Ethics

The Company has adopted a code of ethics that applies to all of our employees, officers and directors, including our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions. Our code of ethics contains written standards that we believe are reasonably designed to deter wrongdoing and to promote:

•Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;

•Full, fair, accurate, timely, and understandable disclosure in reports and documents that we file with, or submit to, any regulatory authority and in other public communications we make;

•Compliance with applicable governmental laws, rules and regulations;

•The prompt internal reporting of violations of the code to an appropriate person or persons named in the code; and

•Accountability for adherence to the code.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires our executive officers and directors and persons who beneficially own more than 10% of the outstanding shares of our Common Stock to file reports of ownership and changes of beneficial ownership with the Securities and Exchange Commission and to furnish us with copies of the reports they file. Based solely on a review of the reports we received, or written representations from certain reporting persons, we believe that with respect to 2016 and prior years all reports were timely filed other than:

(i) Mr. Solon who sold 50 shares of stock which was subsequently reported on a Form 5 on February 8, 2017.

Item 11. Executive Compensation

EXECUTIVE COMPENSATION SUMMARY

Philosophy

The Compensation Committee's principal responsibilities include acting upon matters delegated to the committee by the full board and ensuring the alignment of compensation with the strategic objectives of the organization.

The Compensation Committee recognizes that the Company's success is largely dependent on the selection, training and development of top caliber executive, managerial and professional talent. The committee has established an objective that the Company's executives are among the most highly qualified and talented professionals available in their respective areas of expertise, when compared to a peer group that represents competition for business and talent.

The Company believes successful compensation programs link business and compensation strategies with thought processes that address a broad array of program influences. This approach to strategy is a core value as it relates to how the Company competes with other organizations while meeting the needs of its customers.

Elements of Compensation and Determination of Payments

The Compensation Committee generally annually reviews and approves goals and objectives relevant to the incentive compensation plans of the chief executive officer and other executive officers of the organization. For the purposes of the committee's oversight, executive officers include those individuals who are the annually named executive officers of the Company.

In determining the compensation and benefits of our executive officers, the following factors are generally taken into consideration: the performance of the executive officers in achieving short and long-term goals; payment of compensation commensurate with the ability and expertise of the executive officers; and payment of compensation that is competitive with similar companies. The foregoing factors, as well as others, are considered in determining the compensation and benefits plans of our executive officers.

The following elements include factors that will be considered when reviewing executive officer compensation and benefits: base salary, short-term incentives (bonuses), long-term incentives, officer benefits, retirement plan funding, perquisites and group insurance benefits.

Use of Consultants - From time to time, the compensation committee and management have engaged the services of McLagan, a subsidiary of Aon Hewitt, to assist in compensation reviews of executives and staff, review and design of incentive compensation and equity arrangements, and review of employment agreement arrangements.

The following is a general description of how each of these elements applies to our executive officers.

Base Salary - In determining the base salary of executive officers, the Compensation Committee defines base salary as the annualized regular cash compensation of an employee, excluding bonus awards, Company contributions to employee benefits plans, or other compensation not designated as salary. The Compensation Committee considers the individual job performance of the executive officers, as well as overall corporate performance, and salaries published by our peers and other third party consultants. Base salaries are generally reviewed and considered for adjustment on an annual basis, unless circumstances exist in which the executive is assuming a scope and degree of responsibilities materially greater or lesser than the executive's present duties, or it is deemed that an adjustment is needed to meet marketplace demands. The committee may delegate base salary matters for executive officers, other than that of the chief executive officer, to the chief executive officer.

Short-Term Incentive Compensation (Cash Bonus) - The short-term incentive compensation program is intended to sustain management's focus on the Company's requirement for strategic long-range planning by encouraging attainment of annual goals. In the second quarter of 2014, after TARP-related restrictions were lifted, a short-term incentive compensation program was rolled out. The plan was designed by McLagan, a subsidiary of Aon Hewitt. The plan's objective is to cover top officers (senior vice presidents and higher), as well as commercial producers, and be market competitive, regulatory compliant and aligned with the Company's and bank's strategic goals. Award opportunities for participants are defined as a percentage of base salary, determined based on market competitive practices. The program was designed with a three-year transition to phase-in award opportunities beginning in 2014 with the goal of being fully market competitive in the 2016 plan year. However, awards opportunities in 2016 mirrored those of 2015 and were not increased. In 2016, target incentive opportunities ranged from 5% to 30% of salary.

The Company maintains a retail-focused incentive plan primarily for the benefit of retail division employees.

Long-Term Incentive Compensation - Inclusion in the Company's long-term incentive program is based on the recommendation of the chief executive officer and the Compensation Committee and is approved by the board of directors. On April 26, 2016, the board of directors, following the approval and recommendation of its compensation committee, approved awards in the aggregate of 29,134.5514 shares of restricted stock units ("Restricted Stock Unit") for members of senior management under the 2015 Stock Compensation Plan. Under the terms of the grant, the shares of Restricted Stock may not be sold, assigned, transferred, pledged, or otherwise encumbered by the Grantee, except in the event of the death of the Grantee or by will or the laws of descent and distribution, until vesting. The grantees shall become two-thirds vested in May of 2018 with the remaining one-third to vest in May 2019. Thirteen individuals, including those named executive officers included in the Summary Compensation Table received awards, based on a percentage of their salary, in recognition of their efforts towards the Company's successful performance, including its recapitalization, in 2015.
Officer Benefit Programs - Officer benefit programs focus on two general types of officer benefits: nonqualified retirement benefits and officer life insurance. Officer benefits are considered to be a critical component in attracting, retaining and motivating key talent.

In 2016, members of senior management were invited to participate in the Centrue Financial Corporation Executive Deferred Compensation Plan. Participants could defer up to 50% of salary and up to 100% of bonus into phantom company stock and/or a selection of Vanguard funds. Under the plan, the Company may make discretionary matching contributions with respect to a portion of the participant's deferral and discretionary contributions that are not related to the participant's deferrals. In 2016, the Company made no matching contributions to this plan. No trust was established for the plan. However, the plan is structured to allow for a rabbi trust. Participants may elect to receive distributions upon separation of service or upon normal retirement age (65) in a lump sum, over a five-year period or over a 10-year period. Participants have the option to take a distribution upon a change of control.

A small group of officers, including our chief executive officer, are covered by a split dollar plan which, subject to the achievement of certain conditions, pays out a portion of death benefits to the executives' named beneficiaries.

Retirement Benefits - The Compensation Committee considers various benefits, including retirement benefits, in determining compensation. The primary retirement vehicle is the Company's 401(k) plan which allows eligible participants to defer compensation up to annual IRS limits subject to non-discrimination testing. For Plan Year, the Company adopted a safe harbor status utilizing a matching formula in which the Company matched 100% of eligible deferrals up to 3% and matched 50% of the next 2% of eligible deferrals for a maximum Company match of 4% of eligible compensation.

Company executives participate in retirement plan programs in a manner consistent with plan provisions covering other employees. Currently, the Company does not provide executives with any supplemental executive retirement plan benefits.

Perquisites - Executive officers may have a limited number of perquisites made available to them. The main perquisites that may be offered are reimbursement of business expenses, country club expenses and employment agreements or change-in-control agreements.
Group Insurance Benefits - The Company offers a comprehensive employee benefits package for all eligible employees which includes group health (including a health savings account option), dental, vision, life, dependent life, short and long-term disability insurance and a flexible spending account plan (which terminated on December 31, 2016). Executive officers are afforded the same participation and rewards terms as all other eligible staff.
Total Rewards - The Company considers compensation a single package consisting of the parts described in this statement. When viewed in this manner, the organization is positioned to: 1) establish specific goals for each form of compensation, 2) project funding requirements consistent with the Company's business strategies, and 3) administer the program with predetermined goals as a guide. Assuming strategic goals are met, the combined total rewards would be expected to be comparable to similarly sized banks within the Company's market area. The approach to total

rewards for 2016 reflected the desire to take steps toward a more normalized and market-competitive compensation and benefits package, in recognition of the Company's improved financial performance and, specifically, to recognize and reward those key to that process.

Executive Compensation

The following table shows the compensation earned by the chief executive officer and the two other most highly compensated executive officers in 2016.

Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($)[4]	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)	Non-qualified Deferred Compensation Earnings ($)	All Other Compensation ($)	Total ($)
Kurt R. Stevenson	2016	$345,500	$164,500	$146,250	$—	—$	—$	—$ 11,989	$668,239
President & Chief	2015	$312,917	$133,950	$227,500	$—	—$	—$	—$ 6,746	$681,113
Executive Officer [1]	2014	$288,750	$4,300	$—	$—	—$	—$	—$ 3,116	$332,266
Daniel R. Kadolph	2016	$215,180	$76,020	$47,700	$—	—$	—$	—$ 9,422	$348,322
EVP/Chief Financial	2015	$204,571	$71,956	$116,600	$—	—$	—$	—$ 5,512	$398,639
Officer [2]	2014	$196,243	$23,000	$—	$—	—$	—$	—$ 1,972	$219,243
John E. Christy	2016	$210,870	$76,400	$46,688	$—	—$	—$	—$ 14,307	$348,265
EVP/Chief Lending	2015	$198,088	$73,062	$93,375	$—	—$	—$	—$ 36,015	$400,540
Officer [3]	2014	$18,013	$17,100	$—	$—	—$	—$	—$ 23,950	$219,779

(1) Mr. Stevenson's All Other Compensation figures for 2016, 2015, and 2014 represent imputed income related to Mr. Stevenson's split dollar bank-owned life insurance (BOLI) policy. In addition, Mr. Stevenson's All Other Compensation figures for 2016, 2015 and 2014 include employer 401(k) contributions of $10,600, $5,512 and $2,600, respectively.

(2) Mr. Kadolph's All Other Compensation figures for 2016, 2015 and 2014 include employer 401(k) contributions of $9,422, $5,512 and $1,972, respectively.

(3) Mr. Christy's 2016 All Other Compensation includes a taxable fringe benefit value of $10,913 plus $3,394 for taxes paid on Mr. Christy's behalf by the Company on that benefit. Mr. Christy's 2015 All Other Compensation includes $7,500 of regular earnings to pay for country club dues plus $4,389 to reflect taxes for a gross up; $13,978 to reflect the value of country club expenses paid by the Company; and $4,636 in taxes paid by the Company. Mr. Christy's All Other Compensation figure for 2014 includes $8,975 in reimbursable moving expenses, $10,000 in taxable temporary housing reimbursements and $3,691 of taxes the Company paid on Mr. Christy's behalf related to his temporary housing. In addition, Mr. Christy's All Other Compensation figures for 2016, 2015 and 2014 include employer 401(k) contributions of $10,600, $5,512 and $1,284, respectively.

(4) Amounts included in the 2016 Stock Awards reflect the fair market value of $16.72 for units of restricted stock granted on May 10, 2016. Under the terms of the grant, two-thirds of the units will vest on May 10, 2018 and the remaining one-third of the units will vest on May 10, 2019, assuming continued employment through such dates by the executive. Amounts included in 2015 Stock Awards reflect the fair market value of $17.75 for shares of restricted stock awards granted on November 4, 2015. Under the terms of the grant, the shares of restricted stock could not be sold, pledged or otherwise disposed of by the recipients until November 7, 2016, but the restricted stock was fully vested upon issuance.

Compensation of the Chief Executive Officer

Kurt R. Stevenson

During 2016, Kurt R. Stevenson served as the president and chief executive officer of Centrue Financial Corporation. Mr. Stevenson received a 12.6% salary increase from $325,000 to $366,000, retroactively effective on the payroll of July 1, 2016.

Mr. Stevenson received a bonus in December of 2016 for year 2016 performance in the amount of $164,500, a portion of which were amounts owed under the parameters of the short-term incentive compensation plan and a portion of which was at the discretion of the board of directors in recognition of exemplary performance for the period.

Mr. Stevenson was eligible for participation in company-sponsored benefits programs in 2016, including the Company's group health, dental and vision coverage, group-term life insurance coverage, and company-sponsored retirement programs including the 401(k) and Profit Sharing Plan, as well as a non-qualified deferred compensation plan. Mr. Stevenson also holds a split-dollar BOLI policy which pays out a portion of death benefits to his named beneficiaries.

In May of 2016, Mr. Stevenson received 8,747.0096 restricted stock units at a fair market value of $16.72 of Centrue Financial Corporation restricted stock which was the equivalent of $146,250, or 45% of his then-current salary of $325,000. Under the terms of the grant, the shares of Restricted Stock may not be sold, assigned, transferred, pledged, or otherwise encumbered by Mr.

Stevenson, except in the event of his death or by will or the laws of descent and distribution, until vesting. He shall become two-thirds vested in May of 2018 with the remaining one-third to vest in May 2019.
Mr. Stevenson did not receive any stock options or compensation associated with a car allowance or country club dues in 2016.

The compensation and benefits package for 2016 for Mr. Stevenson was approved by the Company's board of directors and was commensurate with his knowledge, skills and abilities, as supported by his professional experience and accomplishments, as well as the board's belief in his ability to successfully lead the organization. The compensation committee has reviewed all components of the total compensation package of the chief executive officer and the other named executive officers in this proxy statement and believes them to be reasonable and not excessive.

Compensation of Other Executive Officers

Daniel R. Kadolph
During 2016, Daniel R. Kadolph served as the executive vice president and chief financial officer of Centrue Financial Corporation. Mr. Kadolph received a 3.0% salary increase from $212,000 to $218,360, effective on the payroll of July 1, 2016.

Mr. Kadolph received a bonus in December of 2016 for year 2016 performance in the amount of $76,020, a portion of which were amounts owed under the parameters of the short-term incentive compensation plan and a portion of which was at the discretion of the board of directors in recognition of exemplary performance for the period.

Mr. Kadolph was eligible for participation in company-sponsored benefits programs in 2016, including the Company's group health, dental and vision coverage, group-term life insurance coverage and the 401(k) and Profit Sharing Plan, as well as a non-qualified deferred compensation plan.

In May of 2016, Mr. Kadolph received 2,852.8708 restricted stock units at a fair market value of $16.72 of Centrue Financial Corporation restricted stock which was the equivalent of $47,700, or 22.5% of his then-current salary of $212,000. Under the terms of the grant, the shares of Restricted Stock may not be sold, assigned, transferred, pledged, or otherwise encumbered by Mr. Kadolph except in the event of his death or by will or the laws of descent and distribution, until vesting. He shall become two-thirds vested in May of 2018 with the remaining one-third to vest in May 2019.

Mr. Kadolph did not receive any stock options or compensation associated with a car allowance or country club dues in 2016.

John E. Christy
During 2016, John E. Christy served as the executive vice president and chief lending officer. Mr. Christy received a 3.2% salary increase from $207,500 to $214,240, effective on the payroll of July 1, 2016.

Mr. Christy received a bonus in December of 2016 for year 2016 performance in the amount of $76,400, a portion of which were amounts owed under the parameters of the short-term incentive compensation plan and a portion of which was at the discretion of the board of directors in recognition of exemplary performance for the period.

Mr. Christy was eligible for participation in company-sponsored benefits programs in 2016, including the Company's group health, dental and vision coverage, group-term life insurance coverage and the 401(k) and Profit Sharing Plan.

In May of 2016, Mr. Christy received 2,792.3146 restricted stock units at a fair market value of $16.72 of Centrue Financial Corporation restricted stock which was the equivalent of $46,687.50, or 22.5% of his then-current salary of

$207,500. Under the terms of the grant, the shares of Restricted Stock may not be sold, assigned, transferred, pledged, or otherwise encumbered by Mr. Christy except in the event of his death or by will or the laws of descent and distribution, until vesting. He shall become two-thirds vested in May of 2018 with the remaining one-third to vest in May 2019.

Mr. Christy's 2016 All Other Compensation of $14,307 includes Country Club expenses of $10,913 plus $3,394 in taxes paid by the Company.
Mr. Christy did not receive any stock options or compensation associated with a car allowance in 2016.

DIRECTOR COMPENSATION SUMMARY

Name	Fees Earned or Paid in Cash	Stock Awards	Option Awards	Non-Equity Incentive Plan Compensation	Change in Pension Value and Nonqualified Deferred Compensation Earnings	All Other Compensation	Total
	$ (1)	$ (2)	$ (3)	$	$	$	$
Dennis O. Battles	$67,000	$10,000	$ —	$ —	$ —	$ —	$77,000
David J. Butler	$53,000	$10,000	$ —	$ —	$ —	$ —	$63,000
Bradley E. Cooper (4)	$7,250	$10,000	$ —	$ —	$ —	$ —	$17,250
Derek J. Ferber	$14,750	$10,000	$ —	$ —	$ —	$ —	$24,750
Randall E. Ganim	$36,500	$10,000	$ —	$ —	$ —	$ —	$46,500
Richard C. Peterson	$32,000	$10,000	$ —	$ —	$ —	$ —	$42,000
Scott C. Sullivan	$27,000	$10,000	$ —	$ —	$ —	$ —	$37,000

(1) Includes fees related to bank committees including credit committee. As of December 31, 2016 participants in Centrue Financial Corporation Non-Employee Directors Deferred Compensation Plan, which became effective January 1, 2007 held the following shares in their accounts: Mr. Ganim - 81 shares; and Mr. Sullivan - 579 shares. There were no new deferrals into the Plan during 2016.

(2) Restricted Stock Units ("RSUs") valued at $10,000 were granted to each independent director on May 10, 2016.

(3) Stock Options were not granted to directors in 2016. As of December 31, 2016. the directors listed in the table above have the following number of options awards outstanding: Mr. Ganim - 166 shares; and Mr. Sullivan - 166 shares.

(4) Fees are paid to Capital Z Partners III, L.P., not Mr. Cooper. RSUs grant was to Captial Z Partners III, L.P. not Mr. Cooper.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth certain information with respect to the beneficial ownership of our common stock at February 28, 2017, by each person known by us to be the beneficial owner of more than 5% of the outstanding common stock, by each director, by each executive officer named in the summary compensation table which can be found in Item 11 of this Form 10-K, and by all of our directors and executive officers as a group.

The following table is based on information supplied to us by the directors, officers and stockholders described above. The Company has determined beneficial ownership on the same basis used to calculate beneficial ownership under SEC rules. Shares of common stock subject to options that are either currently exercisable or exercisable within 60 days of February 28, 2017 are treated as outstanding and beneficially owned by the option holder for the purpose of computing the percentage ownership of the option holder. However, these shares are not treated as outstanding for the purpose of computing the percentage ownership of any other person. The table lists applicable percentage ownership based on 6,513,694 shares outstanding as of February 28, 2017. Unless otherwise indicated, the address for each person listed below is 122 West Madison Street, Ottawa, Illinois 61350.

Name of Individual or Number of Individuals in Group	Amount and Nature of Beneficial Ownership (1)(2)(3)(7)	Percent of Class
5% Stockholders		
Capital Z Partners Centrue AIV, L.P.[a] 142 West 57th Street, 3rd Floor New York, NY 10019	1,533,931	23.55%
FJ Capital Management, LLC[b] 1313 Dolley Madison Boulevard, Suite 306 McLean, VA 22101	636,911	9.78 %
Stieven Capital Advisors, L.P. 12412 Powerscourt Drive, Suite 250 St. Louis, MO 63131	635,710	9.76 %
Directors		
Bradley E. Cooper[a]	1,533,931	23.55%
David J. Butler	1,598	*
Dennis O. Battles	6,848	*
Derek J. Ferber[b]	637,509	9.79 %
Kurt R. Stevenson	39,146 (5)	*
Randall E. Ganim	9,740 (4)	*
Richard C. Peterson	8,931	*
Scott C. Sullivan	7,864 (6)	*
Other Named Executive Officers		
John E. Christy	48,084	*
Daniel R. Kadolph	15,713	*
All directors and all executive officers as a group (15 persons)	2,371,047	36.40%

* Less than 1%.

(a)Capital Z Partners Centrue AIV, L.P.

Capital Z Partners Centrue AIV, L.P., (“Capital Z AIV”) , is the record holder of 1,533,931 shares of the Company’s common stock. Capital Z Partners Management, LLC (“CZPM”) is the investment manager of Capital Z AIV. Capital Z Partners III GP, L.P. (“Cap Z GP LP”) is the sole general partner of Capital Z AIV. Capital Z Partners III GP, Ltd. (“Cap Z GP Ltd.”) is the sole general partner of Cap Z GP LP. Each of CZPM, Cap Z GP LP and Cap Z GP Ltd. may be deemed to beneficially own the shares of the Company’s common stock held by Capital Z AIV. Bradley E. Cooper and Robert A. Spass are founding partners

of CZPM and shareholders of Cap Z GP Ltd. and may be deemed to beneficially own the shares of the Company's common stock held by CZPM. Each of Messrs. Cooper and Spass disclaims beneficial ownership of the shares of the Company's common stock held by Cap Z AIV.

(b)FJ Capital Management, LLC
Martin S. Friedman as managing member of FJ Capital Management, LLC holds voting power over the shares held by it. As an affiliate of FJ Capital Management, LLC, Mr. Ferber may be deemed to beneficially own the shares of the Company's common stock held by FJ Capital Management, LLC. Each of Messrs. Friedman and Ferber disclaims beneficial ownership of the shares of the Company's common stock held by FJ Capital Management, LLC.

(1) The information contained in this column is based upon information furnished to us by the persons named above and the members of the designated group. Amounts reported include shares held directly as well as shares which are held in retirement accounts and shares held by members of the named individuals' families or held by trusts of which the named individual is a trustee or substantial beneficiary, with respect to which shares the respective individual may be deemed to have sole or shared voting and/or investment power. The nature of beneficial ownership for shares shown in this column is sole voting and investment power, except as set forth in the footnotes below. Inclusion of shares shall not constitute an admission of beneficial ownership or voting and investment power over included shares.

(2) Amounts shown include shares obtainable as of February 28, 2017 (or obtainable within 60 days of February 28, 2017) through the exercise of options to purchase shares of common stock granted under the Company's stock option plans as follows: Mr. Ganim-166 shares; and Mr. Sullivan-166 shares. Option holders have the sole power to exercise their respective options and would also be entitled to exercise sole voting and investment power over the shares issued upon the exercise of such options.

(3) Amounts shown also include phantom shares obtainable as of February 28, 2017 (or obtainable within 60 days of February 28, 2017) in accordance with the terms of the Company's non-employee directors' deferred compensation plan and the executive deferred compensation plan to participants as follows: Mr. Ganim- 81 shares; Mr. Stevenson-392 shares; and Mr. Sullivan- 579 shares.

(4) Includes 533 shares held by Mr. Gamin's spouse, over which Mr. Ganim has no voting or investment power.

(5) Includes 20,847 shares held by Mr. Stevenson jointly with his spouse, over which shares Mr. Stevenson has shared voting and investment power. Also includes 299 shares held by Mr. Stevenson in his 401(k) retirement plan.

(6) Includes 806 shares held by Mr. Sullivan's spouse and 32 shares held by members of Mr. Sullivan's family, over which shares Mr. Sullivan has shared voting and investment power.

(7) Restricted Stock Units were granted May 10, 2016 to each of the Company's independent directors totaling 598 RSUs. The named executive officers received RSUs granted May 10, 2016: Mr. Stevenson - 8,747; Mr. Kadolph - 2,853; and Mr. Christy - 2,792.

(8) Footnotes (2) through (7) are incorporated herein.

Item 13. Certain Relationships and Related Transactions, and Director Independence

DIRECTOR INDEPENDENCE

Our board of directors has determined that the independent directors are Messrs. Battles, Butler, Cooper, Ferber, Ganim, Peterson, and Sullivan. Mr. Stevenson, our president and chief executive officer is a non-independent director.

TRANSACTIONS WITH MANAGEMENT

The Company’s Audit Committee charter requires the review of all related party transactions, other than Regulation O transactions.

Several of our directors and executive officers (including their affiliates, families and companies in which they are principal owners, officers or directors) were loan customers of, and had other transactions with, us and our subsidiary in the ordinary course of business. These loans and lines of credit were made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans with persons not related to the lender and did not involve more than the normal risk of collectability or present other unfavorable features.

RELATED PARTY TRANSACTIONS

In connection with the Company’s recapitalization during March 2015, by virtue of their investment in the Company each of the following five percent (5%) stockholders of the Company became related parties of the Company, and with respect to these stockholders the recapitalization was a related party transaction. The number of shares shown below are prior to the 1:30 reverse stock split.

In accordance with the terms of the agreements memorializing the Company's recapitalization, Capital Z Partners Centrue AIV, L.P. has the right to select one nominee to be slated for election to the Company's board of directors, and the other investors in the recapitalization have the right (selecting as a single class) to select two nominees to be slated for election to the Company's board of directors. Capital Z Partners Centrue AIV, L.P. selected Mr. Cooper. Mr. Cooper is a founding partner of CZPM and an affiliate of Capital Z Partners Centrue AIV, L.P. The other investors selected Mr. Ferber. Mr. Ferber is affiliated with FJ Capital Management, LLC. Other than the recapitalization and the arrangements related to board nominations, there are no arrangements or understandings between the Company and any related party.

Related party transactions are reviewed by our Corporate Governance and Nominating Committee, with the committee provided with the details of each new, existing or proposed related party transaction, including the terms of the transaction, the business purpose of the transaction, and the benefits to the Company and to the relevant related party. In determining whether to approve a related party transaction, the committee will consider, among other factors, the following factors to the extent relevant to the related party transaction (i) whether the terms of the transaction are fair to the Company and on the same basis as would apply if the transaction did not involve a related party; (ii) whether there are business reasons for the Company to enter into the transaction; (iii) whether the related party transaction would impair the independence of an outside director; and (iv) whether the related party transaction would present an improper conflict of interests for any director or executive officer of the Company, taking into account the size of the transaction, the financial situation of the director, executive officer or related party, the direct or indirect nature of the interest in the transaction and the ongoing nature of any proposed relationship, and any other factors the committee deems relevant.

Any member of the committee who has an interest in the transaction under discussion will abstain from voting on the approval of the related party transaction, but may participate in discussions of the transaction. After review, the committee may determine to permit or to prohibit the related party transaction.

A related party transaction entered into without pre-approval of the committee shall not be deemed to violate this policy, or be invalid or unenforceable, so long as the transaction is brought to the committee as promptly as reasonably practical after it is entered into or after it becomes reasonably apparent that the transaction is covered by this policy.

Item 14. Principal Accountant Fees and Services

Audit Fees

Audit fees and expenses billed to the Company by Crowe Horwath LLP for the audit of the Company's financial statements for 2016 and 2015 were $306,825 and $405,350. The audit services also include the review of financial statements included in our quarterly reports on Form 10-Q and other services normally performed by independent registered public accounting firms in connection with statutory and regulatory filings.

Tax Fees

Tax fees and expenses billed to the Company for fiscal years 2016 and 2015 were $50,800 and $51,100 for services related to tax compliance, tax advice and tax planning, consisting primarily of preparing the Company's federal and state income tax returns for the previous fiscal periods and inclusive of expenses.

All Other Fees

Fees and expenses billed to the Company for fiscal years 2016 and 2015 were $0 and $17,000 for all other services, which primarily consisted of the audit of the benefit plans.

The Audit Committee, after consideration of the matter, does not believe that the rendering of these services by Crowe Horwath LLP to be incompatible with maintaining its independence as our principal accountant. In accordance with Section 10A(i) of the Exchange Act, before Crowe Horwath LLP is engaged by us to render audit or non-audit services, the engagement is approved by our audit committee. None of the audit-related, tax and other services described above were required to be approved by the audit committee pursuant to Rule 2-01(c)(7)(i)(C) of Regulation S-X.

The Audit Committee is responsible for reviewing and pre-approving any non-audit services to be performed by the Company's independent auditors. The Audit Committee has delegated its pre-approval authority to the chairman of the Audit Committee to act between meetings of the Audit Committee. Any pre-approval given by the chairman of the Audit Committee pursuant to this delegation is presented to the full Audit Committee at its next regularly scheduled meeting. The Audit Committee or chairman of the Audit Committee reviews and, if appropriate, approves non-audit service engagements, taking into account the proposed scope of the non-audit services, the proposed fees for the non-audit services, whether the non-audit services are permissible under applicable law or regulation and the likely impact of the non-audit services on the independence of the independent auditors.

CENTRUE FINANCIAL CORPORATION
PART IV

Item 15. Exhibits and Financial Statement Schedules

(a)(1) Financial Statement: See Part II - Item 8. Financial Statements and Supplementary Data.

(a)(2) Financial Statement Schedules: All schedules are omitted because they are not required or applicable, or the required information is shown in the Consolidated Financial Statements or the notes thereto.

(a)(3) Schedule of Exhibits: The Exhibit Index which immediately follows the signature pages to this Form 10-K is incorporated herein by reference.

(b) Exhibits: The exhibits required to be files with this Form 10-K are included with this Form 10-K and are located immediately following the Exhibit Index to this Form 10-K.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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 in the City of Ottawa, State of Illinois on March 2, 2017.

CENTRUE FINANCIAL
CORPORATION

By: /s/ Kurt R. Stevenson
Kurt R. Stevenson
President and Chief Executive Officer
(Duly Authorized Representative)

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Kurt R. Stevenson and Daniel R. Kadolph, jointly and severally, his attorneys-in-fact, each with the power of substitution, for him in any and all capacities, to sign any amendments to this Annual Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this registration statement has been signed by the following persons on behalf of the Registrant in the capacities and on the dates indicated.

Signatures	Title	Date
/s/ Kurt R. Stevenson Kurt R. Stevenson	President and Chief Executive Officer (Principal Executive Officer)	March 2, 2017
/s/ Daniel R. Kadolph Daniel R. Kadolph	Executive Vice President and Chief Financial Officer (Principal Accounting and Financial Officer)	March 2, 2017
/s/ Dennis O. Battles Dennis O. Battles	Director	March 2, 2017
/s/ David J. Butler David J. Butler	Director	March 2, 2017
/s/ Bradley E. Cooper Bradley E. Cooper	Director	March 2, 2017
/s/ Scott C. Sullivan Scott C. Sullivan	Director	March 2, 2017
/s/ Derek J. Ferber Derek J. Ferber	Director	March 2, 2017
/s/ Randall E. Ganim Randall E. Ganim	Director	March 2, 2017
/s/ Richard C. Peterson Richard C. Peterson	Director	March 2, 2017

* Signed by Power of Attorney

Centrue Financial Corporation
Exhibit Index to Annual Report on Form 10-K

Exhibit Number	Description
2.1	Agreement and Plan of Merger, dated as of January 26, 2017, among Midland States Bancorp, Inc., Sentinel Acquisition, LLC and Centrue Financial Corporation (filed as Exhibit to Form 8-K filed January 26, 2017)
3.1	Amended and Restated Certificate of Incorporation of the Company.*
3.2	Amended and Restated Bylaws of the Company.*
4.1	Specimen Common Stock Certificate.*
4.2	Stock Purchase Agreement, dated August 8, 2014 (as amended January 9, 2015), between the Company and Capital Z Partners III, L.P. pursuant to which Capital Z Partners III, L.P. agreed to purchase 24.9% of the post-restructuring outstanding shares of common stock of the Company (the agreement includes registration rights in favor of investors in the restructuring).*
10.1	Centrue Financial Corporation 1999 Nonqualified Stock Option Plan [incorporate by reference from Exhibit 10.1 to the registration statement on Form s-8 filed by the Company on December 10, 1999 (File No. 333-92549)].
10.2	Centrue Financial Corporation Amended and Restated 2003 Stock Option Plan [incorporated by reference from from Centrue's 2007 Proxy Statement].
10.3	Form of Stock Option Agreements [incorporated by reference from Exhibit 10.1 and 10.2 to Form 10-Q for the Quarter Ended March 31, 2007]
10.4	Centrue Financial Corporation 2015 Stock Compensation Plan.*
10.5	Kurt R. Stevenson Employment Agreement [incorporated by reference from Current Report on Form 8-K filed on July 7, 2006 (appears as Exhibit F-3 to Exhibit 2.1)]
10.6	Amendment to Kurt R. Stevenson Employment Agreement [incorporated by reference from Exhibit 2.2 to Current Report on Form 8-K filed on November 17, 2006].
10.7	Non-employee Directors' Deferred Compensation Plan [incorporated by reference from Exhibit 10.19 to Annual Report on Form 10-K for the year ended December 31, 2008].
10.8	Kankakee Bancorp, Inc. 1992 Stock Option Plan [incorporated by reference from Schedule 14A for the 1993 Annual Meeting of Stockholders of former Centrue Financial Corporation (Filer No. 001-15025)].
10.9	Kankakee Bancorp, Inc. 2003 Director Short Term Incentive Plan [incorporated by reference from Exhibit 10.1 to Form S-8 (Registration No. 333-104913) of former Centrue Financial Corporation (Filer No. 001-15025) filed on May 1, 2003].
10.10	Kankakee Bancorp, Inc. 2003 Stock Incentive Plan [incorporated by reference from Appendix B to Schedule 14A filed on March 14, 2003 of former Centrue Financial Corporation (Filer No. 001-15025)].
10.11	Executive Deferred Compensation Plan [incorporated by reference from Exhibit 10.25 to annual report on Form 10-K for the year ended December 31, 2008].
10.12	Amendment #1 to Kurt R. Stevenson Employment Agreement [incorporated by reference from Exhibit 10.2 to Current Report on 8-K filed on January 5, 2009].
10.13	Written agreement with the Federal Reserve Bank of Chicago and the Illinois Department of Financial and Professional regulation [incorporated by reference from Exhibit 10.1 to current report on Form 8-K filed on December 24, 2009].
10.14	Letter Agreement dated January 9, 2009 including the Securities Purchase Agreement - Standard Terms incorporated by reference therein between the Company and the U.S. Treasury [incorporated by reference from Form 8-K filed on January 1, 2009].
10.15	Form of Waiver of Senior Executive Officers [incorporated by reference from Form 8-K filed on January 14, 2009].
10.16	Form of Omnibus Amendment Agreement [incorporated by reference from Form 8-K filed on January 14, 2009].
10.17	Centrue Financial Corporation Annual Cash Bonus Plan.*

10.18	Form of 2015 Stock Compensation Plan Restricted Stock Agreement. (filed as Exhibit to Form 8-K, filed November 4, 2015)
10.19	Employment Agreement, dated April 29, 2016, between Centrue Financial Corporation, Inc. and Kurt R. Stevenson. (filed as Exhibit to Form 8-K, filed May 2, 2016)

10.20	Employment Agreement, dated April 29, 2016, between Centrue Financial Corporation, Inc. and Daniel R. Kadolph. (filed as Exhibit to Form 8-K, filed May 2, 2016)
10.21	Employment Agreement, dated April 29, 2016, between Centrue Financial Corporation, Inc. and John E. Christy. (filed as Exhibit to Form 8-K, filed May 2, 2016)
10.22	Centrue Financial Corporation 2015 Stock Compensation Plan Restricted Stock Units Agreement. (filed as Exhibit to Form 10-Q for the period ending March 31, 2016)
10.23	Securities Purchase Agreement by and between OSK, LLC and Centrue Financial Corporation, dated October, 27, 2016 (filed as Exhibit to Form 8-K, filed November 2, 2016)
10.24	Voting and Support Agreement, dated as of January 26, 2017, among Midland States Bancorp, Inc., Sentinel Acquisition, LLC and the Principal Stockholders named therein (filed as Exhibit to Form 8-K filed January 26, 2017)
21.1	Subsidiaries of Centrue Financial Corporation.*
23.1	Consent of Independent Registered Public Accounting Firm.
24.1	Power of Attorney (included on the Signatures page of this Annual Report on Form 10-K).
31.1	Rule 13a-14(a) / 15d-14(a) Certification of Chief Executive Officer.
31.2	Rule 13a-14(a) / 15d-14(a) Certification of Chief Financial Officer.
32.1	Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer.
101	The following financial statements from the Centrue Financial Corporation Annual Report on Form 10-K for the year ended December 31, 2016, formatted in Extensive Business Reporting Language (XBRL): (i) consolidated balance sheets, (ii) consolidated statements of operations, (iii) consolidated statements of comprehensive income, (iv) consolidated statements of cash flows and (v) the notes to consolidated financial statements.

* Filed with Form S-1 on September 25, 2015.