



WELLS
Financial
CORP.

2008 ANNUAL REPORT

**WELLS FINANCIAL CORP.
2008 ANNUAL REPORT**

Table of Contents

Profile.....	1
Selected Consolidated Financial and Other Data.....	2
Letter to Stockholders.....	3
Management's Discussion and Analysis of Financial Condition and Results of Operations.....	4-9
Independent Auditor's Report.....	10
Consolidated Statements of Financial Condition.....	11
Consolidated Statements of Income.....	12
Consolidated Statements of Stockholders' Equity.....	13-14
Consolidated Statements of Cash Flows.....	15
Notes to Consolidated Financial Statements.....	16-43
Other Corporate Information.....	44

Wells Financial Corp.

Profile

Wells Financial Corp. (the "Company") is a Minnesota corporation organized in December 1994 at the direction of the Board of Directors of Wells Federal Bank, fsb (the "Bank") to acquire all of the capital stock that the Bank issued upon its conversion from mutual to stock form of ownership. The Company is a unitary savings and loan holding company which, under existing laws, generally is not restricted in the types of business activities in which it may engage provided that the Bank retains a specified amount of its assets in housing-related investments. At the present time, because the Company does not conduct any active business, the Company does not employ any persons but utilizes the officers and staff of the Bank.

The Bank is a federally chartered stock savings bank headquartered in Wells, Minnesota. The Bank has nine full service offices located in Faribault, Martin, Blue Earth, Nicollet, Freeborn and Steele Counties, Minnesota and one loan origination office in Dakota County, Minnesota. The Bank was founded in 1934 and its deposits have been federally insured by the Savings Association Insurance Fund ("SAIF") and its predecessor, the Federal Savings and Loan Insurance Corporation ("FSLIC"), since 1934. The Bank is a member of the Federal Home Loan Bank ("FHLB") System. The Bank is a community oriented, full-service retail savings institution. The Bank attracts deposits from the general public and uses such deposits to invest in residential lending on owner occupied properties, commercial real estate and construction loans, agricultural real estate and operating loans, home equity and other consumer loans. Cash in excess of amounts needed for lending operations is used to purchase investment securities and to maintain required liquidity. The Bank has two subsidiaries, Greater Minnesota Mortgage (GMM) and Wells Insurance Agency (WIA). GMM originates loans through referrals from community commercial banks and, primarily, sells these loans to the secondary market. WIA is a full service insurance agency that sells property, casualty, life, health and investment products, including mutual funds.

**WELLS FINANCIAL CORP.
SELECTED CONSOLIDATED FINANCIAL AND OTHER DATA**

(dollars in thousands, except per share amounts)

Financial Condition					
December 31,	2008	2007	2006	2005	2004
Total assets	\$253,053	\$258,298	\$267,379	\$259,948	\$239,395
Loans held for sale	2,974	1,821	1,643	2,422	3,454
Loans receivable, net	217,425	220,974	233,670	224,041	205,662
Securities available for sale	8,420	9,082	8,483	10,667	13,945
Certificates of deposit	700	300	200	200	100
Cash and cash equivalents	8,744	14,182	11,701	10,396	5,605
Deposits	182,888	189,631	183,959	177,268	167,495
Borrowed funds	46,806	44,985	55,500	55,640	41,640
Stockholders' equity	20,613	20,652	24,321	23,472	26,590
Summary of Operations					
Years Ended December 31,	2008	2007	2006	2005	2004
Interest income	\$14,854	\$16,493	\$16,321	\$14,419	\$12,402
Interest expense	7,010	8,577	7,891	5,753	4,015
Net interest income	7,844	7,916	8,430	8,666	8,387
Provision for loan losses	503	71	75	195	120
Noninterest income	3,381	3,093	3,172	3,348	3,745
Noninterest expense	8,727	8,273	8,330	8,487	8,627
Net income	1,245	1,714	2,046	1,974	2,164
Other Selected Data					
As of and for Years Ended December 31,	2008	2007	2006	2005	2004
Return on average assets	0.50%	0.66%	0.79%	0.79%	0.95%
Return on average equity	6.03%	7.38%	8.79%	7.92%	7.64%
Average equity to average assets	8.24%	8.89%	8.96%	9.95%	12.40%
Equity to assets	8.15%	8.00%	9.10%	9.03%	11.11%
Net interest rate spread (1)	3.25%	3.06%	3.21%	3.51%	3.75%
Nonperforming assets to total loans (2)	3.67%	3.24%	1.34%	0.22%	0.34%
Allowance for loan losses to total loans	0.50%	0.50%	0.47%	0.47%	0.44%
Allowance for loan losses to nonperforming loans (2)	20.7%	20.0%	35.0%	315.8%	150.0%
Basic earnings per share	\$1.59	\$1.91	\$ 2.17	\$ 1.94	\$ 1.87
Diluted earnings per share	\$1.58	\$1.90	\$ 2.14	\$ 1.91	\$ 1.83
Cash dividends declared per share	\$1.04	\$1.04	\$ 1.04	\$ 0.96	\$ 0.88

(1) Interest rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.

(2) Nonperforming loans are loans over 90 days past due. Nonperforming assets include nonperforming loans and foreclosed real estate.



WELLS
Financial
C O R P .

53 FIRST ST. S.W., PO BOX 310 • WELLS, MN 56097-0310 • 507/553-3151

To Our Stockholders:

Wells Financial Corp. and its subsidiary, Wells Federal Bank, found 2008 to be a challenging year. The residential mortgage market melt down, which resulted in the Federal government bailout of the Federal Home Loan Mortgage Corp. (FHLMC), resulted in the Company realizing a \$484,000 other-than-temporary impairment on the FHLMC preferred stock in its investment portfolio. As overall economic conditions weakened the Company saw an increase in loan delinquencies and repossessed assets which resulted in a \$432,000 increase in the provision for loan loss when compared to 2007. The other-than-temporary impairment and the increase in the provision for loan loss were the primary reasons for a 27% decrease in net income for 2008 when compared to 2007. The Company's costs of funds continued to decrease throughout the year and overall its loan to deposit spreads continued to strengthen. The liquidity position of Wells Financial Corp. continues to remain strong along with the capital levels that exceed regulatory standards to be classified as a well-capitalized institution.

Near the end of 2008, the economic environment created a boom in home refinancing due to long-term interest rate reductions which were reflected in the secondary market rates. This may result in more loan originations than originally anticipated for 2009.

Wells Financial Corp. is committed to provide competitive products to the customers in the markets we serve and to implement the most efficient technologies to deliver those products. The Board of Directors and Management thank you for your interest and investment in Wells Financial Corp.

Sincerely,

Lonnie R. Trasamar
President

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(dollars in thousands)**

General

The Company's business activities to date have been limited to its investment in and loan to the Bank and a loan made to the Bank's Employee Stock Ownership Plan ("ESOP") to enable the ESOP to purchase shares of the Company's common stock and, to a lesser degree, investing in securities and deposits in other financial institutions. As a result of the limited operations of the Company, this discussion primarily relates to the Bank. The principal business of the Bank consists of attracting deposits from the general public and using such deposits, together with borrowings to invest in loans and investment securities.

The Company's primary source of income is the Bank's net interest income. Net interest income is determined by (i) the difference between yields earned on interest-earning assets and rates paid on interest-bearing liabilities (interest rate spread) and (ii) the relative amounts of interest-earning assets and interest-bearing liabilities. The Bank's interest rate spread is affected by regulatory, economic, and competitive factors that influence interest rates, loan demand, and deposit flows. In order to maintain interest rate spread and reduce interest rate risk, management has elected to diversify the Bank's loan portfolio by emphasizing its investment in agriculture and commercial mortgages, commercial operating and term loans and consumer loans

The Company's secondary sources of income are, primarily, the gain on sale of loans originated for sale and loan servicing fees. The Company experienced an increase in the gain on sale of loans originated for sale during 2008 when compared to 2007 due to an increase in the amount of mortgage loans originated for sale to the secondary market, primarily during the first half of 2008.

The operations of the Bank and the entire thrift industry are significantly affected by prevailing economic conditions, competition, and the monetary and fiscal policies of the federal government and governmental agencies. The demand for and supply of housing, competition among lenders, the level of interest rates, and the availability of funds influence lending activities. Deposit flows and costs of funds are influenced by prevailing market rates of interest, primarily on competing investments, account maturities, and the levels of personal income and savings in the Bank's market area.

(dollars in thousands)

The Company may from time to time make written or oral “forward-looking statements” including statements contained in this report and in other communications by the Company which are made in good faith pursuant to the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements, such as statements of the Company’s plans, objectives, estimates and intentions, involve risks and uncertainties and are subject to change based on various important factors (some of which are beyond the Company’s control). The following factors, among others, could cause the Company’s financial performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements: the strength of the United States economy in general and the strength of the local economies in which the Company conducts operations; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System, inflation, interest rate, market and monetary fluctuations; the timely development of and acceptance of new products and services of the Company and the perceived overall value of the products and services by users, including the features, pricing and quality compared to competitor’s products and services; the willingness of users to substitute competitors’ products and services for the Company’s products and services; the success of the Company in gaining regulatory approval of its products and services, when required; the impact of changes in financial services’ laws and regulations (including laws concerning taxes, banking, securities and insurance); technological changes; acquisitions; changes in consumer spending and savings habits; and the success of the Company at managing the risks involved in the foregoing.

The Company cautions that the foregoing list of important factors is not exclusive. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company.

Critical Accounting Estimates

The consolidated financial statements include amounts that are based on informed judgments of management. These estimates and judgments are the result of management’s need to estimate the effect of matters that are inherently uncertain. Therefore, actual results could vary significantly from the estimates used. Management considers the following items to be the critical accounting estimates contained in the consolidated financial statements.

Allowance for Loan Loss. The allowance for loan loss is based on management’s periodic review of the loan portfolio. In evaluating the adequacy of the allowance for loan loss, management considers factors including, but not limited to, specific loan impairment, historical loss experience, the size and composition of the loan portfolio and current economic conditions. Although management believes that the allowance for loan loss is maintained at an adequate level, there can be no assurance that further additions will not be made to the allowance and that losses will not exceed the estimated amounts.

Mortgage Servicing Rights. Mortgage servicing rights are capitalized and then amortized over the period of estimated servicing income. Management periodically evaluates its capitalized mortgage servicing rights for impairment. The valuation of mortgage servicing rights are estimated using discounted cash flows based upon estimated prepayment speeds, ancillary income received from loan servicing and current interest rates. Changes in these estimates may have a material effect on the valuation of the mortgage servicing rights. Although management believes that the estimates used to determine the value of the mortgage servicing rights are reasonable, future material adjustments may be necessary if economic conditions vary from those used to estimate the value of the mortgage servicing rights.

Average Balance Sheet (dollars in thousands)

The following table sets forth certain information relating to the Bank's average balance sheet and reflects the average yield on assets and average cost of liabilities for the periods indicated and the average yields earned and rates paid. Such yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods presented. The yields for the periods presented include deferred loan origination fees that are considered adjustments to yield. Average balances are derived from month-end balances. Management does not believe that the use of month-end balances instead of daily average balances has caused any material difference in the information presented.

	Years Ended December 31,							
	2008			2007				
	Average Balance	Average Cost/Yield	Average Balance	Interest	Average Cost/Yield	Average Balance	Interest	Average Yield/Cost
Interest-earning assets:								
Loans receivable (1)	\$215,071	6.59%	\$228,110	\$15,623	6.85%	\$ 233,341	\$ 15,613	6.69%
Investments (2)	18,933	3.63%	17,134	870	5.08%	15,915	708	4.45%
Total interest-earning assets	<u>234,004</u>	<u>6.35%</u>	<u>245,244</u>	<u>16,493</u>	<u>6.73%</u>	<u>249,256</u>	<u>16,321</u>	<u>6.55%</u>
Noninterest earning assets	<u>16,475</u>		<u>16,065</u>			<u>15,057</u>		
Total assets	<u>\$250,479</u>		<u>\$261,310</u>			<u>\$ 264,313</u>		
Interest bearing liabilities:								
Savings, NOW and money Market accounts	75,831	1.10%	71,249	835	1.17%	70,710	718	1.02%
Certificates of deposit	108,382	3.97%	112,075	5,212	4.65%	108,139	4,488	4.15%
Borrowed funds	41,863	4.47%	50,387	2,530	5.02%	57,477	2,685	4.67%
Total interest bearing liabilities	<u>226,076</u>	<u>3.10%</u>	<u>233,711</u>	<u>8,577</u>	<u>3.67%</u>	<u>236,326</u>	<u>7,891</u>	<u>3.34%</u>
Noninterest bearing liabilities	<u>3,766</u>		<u>4,370</u>			<u>4,313</u>		
Total liabilities	<u>229,842</u>		<u>238,081</u>			<u>240,639</u>		
Equity	<u>20,637</u>		<u>23,229</u>			<u>23,674</u>		
Total liabilities and equity	<u>\$250,479</u>		<u>\$261,310</u>			<u>\$ 264,313</u>		
Net interest income	<u>\$7,844</u>			<u>\$7,916</u>			<u>\$ 8,430</u>	
Interest rate spread (3)		3.25%			3.06%			3.21%
Net yield on interest earning assets (4)		3.35%			3.23%			3.38%
Ratio of average interest earning assets to average interest bearing liabilities	<u>1.04X</u>		<u>1.05X</u>			<u>1.05X</u>		

(1) Average balances include non-accrual loans and loans held for sale.

(2) Includes interest-bearing deposits in other financial institutions.

(3) Interest-rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.

(4) Net yield on interest-earning assets represents net interest income as a percentage of average interest-earning assets.

(dollars in thousands)

Rate/Volume Analysis

The table below sets forth certain information regarding changes in interest income and interest expense of the Bank for the years indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in volume (changes in average volume multiplied by old rate); (ii) changes in rates (changes in rate multiplied by old average volume); (iii) changes in rate-volume (changes in rate multiplied by the change in average volume). The combined effects of changes in both rate and volume that cannot be separately identified have been allocated proportionately to the change due to rate and the change due to volume.

	Years Ended December 31,					
	2008 vs. 2007			2007 vs. 2006		
	Increase (Decrease) Due to			Increase (Decrease) Due to		
	Volume	Rate	Net	Volume	Rate	Net
Interest Income:						
Loans receivable	\$ (873)	\$ (584)	\$(1,457)	\$ (192)	\$ 202	\$ 10
Investments	84	(266)	(182)	45	117	162
Total interest-earning assets	(789)	(850)	(1,639)	(147)	319	172
Interest expense:						
Deposit accounts	(115)	(792)	(907)	173	668	841
Borrowed funds	(292)	(368)	(660)	(347)	192	(155)
Total interest-bearing liabilities	(407)	(1,160)	(1,567)	(174)	860	686
Change in net interest income	\$ (382)	\$ 310	\$ (72)	\$ 27	\$ (541)	\$ (514)

(dollars in thousands)

Financial Condition

Total assets decreased by \$5,245 from \$258,298 at December 31, 2007 to \$253,053 at December 31, 2008. During 2008 the Company continued to concentrate its efforts to fund loans using lower cost of funds deposits while reducing its dependence on certificates of deposit which tend to be at a higher cost. This strategy resulted in a reduction of \$5,438 in cash, from \$14,182 at December 31, 2007 to \$8,744 at December 31, 2008 as the cash was used to fund the reduction in deposits. See the Consolidated Statements of Cash Flows and Note 8 in the accompanying financial statements for additional details. Other assets increased by \$2,594 due to an increase in repossessed assets.

Loans held for sale increased from \$1,821 at December 31, 2007 to \$2,974 at December 31, 2008. On December 31, 2007 and December 31, 2008, the Company had firm commitments to sell the loans that were classified as held for sale. Loans receivable decreased by \$3,549, or 1.6%, from \$220,974 at December 31, 2007 to \$217,425 at December 31, 2008. The decrease in loans receivable primarily resulted from a decrease in construction loans and, to a lesser extent, a decrease in residential loans. Partially offsetting these decreases were increases in home equity, home improvement and second mortgages and in other consumer loans..

In accordance with the Bank's internal classification of assets policy, management evaluates the loan portfolio on a quarterly basis to identify and determine the adequacy of the allowance for loan losses. As of December 31, 2008 and December 31, 2007, the balance in the allowance for loan losses and the allowance for loan losses as a percentage of total loans were \$1,096 and \$1,126 and 0.50% and 0.50%, respectively.

Loans on which the accrual of interest had been discontinued amounted to \$4,830 and \$4,834 at December 31, 2008 and 2007, respectively. The Company includes all loans considered impaired under FASB Statement No. 114 in nonaccrual loans. The amount of impaired loans at December 31, 2008 and 2007 was \$798 and \$2,818, respectively, and the related allowance for loan loss for these loans was \$69 and \$150, respectively.

Liabilities decreased by \$5,206, from \$237,646 at December 31, 2007 to \$232,440 at December 31, 2008. This decrease is due to a decrease of \$6,743 in deposits being partially offset by a \$1,821 increase in borrowed funds.

Stockholders' equity decreased by \$39 from \$20,652 at December 31, 2007 to \$20,613 at December 31, 2008. The decrease in stockholders' equity was the result of treasury stock increasing by \$336 and other comprehensive income decreasing by \$183 being partially offset by an increase of \$427 in retained earnings. The increase in retained earnings resulted from net income of \$1,245 being partially offset by the payment of \$818 in dividends.

(dollars in thousands)

Comparison of Operating Results for the Years Ended December 31, 2008 and 2007

General. Net income decreased by \$469, or 27.4% for 2008 when compared to 2007 due, primarily, to a \$485 other than temporary impairment the Company realized on its Federal Home Loan Mortgage Corp. (FHLMC) preferred stock and to an increase of \$467 in the provision for loan losses.

Interest Income. Interest income decreased by \$1,639, or 9.9% for 2008 when compared to 2007. The changes in interest income from the loan portfolio and investment securities and other interest bearing deposits resulted from changes in the average balances and yields on those interest earning assets. These changes are detailed in the Average Balance Sheet above.

Interest Expense. Interest expense on deposits decreased by \$907, or 15.0% and interest expense on borrowed funds decreased by \$660, or 26.1% for 2008 when compared to 2007. These changes resulted from changes in the average balances and interest rates. These changes are detailed in the Average Balance Sheet above.

Net Interest Income. Net interest income decreased by \$72, or 0.9% for the year ended December 31, 2008 when compared to the year ended December 31, 2007 due to the changes in interest income and interest expense described above.

Provision for Loan Losses. The provision for loan loss increased by \$432 for the year ended December 31, 2008 when compared to the year ended December 31, 2007. The provision reflects management's monitoring of the allowance for loan losses in relation to the size and quality of the loan portfolio and adjusts the provision for loan losses to adequately provide for loan losses. Due to changes in economic conditions and changes in the composition of the loan portfolio, it is possible that the provision for loan losses will increase in future periods.

Noninterest Income. Noninterest income increased by \$288, or 9.3%, for 2008 when compared to 2007 primarily due to an increase in the gain on sale of loans originated for sale. Due to lower interest rates on residential mortgages during 2008 when compared to 2007, primarily during the first half of the year, the Company originated and sold to the secondary market a larger volume of loans during 2008 when compared to 2007 resulting in an increase in gain on sale of loans originated for sale.

Noninterest Expense. Noninterest expense increased by \$454, or 5.5% for 2008 when compared to 2007 primarily due to the other than temporary impairment the Company realized on its FHLMC preferred stock. Partially offsetting this impairment was a \$135 decrease in compensation and benefits and a \$70 decrease in occupancy and rent.

Income Tax Expense. Income tax expense decreased by \$201, or 21.1%, for 2008 when compared to 2007.

McGladrey & Pullen

Certified Public Accountants

Independent Auditor's Report

To the Board of Directors and Stockholders
Wells Financial Corp. and Subsidiary
Wells, Minnesota

We have audited the accompanying consolidated statements of financial condition of **Wells Financial Corp. and Subsidiary** as of December 31, 2008 and 2007, and the related consolidated statements of income, stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of **Wells Financial Corp. and Subsidiary** as of December 31, 2008 and 2007, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

McGladrey & Pullen, LLP

Rochester, Minnesota
February 12, 2009

Wells Financial Corp. and Subsidiary

Consolidated Statements of Financial Condition

December 31, 2008 and 2007

(dollars in thousands, except per share data)

Assets	2008	2007
Cash and cash equivalents, including interest-bearing accounts 2008 \$2,689; 2007 \$7,138 (Note 16)	\$ 8,744	\$ 14,182
Certificates of deposit (Note 2)	700	300
Securities available for sale (Notes 3 and 9)	8,420	9,082
Federal Home Loan Bank Stock, at cost (Note 9)	3,302	2,329
Loans held for sale (Note 4)	2,974	1,821
Loans receivable, net of allowance for loan losses of \$1,096 in 2008; \$1,126 in 2007 (Notes 4 and 9)	217,425	220,974
Accrued interest receivable	1,813	2,056
Premises and equipment (Note 7)	3,961	4,225
Mortgage servicing rights, net (Note 5)	1,294	1,503
Other assets (Note 6)	4,420	1,826
Total assets	\$ 253,053	\$ 258,298
Liabilities and Stockholders' Equity		
Liabilities		
Deposits (Note 8)	\$ 182,888	\$ 189,631
Borrowed funds (Note 9)	46,806	44,985
Advances from borrowers for taxes and insurance (Note 5)	2,081	2,095
Deferred income taxes (Note 10)	205	576
Accrued interest payable	84	128
Accrued expenses and other liabilities	376	231
Total liabilities	232,440	237,646
Commitments, contingencies and credit risk (Notes 11, 14, 15, and 16)		
Stockholders' Equity (Notes 9, 11 and 13)		
Preferred stock, no par value; 500,000 shares authorized; none outstanding	-	-
Common stock, \$.10 par value; 7,000,000 shares authorized; 2,187,500 shares issued	219	219
Additional paid-in capital	17,143	17,091
Retained earnings, substantially restricted	31,312	30,884
Accumulated other comprehensive income	23	206
Less cost of treasury stock, 2008 1,412,060 shares; 2007 1,394,885 shares	(28,084)	(27,748)
Total stockholders' equity	20,613	20,652
Total liabilities and stockholders' equity	\$ 253,053	\$ 258,298

See Notes to Consolidated Financial Statements.

Wells Financial Corp. and Subsidiary

Consolidated Statements of Income
Years Ended December 31, 2008 and 2007
(dollars in thousands, except per share data)

	2008	2007
Interest and Fee Income		
Loans receivable	\$ 14,166	\$ 15,623
Investment securities and interest-bearing deposits	688	870
Total interest income	14,854	16,493
Interest Expense		
Deposits	5,140	6,047
Borrowed funds	1,870	2,530
Total interest expense	7,010	8,577
Net interest income	7,844	7,916
Provision for loan losses (Note 4)	503	71
Net interest income after provision for loan losses	7,341	7,845
Noninterest Income		
Gain on sale of loans originated for sale	853	712
Loan servicing fees	910	927
Insurance commissions	601	572
Fees and service charges	683	703
Other	334	179
Total noninterest income	3,381	3,093
Noninterest Expenses		
Compensation and benefits (Note 13)	4,089	4,224
Occupancy (Note 14)	1,175	1,245
Data processing (Note 14)	780	714
Advertising	238	275
Amortization of mortgage servicing rights (Note 5)	552	545
Impairment of securities available for sale (Note 3)	485	-
Other	1,408	1,270
Total noninterest expenses	8,727	8,273
Income before income taxes	1,995	2,665
Income tax expense (Note 10)	750	951
Net income	\$ 1,245	\$ 1,714
Cash dividends declared per share	\$ 1.04	\$ 1.04
Earnings per share (Note 12):		
Basic	\$ 1.59	\$ 1.91
Diluted	\$ 1.58	\$ 1.90

See Notes to Consolidated Financial Statements.

Wells Financial Corp. and Subsidiary

Consolidated Statements of Stockholders' Equity

Years Ended December 31, 2008 and 2007

(dollars in thousands, except per share data)

	Comprehensive Income	Common Stock	Additional Paid-In Capital
Balances, December 31, 2006		\$ 219	\$ 17,044
Comprehensive Income:			
Net income	\$ 1,714	-	-
Other comprehensive income, net of tax:			
Unrealized gains on securities, net of related taxes	(290)	-	-
Comprehensive income	<u>\$ 1,424</u>		
Cash dividends declared (\$1.04 per share)		-	-
Options exercised, 12,137 options (Note 13)		-	(91)
Stock based compensation			123
Award of management stock bonus plan shares, 2,200 shares		-	(42)
Tax benefit related to MSBP awards		-	57
Treasury stock purchases, 161,518 shares (Note 11)		-	-
Balances, December 31, 2007		<u>219</u>	<u>17,091</u>
Comprehensive Income:			
Net income	\$ 1,245	-	-
Other comprehensive income, net of tax:			
Unrealized gains on securities, net of related taxes	(183)	-	-
Comprehensive income	<u>\$ 1,062</u>		
Cash dividends declared (\$1.04 per share)		-	-
Stock based compensation			52
Treasury stock purchases, 17,175 shares (Note 11)		-	-
Balances, December 31, 2008		<u>\$ 219</u>	<u>\$ 17,143</u>

See Notes to Consolidated Financial Statements.

Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Stockholders' Equity
\$ 30,113	\$ 496	\$ (23,551)	\$ 24,321
1,714	-	-	1,714
-	(290)	-	(290)
(943)	-	-	(943)
-	-	240	149
-	-	-	123
-	-	42	-
-	-	-	57
-	-	(4,479)	(4,479)
<u>30,884</u>	<u>206</u>	<u>(27,748)</u>	<u>20,652</u>
1,245	-	-	1,245
-	(183)	-	(183)
(817)	-	-	(817)
-	-	-	52
-	-	(336)	(336)
<u>\$ 31,312</u>	<u>\$ 23</u>	<u>\$ (28,084)</u>	<u>\$ 20,613</u>

Wells Financial Corp. and Subsidiary

Consolidated Statements of Cash Flows
Years Ended December 31, 2008 and 2007
(dollars in thousands, except per share data)

	2008	2007
Cash Flows From Operating Activities		
Net income	\$ 1,245	\$ 1,714
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	503	71
Gain on sale of loans	(853)	(712)
Amortization of mortgage servicing rights	552	545
Stock based compensation expense	52	180
(Gain) loss on foreclosed real estate	1	(1)
Deferred income taxes	(246)	(214)
Depreciation and amortization on premises and equipment	445	515
Amortization of net deferred loan origination fees	(124)	(151)
Amortization of securities premiums	34	40
Impairment of available for sale securities	485	-
Impairment of foreclosed real estate	322	-
Loans originated for sale	(41,758)	(37,349)
Proceeds from the sale of loans held for sale	41,115	37,583
Changes in assets and liabilities:		
Accrued interest receivable	243	191
Other assets	(178)	(63)
Accrued expenses and other liabilities	102	(128)
Net cash provided by operating activities	1,940	2,221
Cash Flows From Investing Activities		
Net increase in loans	262	11,178
Net purchases of certificates of deposits	(400)	(100)
Purchase of Federal Home Loan Bank Stock	(1,421)	(9)
Proceeds from sale of Federal Home Loan Bank Stock	448	565
Cash flows from available-for-sale securities (Note 3) (Note 18)	(166)	(1,131)
Purchase of premises and equipment	(181)	(117)
Proceeds from the sale of foreclosed real estate	610	44
Investment in foreclosed real estate	(441)	(29)
Net cash provided by (used in) investing activities	(1,289)	10,401
Cash Flows From Financing Activities		
Net increase (decrease) in deposits	(6,743)	5,672
Net decrease in advances from borrowers for taxes and insurance	(14)	(25)
Stock options exercised	-	149
Dividends paid	(817)	(943)
Repayment of borrowed funds	(33,003)	(29,115)
Proceeds from long term borrowing	34,824	18,600
Purchase of treasury stock	(336)	(4,479)
Net cash used in financing activities	(6,089)	(10,141)
Net increase (decrease) in cash	(5,438)	2,481
Cash and cash equivalents		
Beginning	14,182	11,701
Ending	\$ 8,744	\$ 14,182

See Notes to Consolidated Financial Statements.

Wells Financial Corp. and Subsidiary

Notes to Consolidated Financial Statements (dollars in thousands, except per share data)

Note 1. Summary of Significant Accounting Policies

Principles of consolidation: The accompanying consolidated financial statements include the accounts of Wells Financial Corp., its wholly owned subsidiary, Wells Federal Bank, fsb., and the Bank's wholly owned subsidiaries, Wells Insurance Agency, Inc. and Greater Minnesota Mortgage, Inc. All significant intercompany transactions and balances are eliminated in consolidation.

Nature of operations: Operations of Wells Financial Corp. (Company) primarily consist of banking services through Wells Federal Bank, fsb (Bank). Wells Insurance Agency, Inc., is a property and casualty insurance agency. Greater Minnesota Mortgage, Inc., is a mortgage banking company that originates loans through referrals from commercial banks. The Company serves its customers through the Bank's nine locations in South Central Minnesota.

Use of estimates: In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the statements of financial condition and revenues and expenses for the reporting period. Actual results could differ from those estimates. Four estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, valuation of available for sale securities, valuation of mortgage servicing rights, and valuation of other real estate owned.

Management believes that the allowances for losses on loans are adequate. While management uses available information to recognize losses on loans, future additions to the allowances may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowances for losses on loans. Such agencies may require the Company to recognize additions to the allowances based on their judgments about information available to them at the time of their examination.

Securities available for sale are carried at fair value. Unrealized gains or losses, net of the related deferred tax effect, are reported as a net amount in accumulated other comprehensive income. Amortization of premiums and accretion of discounts, computed by the interest method over their contractual lives, are recognized in interest income. Realized gains or losses, determined on the basis of the cost of specific securities sold, are included in earnings. Declines in the fair value of individual securities below their amortized cost that are determined to be other than temporary result in write-downs of the individual securities to their fair value with the resulting write-downs included in current earnings as realized losses.

Mortgage servicing rights are subject to change based primarily on changes in the mix of loans, interest rates, prepayment speeds, or default rates from the estimates used in the valuation of the mortgage servicing rights. Such changes may have a material effect on the amortization and valuation of mortgage servicing rights. Although management believes that the assumptions used to evaluate the mortgage servicing rights for impairment are reasonable, future adjustment may be necessary if future economic conditions differ substantially from the economic assumptions used to determine the value of the mortgage servicing rights.

Real estate acquired in satisfaction of loans is carried at the lower of the recorded investment in the property or its net realizable value less estimated costs to sell. The value of the underlying loan is written down to the fair market value of the real estate at the date acquired by a charge to the allowance for possible loan losses, if necessary. A provision is charged against other operating expense for any subsequent write-downs to net realizable value. Operating expenses of such properties are included in other operating expenses.

Wells Financial Corp. and Subsidiary

Notes to Consolidated Financial Statements (dollars in thousands, except per share data)

Note 1. Summary of Significant Accounting Policies (Continued)

Comprehensive income: Comprehensive income is the total of reported net income and other comprehensive income. Other comprehensive income consists of unrealized gains or losses, net of tax, on securities available for sale.

Cash and cash equivalents: For the purpose of reporting cash flows, cash and cash equivalents includes cash on hand, demand deposits at other financial institutions, amounts due from banks (including cash items in process of clearing) and federal funds sold. Cash flows from loans (except loans originated for sale) and deposits are reported net. Interest bearing deposits are carried at cost.

Federal Home Loan Bank stock: The Bank, as a member of the Federal Home Loan Bank (FHLB) system, is required to maintain an investment in capital stock of the FHLB. The FHLB stock requirement is related to the asset size of the Bank, the amount of advances the Bank has with the FHLB, and to a lesser extent, the amount of loans being serviced by the Bank for FHLB. No ready market exists for the FHLB stock and it has no quoted market value.

Securities available for sale: Securities classified as available for sale includes all equity securities and those debt securities the Company intends to hold for an indefinite period of time, but not necessarily to maturity. 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.

Loans held for sale: Loans held for sale are those loans the Company has the intent to sell in the foreseeable future. They are carried at the lower of aggregate cost or market value. Gains and losses on sales of loans are recognized at settlement dates and are determined by the difference between the sales proceeds and the carrying value of the loans after allocating cost to servicing rights retained. All sales are made without recourse.

Loans receivable: The Company generally originates single-family residential loans within its primary lending area of South Central Minnesota and Northern Iowa. These loans are secured by the underlying properties. The Company is also active in originating agricultural real estate, commercial real estate, commercial operating and secured consumer loans, primarily automobile and home equity loans.

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are stated at the amount of unpaid principal, reduced by an allowance for loan losses and net deferred origination fees. Interest is accrued daily on the outstanding balances.

The Company determines a loan to be delinquent when payments have not been made according to contractual terms, typically evidenced by nonpayment of a monthly installment by the due date. Accrual of interest is discontinued for loans at the time the loan is 120 days delinquent for first mortgage loans or 90 days delinquent for consumer/other loans. All interest accrued but not collected for loans that are placed on nonaccrual status is reversed against interest income. Accrual of interest is generally resumed when the borrower has demonstrated the ability to make all periodic interest and principal payments.

Wells Financial Corp. and Subsidiary

Notes to Consolidated Financial Statements (dollars in thousands, except per share data)

Note 1. Summary of Significant Accounting Policies (Continued)

Allowance for loan losses: The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that collectibility of the principal is unlikely. Subsequent recoveries, if any, are credited to the allowance.

The allowance is an amount that management believes will be adequate to absorb estimated losses relating to specifically identified loans, as well as probable credit losses inherent in the balance of the loan portfolio, based on an evaluation of the collectibility of existing loans and prior loss experience. This evaluation also takes into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay. This evaluation does not include the effects of expected losses on specific loans or groups of loans that are related to future events or expected changes in economic conditions. While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses and may require the Bank to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

The allowance consists of specific and general components. The specific component relates to loans that are classified as special mention, substandard, doubtful and loss. For impaired loans, an allowance is established when the discounted cash flows (or collateral value or observable market value) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors.

A loan is impaired when it is probable, based on current information and events, the Company will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan agreement. Impaired loans are measured on an individual basis based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. The amount of impairment, if any, and any subsequent changes are included in the allowance for loan losses.

Large groups of smaller balance homogenous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment disclosures.

Wells Financial Corp. and Subsidiary

Notes to Consolidated Financial Statements (dollars in thousands, except per share data)

Note 1. Summary of Significant Accounting Policies (Continued)

Loan origination fees and related costs: Loan origination and commitment fees and certain direct loan origination costs are deferred, and the net fee or cost is recognized as an adjustment to interest income using the interest method over the contractual life of the loans, adjusted for estimated prepayments based on the Company's historical prepayment experience.

Loan servicing: The Company generally retains the right to service mortgage loans sold to others. Mortgage servicing rights retained are initially measured at fair value and have been recognized as a separate asset and are being amortized in proportion to and over the period of estimated net servicing income.

Mortgage servicing rights are periodically evaluated for impairment based on the fair value of those rights. Fair values are estimated using discounted cash flows based upon estimated prepayment speeds, ancillary income received from loan servicing and current interest rates. For purposes of measuring impairment, the rights must be stratified by one or more predominant risk characteristics of the underlying loans. The Company stratifies its capitalized mortgage servicing rights based on interest rates and the term of the underlying loans. The amount of impairment recognized is the amount, if any, by which the amortized cost of the rights for each stratum exceeds their fair value.

Foreclosed real estate: Real estate properties acquired through, or in lieu of, loan foreclosure are initially recorded at the lower of cost or fair value less estimated costs to sell at the date of foreclosure. Costs relating to improvement of property are capitalized, whereas costs relating to the holding of property are expensed. Valuations are periodically performed by management and charge-offs to operations are made if the carrying value of a property exceeds its estimated fair value less estimated costs to sell.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the entity, (2) 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 (3) the entity does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Advertising: Advertising costs are expensed as incurred.

Premises and equipment: Land is carried at cost. Bank premises, leasehold improvements, and furniture, fixtures, and equipment are carried at cost, less accumulated depreciation and amortization. Bank premises and furniture, fixtures, and equipment are depreciated using the straight-line method over the estimated useful lives of the assets ranging from 10 to 40 years for bank premises and 3 to 7 years for furniture, fixtures and equipment. The cost of leasehold improvements is being amortized using the straight-line method over the terms of the related leases, generally 7 to 10 years.

Wells Financial Corp. and Subsidiary

Notes to Consolidated Financial Statements (dollars in thousands, except per share data)

Note 1. Summary of Significant Accounting Policies (Continued)

Income taxes: Deferred taxes are provided on an asset and liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss or tax credit carry forwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the amounts of assets and liabilities recorded for income tax and financial reporting purposes. Deferred tax assets are reduced by a valuation allowance when management determines that it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Earnings per share: Basic earnings per common share are computed based upon the weighted average number of common shares outstanding during each year. Dilutive per share amounts assume conversion, exercise or issuance of all potential common stock instruments unless the effect is to reduce a loss or increase income per common share.

Employee Stock Plans: The Company accounts for stock-based compensation plans under the recognition and measurement principles of FASB Statement No. 123 (revised 2004), *Share-Based Payment*. Statement No. 123(R) requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost is measured based on the fair value of the equity or liability instruments issued. Statement No. 123(R) covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. The effect of Statement No. 123(R) is to require entities to measure the cost of employee services received in exchange for stock awards based on the grant-date fair value of the award, and to recognize the cost over the period the employee is required to provide services for the award.

The Company adopted Statement No. 123(R) on January 1, 2006, under the prospective method. Compensation cost for awards issued after January 1, 2006, has been measured using the fair value of an award on the grant dates and is recognized over the service period (usually the vesting period). Compensation cost related to the nonvested portion of awards outstanding as of January 1, 2006, was based on Accounting Principles Board Opinion No. 25 and related interpretations, in accounting for the stock option plan prior to January 1, 2006. Under APB Opinion No. 25, stock options issued under the Company's stock option plan have no intrinsic value at the grant date and, therefore, no compensation cost was recognized for them. Any newly awarded grants under the stock option plans will be expensed over any vesting period.

Wells Financial Corp. and Subsidiary

Notes to Consolidated Financial Statements
(dollars in thousands, except per share data)

Note 1. Summary of Significant Accounting Policies (Continued)

Fair value of financial instruments: The following methods and assumptions were used by the Company in estimating the fair value of its financial instruments:

Cash and cash equivalents: The carrying amounts reported for cash and cash equivalents approximate their fair values.

Certificates of deposit: The carrying amounts reported for certificate of deposits approximate their fair values.

Securities available for sale: The fair value of debt securities were generally determined based on matrix pricing. Matrix pricing is a mathematical technique that utilizes observable market inputs including, for example, yield curves, credit ratings and prepayment speeds.

Federal Home Loan Bank stock: The carrying amount approximates fair value.

Loans held for sale: Fair values are based on quoted market prices of similar loans sold on the secondary market.

Loans and accrued interest receivable: For variable-rate loans that reprice frequently and that have experienced no significant change in credit risk, fair values are based on carrying values. Fair values for all other loans are estimated based on discounted cash flows, using interest rates currently being offered for loans with similar terms to borrowers with similar credit quality. The carrying amount of accrued interest receivable approximates its fair value.

Mortgage servicing rights: Fair values are estimated using discounted cash flows based on current market rates and conditions.

Deposits and other liabilities: The fair values disclosed for demand deposits and savings accounts are, by definition, equal to their carrying amounts, which represent the amounts payable on demand. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on those certificates. The carrying amounts of advances by borrowers for taxes and insurance and accrued interest payable approximate their fair values.

Wells Financial Corp. and Subsidiary

Notes to Consolidated Financial Statements (dollars in thousands, except per share data)

Note 1. Summary of Significant Accounting Policies (Continued)

Borrowed funds: The fair value of long term fixed rate borrowed funds is estimated by using a discounted cash flow analysis based on current incremental borrowing rates for similar types of borrowing arrangements.

Off-statement of financial condition instruments: Since the majority of the Company's off-statement of financial condition instruments consist of non fee-producing commitments to originate and sell loans, the Company has determined they do not have a significant fair value.

Derivatives-rate lock commitments: The Company enters into commitments to originate loans whereby the interest rate on the loan is determined prior to funding (rate lock commitment). Rate lock commitments on mortgage loans held for sale are derivatives. Derivative instruments are recognized in the statement of financial condition at fair value and changes in the fair value thereof are recognized in the statement of income. The Company originates single-family residential loans for sale pursuant to programs primarily with Federal Home Loan Mortgage Corporation (FHLMC). Under the structure of the programs, at the time the Company initially issues a loan commitment in connection with such programs, it does not lock in a specific interest rate. At the time the interest rate is locked in by the borrower, the Company concurrently enters into a forward loan sale agreement with respect to the sale of such loan at a set price in an effort to manage the interest rate risk inherent in the locked loan commitment.

The forward loan sale agreement also meets the definition of a derivative instrument. Any change in the fair value of the loan commitment after the borrower locks in the interest rate is substantially offset by the corresponding change in the fair value of the forward loan sale agreement related to such loan. The period from the time the borrower locks in the interest rate to the time the Company funds the loan and sells it to FHLMC is generally 60 days. The fair value of each instrument will rise or fall in response to changes in market interest rates subsequent to the dates the interest rate locks and forward loan sale agreements are entered into. In the event that interest rates rise after the Company enters into an interest rate lock, the fair value of the loan commitment will decline. However, the fair value of the forward loan sale agreement related to such loan commitment should increase by substantially the same amount, effectively eliminating the Company's interest rate and price risk.

At December 31, 2008, the Company had \$11.3 million of loan commitments outstanding related to loans being originated for sale, all of which were subject to interest rate locks and forward loan sale agreements as described above. The fair value of the interest rate lock commitments and forward sale commitments were considered immaterial to the Company's consolidated financial statements.

Wells Financial Corp. and Subsidiary

Notes to Consolidated Financial Statements (dollars in thousands, except per share data)

Note 1. Summary of Significant Accounting Policies (Continued)

Fair value measurements: In September 2006 the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurement. SFAS No. 157 also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Under SFAS No. 157, fair value measurements are disclosed by level within that hierarchy. In February 2008, the FASB issued FASB Staff Position No. 157-2, *Effective Date of FASB Statement No. 157*, which permits a one-year deferral for the implementation of SFAS No. 157 with regard to nonfinancial assets and liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis. The Company adopted SFAS No. 157 for the fiscal year beginning January 1, 2008, except for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis for which delayed application is permitted until our fiscal year beginning January 1, 2009. The Company is currently assessing the potential effect of the adoption of the remaining provisions of SFAS No. 157 on its financial position, results of operations and cash flows.

The provisions of SFAS No. 159, the Fair Value Option for Financial Assets and Financial Liabilities, which permit an entity to choose to measure eligible financial instruments and other items at fair value, also became effective January 1, 2008. The Company has not made any fair value elections under SFAS No. 159 as of December 31, 2008.

Note 2. Certificates of Deposit

Certificates of deposit with a carrying value of \$700 and \$300 at December 31, 2008 and 2007, respectively, had weighted average yields of 2.7% and 5.0%, respectively, and contractual maturities of less than one year.

Wells Financial Corp. and Subsidiary

Notes to Consolidated Financial Statements
(dollars in thousands, except per share data)

Note 3. Securities Available for Sale

	December 31, 2008			
	Amortized	Gross	Gross	Fair Value
	Cost	Unrealized Gains	Unrealized Losses	
Mortgage backed securities	\$ 5,963	\$ 82	\$ (8)	\$ 6,037
Obligations of states and political subdivisions	2,382	20	(39)	2,363
Equity securities	40	-	(20)	20
	<u>\$ 8,385</u>	<u>\$ 102</u>	<u>\$ (67)</u>	<u>\$ 8,420</u>

	December 31, 2007			
	Amortized	Gross	Gross	Fair Value
	Cost	Unrealized Gains	Unrealized Losses	
Mortgage backed securities	\$ 6,524	\$ 11	\$ (87)	\$ 6,448
Obligations of states and political subdivisions	1,699	9	(4)	1,704
Equity securities	516	534	(120)	930
	<u>\$ 8,739</u>	<u>\$ 554</u>	<u>\$ (211)</u>	<u>\$ 9,082</u>

Contractual maturities: The amortized cost and fair value of securities available for sale as of December 31, 2008 by contractual maturity are shown below. Maturities may differ from contractual maturities in mortgage-backed securities because the mortgages underlying the securities may be called or repaid without any penalties. In addition, equity securities have no maturity. Therefore, these securities are not included in the maturity categories in the following maturity summary.

	Amortized Cost	Fair Value
Due in one year or less	\$ 60	\$ 60
Due in one to five years	125	127
Due in over five years	2,197	2,176
	<u>2,382</u>	<u>2,363</u>
Equity securities	40	20
Mortgage backed securities	5,963	6,037
	<u>\$ 8,385</u>	<u>\$ 8,420</u>

Wells Financial Corp. and Subsidiary

Notes to Consolidated Financial Statements
(dollars in thousands, except per share data)

Note 3. Securities Available for Sale (Continued)

Changes in other comprehensive income - unrealized gains on securities available for sale:

	Years Ended December 31,	
	2008	2007
Balance, beginning	\$ 206	\$ 496
Unrealized losses during the year	(308)	(492)
Deferred tax effect relating to unrealized loss	125	202
Balance, ending	\$ 23	\$ 206

There were 11 and 14 securities in unrealized loss positions as of December 31, 2008 and 2007, respectively.

	December 31, 2008					
	Continuous Unrealized Losses		Continuous Unrealized Losses		Total	
	Existing for 12 Months or Less		Existing Greater Than 12 Months			
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Mortgage-backed securities	\$ -	\$ -	\$ 2,064	\$ 8	\$ 2,064	\$ 8
Obligations of states and political subdivisions	370	5	641	34	1,011	39
Equity securities	20	20	-	-	20	20
	\$ 390	\$ 25	\$ 2,705	\$ 42	\$ 3,095	\$ 67

	December 31, 2007					
	Continuous Unrealized Losses		Continuous Unrealized Losses		Total	
	Existing for 12 Months or Less		Existing Greater Than 12 Months			
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Mortgage-backed securities	\$ -	\$ -	\$ 5,299	\$ 87	\$ 5,299	\$ 87
Obligations of states and political subdivisions	315	1	392	3	707	4
Equity securities	380	120	-	-	380	120
	\$ 695	\$ 121	\$ 5,691	\$ 90	\$ 6,386	\$ 211

Unrealized losses are deemed to be temporary. Most of these underlying securities consist of mortgage-backed securities. Market fluctuations are caused primarily by changes in interest rates and prepayments of underlying mortgages. Volatility in economic conditions influences the prices of these securities.

Wells Financial Corp. and Subsidiary

Notes to Consolidated Financial Statements
(dollars in thousands, except per share data)

Note 3. Securities Available for Sale (Continued)

The Company recognized a \$485 “other-than-temporary” noncash impairment charge on its investment in Federal Home Loan Mortgage Corporation preferred stock issuances. While the Company expects this investment to partially recover its original cost and has both the intent and ability to hold the investment until such recovery occurs, this investment was deemed to be other-than-temporarily impaired given the duration of the unrealized loss position and uncertainty as to the timing of a partial recovery.

Securities with a carrying value of \$3,407 and \$5,299 at December 31, 2008 and 2007, respectively, were pledged to secure borrowed funds and for other purposes as required or permitted by law.

Note 4. Loans Receivable and Loans Held for Sale

Composition of loans receivable:

	December 31,	
	2008	2007
First mortgage loans (principally conventional):		
Secured primarily by one-to-four family residences	\$ 39,475	\$ 41,665
Secured by other properties, primarily agricultural real estate	96,844	96,983
Construction	6,508	11,170
Total first mortgage loans	142,827	149,818
Consumer and other loans:		
Home equity, home improvement and second mortgages	46,065	43,563
Agricultural and commercial operating and term loans	11,970	12,519
Vehicle loans	3,369	3,925
Other	14,436	12,492
Total consumer and other loans	75,840	72,499
Total loans	218,667	222,317
Net deferred loan origination fees	(146)	(217)
Allowance for loan losses	(1,096)	(1,126)
Loans receivable, net	\$ 217,425	\$ 220,974

Wells Financial Corp. and Subsidiary

Notes to Consolidated Financial Statements
(dollars in thousands, except per share data)

Note 4. Loans Receivable and Loans Held for Sale (Continued)

Allowance for loan losses:

	Years Ended December 31,	
	2008	2007
Balance, beginning	\$ 1,126	\$ 1,107
Provision for loan losses	503	71
Loans charged off	(548)	(71)
Recoveries	15	19
Balance, ending	<u>\$ 1,096</u>	<u>\$ 1,126</u>

Nonaccrual and impaired loans: Loans on which the accrual of interest has been discontinued totaled \$4,830 and \$4,834 at December 31, 2008 and 2007 respectively. Interest income recognized on nonaccrual loans was \$378 and \$311 less than the contractual rate on these loans for the years ended December 31, 2008 and 2007, respectively.

Information about impaired and delinquent loans as of and for the years ended December 31, 2008 and 2007 is as follows:

	2008	2007
Total impaired loans	<u>\$ 3,942</u>	<u>\$ 2,818</u>
Related allowance for loan losses	<u>\$ 135</u>	<u>\$ 150</u>
Loans past due ninety days or more still accruing interest	<u>\$ 459</u>	<u>\$ 792</u>

Loans with a carrying value of \$87,411 and \$93,501 at December 31, 2008 and 2007, respectively, were pledged to secure borrowed funds.

Related party loans: The Company has entered into transactions with its executive officers, directors, significant shareholders, and their affiliates (related parties). The aggregate amounts of loans to such related parties at December 31, 2008 and 2007 were \$747 and \$626, respectively. During 2008, new loans to such related parties were \$253 and repayments were \$132.

Loans held for sale: As of December 31, 2008 and 2007, the Company's loans held for sale were \$2,974 and \$1,821, respectively, and consisted of one-to-four family residential real estate loans.

Wells Financial Corp. and Subsidiary

Notes to Consolidated Financial Statements (dollars in thousands, except per share data)

Note 5. Loan Servicing

Mortgage loans serviced for others are not included in the accompanying consolidated statements of financial condition. The unpaid principal balances of these loans as of December 31, 2008 and 2007 were \$350,270 and \$360,929, respectively, and consist of one-to-four family residential real estate loans. These loans are serviced primarily for the Federal Home Loan Mortgage Corporation, Federal Home Loan Bank and Federal National Mortgage Association.

Custodial escrow balances maintained in connection with the foregoing loan servicing, and included in advances from borrowers for taxes and insurance, were \$1,924 and \$1,871 at December 31, 2008 and 2007, respectively.

Mortgage servicing rights are summarized as follows:

	2008	2007
Balance at beginning of year, net	\$ 1,503	\$ 1,748
Mortgage servicing rights capitalized	343	300
Amortization expense	(552)	(545)
Balance at end of year, net	<u>\$ 1,294</u>	<u>\$ 1,503</u>

The estimated fair value of mortgage servicing rights was \$1,697 and \$3,137 at December 31, 2008 and 2007, respectively. Fair values are estimated using discounted cash flows based upon estimated prepayment speeds, ancillary income received from loan servicing and current interest rates. There was no valuation allowance as of December 31, 2008 or 2007.

The following table indicates the estimated future amortization expense for mortgage servicing rights. The estimated amortization expense is based on existing asset balances. The timing of amortization expense actually recognized in future periods may differ significantly depending upon economic conditions, mortgage interest rates, and other matters.

Years ending December 31,	
2009	\$ 652
2010	332
2011	200
2012	95
2013	15
	<u>\$ 1,294</u>

Wells Financial Corp. And Subsidiary

Notes to Consolidated Financial Statements
(dollars in thousands, except per share data)

Note 6. Other Real Estate Owned

The Company had investments in real estate acquired through foreclosure or deeded to the Company in lieu of foreclosure of \$4,008 and \$1,592 as of December 31, 2008 and 2007, respectively. No allowances for losses on foreclosed real estate were required at these dates. The amount of other real estate owned is included in other assets in the consolidated statements of financial condition.

Note 7. Premises and Equipment

	December 31,	
	2008	2007
Land	\$ 464	\$ 464
Buildings and improvements	4,325	4,298
Leasehold improvements	434	361
Furniture, fixtures and equipment	2,601	2,520
	<u>7,824</u>	<u>7,643</u>
Less accumulated depreciation and amortization	3,863	3,418
	<u>\$ 3,961</u>	<u>\$ 4,225</u>

Note 8. Deposits

	December 31,	
	2008	2007
Demand deposits, noninterest bearing	\$ 8,473	\$ 8,251
NOW and money market accounts	48,961	44,357
Savings accounts	21,646	25,593
Certificates of deposit	103,808	111,430
	<u>\$ 182,888</u>	<u>\$ 189,631</u>

The aggregate amount of certificates of deposit over \$100 was \$17,238 and \$21,099 at December 31, 2008 and 2007, respectively.

A summary of scheduled maturities of certificates of deposit is as follows:

Years Ending December 31,	
2009	\$ 74,872
2010	18,393
2011	9,571
2012	972
	<u>\$ 103,808</u>

Wells Financial Corp. And Subsidiary

Notes to Consolidated Financial Statements (dollars in thousands, except per share data)

Note 9. Borrowed Funds

Borrowed funds consist of fixed-rate advances from the Federal Home Loan Bank (FHLB) with interest rates ranging from 2.52% to 5.71% and a variable rate \$4 million revolving line of credit from another bank with an outstanding balance of \$3,306 as of December 31, 2008. All FHLB advances are subject to various prepayment, call, and conversion provisions. The advances are collateralized by FHLB stock, first mortgage loans and securities available for sale with balances exceeding 120% of the amount of the advances. The revolving line of credit is secured by the stock of the Bank, matures May 20, 2009, and has an interest rate of 4.00% as of December 31, 2008 based on the lender's variable base rate. Future annual maturities of the FHLB advances are as follows:

Years Ending December 31:

2009	\$	27,806
2010		19,000
	\$	<u>46,806</u>

Note 10. Income Tax Matters

The Company and its subsidiary file consolidated federal income tax returns. The Company is allowed bad debt deductions based on actual charge-offs.

The components of income tax expense (benefit) are as follows:

	Years Ended December 31,	
	2008	2007
Federal:		
Current	\$ 745	\$ 881
Deferred	(185)	(162)
	<u>560</u>	<u>719</u>
State:		
Current	249	284
Deferred	(59)	(52)
	<u>190</u>	<u>232</u>
Total	\$ 750	\$ 951

Wells Financial Corp. And Subsidiary

Notes to Consolidated Financial Statements
(dollars in thousands, except per share data)

Note 10. Income Tax Matters (Continued)

Total income tax expense differed from the amounts computed by applying the statutory U.S. Federal income tax rates to income before income taxes as a result of the following:

	Years Ended December 31,	
	2008	2007
Computed "expected" tax expense	\$ 698	\$ 933
State income taxes, net of federal benefit	122	160
Effect of graduated rates	(20)	(27)
Other	(50)	(115)
Income tax expense	\$ 750	\$ 951

The net deferred tax liability included in liabilities in the accompanying consolidated statements of financial condition includes the following amounts of deferred tax assets and liabilities:

	December 31,	
	2008	2007
Deferred tax assets:		
Allowance for loan losses	\$ 443	\$ 456
Management stock bonus plan	28	42
Accrued compensation	19	16
Impairment of securities	196	-
Other	132	138
	818	652
Less valuation allowance	-	-
Total deferred tax assets	818	652
Deferred tax liabilities:		
Premises and equipment	256	252
Securities available for sale	12	137
FHLB stock	131	131
Mortgage servicing rights	524	608
Deferred loan origination fees	19	34
Other	81	66
Total deferred tax liabilities	1,023	1,228
Net deferred tax liability	\$ (205)	\$ (576)

Retained earnings at December 31, 2008 and 2007 include approximately \$1,839 related to the pre-1987 allowance for loan losses for which no deferred federal income tax liability has been recognized. This amount represents an allocation of income to bad debt deductions for tax purposes only. If the Bank no longer qualifies as a bank or in the event of a liquidation of the Bank, income would be created for tax purposes only, which would be subject to the then current corporate income tax rate. The unrecorded deferred income tax liability on the above amount for financial statement purposes was approximately \$736 at December 31, 2008 and 2007.

Wells Financial Corp. And Subsidiary

Notes to Consolidated Financial Statements (dollars in thousands, except per share data)

Note 11. Stockholders' Equity, Regulatory Capital and Dividend Restrictions

The Company has initiated several stock buy back programs. Shares totaling 17,175 and 161,518 were purchased during the years ended December 31, 2008 and 2007, respectively.

On January 20, 2009, the Company declared a dividend of \$0.26 per common share payable on February 24, 2009 to stockholders of record as February 10, 2009. The scheduled dividend is approximately \$202.

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's 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 capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2008, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2008, the most recent notification from the Office of Thrift Supervision categorized the Bank as "well capitalized" under the regulatory framework for Prompt Corrective Action. To be categorized as "well capitalized," the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios. There are no conditions or events since that notification that management believes have changed the Bank's category.

Wells Financial Corp. And Subsidiary

Notes to Consolidated Financial Statements (dollars in thousands, except per share data)

Note 11. Stockholders' Equity, Regulatory Capital and Dividend Restrictions (Continued)

The following table summarizes the Bank's compliance with its regulatory capital requirements:

	Actual		Minimum For Capital Adequacy Purposes		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Percent	Amount	Percent	Amount	Percent
As of December 31, 2008:						
Tier 1 (core) capital (to adjusted total assets)	\$ 23,644	9.34%	\$ 10,131	4.00%	\$ 12,664	5.00%
Risk-based capital (to risk-weighted assets)	24,740	11.76%	16,825	8.00%	21,032	10.00%
Tangible (capital to tangible assets)	23,644	9.34%	3,799	1.50%	N/A	N/A
Tier 1 (core) capital (to risk-weighted assets)	23,644	11.24%	N/A	N/A	12,619	6.00%
As of December 31, 2007:						
Tier 1 (core) capital (to adjusted total assets)	\$ 23,202	8.99%	\$ 10,318	4.00%	\$ 12,898	5.00%
Risk-based capital (to risk-weighted assets)	24,515	11.66%	16,821	8.00%	21,027	10.00%
Tangible (capital to tangible assets)	23,202	8.99%	3,869	1.50%	N/A	N/A
Tier 1 (core) capital (to risk-weighted assets)	23,202	11.03%	N/A	N/A	12,621	6.00%

Under current regulations, the Bank is not permitted to pay dividends on its stock if its regulatory capital would reduce below (i) the amount required for the liquidation account established to provide a limited priority claim to the assets of the Bank to certain qualifying depositors who had deposits at the Bank and who continue to maintain those deposits after its conversion from a Federal mutual savings and loan association to a Federal stock savings bank pursuant to its Plan of Conversion (Plan) adopted October 19, 1994, or (ii) the Bank's regulatory capital requirements. As a "Tier 1" institution (an institution with capital in excess of its capital requirements, both immediately before the proposed capital distribution and after giving effect to such distribution), after a 30 day notice the Bank may make capital distributions without the prior consent of the Office of Thrift Supervision in any calendar year. However, without consent, capital distributions during a calendar year must not exceed the net income of the Bank during the calendar year plus retained net income for the preceding two years. The Bank declared dividends of \$1,036 and \$2,186 to the Company during the years ended December 31, 2008 and 2007, respectively.

Wells Financial Corp. And Subsidiary

Notes to Consolidated Financial Statements
(dollars in thousands, except per share data)

Note 12. Earnings Per Share

A reconciliation of the income and common stock share amounts used in the calculation of basic and diluted earnings per share follows:

	For the Year Ended December 31, 2008		
	Income	Shares	Per Share Amount
Basic EPS			
Net income	\$ 1,245	784,746	\$ 1.59
Effect of Dilutive Securities			
Stock options	-	3,281	
Diluted EPS			
Net income plus assumed conversions	\$ 1,245	788,027	\$ 1.58
	For the Year Ended December 31, 2007		
	Income	Shares	Per Share Amount
Basic EPS			
Net income	\$ 1,714	895,663	\$ 1.91
Effect of Dilutive Securities			
Stock options	-	6,165	
Diluted EPS			
Net income plus assumed conversions	\$ 1,714	901,828	\$ 1.90

As of December 31, 2008 and 2007, 59,750 options are not included in the dilutive EPS computation in each year because their inclusion would be antidilutive.

Note 13. Employee Benefit Plans

Defined Contribution 401(k) Plan: The Bank provides a 401(k) plan which covers substantially all of the Bank's employees who are eligible as to age and length of service. A participant may elect to make contributions of up to 15 percent of the participant's annual compensation. At the discretion of the Board of Directors, the Bank may make matching and other contributions to the plan. Discretionary matching contributions of \$67 and \$68 (up to 3% of participant annual compensation) were made for the years ended 2008 and 2007, respectively.

Employee Stock Ownership Plan: An Employee Stock Ownership Plan (ESOP) was adopted on April 11, 1995 covering all full-time employees of the Company who have attained age 21 and completed one year of service during which they work at least 1,500 hours.

The Company makes annual discretionary contributions to the ESOP. As these funds are available, the ESOP acquires shares of Company stock, and allocates the shares to ESOP participants. Dividends on allocated ESOP shares are recorded as a reduction of retained earnings. In 2008 and 2007, 5,700 and 2,411 shares, respectively, were purchased and 2,477 and 2,281 shares, respectively, were allocated to ESOP participants at a cost of approximately \$66 and \$64 for the years ending December 31, 2008 and 2007, respectively, which was charged to compensation expense for those respective periods.

Wells Financial Corp. And Subsidiary

Notes to Consolidated Financial Statements (dollars in thousands, except per share data)

Note 13. Employee Benefit Plans (Continued)

The ESOP held 95,602 shares of company stock at December 31, 2008 and 2007. At December 31, 2008 and 2007, 92,065 and 95,288 have been released for allocation to participants, respectively.

The Company is subject to a put option on ESOP shares distributed to participants. The put option is a right to demand that the Company buy shares of its stock held by the participant for which there is no market. The put price is representative of the fair market value of the stock, which is approximately \$16.25 per share as of December 31, 2008. The Company must pay for the purchase within a five-year period.

Stock Option Plans: The Company, effective November 18, 2003, approved the Wells Financial Corp. 2003 Stock Option Plan (Plan). Pursuant to the Plan, stock options for 120,000 common shares may be granted to officers, directors, employees and other persons providing services to the Company. The Plan options have a maximum term of 10 years, at the market price on the grant date. Awards to non-employee directors are exercisable on the grant date. Awards to employees are generally exercisable on the grant date subject to employment conditions.

Options granted under the Plan may be options that qualify as Incentive Stock Options, as defined in Section 422 of the Internal Revenue Code of 1986, as amended, or options that do not so qualify.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. A grant date fair value of \$6.17 per option was computed using the following assumptions for the March 20, 2007 grant date for 7,950 shares with an exercise price of \$29.60:

Estimated life (in years)	10
Risk-free interest rate	4.70%
Expected volatility	21.8%
Dividend rate	3.65%

The expected volatility is based on historical volatility for the estimated term of the award. The risk-free interest rates for periods within the contractual life of the awards are based on the U.S. Treasury yield curve in effect at the time of the grant. The expected life is based on historical exercise experience. The dividend yield assumption is based on the Company's history and expectation of dividend payouts.

Wells Financial Corp. And Subsidiary

Notes to Consolidated Financial Statements
(dollars in thousands, except per share data)

Note 13. Employee Benefit Plans (Continued)

Stock option activity and balances as of December 31, 2008 and 2007, and during the years then ended are presented below:

	Years Ended December 31,				
	2008			2007	
Fixed Options	Aggregate Intrinsic	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding, beginning of year	\$ 216	68,917	\$ 28.15	74,689	\$ 25.42
Granted		-	-	7,950	29.60
Exercised		-	-	(13,722)	14.18
Forfeited		-	-	-	-
Outstanding, end of year	\$ 32	68,917	\$ 28.15	68,917	\$ 28.15

The aggregate intrinsic value of a stock option in the table above represents the total pretax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holders had all option holders exercised their options on December 31, 2008. The intrinsic value changes based on changes in the market value of the Company's stock. The Company has purchased treasury stock and uses these shares for options exercised. The intrinsic value and cash received for options exercised in 2007 was \$171 and \$149, respectively. There were no options exercised in 2008.

Wells Financial Corp. And Subsidiary

Notes to Consolidated Financial Statements
(dollars in thousands, except per share data)

Note 13. Employee Benefit Plans (Continued)

The status of the 68,917 options outstanding at December 31, 2008 is presented below:

Date of Award	Shares	Exercise Price	Remaining Contractual Life	Number Exercisable	Exercisable Intrinsic Value
September 7, 2000	8,748	\$ 12.88	1.7	8,748	\$ 31
September 19, 2000	419	13.38	1.7	419	1
November 18, 2003	36,000	30.15	5.0	36,000	-
March 16, 2004	7,900	33.38	5.2	7,900	-
April 19, 2005	7,900	30.00	6.3	7,900	-
March 20, 2007	7,950	29.60	8.2	3,975	-

Management Stock Bonus Plan: The Bank adopted the Wells Federal Bank 2003 Stock Bonus Plan in 2003 (2003 Plan). The Company authorized nonvested stock awards of up to 50,000 shares to directors, officers and employees of the Bank. These awards vest at the rate of 25% per year of continuous service with the Bank. There are 23,300 shares available to be issued under the plan.

The status of nonvested shares outstanding as of December 31, 2008 and 2007 and the changes during the years then ended are presented below:

	Years Ended December 31,	
	2008	2007
Outstanding at beginning of year	5,450	10,250
Granted	-	2,200
Forfeited	-	-
Vested	(2,300)	(7,000)
Outstanding at end of year	3,150	5,450

The total fair value of shares vested during the years ended December 31, 2008 and 2007 was \$71 and \$205, respectively. The Bank recorded compensation expense of \$52 and \$123 relating to these plans for the years ended December 31, 2008 and 2007 respectively. At December 31, 2008, there was a total of \$38 of unrecognized compensation expense related to stock-based compensation arrangements granted under the plans. The expense expected to be recognized is \$26 in 2009, \$11 in 2010 and \$1 in 2011. The total tax benefit recognized in the financial statements for the years ended December 31, 2008 and 2007 related to shares granted under the plan was \$-0- and \$57. The total tax benefit realized on the tax returns for the years ended December 31, 2008 was \$54 and \$187.

Wells Financial Corp. And Subsidiary

Notes to Consolidated Financial Statements (dollars in thousands, except per share data)

Note 14. Commitments

The Company leases certain branch facilities under operating leases. Some leases require the Company to pay related insurance, maintenance and repairs, and real estate taxes. The Company also has an agreement with its data processor whereby the processor agrees to provide certain data and item processing services that expire in 2011. The agreement automatically renews in five-year intervals unless terminated by either party. Future minimum rental and data processing commitments under these agreements as of December 31, 2008 are estimated as follows:

Years Ending	Rental	Data Processing
2009	\$ 208	\$ 654
2010	208	654
2011	208	164
2012	142	-
2013	96	-
Thereafter	139	-

Total rental expense related to operating leases was approximately \$294 and \$299 for the years ended December 31, 2008 and 2007 respectively. Total data processing expense related to servicing agreements was approximately \$780 and \$714 for the years ended December 31, 2008 and 2007 respectively.

Note 15. Financial Instruments with Off-Statement of Financial Condition Risk

The Company is a party to financial instruments with off-statement of financial condition risk in the normal course of business to meet the financing needs of its customers. These financial instruments include primarily commitments to extend credit. Those instruments involve, to varying degrees, elements of credit risk and interest-rate risk in excess of the amount recognized in the consolidated statement of financial condition. The contract or notional amounts of those instruments reflect the extent of the Company's involvement in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, standby letters of credit, and financial guarantees written is represented by the contractual notional amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-statement of financial condition instruments.

Commitments to extend credit on loans totaled approximately \$39,658 and \$47,770 at December 31, 2008 and 2007, respectively.

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 some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but normally includes real estate and personal property.

Wells Financial Corp. and Subsidiary

Notes to Consolidated Financial Statements (dollars in thousands, except per share data)

Note 16. Concentrations

Concentration by geographic location: The Company makes agricultural, commercial, residential and consumer loans to customers primarily in South Central Minnesota and Northern Iowa. Although the Company's loan portfolio is diversified, there is a relationship in this region between the agricultural economy and the economic performance of loans made to nonagricultural customers. The Company's lending policies for agricultural and nonagricultural customers require loans to be well-collateralized and supported by cash flows. Collateral for agricultural loans includes equipment, crops, livestock and land. Credit losses from loans related to the agricultural economy are consistent with credit losses experienced in the portfolio as a whole. The concentration of credit in the regional agricultural economy is taken into consideration by management in determining the allowance for loan losses.

Concentration by institution: The nature of the Company's business requires that it maintain amounts due from banks which, at times, may exceed federally insured limits. The Company has not experienced any losses in such amounts. At December 31, 2008 and 2007, the Company had \$5,171 and \$12,415, respectively, on deposit with United Bankers Bank.

Note 17. Fair Value Measurements

Effective January 1, 2008, the Company adopted the provisions of SFAS No. 157, "Fair Value Measurements," for financial assets and financial liabilities. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements.

The definition of fair value is clarified by SFAS No. 157 to be 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. SFAS No. 157 requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, SFAS No. 157 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. SFAS No. 157 establishes a three-level hierarchy for fair value measurements based upon the inputs to the valuation of an asset or liability.

- Level 1 — Valuation is based on quoted prices in active markets for identical assets and liabilities.
- Level 2 — Valuation is determined from quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar instruments in markets that are not active or by model-based techniques in which all significant inputs are observable in the market.
- Level 3 — Valuation is derived from model-based techniques in which at least one significant input is unobservable and based on the Company's own estimates about the assumptions that market participants would use to value the asset or liability.

Wells Financial Corp. and Subsidiary

Notes to Consolidated Financial Statements (dollars in thousands, except per share data)

Note 17. Fair Value Measurements (Continued)

When available, the Company attempts to use quoted market prices to determine fair value and classifies such items as Level 1 or Level 2. If quoted market prices are not available, fair value is often determined using model-based techniques incorporating various assumptions including interest rates, prepayment speeds and credit losses. Assets and liabilities valued using model-based techniques are classified as either Level 2 or Level 3, depending on the extent to which the valuation inputs are based on market data obtained from independent sources.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Investment securities available for sale

The fair values of exchange-listed equity securities are based on quoted market prices and are categorized as Level 1 of the fair value hierarchy. The fair value of debt securities were generally determined based on matrix pricing. Matrix pricing is a mathematical technique that utilizes observable market inputs including, for example, yield curves, credit ratings and prepayment speeds. Fair values determined using matrix pricing are categorized as Level 2 in the fair value hierarchy.

Impaired loans

The specific reserves for collateral-dependent impaired loans are determined based on the fair value of collateral method described in SFAS No. 114, *Accounting by Creditors for Impairment of a Loan*. Under the fair value of collateral method, the specific reserve is equal to the difference between the carrying value of the loan and the fair value of the collateral less estimated selling costs. When a specific reserve is required for an impaired loan, the impaired loan is essentially measured at fair value. The resulting fair value measurement is disclosed in the nonrecurring hierarchy table. Where estimates of fair value used for other collateral supporting commercial loans are based on assumptions not observable in the marketplace, such valuations have been classified as Level 3.

The Company is required, on a nonrecurring basis, to adjust the carrying value of certain assets or provide valuation allowances related to certain assets using fair value measurements in accordance with generally accepted accounting principles.

The specific reserves for collateral-dependent impaired loans are based on the fair value of the collateral less estimated costs to sell. The fair value of collateral was determined based on appraisals with further adjustments made to the appraised values due to various factors including the age of the appraisal, age of comparables included in the appraisal, and known changes in the market and in the collateral. As these significant adjustments are based on unobservable inputs, the resulting fair value measurements have been categorized as a Level 3 measurement.

Wells Financial Corp. and Subsidiary

Notes to Consolidated Financial Statements
(dollars in thousands, except per share data)

Note 17. Fair Value Measurements (Continued)

The following table summarizes financial assets and financial assets and financial liabilities measured at fair value as of December 31, 2008, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
<i>Recurring</i>				
Investment securities available for sale	\$ 20	\$ 8,400	\$ -	\$ 8,420
<i>Non-recurring</i>				
Collateral-dependent impaired loans	\$ -	\$ -	\$ 819	\$ 819

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

	December 31,			
	2008		2007	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	\$ 8,744	\$ 8,744	\$ 14,182	\$ 14,182
Certificates of deposit	700	700	300	300
Securities available for sale	8,420	8,420	9,082	9,082
Federal Home Loan Bank stock	3,302	3,302	2,329	2,329
Loans held for sale	2,974	2,974	1,821	1,821
Loans receivable, net	217,425	221,073	220,974	216,905
Accrued interest receivable	1,813	1,813	2,056	2,056
Mortgage servicing rights	1,294	1,697	1,503	3,137
Financial liabilities				
Deposits	182,888	182,711	189,631	189,727
Borrowed funds	46,806	47,950	44,985	45,560
Advances from borrowers for taxes and insurance	2,081	2,081	2,095	2,095
Accrued interest payable	84	84	128	128

Wells Financial Corp. and Subsidiary

Notes to Consolidated Financial Statements
(dollars in thousands, except per share data)

Note 17. Fair Value Measurements (Continued)

Interest rate risk: The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the Company's financial instruments will change when interest rate levels change, and that change may be either favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to manage interest rate risk. However, borrowers with fixed-rate obligations are more likely to prepay in a falling-rate environment and less likely to prepay in a rising-rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising-rate environment and less likely to do so in a falling-rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Company's overall interest rate risk.

Note 18. Additional Cash Flow Information

Cash flows from securities:

	2008	2007
Available-for-sale securities		
Maturities and calls	\$ 3,797	\$ 1,539
Purchases	(3,963)	(2,670)
	<u>\$ (166)</u>	<u>\$ (1,131)</u>

Supplemental Disclosures of Cash Flow Information

Cash payments for:

Interest	\$ 7,054	\$ 8,572
Income taxes	550	913

Supplemental Schedule of Noncash Investing and Financing Activities

Other real estate acquired in settlement of loans	<u>\$ 4,277</u>	<u>\$ 1,598</u>
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Wells Financial Corp. and Subsidiary

Notes to Consolidated Financial Statements (dollars in thousands, except per share data)

Note 19. Issued but not Effective Accounting Pronouncements

The following accounting pronouncements have been issued but are not yet effective. Management has not determined what effect, if any, they will have on the financial statements.

Summary of FASB Interpretation No. 48 – Accounting for Uncertainty in Income Taxes – An Interpretation of FASB Statement No. 109: In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition.

In December 2008, the FASB provided for a deferral of the effective date of FIN 48 for certain nonpublic enterprises to annual financial statements for fiscal years beginning after December 15, 2008. The Company has elected this deferral and accordingly will be required to adopt FIN 48 in its 2009 annual financial statements. Prior to adoption of FIN 48, the Company will continue to evaluate its uncertain tax positions and related income tax contingencies under Statement No. 5, *Accounting for Contingencies*. SFAS No. 5 requires the Company to accrue for losses it believes are probable and can be reasonably estimated.

Summary of Statement No. 141(R) – Business Combinations: Statement 141R fundamentally changes the manner in which an entity will account for a business combination by including, along with other significant changes, a requirement that an acquirer recognize virtually all assets acquired and liabilities assumed at 100% of their fair values, even in a partial acquisition. This Statement is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008.

Summary of Statement No. 160 – Non-controlling Interests in Consolidated Financial Statements: Statement 160 on consolidated financial statements changes the accounting for noncontrolling (minority) interests to, among other things, require noncontrolling interest be clearly identified and separately reported from parent's equity on its consolidated balance sheet, and net income attributable to the parent and the noncontrolling interest be clearly identified and presented on the face of the consolidated income statement. This Statement is effective for annual periods beginning on or after December 15, 2008.

Summary of Statement No. 161 – Disclosures about Derivative Instruments and Hedging Activities – An Amendment of FASB Statement No. 133: Statement No. 161 requires expanded qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and credit-risk-related contingent features in derivative instruments. This Statement is effective for financial statements issued for any reporting period (annual or quarterly interim) beginning after November 15, 2008.

Other Corporate Information

Wells Financial Corp. (Company) and Wells Federal Bank (Bank)

53 First Street SW, P.O. Box 310, Wells, MN 56097

The Company and the Bank are incorporated in the State of Minnesota. The Company had 775,440 of its common stock, \$0.10 par value, outstanding at December 31, 2008. The Company trades on the Over the Counter Bulletin Board under the symbol "WEFP". There are no broker/dealers affiliated with the Company and the quotation is not being published on behalf of the Company. The Company's transfer agent is: Registrar and Transfer Company, 10 Commerce Drive, Cranford, NJ 07016.

The Company acquired all of the capital stock that the Bank issued upon its conversion from mutual to stock form of ownership. The Company's business activities are limited to its investment in the Bank. The Bank is a federally chartered stock savings bank headquartered in Wells, Minnesota. The Bank has nine full service offices and one loan origination office. The Bank owns the facilities at four of its locations and leases the other six locations. The Bank attracts deposits from the general public and uses such deposits to invest in residential lending on owner occupied properties, commercial real estate and construction loans, agricultural real estate and operating loans, home equity and other consumer loans. The Bank has two subsidiaries, Greater Minnesota Mortgage (GMM) and Wells Insurance Agency (WIA). GMM originates loans through referrals from community commercial banks and, primarily, sells these loans to the secondary market. WIA is a full service insurance agency that sells property, casualty, life, health and investment products, including mutual funds.



Board of Directors of Wells Financial Corp.

Randel I. Bichler, Chairman of the Board

David Buesing

Lonnie R. Trasamar

Gerald D. Bastian

Dale E. Stallkamp

Richard Mueller

Executive Officers of Wells Financial Corp.

Lonnie R. Trasamar
President and Chief
Executive Officer

James D. Moll, CPA
Treasurer and Principal Financial
and Accounting Officer

Richard Mueller
Secretary



Corporate Counsel:
Randel I. Bichler, Esq.
28 South Broadway
Wells, Minnesota 56097

Independent Auditors:
McGladrey & Pullen, LLP
Suite 300
310 Broadway Avenue South
Rochester, Minnesota 55904

Special Counsel:
Malizia Spidi & Fisch, PC
1100 New York Avenue NW
Suite 340 West
Washington, DC 20005



The Company's Annual Report for the fiscal year ended December 31, 2008 is available without charge upon written request. For a copy of the Annual Report or any other investor information, please write to the Secretary of the Company, at the Company's corporate office in Wells, Minnesota. The annual meeting of stockholders will be held on April 21, 2009 at 4:00 p.m. at the Corporate Offices, 53 First Street SW, Wells, Minnesota.



WELLS
Financial
C O R P .

53 FIRST ST. S.W., PO BOX 310 • WELLS, MN 56097-0310 • 507/553-3151