

LAKELAND FINANCIAL CORP

Form 10-Q

August 10, 2015

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

FORM 10-Q

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

For the quarterly period ended June 30, 2015

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

LAKELAND FINANCIAL CORPORATION  
(Exact name of registrant as specified in its charter)

|  |                          |                                      |
|--|--------------------------|--------------------------------------|
| Indiana  | 0-11487                  | 35-1559596                           |
| (State or Other Jurisdiction<br>of Incorporation or<br>Organization) | (Commission File Number) | (IRS Employer<br>Identification No.) |

202 East Center Street, P.O. Box 1387, Warsaw, Indiana 46581-1387  
(Address of Principal Executive Offices)(Zip Code)

(574) 267-6144  
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

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Large accelerated filer  Accelerated filer  Non-accelerated filer  (do not check if a smaller reporting company) Smaller reporting company

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

Number of shares of common stock outstanding at July 31, 2015: 16,629,563

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## ITEM 1. FINANCIAL STATEMENTS

## CONSOLIDATED BALANCE SHEETS (in thousands except share data)

|  | June 30,<br>2015<br>(Unaudited) | December 31,<br>2014 |
|--|---------------------------------|----------------------|
| <b>ASSETS</b>  |                                 |                      |
| Cash and due from banks  | \$77,567                        | \$75,381             |
| Short-term investments   | 11,913                          | 15,257               |
| Total cash and cash equivalents                                  | 89,480                          | 90,638               |
| Securities available for sale (carried at fair value)            | 470,383                         | 475,911              |
| Real estate mortgage loans held for sale                         | 3,405                           | 1,585                |
| Loans, net of allowance for loan losses of \$44,816 and \$46,262 | 2,848,646                       | 2,716,058            |
| Land, premises and equipment, net                                | 43,376                          | 41,983               |
| Bank owned life insurance  | 67,434                          | 66,612               |
| Federal Reserve and Federal Home Loan Bank stock                 | 7,668                           | 9,413                |
| Accrued interest receivable                                      | 9,360                           | 8,662                |
| Goodwill   | 4,970                           | 4,970                |
| Other assets   | 27,384                          | 27,452               |
| Total assets   | \$3,572,106                     | \$3,443,284          |

## LIABILITIES AND STOCKHOLDERS' EQUITY

## LIABILITIES

|  |           |           |
|--|-----------|-----------|
| Noninterest bearing deposits                   | \$602,898 | \$579,495 |
| Interest bearing deposits                      | 2,417,253 | 2,293,625 |
| Total deposits                                 | 3,020,151 | 2,873,120 |
| Short-term borrowings                          |           |           |
| Federal funds purchased                        | 0         | 500       |
| Securities sold under agreements to repurchase | 51,615    | 54,907    |
| Other short-term borrowings                    | 75,000    | 105,000   |
| Total short-term borrowings                    | 126,615   | 160,407   |
| Long-term borrowings                           | 34        | 35        |
| Subordinated debentures                        | 30,928    | 30,928    |
| Accrued interest payable                       | 3,921     | 2,946     |
| Other liabilities                              | 14,693    | 14,463    |
| Total liabilities                              | 3,196,342 | 3,081,899 |

## STOCKHOLDERS' EQUITY

Common stock: 90,000,000 shares authorized, no par value

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|   |             |             |
|---|-------------|-------------|
| 16,618,188 shares issued and 16,528,197 outstanding as of June 30, 2015     |             |             |
| 16,550,324 shares issued and 16,465,621 outstanding as of December 31, 2014 | 96,865      | 96,121      |
| Retained earnings   | 278,301     | 263,345     |
| Accumulated other comprehensive income                                      | 2,722       | 3,830       |
| Treasury stock, at cost (2015 - 89,991 shares, 2014 - 84,703 shares)        | (2,213)     | (2,000)     |
| Total stockholders' equity  | 375,675     | 361,296     |
| Noncontrolling interest   | 89          | 89          |
| Total equity  | 375,764     | 361,385     |
| Total liabilities and equity  | \$3,572,106 | \$3,443,284 |

The accompanying notes are an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENTS OF INCOME (unaudited - in thousands except share and per share data)

|  | Three Months Ended<br>June 30, |               | Six Months Ended<br>June 30, |               |
|--|--------------------------------|---------------|------------------------------|---------------|
|  | 2015                           | 2014          | 2015                         | 2014          |
| <b>NET INTEREST INCOME</b>   |                                |               |                              |               |
| Interest and fees on loans   |                                |               |                              |               |
| Taxable  | \$27,315                       | \$26,270      | \$53,572                     | \$51,604      |
| Tax exempt   | 117                            | 125           | 234                          | 223           |
| Interest and dividends on securities                               |                                |               |                              |               |
| Taxable  | 2,002                          | 2,028         | 4,450                        | 4,039         |
| Tax exempt   | 842                            | 816           | 1,671                        | 1,635         |
| Interest on short-term investments                                 | 14                             | 11            | 27                           | 19            |
| Total interest income  | 30,290                         | 29,250        | 59,954                       | 57,520        |
| Interest on deposits   | 3,930                          | 3,335         | 7,578                        | 6,522         |
| Interest on borrowings   |                                |               |                              |               |
| Short-term   | 35                             | 104           | 95                           | 255           |
| Long-term  | 261                            | 257           | 517                          | 509           |
| Total interest expense   | 4,226                          | 3,696         | 8,190                        | 7,286         |
| <b>NET INTEREST INCOME</b>   | <b>26,064</b>                  | <b>25,554</b> | <b>51,764</b>                | <b>50,234</b> |
| Provision for loan losses  | 0                              | 0             | 0                            | 0             |
| <b>NET INTEREST INCOME AFTER<br/>PROVISION FOR<br/>LOAN LOSSES</b> |                                |               |                              |               |
|  | 26,064                         | 25,554        | 51,764                       | 50,234        |
| <b>NONINTEREST INCOME</b>  |                                |               |                              |               |
| Wealth advisory fees   | 1,106                          | 977           | 2,290                        | 2,016         |
| Investment brokerage fees  | 311                            | 923           | 803                          | 2,040         |
| Service charges on deposit accounts                                | 2,573                          | 2,348         | 4,947                        | 4,499         |
| Loan, insurance and service fees                                   | 1,900                          | 1,757         | 3,469                        | 3,215         |
| Merchant card fee income   | 431                            | 380           | 847                          | 730           |
| Bank owned life insurance income                                   | 360                            | 338           | 735                          | 710           |
| Other income   | 681                            | 686           | 1,635                        | 1,561         |
| Mortgage banking income  | 351                            | 179           | 740                          | 244           |
| Net securities gains   | 0                              | 4             | 42                           | 4             |
| Total noninterest income   | 7,713                          | 7,592         | 15,508                       | 15,019        |
| <b>NONINTEREST EXPENSE</b>   |                                |               |                              |               |
| Salaries and employee benefits                                     | 9,444                          | 9,467         | 19,167                       | 19,454        |
| Net occupancy expense  | 915                            | 903           | 1,999                        | 2,013         |
| Equipment costs  | 913                            | 761           | 1,829                        | 1,534         |
| Data processing fees and supplies                                  | 1,938                          | 1,493         | 3,705                        | 2,984         |
| Corporate and business development                                 | 714                            | 673           | 1,504                        | 1,326         |
| FDIC insurance and other regulatory fees                           | 511                            | 488           | 997                          | 965           |
| Professional fees  | 728                            | 736           | 1,417                        | 1,536         |
| Other expense  | 1,578                          | 1,563         | 3,024                        | 3,062         |

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|                                    |            |            |            |            |
|------------------------------------|------------|------------|------------|------------|
| Total noninterest expense          | 16,741     | 16,084     | 33,642     | 32,874     |
| <b>INCOME BEFORE INCOME TAX</b>    |            |            |            |            |
| EXPENSE                            | 17,036     | 17,062     | 33,630     | 32,379     |
| Income tax expense                 | 5,656      | 5,750      | 11,114     | 11,155     |
| NET INCOME                         | \$11,380   | \$11,312   | \$22,516   | \$21,224   |
| <b>BASIC WEIGHTED AVERAGE</b>      |            |            |            |            |
| COMMON SHARES                      | 16,611,974 | 16,536,112 | 16,601,189 | 16,524,079 |
| <b>BASIC EARNINGS PER COMMON</b>   |            |            |            |            |
| SHARE                              | \$0.69     | \$0.68     | \$1.36     | \$1.28     |
| <b>DILUTED WEIGHTED AVERAGE</b>    |            |            |            |            |
| COMMON SHARES                      | 16,820,052 | 16,739,069 | 16,795,907 | 16,729,479 |
| <b>DILUTED EARNINGS PER COMMON</b> |            |            |            |            |
| SHARE                              | \$0.68     | \$0.68     | \$1.34     | \$1.27     |

The accompanying notes are an integral part of these consolidated financial statements.



CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited - in thousands)

|   | Three months ended June 30, |          | Six months ended June 30, |          |
|---|-----------------------------|----------|---------------------------|----------|
|   | 2015                        | 2014     | 2015                      | 2014     |
| Net income  | \$11,380                    | \$11,312 | \$22,516                  | \$21,224 |
| Other comprehensive income (loss)   |                             |          |                           |          |
| Change in securities available for sale:  |                             |          |                           |          |
| Unrealized holding gain (loss) on securities available for sale arising during the period | (5,230)                     | 4,761    | (1,568)                   | 9,552    |
| Reclassification adjustment for (gains) losses included in net income                     | 0                           | (4)      | (42)                      | (4)      |
| Net securities gain (loss) activity during the period                                     | (5,230)                     | 4,757    | (1,610)                   | 9,548    |
| Tax effect  | 2,046                       | (1,888)  | 603                       | (3,792)  |
| Net of tax amount   | (3,184)                     | 2,869    | (1,007)                   | 5,756    |
| Defined benefit pension plans:  |                             |          |                           |          |
| Net gain (loss) on defined benefit pension plans  | 0                           | 0        | (276)                     | 64       |
| Amortization of net actuarial loss  | 61                          | 50       | 122                       | 99       |
| Net gain (loss) activity during the period  | 61                          | 50       | (154)                     | 163      |
| Tax effect  | (24)                        | (21)     | 53                        | (73)     |
| Net of tax amount   | 37                          | 29       | (101)                     | 90       |
| Total other comprehensive income (loss), net of tax                                       | (3,147)                     | 2,898    | (1,108)                   | 5,846    |
| Comprehensive income  | \$8,233                     | \$14,210 | \$21,408                  | \$27,070 |

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (unaudited - in thousands except share and per share data)

|  | Common Stock<br>Shares | Common Stock<br>Stock | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Treasury<br>Stock | Total<br>Stockholders'<br>Equity |
|--|------------------------|-----------------------|----------------------|--|-------------------|----------------------------------|
| Balance at January 1,<br>2014  | 16,377,449             | \$93,249              | \$233,108            | \$(2,494)  | \$(1,988)         | \$321,875                        |
| Comprehensive income:  |                        |                       |                      |  |                   |                                  |
| Net income   |                        |                       | 21,224               |  |                   | 21,224                           |
| Other comprehensive<br>income (loss), net of tax                         |                        |                       |                      | 5,846  |                   | 5,846                            |
| Cash dividends<br>declared, \$0.40 per share                             |                        |                       | (6,617)              |  |                   | (6,617)                          |
| Treasury shares<br>purchased under deferred<br>directors' plan           | (6,022)                | 230                   |                      |  | (230)             | 0                                |
| Treasury stock sold and<br>distributed under deferred<br>directors' plan | 25,031                 | (432)                 |                      |  | 432               |                                  |
| Stock activity under<br>equity compensation<br>plans                     | 62,901                 | (70)                  |                      |  |                   | (70)                             |
| Stock based<br>compensation expense                                      |                        | 1,228                 |                      |  |                   | 1,228                            |
| Balance at June 30, 2014   | 16,459,359             | \$94,205              | \$247,715            | \$3,352  | \$(1,786)         | \$343,486                        |
| Balance at January 1,<br>2015  | 16,465,621             | \$96,121              | \$263,345            | \$3,830  | \$(2,000)         | \$361,296                        |
| Comprehensive income:  |                        |                       |                      |  |                   |                                  |
| Net income   |                        |                       | 22,516               |  |                   | 22,516                           |
| Other comprehensive<br>income (loss), net of tax                         |                        |                       |                      | (1,108)  |                   | (1,108)                          |
| Cash dividends<br>declared, \$0.455 per<br>share                         |                        |                       | (7,560)              |  |                   | (7,560)                          |
| Treasury shares<br>purchased under deferred<br>directors' plan           | (5,288)                | 213                   |                      |  | (213)             | 0                                |
| Stock activity under<br>equity compensation<br>plans                     | 67,864                 | (390)                 |                      |  |                   | (390)                            |
| Stock based<br>compensation expense                                      |                        | 921                   |                      |  |                   | 921                              |
| Balance at June 30, 2015   | 16,528,197             | \$96,865              | \$278,301            | \$2,722  | \$(2,213)         | \$375,675                        |

The accompanying notes are an integral part of these consolidated financial statements.

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## CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited - in thousands)

| Six Months Ended June 30  | 2015      | 2014      |
|---|-----------|-----------|
| Cash flows from operating activities:   |           |           |
| Net income  | \$22,516  | \$21,224  |
| Adjustments to reconcile net income to net cash from operating activities:              |           |           |
| Depreciation  | 1,915     | 1,657     |
| Net (gain) loss on sale and write down of other real estate owned                       | (14)      | 58        |
| Amortization of loan servicing rights   | 279       | 262       |
| Loans originated for sale   | (38,470)  | (26,251)  |
| Net gain on sales of loans  | (814)     | (493)     |
| Proceeds from sale of loans   | 37,106    | 27,269    |
| Net gain on sales of premises and equipment   | (11)      | (5)       |
| Net gain on sales and calls of securities available for sale                            | (42)      | (4)       |
| Net securities amortization   | 2,353     | 2,893     |
| Stock based compensation expense  | 921       | 1,228     |
| Earnings on life insurance  | (735)     | (709)     |
| Tax benefit of stock option exercises   | (56)      | (34)      |
| Net change:   |           |           |
| Interest receivable and other assets  | 75        | (618)     |
| Interest payable and other liabilities  | 1,422     | (665)     |
| Total adjustments   | 3,929     | 4,588     |
| Net cash from operating activities  | 26,445    | 25,812    |
| Cash flows from investing activities:   |           |           |
| Proceeds from sale of securities available for sale                                     | 7,787     | 0         |
| Proceeds from maturities, calls and principal paydowns of securities available for sale |           |           |
| Purchases of securities available for sale  | (43,862)  | (29,454)  |
| Purchase of life insurance  | (208)     | (124)     |
| Proceeds from loans sold to others  | 0         | 4,307     |
| Net increase in total loans   | (132,782) | (146,573) |
| Proceeds from sales of land, premises and equipment                                     | 24        | 6         |
| Purchases of land, premises and equipment   | (3,321)   | (2,190)   |
| Proceeds from redemption of Federal Home Loan Bank stock                                | 1,745     | 0         |
| Proceeds from sales of other real estate  | 257       | 150       |
| Distribution from life insurance  | 0         | 302       |
| Net cash from investing activities  | (132,678) | (144,358) |
| Cash flows from financing activities:   |           |           |
| Net increase in total deposits  | 147,031   | 281,677   |
| Net decrease in short-term borrowings   | (33,792)  | (58,915)  |
| Payments on long-term borrowings  | (1)       | (2)       |
| Common dividends paid   | (7,547)   | (6,604)   |

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|  |          |           |
|--|----------|-----------|
| Preferred dividends paid                             | (13)     | (13)      |
| Payments related to equity incentive plans           | (390)    | (70)      |
| Purchase of treasury stock                           | (213)    | (230)     |
| Net cash from financing activities                   | 105,075  | 215,843   |
| Net change in cash and cash equivalents              | (1,158)  | 97,297    |
| Cash and cash equivalents at beginning of the period | 90,638   | 63,105    |
| Cash and cash equivalents at end of the period       | \$89,480 | \$160,402 |
| Cash paid during the period for:                     |          |           |
| Interest   | \$7,215  | \$7,208   |
| Income taxes   | 9,864    | 10,185    |
| Supplemental non-cash disclosures:                   |          |           |
| Loans transferred to other real estate owned         | 194      | 845       |
| Securities purchases payable                         | 0        | 0         |

The accompanying notes are an integral part of these consolidated financial statements.

## NOTE 1. BASIS OF PRESENTATION

This report is filed for Lakeland Financial Corporation (the “Company”) and its wholly owned subsidiaries, Lake City Bank (the “Bank”) and LCB Risk Management, a captive insurance company. Also included in this report is the Bank’s wholly owned subsidiary, LCB Investments II, Inc. (“LCB Investments”), which manages a portion of the Bank’s investment portfolio. LCB Investments also owns LCB Funding, Inc. (“LCB Funding”), a real estate investment trust. All significant inter-company balances and transactions have been eliminated in consolidation.

The unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions for Form 10-Q. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements and are unaudited. In the opinion of management, all adjustments (all of which are normal and recurring in nature) considered necessary for a fair presentation have been included. Operating results for the three-month and six-month periods ending June 30, 2015 are not necessarily indicative of the results that may be expected for any subsequent reporting periods, including the year ending December 31, 2015. The Company’s 2014 Annual Report on Form 10-K should be read in conjunction with these statements.

## NOTE 2. SECURITIES

Information related to the fair value and amortized cost of securities available for sale and the related gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) is provided in the tables below.

| (dollars in thousands)                        | Amortized<br>Cost | Gross<br>Unrealized<br>Gain | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|---|-------------------|-----------------------------|-------------------------------|---------------|
| June 30, 2015                                 |                   |                             |                               |               |
| U.S. Treasury securities                      | \$987             | \$15                        | \$0                           | \$1,002       |
| Agency residential mortgage-backed securities | 356,737           | 7,098                       | (1,917)                       | 361,918       |
| State and municipal securities                | 105,339           | 3,034                       | (910)                         | 107,463       |
| Total   | \$463,063         | \$10,147                    | \$(2,827)                     | \$470,383     |
| December 31, 2014                             |                   |                             |                               |               |
| U.S. Treasury securities                      | \$986             | \$18                        | \$0                           | \$1,004       |
| Agency residential mortgage-backed securities | 366,596           | 7,178                       | (1,679)                       | 372,095       |
| State and municipal securities                | 99,399            | 3,857                       | (444)                         | 102,812       |
| Total   | \$466,981         | \$11,053                    | \$(2,123)                     | \$475,911     |

Information regarding the fair value and amortized cost of available for sale debt securities by maturity as of June 30, 2015 is presented below. Maturity information is based on contractual maturity for all securities other than mortgage-backed securities. Actual maturities of securities may differ from contractual maturities because borrowers may have the right to prepay the obligation without a prepayment penalty.

| (dollars in thousands)  | Amortized<br>Cost | Fair<br>Value |
|-------------------------|-------------------|---------------|
| Due in one year or less | \$5,048           | \$5,083       |

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|  |           |           |
|--|-----------|-----------|
| Due after one year through five years  | 18,923    | 19,673    |
| Due after five years through ten years | 45,452    | 46,942    |
| Due after ten years                    | 36,903    | 36,767    |
|  | 106,326   | 108,465   |
| Mortgage-backed securities             | 356,737   | 361,918   |
| Total debt securities .....            |           |           |
| .....                                  | \$463,063 | \$470,383 |

Securities proceeds, gross gains and gross losses are presented below.

| (dollars in thousands)                 | Six months ended June 30, |      |
|--|---------------------------|------|
|  | 2015                      | 2014 |
| Sales of securities available for sale |                           |      |
| Proceeds                               | \$7,787                   | \$0  |
| Gross gains                            | 42                        | 0    |
| Gross losses                           | 0                         | 0    |

The Company sold two securities with a total book value of \$7.7 million and a total fair value of \$7.8 million during the first six months of 2015. There were no securities sales during the first six months of 2014.

Purchase premiums or discounts are recognized in interest income using the interest method over the terms of the securities or over the estimated lives of mortgage-backed securities. Gains and losses on sales are based on the amortized cost of the security sold and recorded on the trade date.

Securities with carrying values of \$179.9 million and \$202.4 million were pledged as of June 30, 2015 and December 31, 2014, as collateral for deposits of public funds, securities sold under agreements to repurchase, borrowings from the Federal Home Loan Bank and for other purposes as permitted or required by law.

Information regarding securities with unrealized losses as of June 30, 2015 and December 31, 2014 is presented below. The tables divide the securities between those with unrealized losses for less than twelve months and those with unrealized losses for twelve months or more.

| (dollars in thousands)                        | Less than 12 months |                   | 12 months or more |                   | Total      |                   |
|---|---------------------|-------------------|-------------------|-------------------|------------|-------------------|
|   | Fair Value          | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value | Unrealized Losses |
| June 30, 2015                                 |                     |                   |                   |                   |            |                   |
| Agency residential mortgage-backed securities | \$96,752            | \$(1,146)         | \$30,924          | \$(771)           | \$127,676  | \$(1,917)         |
| State and municipal securities                | 21,660              | (514)             | 9,319             | (396)             | 30,979     | (910)             |
| Total temporarily impaired                    | \$118,412           | \$(1,660)         | \$40,243          | \$(1,167)         | \$158,655  | \$(2,827)         |
| December 31, 2014                             |                     |                   |                   |                   |            |                   |
| Agency residential mortgage-backed securities | \$33,420            | \$(148)           | \$102,512         | \$(1,531)         | \$135,932  | \$(1,679)         |
| State and municipal securities                | 2,458               | (28)              | 16,391            | (416)             | 18,849     | (444)             |
| Total temporarily impaired                    | \$35,878            | \$(176)           | \$118,903         | \$(1,947)         | \$154,781  | \$(2,123)         |



The total number of securities with unrealized losses as of June 30, 2015 and December 31, 2014 is presented below.

|   | Less than<br>12 months | 12 months<br>or more | Total |
|---|------------------------|----------------------|-------|
| June 30, 2015                                 |                        |                      |       |
| Agency residential mortgage-backed securities | 31                     | 9                    | 40    |
| State and municipal securities                | 48                     | 13                   | 61    |
| Total temporarily impaired                    | 79                     | 22                   | 101   |
| December 31, 2014                             |                        |                      |       |
| Agency residential mortgage-backed securities | 9                      | 27                   | 36    |
| State and municipal securities                | 8                      | 29                   | 37    |
| Total temporarily impaired                    | 17                     | 56                   | 73    |

The following factors are considered in determining whether or not the impairment of these securities is other-than-temporary. In making this determination, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer, as well as the underlying fundamentals of the relevant market and the outlook for such market in the near future. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. Credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings. As of June 30, 2014 and December 31, 2014, ninety-nine percent of the securities in the Company's portfolio are backed by the U.S. government, government agencies, government sponsored agencies or are A-rated or better, except for certain non-local or local municipal securities, which are not rated. For the government, government-sponsored agency and municipal securities, management did not believe that there would be credit losses or that full principal would not be received. Management considered the unrealized losses on these securities to be primarily interest rate driven and does not expect material losses given current market conditions unless the securities are sold. However, at this time management does not have the intent to sell, and it is more likely than not that the Company will not be required to sell these securities before the recovery of their amortized cost basis.

## NOTE 3. LOANS

| (dollars in thousands)  | June 30,<br>2015 |       |   | December 31,<br>2014 |       |   |
|---|------------------|-------|---|----------------------|-------|---|
| Commercial and industrial loans:                                |                  |       |   |                      |       |   |
| Working capital lines of credit loans                           | \$606,169        | 20.9  | % | \$544,043            | 19.7  | % |
| Non-working capital loans                                       | 537,708          | 18.6  |   | 491,330              | 17.8  |   |
| Total commercial and industrial loans                           | 1,143,877        | 39.5  |   | 1,035,373            | 37.5  |   |
| Commercial real estate and multi-family residential loans:      |                  |       |   |                      |       |   |
| Construction and land development loans                         | 152,292          | 5.3   |   | 156,636              | 5.7   |   |
| Owner occupied loans  | 409,650          | 14.2  |   | 403,154              | 14.6  |   |
| Nonowner occupied loans   | 399,583          | 13.8  |   | 394,458              | 14.3  |   |
| Multifamily loans   | 90,175           | 3.1   |   | 71,811               | 2.6   |   |
| Total commercial real estate and multi-family residential loans | 1,051,700        | 36.3  |   | 1,026,059            | 37.1  |   |
| Agri-business and agricultural loans:                           |                  |       |   |                      |       |   |
| Loans secured by farmland                                       | 156,001          | 5.4   |   | 137,407              | 5.0   |   |
| Loans for agricultural production                               | 95,327           | 3.3   |   | 136,380              | 4.9   |   |
| Total agri-business and agricultural loans                      | 251,328          | 8.7   |   | 273,787              | 9.9   |   |
| Other commercial loans  | 82,247           | 2.8   |   | 75,715               | 2.7   |   |
| Total commercial loans  | 2,529,152        | 87.4  |   | 2,410,934            | 87.3  |   |
| Consumer 1-4 family mortgage loans:                             |                  |       |   |                      |       |   |
| Closed end first mortgage loans                                 | 148,977          | 5.1   |   | 145,167              | 5.3   |   |
| Open end and junior lien loans                                  | 155,902          | 5.4   |   | 150,220              | 5.4   |   |
| Residential construction and land development loans             | 8,821            | 0.3   |   | 6,742                | 0.2   |   |
| Total consumer 1-4 family mortgage loans                        | 313,700          | 10.8  |   | 302,129              | 10.9  |   |
| Other consumer loans  | 50,813           | 1.8   |   | 49,541               | 1.8   |   |
| Total consumer loans  | 364,513          | 12.6  |   | 351,670              | 12.7  |   |
| Subtotal  | 2,893,665        | 100.0 | % | 2,762,604            | 100.0 | % |
| Less: Allowance for loan losses                                 | (44,816)         |       |   | (46,262)             |       |   |
| Net deferred loan fees  | (203)            |       |   | (284)                |       |   |
| Loans, net  | \$2,848,646      |       |   | \$2,716,058          |       |   |

The recorded investment in loans does not include accrued interest.

The Company had \$925,000 in residential real estate loans in process of foreclosure as of June 30, 2015.

## NOTE 4. ALLOWANCE FOR LOAN LOSSES AND CREDIT QUALITY

The following tables present the activity in the allowance for loan losses by portfolio segment for the three-month periods ended June 30, 2015 and 2014:

|  | Commercial<br>and<br>Industrial | Commercial<br>Real Estate<br>and<br>Multifamily<br>Residential | Agri-business<br>and<br>Agricultural | Other<br>Commercial | Consumer<br>1-4<br>Family<br>Mortgage | Other<br>Consumer | Unallocated | Total    |
|--|---------------------------------|--|--------------------------------------|---------------------|---------------------------------------|-------------------|-------------|----------|
| (dollars in thousands)<br>Three Months Ended June 30, 2015 |                                 |  |                                      |                     |                                       |                   |             |          |
| Beginning balance, April 1                                 | \$23,024                        | \$13,804   | \$1,627                              | \$398               | \$3,313                               | \$430             | \$3,081     | \$45,677 |
| Provision for loan losses                                  | (228)                           | (283)  | 248                                  | (40)                | 160                                   | (16)              | 159         | 0        |
| Loans charged-off  | (507)                           | (429)  | 0                                    | 0                   | (6)                                   | (53)              | 0           | (995)    |
| Recoveries   | 71                              | 20   | 6                                    | 0                   | 6                                     | 31                | 0           | 134      |
| Net loans charged-off                                      | (436)                           | (409)  | 6                                    | 0                   | 0                                     | (22)              | 0           | (861)    |
| Ending balance   | \$22,360                        | \$13,112   | \$1,881                              | \$358               | \$3,473                               | \$392             | \$3,240     | \$44,816 |

|  | Commercial<br>and<br>Industrial | Commercial<br>Real Estate<br>and<br>Multifamily<br>Residential | Agri-business<br>and<br>Agricultural | Other<br>Commercial | Consumer<br>1-4<br>Family<br>Mortgage | Other<br>Consumer | Unallocated | Total    |
|--|---------------------------------|--|--------------------------------------|---------------------|---------------------------------------|-------------------|-------------|----------|
| (dollars in thousands)<br>Three Months Ended June 30, 2014 |                                 |  |                                      |                     |                                       |                   |             |          |
| Beginning balance  | \$21,730                        | \$15,648   | \$1,408                              | \$249               | \$3,064                               | \$549             | \$3,489     | \$46,137 |
| Provision for loan losses                                  | (343)                           | 329  | (10)                                 | (15)                | 276                                   | (56)              | (181)       | 0        |
| Loans charged-off  | (483)                           | (22)   | 0                                    | 0                   | (107)                                 | (43)              | 0           | (655)    |
| Recoveries   | 18                              | 20   | 6                                    | 0                   | 42                                    | 37                | 0           | 123      |
| Net loans charged-off                                      | (465)                           | (2)  | 6                                    | 0                   | (65)                                  | (6)               | 0           | (532)    |
| Ending balance   | \$20,922                        | \$15,975   | \$1,404                              | \$234               | \$3,275                               | \$487             | \$3,308     | \$45,605 |

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The following tables present the activity in the allowance for loan losses by portfolio segment for the six-month periods ended June 30, 2015 and 2014:

| (dollars in thousands)<br>Six Months Ended June 30,<br>2015 | Commercial        | Commercial<br>Real Estate<br>and<br>Multifamily | Agri-business<br>and<br>Agricultural | Other      | Consumer<br>1-4<br>Family<br>Mortgage | Consumer<br>Other | Unallocated | Total    |
|---|-------------------|---|--------------------------------------|------------|---------------------------------------|-------------------|-------------|----------|
|   | Industrial<br>and | Residential                                     |                                      | Commercial |                                       | Consumer          |             |          |
| Beginning balance, January 1                                | \$22,785          | \$14,153  | \$1,790                              | \$276      | \$3,459                               | \$483             | \$3,316     | \$46,262 |
| Provision for loan losses                                   | 328               | (621)   | 81                                   | 204        | 135                                   | (51)              | (76)        | 0        |
| Loans charged-off   | (876)             | (459)   | 0                                    | (122)      | (140)                                 | (106)             | 0           | (1,703)  |
| Recoveries  | 123               | 39  | 10                                   | 0          | 19                                    | 66                | 0           | 257      |
| Net loans charged-off                                       | (753)             | (420)   | 10                                   | (122)      | (121)                                 | (40)              | 0           | (1,446)  |
| Ending balance  | \$22,360          | \$13,112  | \$1,881                              | \$358      | \$3,473                               | \$392             | \$3,240     | \$44,816 |

| (dollars in thousands)<br>Six Months Ended June 30,<br>2014 | Commercial        | Commercial<br>Real Estate<br>and<br>Multifamily | Agri-business<br>and<br>Agricultural | Other      | Consumer<br>1-4<br>Family<br>Mortgage | Consumer<br>Other | Unallocated | Total    |
|---|-------------------|---|--------------------------------------|------------|---------------------------------------|-------------------|-------------|----------|
|   | Industrial<br>and | Residential                                     |                                      | Commercial |                                       | Consumer          |             |          |
| Beginning balance   | \$21,005          | \$18,556  | \$1,682                              | \$391      | \$3,046                               | \$608             | \$3,509     | \$48,797 |
| Provision for loan losses                                   | 377               | (59)  | (289)                                | (157)      | 408                                   | (79)              | (201)       | 0        |
| Loans charged-off   | (513)             | (2,553)   | 0                                    | 0          | (222)                                 | (118)             | 0           | (3,406)  |
| Recoveries  | 53                | 31  | 11                                   | 0          | 43                                    | 76                | 0           | 214      |
| Net loans charged-off                                       | (460)             | (2,522)   | 11                                   | 0          | (179)                                 | (42)              | 0           | (3,192)  |
| Ending balance  | \$20,922          | \$15,975  | \$1,404                              | \$234      | \$3,275                               | \$487             | \$3,308     | \$45,605 |

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The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of June 30, 2015 and December 31, 2014:

|   | Commercial<br>and<br>Industrial | Commercial<br>Real Estate<br>and<br>Multifamily<br>Residential | Agri-business<br>and<br>Agricultural | Other<br>Commercial | Consumer<br>1-4<br>Family<br>Mortgage | Other<br>Consumer | Unallocated | Total       |
|---|---------------------------------|--|--------------------------------------|---------------------|---------------------------------------|-------------------|-------------|-------------|
| (dollars in thousands)<br>June 30, 2015         |                                 |  |                                      |                     |                                       |                   |             |             |
| Allowance for loan losses:                      |                                 |  |                                      |                     |                                       |                   |             |             |
| Ending allowance balance attributable to loans: |                                 |  |                                      |                     |                                       |                   |             |             |
| Individually evaluated for impairment           | \$2,228                         | \$862  | \$0                                  | \$0                 | \$416                                 | \$66              | \$0         | \$3,572     |
| Collectively evaluated for impairment           | 20,132                          | 12,250   | 1,881                                | 358                 | 3,057                                 | 326               | 3,240       | 41,244      |
| Total ending allowance balance                  | \$22,360                        | \$13,112   | \$1,881                              | \$358               | \$3,473                               | \$392             | \$3,240     | \$44,816    |
| Loans:  |                                 |  |                                      |                     |                                       |                   |             |             |
| Loans individually evaluated for impairment     | \$7,411                         | \$11,209   | \$477                                | \$0                 | \$3,126                               | \$112             | \$0         | \$22,335    |
| Loans collectively evaluated for impairment     | 1,136,650                       | 1,039,318  | 250,933                              | 82,242              | 311,370                               | 50,614            | 0           | 2,871,127   |
| Total ending loans balance                      | \$1,144,061                     | \$1,050,527  | \$251,410                            | \$82,242            | \$314,496                             | \$50,726          | \$0         | \$2,893,462 |
|   |                                 |  |                                      |                     |                                       |                   |             |             |
|   | Commercial<br>and<br>Industrial | Commercial<br>Real Estate<br>and<br>Multifamily<br>Residential | Agri-business<br>and<br>Agricultural | Other<br>Commercial | Consumer<br>1-4<br>Family<br>Mortgage | Other<br>Consumer | Unallocated | Total       |
| (dollars in thousands)<br>December 31, 2014     |                                 |  |                                      |                     |                                       |                   |             |             |

Allowance for  
loan losses:Ending  
allowance  
balance  
attributable to  
loans:Individually  
evaluated for  
impairment

|         |         |      |      |       |      |     |         |
|---------|---------|------|------|-------|------|-----|---------|
| \$3,306 | \$1,531 | \$14 | \$15 | \$482 | \$73 | \$0 | \$5,421 |
|---------|---------|------|------|-------|------|-----|---------|

Collectively  
evaluated for  
impairment

|        |        |       |     |       |     |       |        |
|--------|--------|-------|-----|-------|-----|-------|--------|
| 19,479 | 12,622 | 1,776 | 261 | 2,977 | 410 | 3,316 | 40,841 |
|--------|--------|-------|-----|-------|-----|-------|--------|

Total ending  
allowance  
balance

|          |          |         |       |         |       |         |          |
|----------|----------|---------|-------|---------|-------|---------|----------|
| \$22,785 | \$14,153 | \$1,790 | \$276 | \$3,459 | \$483 | \$3,316 | \$46,262 |
|----------|----------|---------|-------|---------|-------|---------|----------|

## Loans:

Loans  
individually  
evaluated for  
impairment

|          |          |       |      |         |       |     |          |
|----------|----------|-------|------|---------|-------|-----|----------|
| \$14,702 | \$13,005 | \$486 | \$30 | \$3,614 | \$127 | \$0 | \$31,964 |
|----------|----------|-------|------|---------|-------|-----|----------|

Loans  
collectively  
evaluated for  
impairment

|           |           |         |        |         |        |   |           |
|-----------|-----------|---------|--------|---------|--------|---|-----------|
| 1,020,897 | 1,011,858 | 273,388 | 75,684 | 299,189 | 49,340 | 0 | 2,730,356 |
|-----------|-----------|---------|--------|---------|--------|---|-----------|

Total ending  
loans balance

|             |             |           |          |           |          |     |             |
|-------------|-------------|-----------|----------|-----------|----------|-----|-------------|
| \$1,035,599 | \$1,024,863 | \$273,874 | \$75,714 | \$302,803 | \$49,467 | \$0 | \$2,762,320 |
|-------------|-------------|-----------|----------|-----------|----------|-----|-------------|

The following table presents loans individually evaluated for impairment by class of loans as of June 30, 2015:

| (dollars in thousands)                                     | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Allowance<br>for<br>Loan Losses<br>Allocated |
|--|--------------------------------|------------------------|--|
| With no related allowance recorded:                        |                                |                        |  |
| Commercial and industrial loans:                           |                                |                        |  |
| Working capital lines of credit loans                      | \$21                           | \$21                   | \$0  |
| Non-working capital loans                                  | 2,519                          | 752                    | 0  |
| Commercial real estate and multi-family residential loans: |                                |                        |  |
| Construction and land development loans                    | 0                              | 0                      | 0  |
| Owner occupied loans                                       | 2,737                          | 2,557                  | 0  |
| Nonowner occupied loans                                    | 5,536                          | 5,541                  | 0  |
| Multifamily loans  | 0                              | 0                      | 0  |
| Agri-business and agricultural loans:                      |                                |                        |  |
| Loans secured by farmland                                  | 976                            | 477                    | 0  |
| Loans for ag production                                    | 0                              | 0                      | 0  |
| Other commercial loans                                     | 0                              | 0                      | 0  |
| Consumer 1-4 family loans:                                 |                                |                        |  |
| Closed end first mortgage loans                            | 403                            | 338                    | 0  |
| Open end and junior lien loans                             | 132                            | 132                    | 0  |
| Residential construction loans                             | 0                              | 0                      | 0  |
| Other consumer loans                                       | 4                              | 4                      | 0  |
| With an allowance recorded:                                |                                |                        |  |
| Commercial and industrial loans:                           |                                |                        |  |
| Working capital lines of credit loans                      | 983                            | 983                    | 433  |
| Non-working capital loans                                  | 7,847                          | 5,655                  | 1,795  |
| Commercial real estate and multi-family residential loans: |                                |                        |  |
| Construction and land development loans                    | 373                            | 373                    | 58   |
| Owner occupied loans                                       | 2,768                          | 2,738                  | 804  |
| Nonowner occupied loans                                    | 0                              | 0                      | 0  |
| Multifamily loans  | 0                              | 0                      | 0  |
| Agri-business and agricultural loans:                      |                                |                        |  |
| Loans secured by farmland                                  | 0                              | 0                      | 0  |
| Loans for agricultural production                          | 0                              | 0                      | 0  |
| Other commercial loans                                     | 0                              | 0                      | 0  |
| Consumer 1-4 family mortgage loans:                        |                                |                        |  |
| Closed end first mortgage loans                            | 2,721                          | 2,622                  | 413  |
| Open end and junior lien loans                             | 34                             | 34                     | 3  |
| Residential construction loans                             | 0                              | 0                      | 0  |
| Other consumer loans                                       | 108                            | 108                    | 66   |
| <b>Total</b>   | <b>\$27,162</b>                | <b>\$22,335</b>        | <b>\$3,572</b>                               |





The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2014:

| (dollars in thousands)                                     | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Allowance<br>for<br>Loan Losses<br>Allocated |
|--|--------------------------------|------------------------|--|
| With no related allowance recorded:                        |                                |                        |  |
| Commercial and industrial loans:                           |                                |                        |  |
| Working capital lines of credit loans                      | \$21                           | \$21                   | \$0  |
| Non-working capital loans                                  | 1,673                          | 279                    | 0  |
| Commercial real estate and multi-family residential loans: |                                |                        |  |
| Construction and land development loans                    | 526                            | 526                    | 0  |
| Owner occupied loans                                       | 554                            | 374                    | 0  |
| Nonowner occupied loans                                    | 3,030                          | 3,036                  | 0  |
| Agri-business and agricultural loans:                      |                                |                        |  |
| Loans secured by farmland                                  | 603                            | 283                    | 0  |
| Consumer 1-4 family loans:                                 |                                |                        |  |
| Closed end first mortgage loans                            | 724                            | 712                    | 0  |
| Open end and junior lien loans                             | 317                            | 317                    | 0  |
| Residential construction loans                             | 129                            | 129                    | 0  |
| Other consumer loans                                       | 1                              | 1                      | 0  |
| With an allowance recorded:                                |                                |                        |  |
| Commercial and industrial loans:                           |                                |                        |  |
| Working capital lines of credit loans                      | 1,409                          | 1,408                  | 837  |
| Non-working capital loans                                  | 15,557                         | 12,994                 | 2,469  |
| Commercial real estate and multi-family residential loans: |                                |                        |  |
| Construction and land development loans                    | 449                            | 448                    | 107  |
| Owner occupied loans                                       | 5,298                          | 5,297                  | 1,213  |
| Nonowner occupied loans                                    | 3,324                          | 3,324                  | 211  |
| Agri-business and agricultural loans:                      |                                |                        |  |
| Loans secured by farmland                                  | 381                            | 203                    | 14   |
| Other commercial loans                                     | 30                             | 30                     | 15   |
| Consumer 1-4 family mortgage loans:                        |                                |                        |  |
| Closed end first mortgage loans                            | 2,505                          | 2,375                  | 474  |
| Open end and junior lien loans                             | 81                             | 81                     | 8  |
| Other consumer loans                                       | 126                            | 126                    | 73   |
| <b>Total</b>   | <b>\$36,738</b>                | <b>\$31,964</b>        | <b>\$5,421</b>                               |

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The following table presents loans individually evaluated for impairment by class of loans as of and for the three-month period ended June 30, 2015:

| (dollars in thousands)                                     | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Cash Basis<br>Interest<br>Income<br>Recognized |
|--|-----------------------------------|----------------------------------|--|
| With no related allowance recorded:                        |                                   |                                  |  |
| Commercial and industrial loans:                           |                                   |                                  |  |
| Working capital lines of credit loans                      | \$21                              | \$0                              | \$0  |
| Non-working capital loans                                  | 767                               | 0                                | 0  |
| Commercial real estate and multi-family residential loans: |                                   |                                  |  |
| Construction and land development loans                    | 0                                 | 0                                | 0  |
| Owner occupied loans                                       | 2,865                             | 0                                | 0  |
| Nonowner occupied loans                                    | 5,590                             | 26                               | 27   |
| Multifamily loans  | 0                                 | 0                                | 0  |
| Agri-business and agricultural loans:                      |                                   |                                  |  |
| Loans secured by farmland                                  | 479                               | 0                                | 0  |
| Loans for ag production                                    | 0                                 | 0                                | 0  |
| Other commercial loans                                     | 0                                 | 0                                | 0  |
| Consumer 1-4 family loans:                                 |                                   |                                  |  |
| Closed end first mortgage loans                            | 329                               | 0                                | 0  |
| Open end and junior lien loans                             | 245                               | 0                                | 0  |
| Residential construction loans                             | 0                                 | 0                                | 0  |
| Other consumer loans                                       | 4                                 | 0                                | 0  |
| With an allowance recorded:                                |                                   |                                  |  |
| Commercial and industrial loans:                           |                                   |                                  |  |
| Working capital lines of credit loans                      | 994                               | 7                                | 7  |
| Non-working capital loans                                  | 9,670                             | 112                              | 124  |
| Commercial real estate and multi-family residential loans: |                                   |                                  |  |
| Construction and land development loans                    | 373                               | 4                                | 5  |
| Owner occupied loans                                       | 2,753                             | 0                                | 0  |
| Nonowner occupied loans                                    | 0                                 | 0                                | 0  |
| Multifamily loans  | 0                                 | 0                                | 0  |
| Agri-business and agricultural loans:                      |                                   |                                  |  |
| Loans secured by farmland                                  | 0                                 | 0                                | 0  |
| Loans for agricultural production                          | 0                                 | 0                                | 0  |
| Other commercial loans                                     | 0                                 | 0                                | 0  |
| Consumer 1-4 family mortgage loans:                        |                                   |                                  |  |
| Closed end first mortgage loans                            | 2,687                             | 16                               | 16   |
| Open end and junior lien loans                             | 34                                | 0                                | 0  |
| Residential construction loans                             | 0                                 | 0                                | 0  |
| Other consumer loans                                       | 111                               | 1                                | 1  |
| <b>Total</b>   | <b>\$26,922</b>                   | <b>\$166</b>                     | <b>\$180</b>                                   |



The following table presents loans individually evaluated for impairment by class of loans as of and for the three-month period ended June 30, 2014:

| (dollars in thousands)                                     | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Cash Basis<br>Interest<br>Income<br>Recognized |
|--|-----------------------------------|----------------------------------|--|
| With no related allowance recorded:                        |                                   |                                  |  |
| Commercial and industrial loans:                           |                                   |                                  |  |
| Working capital lines of credit loans                      | \$462                             | \$0                              | \$1  |
| Non-working capital loans                                  | 124                               | 0                                | 0  |
| Commercial real estate and multi-family residential loans: |                                   |                                  |  |
| Construction and land development loans                    | 0                                 | 0                                | 0  |
| Owner occupied loans                                       | 168                               | 0                                | 0  |
| Nonowner occupied loans                                    | 344                               | 0                                | 0  |
| Multifamily loans  | 0                                 | 0                                | 0  |
| Agri-business and agricultural loans:                      |                                   |                                  |  |
| Loans secured by farmland                                  | 0                                 | 0                                | 0  |
| Loans for ag production                                    | 0                                 | 0                                | 0  |
| Other commercial loans                                     | 0                                 | 0                                | 0  |
| Consumer 1-4 family loans:                                 |                                   |                                  |  |
| Closed end first mortgage loans                            | 688                               | 0                                | 0  |
| Open end and junior lien loans                             | 157                               | 0                                | 0  |
| Residential construction loans                             | 141                               | 0                                | 0  |
| Other consumer loans                                       | 3                                 | 0                                | 0  |
| With an allowance recorded:                                |                                   |                                  |  |
| Commercial and industrial loans:                           |                                   |                                  |  |
| Working capital lines of credit loans                      | 1,549                             | 21                               | 16   |
| Non-working capital loans                                  | 13,898                            | 134                              | 136  |
| Commercial real estate and multi-family residential loans: |                                   |                                  |  |
| Construction and land development loans                    | 2,695                             | 15                               | 16   |
| Owner occupied loans                                       | 1,921                             | 6                                | 0  |
| Nonowner occupied loans                                    | 7,218                             | 35                               | 35   |
| Multifamily loans  | 0                                 | 0                                | 0  |
| Agri-business and agricultural loans:                      |                                   |                                  |  |
| Loans secured by farmland                                  | 616                               | 0                                | 0  |
| Loans for agricultural production                          | 0                                 | 0                                | 0  |
| Other commercial loans                                     | 0                                 | 0                                | 0  |
| Consumer 1-4 family mortgage loans:                        |                                   |                                  |  |
| Closed end first mortgage loans                            | 2,736                             | 17                               | 17   |
| Open end and junior lien loans                             | 29                                | 0                                | 0  |
| Residential construction loans                             | 0                                 | 0                                | 0  |
| Other consumer loans                                       | 82                                | 0                                | 0  |
| <b>Total</b>   | <b>\$32,831</b>                   | <b>\$228</b>                     | <b>\$221</b>                                   |



The following table presents loans individually evaluated for impairment by class of loans as of and for the six-month period ended June 30, 2015:

| (dollars in thousands)                                     | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Cash Basis<br>Interest<br>Income<br>Recognized |
|--|-----------------------------------|----------------------------------|--|
| With no related allowance recorded:                        |                                   |                                  |  |
| Commercial and industrial loans:                           |                                   |                                  |  |
| Working capital lines of credit loans                      | \$21                              | \$0                              | \$0  |
| Non-working capital loans                                  | 565                               | 1                                | 1  |
| Commercial real estate and multi-family residential loans: |                                   |                                  |  |
| Construction and land development loans                    | 263                               | 0                                | 0  |
| Owner occupied loans                                       | 1,704                             | 0                                | 0  |
| Nonowner occupied loans                                    | 4,053                             | 54                               | 56   |
| Multifamily loans  | 0                                 | 0                                | 0  |
| Agri-business and agricultural loans:                      |                                   |                                  |  |
| Loans secured by farmland                                  | 381                               | 0                                | 0  |
| Loans for ag production                                    | 0                                 | 0                                | 0  |
| Other commercial loans                                     | 0                                 | 0                                | 0  |
| Consumer 1-4 family loans:                                 |                                   |                                  |  |
| Closed end first mortgage loans                            | 244                               | 0                                | 0  |
| Open end and junior lien loans                             | 292                               | 0                                | 0  |
| Residential construction loans                             | 21                                | 0                                | 0  |
| Other consumer loans                                       | 2                                 | 0                                | 0  |
| With an allowance recorded:                                |                                   |                                  |  |
| Commercial and industrial loans:                           |                                   |                                  |  |
| Working capital lines of credit loans                      | 1,003                             | 16                               | 14   |
| Non-working capital loans                                  | 11,118                            | 234                              | 247  |
| Commercial real estate and multi-family residential loans: |                                   |                                  |  |
| Construction and land development loans                    | 411                               | 8                                | 9  |
| Owner occupied loans                                       | 4,201                             | 21                               | 22   |
| Nonowner occupied loans                                    | 1,635                             | 0                                | 0  |
| Multifamily loans  | 0                                 | 0                                | 0  |
| Agri-business and agricultural loans:                      |                                   |                                  |  |
| Loans secured by farmland                                  | 100                               | 0                                | 0  |
| Loans for agricultural production                          | 0                                 | 0                                | 0  |
| Other commercial loans                                     | 5                                 | 0                                | 0  |
| Consumer 1-4 family mortgage loans:                        |                                   |                                  |  |
| Closed end first mortgage loans                            | 2,850                             | 33                               | 30   |
| Open end and junior lien loans                             | 34                                | 0                                | 0  |
| Residential construction loans                             | 0                                 | 0                                | 0  |
| Other consumer loans                                       | 116                               | 2                                | 2  |
| <b>Total</b>   | <b>\$29,019</b>                   | <b>\$369</b>                     | <b>\$381</b>                                   |



The following table presents loans individually evaluated for impairment by class of loans as of and for the six-month period ended June 30, 2014:

| (dollars in thousands)                                     | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Cash Basis<br>Interest<br>Income<br>Recognized |
|--|-----------------------------------|----------------------------------|--|
| With no related allowance recorded:                        |                                   |                                  |  |
| Commercial and industrial loans:                           |                                   |                                  |  |
| Working capital lines of credit loans                      | \$287                             | \$1                              | \$1  |
| Non-working capital loans                                  | 62                                | 0                                | 0  |
| Commercial real estate and multi-family residential loans: |                                   |                                  |  |
| Construction and land development loans                    | 0                                 | 0                                | 0  |
| Owner occupied loans                                       | 243                               | 0                                | 0  |
| Nonowner occupied loans                                    | 349                               | 0                                | 0  |
| Multifamily loans  | 0                                 | 0                                | 0  |
| Agri-business and agricultural loans:                      |                                   |                                  |  |
| Loans secured by farmland                                  | 196                               | 0                                | 0  |
| Loans for ag production                                    | 0                                 | 0                                | 0  |
| Other commercial loans                                     | 0                                 | 0                                | 0  |
| Consumer 1-4 family loans:                                 |                                   |                                  |  |
| Closed end first mortgage loans                            | 689                               | 0                                | 0  |
| Open end and junior lien loans                             | 113                               | 0                                | 0  |
| Residential construction loans                             | 144                               | 0                                | 0  |
| Other consumer loans                                       | 2                                 | 0                                | 0  |
| With an allowance recorded:                                |                                   |                                  |  |
| Commercial and industrial loans:                           |                                   |                                  |  |
| Working capital lines of credit loans                      | 2,000                             | 33                               | 29   |
| Non-working capital loans                                  | 13,840                            | 260                              | 262  |
| Commercial real estate and multi-family residential loans: |                                   |                                  |  |
| Construction and land development loans                    | 2,663                             | 30                               | 31   |
| Owner occupied loans                                       | 2,816                             | 19                               | 14   |
| Nonowner occupied loans                                    | 9,526                             | 69                               | 69   |
| Multifamily loans  | 0                                 | 0                                | 0  |
| Agri-business and agricultural loans:                      |                                   |                                  |  |
| Loans secured by farmland                                  | 559                               | 0                                | 0  |
| Loans for agricultural production                          | 0                                 | 0                                | 0  |
| Other commercial loans                                     | 0                                 | 0                                | 0  |
| Consumer 1-4 family mortgage loans:                        |                                   |                                  |  |
| Closed end first mortgage loans                            | 2,835                             | 33                               | 36   |
| Open end and junior lien loans                             | 73                                | 0                                | 0  |
| Residential construction loans                             | 0                                 | 0                                | 0  |
| Other consumer loans                                       | 87                                | 0                                | 0  |
| <b>Total</b>   | <b>\$36,484</b>                   | <b>\$445</b>                     | <b>\$442</b>                                   |





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The following table presents the aging of the recorded investment in past due loans as of June 30, 2015 by class of loans:

| (dollars in thousands)                                     | Loans Not<br>Past Due | 30-89<br>Days<br>Past<br>Due | Greater<br>than     | Total           |                 |                    |
|--|-----------------------|------------------------------|---------------------|-----------------|-----------------|--------------------|
|  |                       |                              | 90 Days<br>Past Due | Nonaccrual      | Past Due        | Total              |
| Commercial and industrial loans:                           |                       |                              |                     |                 |                 |                    |
| Working capital lines of credit loans                      | \$605,190             | \$40                         | \$0                 | \$580           | \$620           | \$605,810          |
| Non-working capital loans                                  | 534,829               | 127                          | 275                 | 3,020           | 3,422           | 538,251            |
| Commercial real estate and multi-family residential loans: |                       |                              |                     |                 |                 |                    |
| Construction and land development loans                    | 151,936               | 0                            | 0                   | 0               | 0               | 151,936            |
| Owner occupied loans                                       | 401,579               | 2,439                        | 0                   | 5,295           | 7,734           | 409,313            |
| Nonowner occupied loans                                    | 395,575               | 269                          | 0                   | 3,359           | 3,628           | 399,203            |
| Multifamily loans  | 90,075                | 0                            | 0                   | 0               | 0               | 90,075             |
| Agri-business and agricultural loans:                      |                       |                              |                     |                 |                 |                    |
| Loans secured by farmland                                  | 155,526               | 0                            | 0                   | 477             | 477             | 156,003            |
| Loans for agricultural production                          | 95,407                | 0                            | 0                   | 0               | 0               | 95,407             |
| Other commercial loans                                     | 82,242                | 0                            | 0                   | 0               | 0               | 82,242             |
| Consumer 1-4 family mortgage loans:                        |                       |                              |                     |                 |                 |                    |
| Closed end first mortgage loans                            | 146,031               | 1,508                        | 9                   | 1,154           | 2,671           | 148,702            |
| Open end and junior lien loans                             | 156,736               | 86                           | 0                   | 166             | 252             | 156,988            |
| Residential construction loans                             | 8,806                 | 0                            | 0                   | 0               | 0               | 8,806              |
| Other consumer loans                                       | 50,569                | 117                          | 0                   | 40              | 157             | 50,726             |
| <b>Total</b>   | <b>\$2,874,501</b>    | <b>\$4,586</b>               | <b>\$284</b>        | <b>\$14,091</b> | <b>\$18,961</b> | <b>\$2,893,462</b> |

The following table presents the aging of the recorded investment in past due loans as of December 31, 2014 by class of loans:

| (dollars in thousands)                | Loans Not<br>Past Due | 30-89<br>Days<br>Past<br>Due | Greater<br>than     | Total      |          |           |
|---------------------------------------|-----------------------|------------------------------|---------------------|------------|----------|-----------|
|                                       |                       |                              | 90 Days<br>Past Due | Nonaccrual | Past Due | Total     |
| Commercial and industrial loans:      |                       |                              |                     |            |          |           |
| Working capital lines of credit loans | \$543,613             | \$0                          | \$0                 | \$632      | \$632    | \$544,245 |

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|  |             |         |       |          |          |             |
|--|-------------|---------|-------|----------|----------|-------------|
| Non-working capital loans                                  | 487,655     | 0       | 101   | 3,598    | 3,699    | 491,354     |
| Commercial real estate and multi-family residential loans: |             |         |       |          |          |             |
| Construction and land development loans                    | 155,711     | 0       | 0     | 526      | 526      | 156,237     |
| Owner occupied loans                                       | 399,028     | 800     | 0     | 3,049    | 3,849    | 402,877     |
| Nonowner occupied loans                                    | 390,394     | 31      | 0     | 3,629    | 3,660    | 394,054     |
| Multi-family loans   | 71,695      | 0       | 0     | 0        | 0        | 71,695      |
| Agri-business and agricultural loans:                      |             |         |       |          |          |             |
| Loans secured by farmland                                  | 136,923     | 0       | 0     | 485      | 485      | 137,408     |
| Loans for agricultural production                          | 136,466     | 0       | 0     | 0        | 0        | 136,466     |
| Other commercial loans                                     | 75,684      | 0       | 0     | 30       | 30       | 75,714      |
| Consumer 1-4 family mortgage loans:                        |             |         |       |          |          |             |
| Closed end first mortgage loans                            | 142,615     | 1,198   | 20    | 1,051    | 2,269    | 144,884     |
| Open end and junior lien loans                             | 150,551     | 235     | 9     | 398      | 642      | 151,193     |
| Residential construction loans                             | 6,597       | 0       | 0     | 129      | 129      | 6,726       |
| Other consumer loans                                       | 49,308      | 108     | 0     | 51       | 159      | 49,467      |
| Total  | \$2,746,240 | \$2,372 | \$130 | \$13,578 | \$16,080 | \$2,762,320 |

## Troubled Debt Restructurings:

Troubled debt restructured loans are included in the totals for impaired loans. The Company has allocated \$2.7 million and \$3.4 million of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of June 30, 2015 and December 31, 2014. The Company is not committed to lend additional funds to debtors whose loans have been modified in a troubled debt restructuring.

| (dollars in thousands)                      | June 30,<br>2015 | December 31,<br>2014 |
|---|------------------|----------------------|
| Accruing troubled debt restructured loans   | \$7,606          | \$16,492             |
| Nonaccrual troubled debt restructured loans | 11,177           | 9,161                |
| Total troubled debt restructured loans      | \$18,783         | \$25,653             |

During the quarter ending June 30, 2015, certain loans were modified as troubled debt restructurings. The modified terms of these loans include one or a combination of the following: inadequate compensation for the terms of the restructure or renewal; a modification of the repayment terms which delays principal repayment for some period; or renewal terms offered to borrowers in financial distress where no additional credit enhancements were obtained at the time of renewal.

There were renewal terms offered to two borrowers under financial duress which did not require additional compensation or consideration, and the terms offered would not have been readily available in the marketplace for loans bearing similar risk profiles. In these instances, it was determined that a concession had been granted. It is difficult to quantify the concessions granted due to an absence of readily available market terms to be used for comparison. These loans were both commercial and industrial working capital loans with recorded investments of \$379,000 and \$185,000, respectively.

During the quarter ending March 31, 2015, there were renewal terms offered to one borrower under financial duress which did not require additional compensation or consideration, and the terms offered would not have been readily available in the marketplace for loans bearing similar risk profiles. In this instance, it was determined that a concession had been granted. It is difficult to quantify the concession granted due to an absence of readily available market terms to be used for comparison. The loan to the borrower is for a commercial real estate building where the collateral value and cash flows from the company occupying the building did not support the loan with a recorded investment of \$788,000.

The following table presents loans by class modified as new troubled debt restructurings that occurred during the three month period ending June 30, 2015:

| (dollars in thousands)           | Number<br>of<br>Loans | All Modifications<br>Pre-Modification<br>Outstanding<br>Recorded<br>Investment | Post-Modification<br>Outstanding<br>Recorded<br>Investment | Modified Repayment Terms<br>Extension<br>Period or<br>Range<br>(in months) |
|----------------------------------|-----------------------|--|--|--|
| Troubled Debt Restructurings     |                       |  |  |  |
| Commercial and industrial loans: |                       |  |  |  |

|  |   |         |         |   |      |
|--|---|---------|---------|---|------|
| Working capital lines of credit loans                      | 2 | \$564   | \$564   |   |      |
| Non-working capital loans                                  | 1 | 783     | 783     | 1 | 12   |
| Commercial real estate and multi-family residential loans: |   |         |         |   |      |
| Owner occupied loans                                       | 1 | 67      | 67      | 1 | 6    |
| Total  | 4 | \$1,414 | \$1,414 | 2 | 6-12 |

The following table presents loans by class modified as new troubled debt restructurings that occurred during the six month period ending June 30, 2015:

| (dollars in thousands)  | Number of Loans | All Modifications                                |   | Modified Repayment Terms |                                       |
|---|-----------------|--|---|--------------------------|---------------------------------------|
|   |                 | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Number of Loans          | Extension Period or Range (in months) |
| Troubled Debt Restructurings Commercial and industrial loans: |                 |  |   |                          |                                       |
| Working capital lines of credit loans                         | 2               | \$564  | \$564   |                          |                                       |
| Non-working capital loans                                     | 1               | 783  | 783   | 1                        | 12                                    |
| Commercial real estate and multi-family residential loans:    |                 |  |   |                          |                                       |
| Owner occupied loans  | 2               | 855  | 855   | 1                        | 6                                     |
| Total   | 5               | \$2,202  | \$2,202   | 2                        | 6-12                                  |

For the three month period ending June 30, 2015, the commercial and industrial troubled debt restructurings described above increased the allowance for loan losses by \$49,000 and the commercial real estate and multi-family residential loan troubled debt restructuring described above decreased the allowance for loan losses by \$28,000. For the six month period ending June 30, 2015, the commercial and industrial troubled debt restructurings described above increased the allowance for loan losses by \$170,000 and the commercial real estate and multi-family residential loan troubled debt restructuring described above decreased the allowance for loan losses by \$22,000.

No charge-offs resulted from the troubled debt restructuring described above during the three or six month periods ending June 30, 2015.

For the three month period ending June 30, 2014, the commercial and industrial troubled debt restructurings increased the allowance for loan losses by \$36,000 and the commercial real estate and multi-family residential loan troubled debt restructuring increased the allowance for loan losses by \$8,000. For the six month period ending June 30, 2014, the commercial and industrial troubled debt restructurings increased the allowance for loan losses by \$137,000 and the commercial real estate and multi-family residential loan troubled debt restructuring increased the allowance for loan losses by \$2,000.

No charge-offs resulted from the troubled debt restructuring during the three or six month periods ending June 30, 2014.

No loans were modified as troubled debt restructurings during the second quarter of 2014.

The following table presents loans by class modified as troubled debt restructurings that occurred during the six months ending June 30, 2014:

#### All Modifications

| (dollars in thousands)   | Number<br>of<br>Loans | Pre-Modification                      | Post-Modification                     | Modified Repayment             |   |
|--|-----------------------|---------------------------------------|---------------------------------------|--------------------------------|---|
|  |                       | Outstanding<br>Recorded<br>Investment | Outstanding<br>Recorded<br>Investment | Terms<br>Number<br>of<br>Loans | Extension<br>Period or<br>Range<br>(in<br>months) |
| Troubled Debt Restructurings<br>Commercial and industrial<br>loans:<br>Non-working capital loans | 2                     | \$ 433                                | \$ 433                                | 2                              | 12-15   |
| Commercial real estate and<br>multi-<br>family residential loans:<br>Owner occupied loans        | 1                     | 158                                   | 159                                   |                                |   |
| <b>Total</b>   | <b>3</b>              | <b>\$ 591</b>                         | <b>\$ 592</b>                         | <b>2</b>                       | <b>12-15</b>                                      |

There were no troubled debt restructurings that had payment defaults within the twelve months following modification during the three or six month periods ended June 30, 2015 and the three month period ended June 30, 2014.

Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors. The Company analyzes commercial loans individually by classifying the loans as to credit risk. This analysis is performed on a quarterly basis for Special Mention, Substandard and Doubtful grade loans and annually on Pass grade loans over \$150,000.

The Company uses the following definitions for risk ratings:

**Special Mention.** Loans classified as Special Mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

**Substandard.** Loans classified as Substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

**Doubtful.** Loans classified as Doubtful have all the weaknesses inherent in those classified as Substandard, with the added characteristics that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.



Loans not meeting the criteria above that are analyzed individually as part of the above-described process are considered to be Pass rated loans with the exception of consumer troubled debt restructurings which are evaluated and listed with Substandard commercial grade loans and consumer nonaccrual loans which are evaluated individually and listed with Not Rated loans. Loans listed as Not Rated are consumer loans included in groups of homogenous loans which are analyzed for credit quality indicators utilizing delinquency status. As of June 30, 2015, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

| (dollars in thousands)                                     | Pass         | Special<br>Mention | Substandard | Doubtful | Not<br>Rated | Total        |
|--|--------------|--------------------|-------------|----------|--------------|--------------|
| Commercial and industrial loans:                           |              |                    |             |          |              |              |
| Working capital lines of credit loans                      | \$ 563,337   | \$ 36,003          | \$ 6,470    | \$ 0     | \$ 0         | \$ 605,810   |
| Non-working capital loans                                  | 488,192      | 36,406             | 10,783      | 0        | 2,870        | 538,251      |
| Commercial real estate and multi-family residential loans: |              |                    |             |          |              |              |
| Construction and land development loans                    | 148,079      | 1,272              | 2,585       | 0        | 0            | 151,936      |
| Owner occupied loans                                       | 375,025      | 24,646             | 9,642       | 0        | 0            | 409,313      |
| Nonowner occupied loans                                    | 381,942      | 11,753             | 5,508       | 0        | 0            | 399,203      |
| Multifamily loans  | 90,075       | 0                  | 0           | 0        | 0            | 90,075       |
| Agri-business and agricultural loans:                      |              |                    |             |          |              |              |
| Loans secured by farmland                                  | 155,526      | 0                  | 477         | 0        | 0            | 156,003      |
| Loans for agricultural production                          | 95,407       | 0                  | 0           | 0        | 0            | 95,407       |
| Other commercial loans                                     | 82,238       | 0                  | 0           | 0        | 4            | 82,242       |
| Consumer 1-4 family mortgage loans:                        |              |                    |             |          |              |              |
| Closed end first mortgage loans                            | 40,008       | 126                | 1,841       | 0        | 106,727      | 148,702      |
| Open end and junior lien loans                             | 9,374        | 0                  | 2,015       | 0        | 145,599      | 156,988      |
| Residential construction loans                             | 0            | 0                  | 0           | 0        | 8,806        | 8,806        |
| Other consumer loans                                       | 16,572       | 0                  | 72          | 0        | 34,082       | 50,726       |
| Total  | \$ 2,445,775 | \$ 110,206         | \$ 39,393   | \$ 0     | \$ 298,088   | \$ 2,893,462 |

As of December 31, 2014, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

| (dollars in thousands)  | Pass               | Special<br>Mention | Substandard     | Doubtful     | Not<br>Rated     | Total              |
|---|--------------------|--------------------|-----------------|--------------|------------------|--------------------|
| Commercial and industrial<br>loans:                               |                    |                    |                 |              |                  |                    |
| Working capital lines of<br>credit loans                          | \$504,806          | \$28,485           | \$10,343        | \$611        | \$0              | \$544,245          |
| Non-working capital<br>loans                                      | 436,735            | 31,781             | 20,324          | 0            | 2,514            | 491,354            |
| Commercial real estate<br>and multi-<br>family residential loans: |                    |                    |                 |              |                  |                    |
| Construction and land<br>development loans                        | 150,442            | 1,033              | 4,762           | 0            | 0                | 156,237            |
| Owner occupied loans  | 369,520            | 20,960             | 12,397          | 0            | 0                | 402,877            |
| Nonowner occupied<br>loans  | 375,702            | 12,512             | 5,840           | 0            | 0                | 394,054            |
| Multi-family loans  | 71,695             | 0                  | 0               | 0            | 0                | 71,695             |
| Agri-business and<br>agricultural loans:                          |                    |                    |                 |              |                  |                    |
| Loans secured by<br>farmland                                      | 136,923            | 0                  | 485             | 0            | 0                | 137,408            |
| Loans for agricultural<br>production                              | 136,466            | 0                  | 0               | 0            | 0                | 136,466            |
| Other commercial loans  | 75,680             | 0                  | 30              | 0            | 4                | 75,714             |
| Consumer 1-4 family<br>mortgage loans:                            |                    |                    |                 |              |                  |                    |
| Closed end first mortgage<br>loans                                | 39,156             | 0                  | 2,199           | 0            | 103,529          | 144,884            |
| Open end and junior lien<br>loans                                 | 8,400              | 291                | 2,015           | 0            | 140,487          | 151,193            |
| Residential construction<br>loans                                 | 0                  | 0                  | 0               | 0            | 6,726            | 6,726              |
| Other consumer loans  | 15,879             | 290                | 75              | 0            | 33,223           | 49,467             |
| <b>Total</b>  | <b>\$2,321,404</b> | <b>\$95,352</b>    | <b>\$58,470</b> | <b>\$611</b> | <b>\$286,483</b> | <b>\$2,762,320</b> |

#### NOTE 5. FAIR VALUE DISCLOSURES

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

##### Level 1

Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

|         |  |
|---------|--|
| Level 2 | Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data. |
| Level 3 | Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.  |

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

Securities: Securities available for sale are valued primarily by a third party pricing service. The fair values of securities available for sale are determined on a recurring basis by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or pricing models which utilize significant observable inputs such as matrix pricing. This is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). These models utilize the market approach with standard inputs that include, but are not limited to, benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data. For certain municipal securities that are not rated and observable inputs about the specific issuer are not available, fair values are estimated using observable data from other municipal securities presumed to be similar or other market data on other non-rated municipal securities (Level 3 inputs).

The Company's Controlling Department, which is responsible for all accounting and SEC compliance, and the Company's Treasury Department, which is responsible for investment portfolio management and asset/liability modeling, are the two areas that determine the Company's valuation policies and procedures. Both of these areas report directly to the Executive Vice President and Chief Financial Officer of the Company. For assets or liabilities that may be considered for Level 3 fair value measurement on a recurring basis, these two departments and the Executive Vice President and Chief Financial Officer determine the appropriate level of the assets or liabilities under consideration. If there are assets or liabilities that are determined to be Level 3 by this group, the Risk Management Committee of the Company and the Audit Committee of the Board of Directors are made aware of such assets at their next scheduled meeting.

Securities pricing is obtained from a third party pricing service and is tested at least annually against prices from another third party provider and reviewed with a market value price tolerance variance of +/-3%, an individual security market value tolerance of +/- \$50,000 and an aggregate market value tolerance of +/- \$500,000 for all securities. If any securities fall outside any of these tolerance thresholds, they are reviewed in more detail to determine why the variance exists. Changes in market value are reviewed monthly in aggregate yield by security type and any material differences are reviewed to determine why they exist. At least annually, the pricing methodology of the pricing service is received and reviewed to support the fair value levels used by the Company. A detailed pricing evaluation is requested and reviewed on any security determined to be fair valued using unobservable inputs by the pricing service.

Mortgage banking derivatives: The fair value of mortgage banking derivatives are based on observable market data as of the measurement date (Level 2).

Interest rate swap derivatives: Our derivatives are traded in an over-the-counter market where quoted market prices are not always available. Therefore, the fair values of derivatives are determined using quantitative models that utilize multiple market inputs. The inputs will vary based on the type of derivative, but could include interest rates, prices and indices to generate continuous yield or pricing curves, prepayment rates, and volatility factors to value the position. The majority of market inputs are actively quoted and can be validated through external sources, including brokers, market transactions and third-party pricing services. The fair value of interest rate swap derivatives is determined by pricing or valuation models using observable market data as of the measurement date (Level 2).

Impaired loans: Impaired loans with specific allocations of the allowance for loan losses are generally based on the fair value of the underlying collateral if repayment is expected solely from the collateral. Fair value is determined using several methods. Generally, the fair value of real estate is based on appraisals by qualified third party appraisers. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and result in a Level 3 classification of the inputs for determining fair value. In addition, the Company's management routinely applies internal discount factors to the value of appraisals used in the fair value evaluation of impaired loans. The deductions to the appraisals take into account changing business factors and market conditions, as well as value impairment in cases where the appraisal date predates a likely change in market conditions. Commercial real estate is generally discounted from its appraised value by 0-50% with the higher discounts applied to real estate that is determined to have a thin trading market or to be specialized collateral. In addition to real estate, the Company's management evaluates other types of collateral as follows: (a) raw and finished inventory is discounted from its cost or book value by 35-65%, depending on the marketability of the goods; (b) finished goods are generally discounted by 30-60%, depending on the ease of marketability, cost of transportation or scope of use of the finished good; (c) work in process inventory is typically discounted by 50-100%, depending on the length of manufacturing time, types of components used in the completion process, and the breadth of the user base; (d) equipment is valued at a percentage of depreciated book value or recent appraised value, if available, and is typically discounted at 30-70% after various considerations including age and condition of the equipment, marketability, breadth of use, and whether the

equipment includes unique components or add-ons; and (e) marketable securities are discounted by 10-30%, depending on the type of investment, age of valuation report and general market conditions. This methodology is based on a market approach and typically results in a Level 3 classification of the inputs for determining fair value.

Mortgage servicing rights: As of June 30, 2015 the fair value of the Company's Level 3 servicing assets for residential mortgage loans was \$3.4 million, none of which are currently impaired and therefore are carried at amortized cost. These residential mortgage loans have a weighted average interest rate of 3.97%, a weighted average maturity of 19 years and are secured by homes generally within the Company's market area, which is primarily Northern Indiana. A valuation model is used to estimate fair value, which is based on an income approach. The inputs used include estimates of prepayment speeds, discount rate, cost to service, escrow account earnings, contractual servicing fee income, ancillary income, late fees, and float income. The most significant assumption used to value mortgage servicing rights is prepayment rate. Prepayment rates are estimated based on published industry consensus prepayment rates. The most significant unobservable assumption is the discount rate. At June 30, 2015, the constant prepayment speed (PSA) used was 181 and the discount rate used was 9.3%. At December 31, 2014, the PSA used was 212 and the discount rate used was 9.4%.

Other real estate owned: Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property and are reviewed by the Company's internal appraisal officer. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable properties used to determine value. Such adjustments are usually significant and result in a Level 3 classification. In addition, the Company's management may apply discount factors to the appraisals to take into account changing business factors and market conditions, as well as value impairment in cases where the appraisal date predates a likely change in market conditions. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

Real estate mortgage loans held for sale: Real estate mortgage loans held for sale are carried at the lower of cost or fair value, as determined by outstanding commitments, from third party investors, and result in a Level 2 classification.

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The table below presents the balances of assets measured at fair value on a recurring basis:

| (dollars in thousands)         | June 30, 2015 |  |         | Assets<br>at Fair Value |
|--------------------------------|---------------|--|---------|-------------------------|
|                                | Level 1       | Fair Value Measurements Using<br>Level 2 | Level 3 |                         |
| <b>Assets</b>                  |               |  |         |                         |
| U.S. Treasury securities       | \$ 1,002      | \$ 0                                     | \$ 0    | \$ 1,002                |
| Mortgage-backed securities     | 0             | 361,918                                  | 0       | 361,918                 |
| State and municipal securities | 0             | 106,655                                  | 808     | 107,463                 |
| Total Securities               | 1,002         | 468,573                                  | 808     | 470,383                 |
| Mortgage banking derivative    | 0             | 329                                      | 0       | 329                     |
| Interest rate swap derivative  | 0             | 1,463                                    | 0       | 1,463                   |
| Total assets                   | \$ 1,002      | \$ 470,365                               | \$ 808  | \$ 472,175              |
| <b>Liabilities</b>             |               |  |         |                         |
| Mortgage banking derivative    | 0             | 40                                       | 0       | 40                      |
| Interest rate swap derivative  | 0             | 1,377                                    | 0       | 1,377                   |
| Total liabilities              | \$ 0          | \$ 1,417                                 | \$ 0    | \$ 1,417                |

| (dollars in thousands)         | December 31, 2014 |  |         | Assets<br>at Fair Value |
|--------------------------------|-------------------|--|---------|-------------------------|
|                                | Level 1           | Fair Value Measurements Using<br>Level 2 | Level 3 |                         |
| <b>Assets</b>                  |                   |  |         |                         |
| U.S. Treasury securities       | \$ 1,004          | \$ 0                                     | \$ 0    | \$ 1,004                |
| Mortgage-backed securities     | 0                 | 372,095                                  | 0       | 372,095                 |
| State and municipal securities | 0                 | 101,962                                  | 850     | 102,812                 |
| Total Securities               | 1,004             | 474,057                                  | 850     | 475,911                 |
| Mortgage banking derivative    | 0                 | 96                                       | 0       | 96                      |
| Interest rate swap derivative  | 0                 | 1,191                                    | 0       | 1,191                   |
| Total assets                   | \$ 1,004          | \$ 475,344                               | \$ 850  | \$ 477,198              |
| <b>Liabilities</b>             |                   |  |         |                         |
| Mortgage banking derivative    | 0                 | 11                                       | 0       | 11                      |
| Interest rate swap derivative  | 0                 | 1,242                                    | 0       | 1,242                   |
| Total liabilities              | \$ 0              | \$ 1,253                                 | \$ 0    | \$ 1,253                |

There were no transfers between Level 1 and Level 2 during the six months ended June 30, 2015 and there were no transfers between Level 1 and Level 2 during 2014.

The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the six months ended June 30, 2015 and 2014:

| (dollars in thousands)  | State and Municipal Securities |        |
|---|--------------------------------|--------|
|   | 2015                           | 2014   |
| Balance of recurring Level 3 assets at January 1                              | \$ 850                         | \$ 975 |
| Changes in fair value of securities<br>included in other comprehensive income | (2)                            | 24     |

|  |    |      |    |      |
|--|----|------|----|------|
| Principal payments                             |    | (40) |    | (85) |
| Balance of recurring Level 3 assets at June 30 | \$ | 808  | \$ | 914  |



The state and municipal securities measured at fair value included below are non-rated Indiana municipal revenue bonds and are not actively traded.

## Quantitative Information about Level 3 Fair Value Measurements

| (dollars in thousands)         | Fair Value at<br>6/30/2015 | Valuation<br>Technique   | Unobservable Input          | Range of<br>Inputs<br>(Average) |
|--------------------------------|----------------------------|--------------------------|-----------------------------|---------------------------------|
| State and municipal securities | \$ 808                     | Price to type, par, call | Discount to benchmark index | 0-5%<br>(2.24%)                 |

## Quantitative Information about Level 3 Fair Value Measurements

| (dollars in thousands)         | Fair Value at<br>12/31/2014 | Valuation<br>Technique   | Unobservable Input          | Range of<br>Inputs<br>(Average) |
|--------------------------------|-----------------------------|--------------------------|-----------------------------|---------------------------------|
| State and municipal securities | \$ 850                      | Price to type, par, call | Discount to benchmark index | 0-6%<br>(2.49%)                 |

The primary methodology used in the fair value measurement of the Company's state and municipal securities classified as Level 3 is a discount to the AAA municipal benchmark index. Significant increases or (decreases) in this index as well as the degree to which the security differs in ratings, coupon, call and duration will result in a higher or (lower) fair value measurement for those securities that are not callable. For those securities that are continuously callable, a slight premium to par is used.

The table below presents the balances of assets measured at fair value on a nonrecurring basis:

| (dollars in thousands)                                     | June 30, 2015 |  |          | Assets<br>at Fair Value |
|--|---------------|--|----------|-------------------------|
|  | Level 1       | Fair Value Measurements Using<br>Level 2 | Level 3  |                         |
| Assets   |               |  |          |                         |
| Impaired loans:  |               |  |          |                         |
| Commercial and industrial loans:                           |               |  |          |                         |
| Working capital lines of credit loans                      | \$ 0          | \$ 0                                     | \$ 517   | \$ 517                  |
| Non-working capital loans                                  | 0             | 0  | 1,792    | 1,792                   |
| Commercial real estate and multi-family residential loans: |               |  |          |                         |
| Construction and land development loans                    | 0             | 0  | 315      | 315                     |
| Owner occupied loans                                       | 0             | 0  | 1,934    | 1,934                   |
| Consumer 1-4 family mortgage loans:                        |               |  |          |                         |
| Closed end first mortgage loans                            | 0             | 0  | 885      | 885                     |
| Open end and junior lien loans                             | 0             | 0  | 31       | 31                      |
| Other consumer loans                                       | 0             | 0  | 21       | 21                      |
| Total impaired loans                                       | \$ 0          | \$ 0                                     | \$ 5,495 | \$ 5,495                |

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|                         |      |      |          |          |
|-------------------------|------|------|----------|----------|
| Other real estate owned | 0    | 0    | 75       | 75       |
| Total assets            | \$ 0 | \$ 0 | \$ 5,570 | \$ 5,570 |

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| (dollars in thousands)                                     | December 31, 2014 |  |           | Assets<br>at Fair Value |
|--|-------------------|--|-----------|-------------------------|
|  | Level 1           | Fair Value Measurements Using<br>Level 2 | Level 3   |                         |
| Assets   |                   |  |           |                         |
| Impaired loans:  |                   |  |           |                         |
| Commercial and industrial loans:                           |                   |  |           |                         |
| Working capital lines of credit loans                      | \$ 0              | \$ 0                                     | \$ 531    | \$ 531                  |
| Non-working capital loans                                  | 0                 | 0  | 2,257     | 2,257                   |
| Commercial real estate and multi-family residential loans: |                   |  |           |                         |
| Construction and land development loans                    | 0                 | 0  | 341       | 341                     |
| Owner occupied loans                                       | 0                 | 0  | 4,084     | 4,084                   |
| Nonowner occupied loans                                    | 0                 | 0  | 3,113     | 3,113                   |
| Agri-business and agricultural loans:                      |                   |  |           |                         |
| Loans secured by farmland                                  | 0                 | 0  | 189       | 189                     |
| Other commercial loans                                     | 0                 | 0  | 15        | 15                      |
| Consumer 1-4 family mortgage loans:                        |                   |  |           |                         |
| Closed end first mortgage loans                            | 0                 | 0  | 399       | 399                     |
| Residential construction loans                             | 0                 | 0  | 73        | 73                      |
| Other consumer loans                                       | 0                 | 0  | 29        | 29                      |
| Total impaired loans                                       | \$ 0              | \$ 0                                     | \$ 11,031 | \$ 11,031               |
| Other real estate owned                                    | 0                 | 0  | 75        | 75                      |
| Total assets   | \$ 0              | \$ 0                                     | \$ 11,106 | \$ 11,106               |

The following table presents the valuation methodology and unobservable inputs for Level 3 assets measured at fair value on a non-recurring basis at June 30, 2015:

| (dollars in thousands)    | Fair Value | Valuation Methodology         | Unobservable Inputs   | Average | Range of Inputs |
|---------------------------|------------|-------------------------------|---|---------|-----------------|
| Impaired loans:           |            |                               |   |         |                 |
| Commercial and industrial | \$ 2,309   | Collateral based measurements | Discount to reflect current market conditions and ultimate collectability | 40%     | (19% - 100%)    |
| Impaired loans:           |            |                               |   |         |                 |
| Commercial real estate    | 2,249      | Collateral based measurements | Discount to reflect current market conditions and ultimate collectability | 31%     | (10% - 78%)     |
| Impaired loans:           |            |                               |   |         |                 |
|                           | 916        | Collateral based              | Discount to reflect   | 27%     | (2% - 72%)      |

|                              |    |                               |   |                 |
|------------------------------|----|-------------------------------|---|-----------------|
| Consumer 1-4 family mortgage |    |                               |   |                 |
|                              |    | measurements                  | current market conditions and ultimate collectability                     |                 |
| Impaired loans:              |    |                               |   |                 |
| Other consumer               | 21 | Collateral based measurements | Discount to reflect current market conditions and ultimate collectability | 47% (18% - 63%) |
| Other real estate owned      | 75 | Appraisals                    | Discount to reflect current market conditions                             | 49%             |

The following table presents the valuation methodology and unobservable inputs for Level 3 assets measured at fair value on a non-recurring basis at December 31, 2014:

| (dollars in thousands)         | Fair Value | Valuation Methodology         | Unobservable Inputs   | Average | Range of Inputs |
|--------------------------------|------------|-------------------------------|---|---------|-----------------|
| Impaired loans:                |            |                               |   |         |                 |
| Commercial and industrial      | \$ 2,788   | Collateral based measurements | Discount to reflect current market conditions and ultimate collectability | 40%     | (11% - 68%)     |
| Impaired loans:                |            |                               |   |         |                 |
| Commercial real estate         | 7,538      | Collateral based measurements | Discount to reflect current market conditions and ultimate collectability | 25%     | (6% - 50%)      |
| Impaired loans:                |            |                               |   |         |                 |
| Agri-business and agricultural | 189        | Collateral based measurements | Discount to reflect current market conditions and ultimate collectability | 7%      |                 |
| Impaired loans:                |            |                               |   |         |                 |
| Other commercial               | 15         | Collateral based measurements | Discount to reflect current market conditions and ultimate collectability | 50%     |                 |
| Impaired loans:                |            |                               |   |         |                 |
| Consumer 1-4 family mortgage   | 472        | Collateral based measurements | Discount to reflect current market conditions and ultimate collectability | 32%     | (3% - 77%)      |
| Impaired loans:                |            |                               |   |         |                 |
| Other consumer                 | 29         | Collateral based measurements | Discount to reflect current market conditions and ultimate collectability | 43%     | (33% - 50%)     |
| Other real estate owned        | 75         | Appraisals                    | Discount to reflect   | 49%     |                 |

current market  
conditions

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a gross carrying amount of \$7.7 million, with a valuation allowance of \$2.2 million at June 30, 2015, resulting in a net reduction in the provision for loan losses of \$1.3 million and \$610,000, respectively, in the three and six months ended June 30, 2015. At June 30, 2014, impaired loans had a gross carrying amount of \$16.5 million, with a valuation allowance of \$4.1 million, resulting in a net reduction in the provision for loan losses of \$100,000 and \$2.2 million for the three and six months ended June 30, 2014.

Other real estate owned measured at fair value less costs to sell, at June 30, 2015 had a net carrying amount of \$75,000, which is made up of the outstanding balance of \$147,000, net of a valuation allowance of \$72,000, all of which was written down during 2012. Other real estate owned measured at fair value less costs to sell at June 30, 2014 had a net carrying amount of \$263,000, which is made up of the outstanding balance of \$376,000, net valuation allowance of \$113,000, resulting in an additional provision of \$41,000 during the three months and six months ended June 30, 2014.

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The following table contains the estimated fair values and the related carrying values of the Company's financial instruments. Items which are not financial instruments are not included.

| (dollars in thousands)                  | Carrying Value | June 30, 2015 |             |           | Total       |
|---|----------------|---------------|-------------|-----------|-------------|
|   |                | Level 1       | Level 2     | Level 3   |             |
| <b>Financial Assets:</b>                |                |               |             |           |             |
| Cash and cash equivalents               | \$ 89,480      | \$ 89,480     | \$ 0        | \$ 0      | \$ 89,480   |
| Securities available for sale           | 470,383        | 1,002         | 468,573     | 808       | 470,383     |
| Real estate mortgages held for sale     | 3,405          | 0             | 3,459       | 0         | 3,459       |
| Loans, net                              | 2,848,646      | 0             | 0           | 2,833,515 | 2,833,515   |
| Federal Home Loan Bank stock            | 4,248          | N/A           | N/A         | N/A       | N/A         |
| Federal Reserve Bank stock              | 3,420          | N/A           | N/A         | N/A       | N/A         |
| Accrued interest receivable             | 9,360          | 3             | 2,284       | 7,073     | 9,360       |
| <b>Financial Liabilities:</b>           |                |               |             |           |             |
| Certificates of deposit                 | (995,053)      | 0             | (1,000,619) | 0         | (1,000,619) |
| All other deposits                      | (2,025,098)    | (2,025,098)   | 0           | 0         | (2,025,098) |
| <b>Securities sold under agreements</b> |                |               |             |           |             |
| to repurchase                           | (51,615)       | 0             | (51,615)    | 0         | (51,615)    |
| Federal funds purchased                 | 0              | 0             | 0           | 0         | 0           |
| Other short-term borrowings             | (75,000)       | 0             | (75,000)    | 0         | (75,000)    |
| Long-term borrowings                    | (34)           | 0             | (38)        | 0         | (38)        |
| Subordinated debentures                 | (30,928)       | 0             | 0           | (31,226)  | (31,226)    |
| Standby letters of credit               | (406)          | 0             | 0           | (406)     | (406)       |
| Accrued interest payable                | (3,921)        | (101)         | (3,817)     | (3)       | (3,921)     |

| (dollars in thousands)                  | Carrying Value | December 31, 2014 |           |           | Total       |
|---|----------------|-------------------|-----------|-----------|-------------|
|   |                | Level 1           | Level 2   | Level 3   |             |
| <b>Financial Assets:</b>                |                |                   |           |           |             |
| Cash and cash equivalents               | \$ 90,638      | \$ 90,638         | \$ 0      | \$ 0      | \$ 90,638   |
| Securities available for sale           | 475,911        | 1,004             | 474,057   | 850       | 475,911     |
| Real estate mortgages held for sale     | 1,585          | 0                 | 1,612     | 0         | 1,612       |
| Loans, net                              | 2,716,058      | 0                 | 0         | 2,698,767 | 2,698,767   |
| Federal Home Loan Bank stock            | 5,993          | N/A               | N/A       | N/A       | N/A         |
| Federal Reserve Bank stock              | 3,420          | N/A               | N/A       | N/A       | N/A         |
| Accrued interest receivable             | 8,662          | 3                 | 2,312     | 6,347     | 8,662       |
| <b>Financial Liabilities:</b>           |                |                   |           |           |             |
| Certificates of deposit                 | (870,590)      | 0                 | (876,953) | 0         | (876,953)   |
| All other deposits                      | (2,002,530)    | (2,002,530)       | 0         | 0         | (2,002,530) |
| <b>Securities sold under agreements</b> |                |                   |           |           |             |
| to repurchase                           | (54,907)       | 0                 | (54,907)  | 0         | (54,907)    |

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|                             |           |       |           |          |           |
|-----------------------------|-----------|-------|-----------|----------|-----------|
| Federal funds purchased     | (500)     | 0     | (500)     | 0        | (500)     |
| Other short-term borrowings | (105,000) | 0     | (105,001) | 0        | (105,001) |
| Long-term borrowings        | (35)      | 0     | (40)      | 0        | (40)      |
| Subordinated debentures     | (30,928)  | 0     | 0         | (31,212) | (31,212)  |
| Standby letters of credit   | (379)     | 0     | 0         | (379)    | (379)     |
| Accrued interest payable    | (2,946)   | (109) | (2,834)   | (3)      | (2,946)   |

The methods and assumptions, not previously presented, used to estimate fair values are described as follows:

Cash and cash equivalents - The carrying amount of cash and cash equivalents approximate fair value and are classified as Level 1.



Loans, net – Fair values of loans, excluding loans held for sale, are estimated as follows: For variable rate loans, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using current market rates applied to the estimated life of the loan resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value as described previously. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

Federal Home Loan Bank stock and Federal Reserve Bank stock– It is not practical to determine the fair value of Federal Home Loan Bank stock and Federal Reserve Bank stock due to restrictions placed on its transferability.

Certificates of deposit - Fair values of certificates of deposit are estimated using discounted cash flow analyses using current market rates applied to the estimated life resulting in a Level 2 classification.

All other deposits- The fair values for all other deposits other than certificates of deposit are equal to the amount payable on demand (the carrying value) resulting in a Level 1 classification.

Securities sold under agreements to repurchase – The carrying amount of borrowings under repurchase agreements approximates their fair values resulting in a Level 2 classification.

Federal funds purchased – The carrying amount of federal funds purchased approximates their fair values resulting in a Level 2 classification.

Other short-term borrowings – The fair value of other short-term borrowings is estimated using discounted cash flow analysis based on current borrowing rates resulting in a Level 2 classification.

Long-term borrowings – The fair value of long-term borrowings is estimated using discounted cash flow analyses based on current borrowing rates resulting in a Level 2 classification.

Subordinated debentures - The fair value of subordinated debentures is based on the rates currently available to the Company with similar term and remaining maturity and credit spread resulting in a Level 3 classification.

Standby letters of credit – The fair value of off-balance sheet items is based on the current fees and costs that would be charged to enter into or terminate such arrangements resulting in a Level 3 classification.

Accrued interest receivable/payable – The carrying amounts of accrued interest approximates fair value resulting in a Level 1, Level 2 or Level 3 classification which is consistent with its associated asset/liability.

#### NOTE 6. SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

Securities sold under agreements to repurchase represent collateralized borrowings with customers located primarily within the Company's service area. These repurchase liabilities are not covered by federal deposit insurance and are secured by securities owned. The Company retains the right to substitute similar type securities and has the right to withdraw all excess collateral applicable to the repurchase liabilities whenever the collateral values are in excess of the related repurchase liabilities. However, as a means of mitigating market risk, the Company maintains excess collateral to cover normal changes in the repurchase liability by monitoring daily usage. The Company maintains control of the securities through the use of third-party safekeeping arrangements.

Securities sold under agreements to repurchase of \$51.6 million and \$54.9 million, which mature on demand, are secured by mortgage-backed securities with a carrying amount of \$88.0 million and \$94.2 million at June 30, 2015 and December 31, 2014. Additional information concerning recognition of these liabilities is disclosed in Note 8.



## NOTE 7. EMPLOYEE BENEFIT PLANS

Components of net periodic benefit cost:

| (dollars in thousands)         | Six Months Ended June 30, |      |               |      | Three Months Ended June 30, |      |               |      |
|--------------------------------|---------------------------|------|---------------|------|-----------------------------|------|---------------|------|
|                                | Pension Benefits          |      | SERP Benefits |      | Pension Benefits            |      | SERP Benefits |      |
|                                | 2015                      | 2014 | 2015          | 2014 | 2015                        | 2014 | 2015          | 2014 |
| Interest cost                  | \$52                      | \$60 | \$23          | \$25 | \$26                        | \$30 | \$12          | \$13 |
| Expected return on plan assets | (70)                      | (63) | (39)          | (36) | (35)                        | (32) | (20)          | (18) |
| Recognized net actuarial loss  | 81                        | 59   | 41            | 40   | 41                          | 30   | 20            | 20   |
| Net pension expense            | \$63                      | \$56 | \$25          | \$29 | \$32                        | \$28 | \$12          | \$15 |

The Company previously disclosed in its financial statements for the year ended December 31, 2014 that it expected to contribute \$318,000 to its pension plan and \$110,000 to its Supplemental Executive Retirement Plan (“SERP”) in 2015. The Company has contributed \$172,000 to its pension plan and \$110,000 to its SERP as of June 30, 2015. The Company expects to contribute \$146,000 to its pension plan during the remainder of 2015. The Company does not expect to make any additional contributions to its SERP during the remainder of 2015.

## NOTE 8. OFFSETTING ASSETS AND LIABILITIES

The following tables summarize gross and net information about financial instruments and derivative instruments that are offset in the statement of financial position or that are subject to an enforceable master netting arrangement at June 30, 2015 and December 31, 2014.

| (dollars in thousands) | June 30, 2015                                  |   |  |  |               |         |
|------------------------|--|---|--|--|---------------|---------|
|                        | Gross Amounts of Recognized Assets/Liabilities | Gross Amounts Offset in the Statement of Financial Position | Net Amounts of Assets presented in the Statement of Financial Position | Gross Amounts Not Offset in the Statement of Financial Instruments | Cash Received | Net     |
| <b>Assets</b>          |  |   |  |  |               |         |
| Interest Rate Swap     |  |   |  |  |               |         |
| Derivatives            | \$1,463  | \$0   | \$1,463  | \$0  | \$0           | \$1,463 |
| Total Assets           | \$1,463  | \$0   | \$1,463  | \$0  | \$0           | \$1,463 |
| <b>Liabilities</b>     |  |   |  |  |               |         |
| Interest Rate Swap     |  |   |  |  |               |         |
| Derivatives            | \$1,377  | \$0   | \$1,377  | \$0  | \$(1,030)     | \$347   |
| Repurchase Agreements  | 51,615   | 0   | 51,615   | (51,615)   | 0             | 0       |
| Total Liabilities      | \$52,992                                       | \$0   | \$52,992   | \$(51,615)   | \$(1,030)     | \$347   |

|  | December 31, 2014 |                             |                                    |   |
|--|-------------------|-----------------------------|------------------------------------|---|
|  | Gross Amounts of  | Gross Amounts Offset in the | Net Amounts of Assets presented in | Gross Amounts Not Offset in the Statement |

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| (dollars in thousands)    | Recognized<br>Assets/<br>Liabilities | Statement of<br>Financial<br>Position | the Statement<br>of Financial<br>Position | of Financial Position<br>Financial<br>Instruments | Cash<br>Received | Net     |
|---------------------------|--------------------------------------|---------------------------------------|---|---|------------------|---------|
| <b>Assets</b>             |                                      |                                       |   |   |                  |         |
| <b>Interest Rate Swap</b> |                                      |                                       |   |   |                  |         |
| Derivatives               | \$1,191                              | \$0                                   | \$1,191                                   | \$0   | \$0              | \$1,191 |
| Total Assets              | \$1,191                              | \$0                                   | \$1,191                                   | \$0   | \$0              | \$1,191 |
| <b>Liabilities</b>        |                                      |                                       |   |   |                  |         |
| <b>Interest Rate Swap</b> |                                      |                                       |   |   |                  |         |
| Derivatives               | \$1,242                              | \$0                                   | \$1,242                                   | \$0   | \$(1,242)        | \$0     |
| <b>Repurchase</b>         |                                      |                                       |   |   |                  |         |
| Agreements                | 54,907                               | 0                                     | 54,907                                    | (54,907)  | 0                | 0       |
| Total Liabilities         | \$56,149                             | \$0                                   | \$56,149                                  | \$(54,907)  | \$(1,242)        | \$0     |

If an event of default occurs causing an early termination of an interest rate swap derivative, any early termination amount payable to one party by the other party may be reduced by set-off against any other amount payable by the one party to the other party. If a default in performance of any obligation of a repurchase agreement occurs, each party will set-off property held in respect of transactions against obligations owing in respect of any other transactions.

## NOTE 9. EARNINGS PER SHARE

Basic earnings per common share is net income available to common shareholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable under stock options, stock awards and warrants, none of which were antidilutive.

|   | Three Months Ended June 30, |            | Six Months Ended June 30, |            |
|---|-----------------------------|------------|---------------------------|------------|
|   | 2015                        | 2014       | 2015                      | 2014       |
| Weighted average shares outstanding for basic earnings per common share   | 16,611,974                  | 16,536,112 | 16,601,189                | 16,524,079 |
| Dilutive effect of stock options, awards and warrants                     | 208,078                     | 202,957    | 194,718                   | 205,400    |
| Weighted average shares outstanding for diluted earnings per common share | 16,820,052                  | 16,739,069 | 16,795,907                | 16,729,479 |
| Basic earnings per common share   | \$0.69                      | \$0.68     | \$1.36                    | \$1.28     |
| Diluted earnings per common share   | \$0.68                      | \$0.68     | \$1.34                    | \$1.27     |

## NOTE 10. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following tables summarize the changes within each classification of accumulated other comprehensive income (loss) for the six months ended June 30, 2015 and the year ended December 31, 2014:

| (dollars in thousands)  | Unrealized<br>Gains and<br>Losses on<br>Available-<br>for-Sales<br>Securities | Defined<br>Benefit<br>Pension<br>Items | Total   |
|---|---|--|---------|
| Balance at December 31, 2014  | \$5,467   | \$(1,637)                              | \$3,830 |
| Other comprehensive income before reclassification                      | (982)   | (174)                                  | (1,156) |
| Amounts reclassified from accumulated other comprehensive income (loss) | (25)  | 73                                     | 48      |
| Net current period other comprehensive income                           | (1,007)   | (101)                                  | (1,108) |
| Balance at June 30, 2015  | \$4,460   | \$(1,738)                              | \$2,722 |

| (dollars in thousands) | Unrealized<br>Gains and<br>Losses on<br>Available-<br>for-Sales<br>Securities | Defined<br>Benefit<br>Pension<br>Items | Total |
|------------------------|---|--|-------|
|------------------------|---|--|-------|

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|   |           |           |           |
|---|-----------|-----------|-----------|
| Balance at December 31, 2013  | \$(1,138) | \$(1,356) | \$(2,494) |
| Other comprehensive income before reclassification                      | 6,471     | (399)     | 6,072     |
| Amounts reclassified from accumulated other comprehensive income (loss) | 134       | 118       | 252       |
| Net current period other comprehensive income                           | 6,605     | (281)     | 6,324     |
| Balance at December 31, 2014  | \$5,467   | \$(1,637) | \$3,830   |

Reclassifications out of accumulated comprehensive income for the three months ended June 30, 2015 are as follows:

| Details about<br>Accumulated Other<br>Comprehensive<br><br>Income Components | Amount<br>Reclassified From<br>Accumulated Other<br>Comprehensive<br>Income | Affected Line Item<br>in the Statement<br>Where Net<br><br>Income is Presented |
|--|---|--|
| (dollars in thousands)   |   |  |
| Unrealized gains and losses on available-for-sale securities                 | \$0   | Net securities gains (losses)  |
| Tax effect   | 0   | Income tax expense   |
|  | 0   | Net of tax   |
|  |   | Salaries and employee  |
| Amortization of defined benefit pension items                                | (61)  | benefits   |
| Tax effect   | 25  | Income tax expense   |
|  | (36)  | Net of tax   |
| <b>Total reclassifications for the period</b>                                | <b>\$(36)</b>   | <b>Net of tax</b>  |

Reclassifications out of accumulated comprehensive income for the three months ended June 30, 2014 are as follows:

| Details about<br>Accumulated Other<br>Comprehensive<br><br>Income Components | Amount<br>Reclassified From<br>Accumulated Other<br>Comprehensive<br>Income | Affected Line Item<br>in the Statement<br>Where Net<br><br>Income is Presented |
|--|---|--|
| (dollars in thousands)   |   |  |
| Unrealized gains and losses on available-for-sale securities                 | \$4   | Net securities gains (losses)  |
| Tax effect   | 0   | Income tax expense   |
|  | 4   | Net of tax   |
|  |   | Salaries and employee  |
| Amortization of defined benefit pension items                                | (50)  | benefits   |
| Tax effect   | 21  | Income tax expense   |
|  | (29)  | Net of tax   |
| <b>Total reclassifications for the period</b>                                | <b>\$(25)</b>   | <b>Net of tax</b>  |

Reclassifications out of accumulated comprehensive income for the six months ended June 30, 2015 are as follows:

| Details about<br>Accumulated Other<br>Comprehensive<br><br>Income Components | Amount<br>Reclassified From<br>Accumulated Other<br>Comprehensive<br>Income | Affected Line Item<br>in the Statement<br>Where Net<br><br>Income is Presented |
|--|---|--|
|--|---|--|

Comprehensive  
Income

(dollars in thousands)

|  |        |                                |
|--|--------|--------------------------------|
| Unrealized gains and losses on available-for-sale securities | \$42   | Net securities gains (losses)  |
| Tax effect   | (17)   | Income tax expense             |
|  | 25     | Net of tax                     |
|  |        | Salaries and employee benefits |
| Amortization of defined benefit pension items                | (122)  | Income tax expense             |
| Tax effect   | 49     | Net of tax                     |
|  | (73)   | Net of tax                     |
| Total reclassifications for the period                       | \$(48) | Net of tax                     |



Reclassifications out of accumulated comprehensive income for the six months ended June 30, 2014 are as follows:

| Details about<br>Accumulated Other<br>Comprehensive<br>Income Components | Amount<br>Reclassified From<br>Accumulated Other<br>Comprehensive<br>Income | Affected Line Item<br>in the Statement<br>Where Net<br>Income is Presented |
|--|---|--|
| (dollars in thousands)   |   |  |
| Unrealized gains and losses on available-for-sale securities             | \$4   | Net securities gains (losses)  |
| Tax effect   | 0   | Income tax expense   |
|  | 4   | Net of tax   |
|  |   | Salaries and employee benefits   |
| Amortization of defined benefit pension items                            | (99)  | Income tax expense   |
| Tax effect   | 40  | Net of tax   |
|  | (59)  | Net of tax   |
| Total reclassifications for the period                                   | \$(55)  | Net of tax   |

#### NOTE 11. NEW ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB issued new accounting guidance related to revenue recognition. This new standard will replace all current U.S. GAAP guidance on this topic and eliminate all industry-specific guidance. The new revenue recognition standard provides a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration for which the entity expects to be entitled in exchange for those goods or services. This guidance will be effective for the Company beginning January 1, 2018 and can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. Management is evaluating the impact of adopting this new accounting standard on our financial statements.

#### NOTE 12. SUBSEQUENT EVENTS

There were no subsequent events that would have a material impact on the financial statements presented in this Form 10-Q.

#### NOTE 13. RECLASSIFICATIONS

Certain amounts appearing in the financial statements and notes thereto for prior periods have been reclassified to conform with the current presentation. The reclassification had no effect on net income or stockholders' equity as previously reported.

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

### OVERVIEW

Net income in the first six months of 2015 was \$22.5 million, up 6.1% from \$21.2 million for the comparable period of 2014. Diluted income per common share was \$1.34 in the first six months of 2015, up 5.5% from \$1.27 in the comparable period of 2014. Return on average total assets was 1.30% in the first six months of 2015 versus 1.32% in the comparable period of 2014. The equity to average assets ratio was 10.60% in the first six months of 2015 versus 10.23% in the comparable period of 2014.

Net income in the second quarter of 2015 was \$11.4 million, up 0.6% from \$11.3 million for the comparable period of 2014. Diluted income per common share was \$0.68 in the second quarter of 2015, no change from \$0.68 in the comparable period of 2014. Return on average total assets was 1.29% in the second quarter of 2015 versus 1.37% in the comparable period of 2014. The equity to average assets ratio was 10.54% in the second quarter of 2015 versus 10.18% in the comparable period of 2014.

Total assets were \$3.572 billion as of June 30, 2015 versus \$3.443 billion as of December 31, 2014, an increase of \$128.8 million, or 3.7%. This increase was primarily due to a \$132.6 million increase in total loans.

### CRITICAL ACCOUNTING POLICIES

Certain of the Company's accounting policies are important to the portrayal of the Company's financial condition since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Estimates associated with these policies are susceptible to material changes as a result of changes in facts and circumstances. Some of the facts and circumstances which could affect these judgments include changes in interest rates, in the performance of the economy or in the financial condition of borrowers. Management believes that its critical accounting policies include determining the allowance for loan losses and the valuation and other-than-temporary impairment of investment securities.

#### Allowance for Loan Losses

The Company maintains an allowance for loan losses to provide for probable incurred credit losses. Loan losses are charged against the allowance when management believes that the principal is uncollectable. Subsequent recoveries, if any, are credited to the allowance. Allocations of the allowance are made for specific loans and for pools of similar types of loans, although the entire allowance is available for any loan that, in management's judgment, should be charged against the allowance. A provision for loan losses is taken based on management's ongoing evaluation of the appropriate allowance balance. A formal evaluation of the adequacy of the loan loss allowance is conducted monthly. The ultimate recovery of all loans is susceptible to future market factors beyond the Company's control.

The level of loan loss provision is influenced by growth in the overall loan portfolio, emerging market risk, emerging concentration risk, commercial loan focus and large credit concentration, new industry lending activity, general economic conditions and historical loss analysis. In addition, management gives consideration to changes in the allocation for specific watch list credits in determining the appropriate level of the loan loss provision. Furthermore, management's overall view on credit quality is a factor in the determination of the provision.

The determination of the appropriate allowance is inherently subjective, as it requires significant estimates by management. The Company has an established process to determine the adequacy of the allowance for loan losses that

generally includes consideration of the following factors: changes in the nature and volume of the loan portfolio, overall portfolio quality and current economic conditions that may affect the borrowers' ability to repay. Consideration is not limited to these factors although they represent the most commonly cited factors. With respect to specific allocation levels for individual credits, management considers the amounts and timing of expected future cash flows and the current valuation of collateral as the primary measures. Management also considers trends in adversely classified loans based upon an ongoing review of those credits. With respect to pools of similar loans, allocations are assigned based upon historical experience unless the rate of loss is expected to be greater than historical losses as noted below. A detailed analysis is performed on loans that are classified but determined not to be impaired which incorporates probability of default with a loss given default scenario to develop non-specific allocations for the loan pool. These allocations may be adjusted based on the other factors cited above. An appropriate level of general allowance for pooled loans is determined after considering the following: application of historical loss percentages, emerging market risk, commercial loan focus and large credit concentration, new industry lending activity and general economic conditions. It is also possible that the following could affect the overall process: social, political, economic and terrorist events or activities. All of these factors are susceptible to change, which may be significant. As a result of this detailed process, the allowance results in two forms of allocations, specific and general. These two components represent the total allowance for loan losses deemed adequate to cover probable losses inherent in the loan portfolio.

Commercial loans are subject to a dual standardized grading process administered by the credit administration function. These grade assignments are performed independent of each other and a consensus is reached by credit administration and the loan review officer. Specific allowances are established in cases where management has identified significant conditions or circumstances related to an individual credit that indicate the loan is impaired. Considerations with respect to specific allocations for these individual credits include, but are not limited to, the following: (a) does the customer's cash flow or net worth appear insufficient to repay the loan; (b) is there adequate collateral to repay the loan; (c) has the loan been criticized in a regulatory examination; (d) is the loan impaired; (e) are there other reasons where the ultimate collectability of the loan is in question; or (f) are there unique loan characteristics that require special monitoring.

Allocations are also applied to categories of loans considered not to be individually impaired, but for which the rate of loss is expected to be consistent with or greater than historical averages. Such allocations are based on past loss experience and information about specific borrower situations and estimated collateral values. In addition, general allocations are made for other pools of loans, including non-classified loans. These general pooled loan allocations are performed for portfolio segments of commercial and industrial, commercial real estate and multi-family, agri-business and agricultural, other commercial, consumer 1-4 family mortgage and other consumer loans, and loans within certain industry categories believed to present unique risk of loss. General allocations of the allowance are primarily made based on a three-year historical average for loan losses for these portfolios, subjectively adjusted for economic factors and portfolio trends.

Due to the imprecise nature of estimating the allowance for loan losses, the Company's allowance for loan losses includes an unallocated component. The unallocated component of the allowance for loan losses incorporates the Company's judgmental determination of inherent losses that may not be fully reflected in other allocations, including factors such as the level of classified credits, economic uncertainties, industry trends impacting specific portfolio segments, broad portfolio quality trends and trends in the composition of the Company's large commercial loan portfolio and related large dollar exposures to individual borrowers.

#### Valuation and Other-Than-Temporary Impairment of Investment Securities

The fair values of securities available for sale are determined on a recurring basis by obtaining quoted prices on nationally recognized securities exchanges or pricing models, which utilize significant observable inputs such as matrix pricing. This is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities. Different judgments and assumptions used in pricing could result in different estimates of value. The fair value of certain securities is determined using unobservable inputs, primarily observable inputs of similar securities.

At the end of each reporting period, securities held in the investment portfolio are evaluated on an individual security level for other-than-temporary impairment in accordance with current accounting guidance. Impairment is other-than-temporary if the decline in the fair value of the security is below its amortized cost and it is probable that all amounts due according to the contractual terms of a debt security will not be received.

Significant judgments are required in determining impairment, which includes making assumptions regarding the estimated prepayments, loss assumptions and the change in interest rates.

We consider the following factors when determining other-than-temporary impairment for a security or investment:

- the length of time and the extent to which the market value has been less than amortized cost;
- the financial condition and near-term prospects of the issuer;
- the underlying fundamentals of the relevant market and the outlook for such market for the near future; and

- our intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in market value.

If, in management's judgment, other-than-temporary impairment exists, the cost basis of the security will be written down to the computed net present value, and the unrealized loss will be transferred from accumulated other comprehensive loss as an immediate reduction of current earnings (as if the loss had been realized in the period of other-than-temporary impairment). In addition, discount accretion will be discontinued on any bond that meets one or both of the following: (1) the rating by S&P, Moody's or Fitch decreases to below "A" and/or (2) the cash flow analysis on a security indicates that, under any scenario modeled by the third party, there is a potential to not receive the full amount invested in the security.

## RESULTS OF OPERATIONS

## Overview

Selected income statement information for the three months and six months ended June 30, 2015 and 2014 is presented in the following table:

| (dollars in thousands)              | Three Months Ended June 30, |          | Six Months Ended June 30, |          |
|-------------------------------------|-----------------------------|----------|---------------------------|----------|
|                                     | 2015                        | 2014     | 2015                      | 2014     |
| <b>Income Statement Summary:</b>    |                             |          |                           |          |
| Net interest income                 | \$26,064                    | \$25,554 | \$51,764                  | \$50,234 |
| Provision for loan losses           | 0                           | 0        | 0                         | 0        |
| Noninterest income                  | 7,713                       | 7,592    | 15,508                    | 15,019   |
| Noninterest expense                 | 16,741                      | 16,084   | 33,642                    | 32,874   |
| <b>Other Data:</b>                  |                             |          |                           |          |
| Efficiency ratio                    | 49.57%                      | 48.53%   | 50.01%                    | 50.38%   |
| Dilutive EPS                        | \$0.68                      | \$0.68   | \$1.34                    | \$1.27   |
| Tangible capital ratio              | 10.44%                      | 9.96%    | 10.44%                    | 9.96%    |
| Net charge-offs to average loans    | 0.12%                       | 0.08%    | 0.10%                     | 0.25%    |
| Net interest margin                 | 3.18%                       | 3.34%    | 3.23%                     | 3.35%    |
| Noninterest income to total revenue | 22.84%                      | 22.90%   | 23.05%                    | 23.02%   |

## Net Income

Net income was \$22.5 million in the first six months of 2015, an increase of \$1.3 million, or 6.1%, versus net income of \$21.2 million in the first six months of 2014. Net interest income increased \$1.5 million, or 3.1%, to \$51.8 million versus \$50.2 million in the first six months of 2014. Net interest income increased primarily due to a 7.1% increase in average earning assets. Significantly affecting average earning assets during 2015 was an increase of 8.2% in the commercial loan portfolio, which reflects our continuing strategic focus on commercial lending. The net interest margin was 3.23% in the first six months of 2015 versus 3.35% in 2014. The lower margin reflected a decline in loan yields, and a modest increase in the cost of funds offset by increased security yields.

Net income was \$11.4 million in the second quarter of 2015, an increase of \$68,000, or 0.6%, versus net income of \$11.3 million in the second quarter of 2014. Net interest income increased \$510,000, or 2.0%, to \$26.1 million versus \$25.6 million in the second quarter of 2014. Net interest income increased primarily due to a 6.8% increase in average earning assets, driven by an increase of 7.8% in the commercial loan portfolio. The net interest margin was 3.18% in the second quarter of 2015 versus 3.34% in 2014. The lower margin reflected a decline in loan yields and increase in funding costs.

## Net Interest Income

The following tables set forth consolidated information regarding average balances and rates:

|   | Six Months Ended June 30, |                    |                       |                    |                    |                       |
|---|---------------------------|--------------------|-----------------------|--------------------|--------------------|-----------------------|
|   | 2015                      |                    |                       | 2014               |                    |                       |
| (fully tax equivalent basis,<br>dollars in thousands) | Average<br>Balance        | Interest<br>Income | Yield<br>(1)/<br>Rate | Average<br>Balance | Interest<br>Income | Yield<br>(1)/<br>Rate |
| <b>Earning Assets</b>                                 |                           |                    |                       |                    |                    |                       |
| Loans:  |                           |                    |                       |                    |                    |                       |
| Taxable (2)(3)  | \$2,791,019               | \$53,572           | 3.87%                 | \$2,581,465        | \$51,604           | 4.03%                 |
| Tax exempt (1)  | 12,865                    | 349                | 5.47                  | 10,978             | 336                | 6.17                  |
| Investments: (1)                                      |                           |                    |                       |                    |                    |                       |
| Available for sale                                    | 476,520                   | 6,987              | 2.96                  | 473,876            | 6,521              | 2.78                  |
| Short-term investments                                | 4,869                     | 2                  | 0.08                  | 5,368              | 2                  | 0.08                  |
| Interest bearing deposits                             | 9,489                     | 25                 | 0.53                  | 4,297              | 17                 | 0.80                  |
| <b>Total earning assets</b>                           | <b>\$3,294,762</b>        | <b>\$60,935</b>    | <b>3.73%</b>          | <b>\$3,075,984</b> | <b>\$58,480</b>    | <b>3.83%</b>          |
| Less: Allowance for loan losses                       | (45,866)                  |                    |                       | (47,340)           |                    |                       |
| <b>Nonearning Assets</b>                              |                           |                    |                       |                    |                    |                       |
| Cash and due from banks                               | 90,891                    |                    |                       | 72,766             |                    |                       |
| Premises and equipment                                | 42,508                    |                    |                       | 39,712             |                    |                       |
| Other nonearning assets                               | 114,565                   |                    |                       | 112,708            |                    |                       |
| <b>Total assets</b>                                   | <b>\$3,496,860</b>        |                    |                       | <b>\$3,253,830</b> |                    |                       |
| <b>Interest Bearing Liabilities</b>                   |                           |                    |                       |                    |                    |                       |
| Savings deposits                                      | \$228,165                 | \$223              | 0.20%                 | \$239,243          | \$265              | 0.22%                 |
| Interest bearing checking accounts                    | 1,229,747                 | 2,412              | 0.40                  | 1,146,784          | 2,255              | 0.40                  |
| Time deposits:  |                           |                    |                       |                    |                    |                       |
| In denominations under \$100,000                      | 286,560                   | 1,687              | 1.19                  | 280,994            | 1,589              | 1.14                  |
| In denominations over \$100,000                       | 690,531                   | 3,256              | 0.95                  | 579,171            | 2,413              | 0.84                  |
| Miscellaneous short-term borrowings                   | 75,031                    | 95                 | 0.26                  | 159,113            | 255                | 0.32                  |
| Long-term borrowings and subordinated debentures      | 30,962                    | 517                | 3.37                  | 30,964             | 509                | 3.32                  |
| <b>Total interest bearing liabilities</b>             | <b>\$2,540,996</b>        | <b>\$8,190</b>     | <b>0.65%</b>          | <b>\$2,436,269</b> | <b>\$7,286</b>     | <b>0.60%</b>          |
| <b>Noninterest Bearing Liabilities</b>                |                           |                    |                       |                    |                    |                       |
| Demand deposits                                       | 567,182                   |                    |                       | 469,561            |                    |                       |
| Other liabilities                                     | 18,146                    |                    |                       | 14,984             |                    |                       |
| Stockholders' Equity                                  | 370,536                   |                    |                       | 333,016            |                    |                       |
|   | <b>\$3,496,860</b>        |                    |                       | <b>\$3,253,830</b> |                    |                       |

Total liabilities and  
stockholders' equity

Interest Margin Recap

|  |          |       |          |       |
|--|----------|-------|----------|-------|
| Interest income/average<br>earning assets  | 60,935   | 3.73  | 58,480   | 3.83  |
| Interest expense/average<br>earning assets | 8,190    | 0.50  | 7,286    | 0.48  |
| Net interest income and<br>margin          | \$52,745 | 3.23% | \$51,194 | 3.35% |

- (1) Tax exempt income was converted to a fully taxable equivalent basis at a 35 percent tax rate for 2015 and 2014. The tax equivalent rate for tax exempt loans and tax exempt securities acquired after January 1, 1983 included the Tax Equity and Fiscal Responsibility Act of 1982 (“TEFRA”) adjustment applicable to nondeductible interest expenses.
- (2) Loan fees, which are immaterial in relation to total taxable loan interest income for the six months ended June 30, 2015 and 2014, are included as taxable loan interest income.
- (3) Nonaccrual loans are included in the average balance of taxable loans.



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| (fully tax equivalent basis,<br>dollars in thousands) | Three Months Ended June 30, |                    |                       |                    |                    |                       |
|---|-----------------------------|--------------------|-----------------------|--------------------|--------------------|-----------------------|
|   | 2015                        |                    |                       | 2014               |                    |                       |
|   | Average<br>Balance          | Interest<br>Income | Yield<br>(1)/<br>Rate | Average<br>Balance | Interest<br>Income | Yield<br>(1)/<br>Rate |
| <b>Earning Assets</b>                                 |                             |                    |                       |                    |                    |                       |
| Loans:  |                             |                    |                       |                    |                    |                       |
| Taxable (2)(3)  | \$2,839,605                 | \$27,315           | 3.86%                 | \$2,632,012        | \$26,270           | 4.00%                 |
| Tax exempt (1)  | 12,777                      | 174                | 5.47                  | 13,660             | 187                | 5.50                  |
| Investments: (1)                                      |                             |                    |                       |                    |                    |                       |
| Available for sale                                    | 475,803                     | 3,282              | 2.77                  | 474,561            | 3,266              | 2.76                  |
| Short-term investments                                | 5,154                       | 1                  | 0.08                  | 5,257              | 1                  | 0.08                  |
| Interest bearing deposits                             | 8,936                       | 13                 | 0.58                  | 4,438              | 10                 | 0.90                  |
| Total earning assets                                  | \$3,342,275                 | \$30,785           | 3.69%                 | \$3,129,928        | \$29,734           | 3.81%                 |
| Less: Allowance for loan losses                       | (45,693)                    |                    |                       | (46,101)           |                    |                       |
| <b>Nonearning Assets</b>                              |                             |                    |                       |                    |                    |                       |
| Cash and due from banks                               | 98,133                      |                    |                       | 83,670             |                    |                       |
| Premises and equipment                                | 42,919                      |                    |                       | 39,795             |                    |                       |
| Other nonearning assets                               | 114,395                     |                    |                       | 112,503            |                    |                       |
| Total assets  | \$3,552,029                 |                    |                       | \$3,319,795        |                    |                       |
| <b>Interest Bearing Liabilities</b>                   |                             |                    |                       |                    |                    |                       |
| Savings deposits                                      | \$231,505                   | \$116              | 0.20%                 | \$236,358          | \$131              | 0.22%                 |
| Interest bearing checking accounts                    | 1,255,838                   | 1,250              | 0.40                  | 1,193,073          | 1,193              | 0.40                  |
| Time deposits:  |                             |                    |                       |                    |                    |                       |
| In denominations under \$100,000                      | 286,266                     | 855                | 1.20                  | 276,571            | 766                | 1.11                  |
| In denominations over \$100,000                       | 714,618                     | 1,709              | 0.96                  | 606,747            | 1,245              | 0.82                  |
| Miscellaneous short-term borrowings                   | 62,475                      | 35                 | 0.22                  | 147,620            | 104                | 0.28                  |
| Long-term borrowings and subordinated debentures      | 30,962                      | 261                | 3.38                  | 30,963             | 257                | 3.33                  |
| Total interest bearing liabilities                    | \$2,581,664                 | \$4,226            | 0.66%                 | \$2,491,332        | \$3,696            | 0.60%                 |
| <b>Noninterest Bearing Liabilities</b>                |                             |                    |                       |                    |                    |                       |
| Demand deposits                                       | 578,255                     |                    |                       | 475,394            |                    |                       |
| Other liabilities                                     | 17,772                      |                    |                       | 15,150             |                    |                       |
| Stockholders' Equity                                  | 374,338                     |                    |                       | 337,919            |                    |                       |
| Total liabilities and stockholders' equity            | \$3,552,029                 |                    |                       | \$3,319,795        |                    |                       |
| <b>Interest Margin Recap</b>                          |                             |                    |                       |                    |                    |                       |
| Interest income/average earning assets                |                             | 30,785             | 3.69                  |                    | 29,734             | 3.81                  |
|   |                             | 4,226              | 0.51                  |                    | 3,696              | 0.47                  |

Interest expense/average  
earning assetsNet interest income and  
margin

\$26,559

3.18%

\$26,038

3.34%

- (1) Tax exempt income was converted to a fully taxable equivalent basis at a 35 percent tax rate for 2015 and 2014. The tax equivalent rate for tax exempt loans and tax exempt securities acquired after January 1, 1983 included the Tax Equity and Fiscal Responsibility Act of 1982 (“TEFRA”) adjustment applicable to nondeductible interest expenses.
- (2) Loan fees, which are immaterial in relation to total taxable loan interest income for the three months ended June 30, 2015 and 2014, are included as taxable loan interest income.
- (3) Nonaccrual loans are included in the average balance of taxable loans.

Net interest income increased \$1.5 million, or 3.1%, for the six months ended June 30, 2015 compared with the first six months of 2014. The increased level of net interest income during the first six months of 2015 compared with the first six months of 2014 was largely driven by an increase in net earning assets of \$243.0 million as well as a deceleration in the amortization of premiums on agency mortgage-backed securities. The deceleration was primarily the result of rising long-term mortgage interest rates which have reduced prepayments in the loans underlying the securities. Average loans outstanding increased \$211.4 million during the six months ended June 30, 2015 compared with the same period of 2014, with most of the growth being in commercial loans. The average securities portfolio increased \$2.6 million in the six months ended June 30, 2015 compared with the same period of 2014. The tax equivalent net interest margin was 3.23% for the first six months of 2015 compared to 3.35% during the first six months of 2014. The yield on earning assets totaled 3.73% during the six months ended June 30, 2015 compared to 3.83% in the same period of 2014 while the cost of funds (expressed as a percentage of average earning assets) totaled 0.50% during the first six months of 2015 compared to 0.48% in the same period of 2014. Net interest income increased \$1.0 million, or 2.0%, for the second quarter of 2015 compared to the second quarter of 2014. The increase was driven by an increase in net earning assets. The tax equivalent net interest margin was 3.18% for the second quarter of 2015 compared to 3.34% during the second quarter of 2014.

Average earning assets increased by \$232.3 million for the three months ended June 30, 2015 compared with the same period 3of 2014. Average loans outstanding increased \$206.7 million during the three months ended June 30, 2015 compared with the same period of 2014, with most of the growth being in commercial loans. The average securities portfolio increased \$1.2 million in the three months ended June 30, 2015 compared with the same period of 2014.

#### Provision for Loan Losses

No provisions for loan loss expense were recorded during the six month and three month periods ended June 30, 2015 and 2014. The allowance for loan losses at June 30, 2015 represented 1.55% of the loan portfolio, versus 1.67% at December 31, 2014 and 1.71% at June 30, 2014. Factors impacting the decision not to record a provision in the first six months of 2015 included the stabilization or improvement in key loan quality metrics including strong reserve coverage of nonperforming loans, a decrease in historical loss percentages, stable economic conditions in the Company's markets and sustained signs of improvement in borrower performance and future prospects. In addition, management gave consideration to changes in the allocation for specific watch list credits in determining the appropriate level of the loan loss provision. Management's overall view on current credit quality was also a factor in the determination of the provision for loan losses. The Company's management continues to monitor the adequacy of the provision based on loan levels, asset quality, economic conditions and other factors that may influence the assessment of the collectability of loans.

#### Noninterest Income

Noninterest income categories for the six-month and three-month periods ended June 30, 2015 and 2014 are shown in the following tables:

| (dollars in thousands)                 | Six Months Ended<br>June 30, |          | Percent<br>Change |
|--|------------------------------|----------|-------------------|
|  | 2015                         | 2014     |                   |
| Wealth advisory fees                   | \$2,290                      | \$2,016  | 13.6%             |
| Investment brokerage fees              | 803                          | 2,040    | (60.6)            |
| Service charges on deposit<br>accounts | 4,947                        | 4,499    | 10.0              |
| Loan, insurance and service fees       | 3,469                        | 3,215    | 7.9               |
| Merchant card fee income               | 847                          | 730      | 16.0              |
| Bank owned life insurance              | 735                          | 710      | 3.5               |
| Other income                           | 1,635                        | 1,561    | 4.7               |
| Mortgage banking income                | 740                          | 244      | 203.3             |
| Net securities gains (losses)          | 42                           | 4        | 950.0             |
| Total noninterest income               | \$15,508                     | \$15,019 | 3.3%              |
| Noninterest income to total<br>revenue | 23.05%                       | 23.02%   |                   |

| (dollars in thousands)    | Three Months Ended<br>June 30, |       | Percent<br>Change |
|---------------------------|--------------------------------|-------|-------------------|
|                           | 2015                           | 2014  |                   |
| Wealth advisory fees      | \$1,106                        | \$977 | 13.3%             |
| Investment brokerage fees | 311                            | 923   | (66.3)            |

|                                     |         |         |         |
|-------------------------------------|---------|---------|---------|
| Service charges on deposit accounts | 2,573   | 2,348   | 9.6     |
| Loan, insurance and service fees    | 1,900   | 1,757   | 8.1     |
| Merchant card fee income            | 431     | 380     | 13.4    |
| Bank owned life insurance           | 360     | 338     | 6.5     |
| Other income                        | 681     | 686     | (0.7)   |
| Mortgage banking income             | 351     | 179     | 96.1    |
| Net securities gains (losses)       | 0       | 4       | (100.0) |
| Total noninterest income            | \$7,713 | \$7,592 | 1.6%    |
| Noninterest income to total revenue | 22.84%  | 22.90%  |         |

The Company's noninterest income increased 3.3% to \$15.5 million for the first six months of 2015 versus \$15.0 million for the same period of 2014. Noninterest income increased 1.6% to \$7.7 million for three month period ending June 30, 2015 versus \$7.6 million for the same period of 2014. Noninterest income for first six months of 2015 and three month period ending June 30, 2015 were positively impacted by increases in mortgage banking income due to higher production volumes, as well as increases in merchant card fees, service charges on deposit accounts, wealth advisory fees and loan, insurance and service fees. The increases were driven by higher fees on commercial deposit accounts as well as fees related to new wealth advisory client relationships. In addition, many wealth advisory fees are performance based and have been positively impacted by rising financial markets. Offsetting these increases was a decrease in investment brokerage fees driven by lower production volumes and the Company modifying product mix in order to provide a more consistent revenue stream by focusing less on front end income loaded products.

### Noninterest Expense

Noninterest expense categories for the six-month and three-month periods ended June 30, 2015 and 2014 are shown in the following tables:

| (dollars in thousands)                      | Six Months Ended<br>June 30, |          | Percent<br>Change |
|---|------------------------------|----------|-------------------|
|   | 2015                         | 2014     |                   |
| Salaries and employee benefits              | \$19,167                     | \$19,454 | (1.5)%            |
| Net occupancy expense                       | 1,999                        | 2,013    | (0.7)             |
| Equipment costs                             | 1,829                        | 1,534    | 19.2              |
| Data processing fees and supplies           | 3,705                        | 2,984    | 24.2              |
| Corporate and business<br>development       | 1,504                        | 1,326    | 13.4              |
| FDIC insurance and other<br>regulatory fees | 997                          | 965      | 3.3               |
| Professional fees                           | 1,417                        | 1,536    | (7.7)             |
| Other expense                               | 3,024                        | 3,062    | (1.2)             |
| Total noninterest expense                   | \$33,642                     | \$32,874 | 2.3%              |

| (dollars in thousands)                      | Three Months Ended<br>June 30, |         | Percent<br>Change |
|---|--------------------------------|---------|-------------------|
|   | 2015                           | 2014    |                   |
| Salaries and employee benefits              | \$9,444                        | \$9,467 | (0.2)%            |
| Net occupancy expense                       | 915                            | 903     | 1.3               |
| Equipment costs                             | 913                            | 761     | 20.0              |
| Data processing fees and supplies           | 1,938                          | 1,493   | 29.8              |
| Corporate and business<br>development       | 714                            | 673     | 6.1               |
| FDIC insurance and other<br>regulatory fees | 511                            | 488     | 4.7               |
| Professional fees                           | 728                            | 736     | (1.1)             |

|                           |          |          |      |
|---------------------------|----------|----------|------|
| Other expense             | 1,578    | 1,563    | 1.0  |
| Total noninterest expense | \$16,741 | \$16,084 | 4.1% |

The Company's noninterest expense increased \$768,000 and \$657,000, respectively, in the six-month and three-month periods ended June 30, 2015 versus the same periods in 2014. Salaries and employee benefits decreased by \$287,000 and \$23,000, respectively. The decrease in salary and employee benefits was driven by lower employee benefit costs including lower incentive-based compensation accruals and lower commissions paid on investment brokerage fees as a result of lower production. Data processing fees increased by \$721,000 and \$445,000, respectively, due to technology related expenditures with the Company's core processor and other technology based providers to enhance the delivery of electronic banking alternatives and improve commercial product solutions. Equipment costs increased \$295,000 and \$152,000, respectively, driven by higher depreciation expenses primarily due to branch upgrades including signage and new ATM's. Professional fees decreased by \$119,000 and \$8,000, respectively, driven by lower legal fees for the six month period and lower accounting fees for the three month period. Corporate and business development expense increased due to higher advertising and marketing expenses. The Company's efficiency ratio was 50.1% and 49.6%, respectively, for the six-month and three-month periods ended June 30, 2015 compared to 50.4% and 48.5% for the comparable periods in 2014.

## Income Taxes

Income tax expense decreased \$41,000 and \$94,000, respectively, in the six month and three month periods ended June 30, 2015, compared to the same period in 2014. The combined state franchise tax expense and the federal income tax expense, as a percentage of income before income tax expense, was 33.1% and 33.2%, respectively, in the six month and three month periods ended June 30, 2015, compared to 34.5% and 33.7% for the comparable periods of 2014. Income tax expense for the first quarter of 2014 was impacted by a \$431,000 provision for state income tax due to a revaluation of the Company's state deferred tax items. During the first quarter of 2014, the Indiana legislature approved new tax rates for financial institutions. The tax rate, currently 7.5%, is scheduled to drop to 6.5% for 2017. The new legislation further reduces the rate to 4.9%, phased-in beginning in 2019. The lowering of future rates reduces the benefit that will be provided by the Company's existing net deferred tax asset items thereby requiring the non-cash income tax expense adjustment in 2014.

## FINANCIAL CONDITION

## Overview

Total assets of the Company were \$3.572 billion as of June 30, 2015, an increase of \$128.8 million, or 3.7%, when compared to \$3.443 billion as of December 31, 2014. Total loans increased by \$131.1 million, or 4.7%, to \$2.893 billion at June 30, 2015 from \$2.762 billion at December 31, 2014. Funding for the loan growth came from a \$147.0 million increase in deposits offset by a \$33.8 million decrease in short-term borrowings.

## Uses of Funds

## Total Cash and Cash Equivalents

Total cash and cash equivalents decreased by \$1.2 million, or 1.3%, to \$89.5 million at June 30, 2015, from \$90.6 million at December 31, 2014.

## Investment Portfolio

The amortized cost and the fair value of securities as of June 30, 2015 and December 31, 2014 were as follows:

| (dollars in thousands)                        | June 30, 2015  |            | December 31, 2014 |            |
|---|----------------|------------|-------------------|------------|
|   | Amortized Cost | Fair Value | Amortized Cost    | Fair Value |
| U.S. Treasury securities                      | \$987          | \$1,002    | \$986             | \$1,004    |
| Agency residential mortgage-backed securities | 356,737        | 361,918    | 366,596           | 372,095    |
| State and municipal securities                | 105,339        | 107,463    | 99,399            | 102,812    |
| Total   | \$463,063      | \$470,383  | \$466,981         | \$475,911  |

At June 30, 2015 and December 31, 2014, there were no holdings of securities of any one issuer, other than the U.S. government, government agencies and government sponsored agencies, in an amount greater than 10% of stockholders' equity.

Purchases of securities available for sale totaled \$43.9 million in the first six months of 2015. Paydowns from prepayments and scheduled payments of \$29.7 million were received in the first six months of 2015, and the amortization of premiums, net of the accretion of discounts, was \$2.4 million. Sales of securities totaled \$7.8 million in the first six months of 2015. Maturities and calls of securities totaled \$8.0 million in the first six months of 2015. No other-than-temporary impairment was recognized in the first six months of 2015. The investment portfolio is managed to provide for an appropriate balance between, liquidity, credit risk and investment return and to limit the Company's exposure to risk to an acceptable level. The Company does not trade or invest in or sponsor certain unregistered investment companies defined as hedge funds and private equity funds in the so called "Volcker Rule" of the Dobb-Frank Wall Street Reform and Consumer Protection Act.



## Real Estate Mortgage Loans HFS

Real estate mortgage loans held-for-sale increased by \$1.8 million, or 114.8%, to \$3.4 million at June 30, 2015, from \$1.6 million at December 31, 2014. The balance of this asset category is subject to a high degree of variability depending on, among other things, recent mortgage loan rates and the timing of loan sales into the secondary market. The Company generally sells all of the mortgage loans it originates on the secondary market. Proceeds from sales totaled \$37.1 million in the first six months of 2015 compared to \$17.9 million in the first six months of 2014.

## Loan Portfolio

The loan portfolio by class as of June 30, 2015 and December 31, 2014 is summarized as follows:

| (dollars in thousands)                                    | June 30,<br>2015 |         | December 31,<br>2014 |         | Current<br>Period<br>Change |
|---|------------------|---------|----------------------|---------|-----------------------------|
| Commercial and industrial loans                           | \$1,143,877      | 39.5 %  | \$1,035,373          | 35.6 %  | \$108,504                   |
| Commercial real estate and multi-family residential loans | 1,051,700        | 36.3    | 1,026,059            | 38.9    | 25,641                      |
| Agri-business and agricultural loans                      | 251,328          | 8.7     | 273,787              | 10.0    | (22,459)                    |
| Other commercial loans                                    | 82,247           | 2.8     | 75,715               | 2.8     | 6,532                       |
| Consumer 1-4 family mortgage loans                        | 313,700          | 10.8    | 302,129              | 10.9    | 11,571                      |
| Other consumer loans                                      | 50,813           | 1.8     | 49,541               | 1.8     | 1,272                       |
| Subtotal  | 2,893,665        | 100.0 % | 2,762,604            | 100.0 % | 131,061                     |
| Less: Allowance for loan losses                           | (44,816)         |         | (46,262)             |         | 1,446                       |
| Net deferred loan fees                                    | (203)            |         | (284)                |         | 81                          |
| Loans, net  | \$2,848,646      |         | \$2,716,058          |         | \$132,588                   |

Total loans, excluding real estate mortgage loans held for sale, increased by \$131.1 million to \$2.894 billion at June 30, 2015 from \$2.763 billion at December 31, 2014. The increase was concentrated in the commercial and commercial real estate categories and reflected the Company's long standing strategic plan that is focused on expanding and growing the commercial lending business throughout our market areas. The increase was partially offset by seasonal declines in agri-business loans.

The following table summarizes the Company's non-performing assets as of June 30, 2015 and December 31, 2014:

| (dollars in thousands)   | June 30,<br>2015 | December<br>31,<br>2014 |
|--|------------------|-------------------------|
| Nonaccrual loans including nonaccrual troubled debt restructured loans | \$14,089         | \$13,577                |
| Loans past due over 90 days and still accruing                         | 284              | 130                     |
| Total nonperforming loans  | \$14,373         | \$13,707                |
| Other real estate owned  | 231              | 284                     |
| Repossessions  | 7                | 9                       |
| Total nonperforming assets   | \$14,611         | \$14,000                |
| Impaired loans including troubled debt restructurings                  | \$22,328         | \$31,957                |

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|   |          |          |
|---|----------|----------|
| Nonperforming loans to total loans  | 0.50%    | 0.50%    |
| Nonperforming assets to total assets  | 0.41%    | 0.41%    |
| Performing troubled debt restructured loans                                   | \$7,606  | \$16,492 |
| Nonperforming troubled debt restructured loans (included in nonaccrual loans) | 11,176   | 9,160    |
| Total troubled debt restructured loans  | \$18,782 | \$25,652 |

Total nonperforming assets increased by \$611,000, or 4.4%, to \$14.6 million during the six-month period ended June 30, 2015. The increase in nonperforming assets primarily resulted from placing six commercial credits on nonaccrual status. Offsetting the increase in nonperforming assets was the removal of two loans from nonaccrual status.

Net charge-offs totaled \$861,000 in the second quarter of 2015, versus net charge-offs of \$532,000 during the second quarter of 2014 and net charge-offs of \$585,000 during the first quarter of 2015.

A loan is impaired when full payment under the original loan terms is not expected. Impairment for smaller loans that are similar in nature and which are not in nonaccrual or troubled debt restructured status, such as residential mortgage, consumer, and credit card loans, is determined based on the class of loans and impairment is determined on an individual loan basis for other loans. If a loan is impaired, a portion of the allowance may be allocated so that the loan is reported, net, at the present value of estimated future cash flows or at the fair value of collateral if repayment is expected solely from the collateral.

Total impaired loans decreased by \$9.6 million, or 30.1%, to \$22.3 million at June 30, 2015 from \$32.0 million at December 31, 2014. The decrease in the impaired loans category was primarily due to the removal of a \$5.8 million commercial loan from impaired status due to improved condition. The loan was previously accounted for as a troubled debt restructuring. Additional decreases in the impaired loans category were from payments received and charge-offs on several impaired commercial credits.

Loans are charged against the allowance for loan losses when management believes that the principal is uncollectible. Subsequent recoveries, if any, are credited to the allowance. The allowance is an amount that management believes will be adequate to absorb probable incurred credit losses relating to specifically identified loans based on an evaluation of the loans by management, as well as other probable incurred losses inherent in the loan portfolio. The evaluations take 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 repay. Management also considers trends in adversely classified loans based upon a monthly review of those credits. An appropriate level of general allowance is determined after considering the following factors: application of historical loss percentages, emerging market risk, commercial loan focus and large credit concentrations, new industry lending activity and current economic conditions. Federal regulations require insured institutions to classify their own assets on a regular basis. The regulations provide for three categories of classified loans: Substandard, Doubtful and Loss. The regulations also contain a Special Mention category. Special Mention is defined as loans that do not currently expose an insured institution to a sufficient degree of risk to warrant classification as Substandard, Doubtful or Loss but do possess credit deficiencies or potential weaknesses deserving management's close attention. The Company's policy is to establish a specific allowance for loan losses for any assets where management has identified conditions or circumstances that indicate an asset is impaired. If an asset or portion thereof is classified as a loss, the Company's policy is to either establish specified allowances for loan losses in the amount of 100% of the portion of the asset classified loss or charge-off such amount.

At June 30, 2015, the allowance for loan losses was 1.55% of total loans outstanding, versus 1.67% of total loans outstanding at December 31, 2014. At June 30, 2015, management believed the allowance for loan losses was at a level commensurate with the overall risk exposure of the loan portfolio. However, if economic conditions do not continue to improve, certain borrowers may experience difficulty and the level of nonperforming loans, charge-offs and delinquencies could rise and require increases in the allowance for loan losses. The process of identifying probable credit losses is a subjective process. Therefore, the Company maintains a general allowance to cover probable incurred credit losses within the entire portfolio. The methodology management uses to determine the adequacy of the loan loss reserve includes the considerations below.

The Company has a relatively high percentage of commercial and commercial real estate loans, most of which are extended to small or medium-sized businesses from a wide variety of industries. Generally, this type of lending has

more credit risk than other types of lending because of the size and diversity of the credits. The Company manages this risk by adjusting its pricing to the perceived risk of each individual credit and by diversifying the portfolio by customer, product, industry and market area.

As of June 30, 2015, on the basis of management's review of the loan portfolio, the Company had 81 credits totaling \$150.3 million on the classified loan list versus 92 credits totaling \$155.6 million on December 31, 2014. As of June 30, 2015, the Company had \$110.2 million of assets classified as Special Mention, \$39.4 million classified as Substandard, \$0 classified as Doubtful and \$0 classified as Loss as compared to \$95.4 million, \$58.5 million, \$611,000 and \$0, respectively at December 31, 2014.

Allowance estimates are developed by management after taking into account actual loss experience adjusted for current economic conditions. The Company has regular discussions regarding this methodology with regulatory authorities. Allowance estimates are considered a prudent measurement of the risk in the Company's loan portfolio and are applied to individual loans based on loan type. In accordance with current accounting guidance, the allowance is provided for losses that have been incurred as of the balance sheet date and is based on past events and current economic conditions and 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. For a more thorough discussion of the allowance for loan losses methodology see the Critical Accounting Policies section of this Item 2.

The allowance for loan losses decreased 3.1%, or \$1.4 million, from \$46.3 million at December 31, 2014 to \$44.8 million at June 30, 2015. Pooled loan allocations increased from \$40.8 million at December 31, 2014 to \$41.2 million at June 30, 2015, which was due to an increase in pooled loan balances as well as management's view of current credit quality and the current economic environment. Impaired loan allocations decreased \$1.8 million from \$5.4 million at December 31, 2014 to \$3.6 million at June 30, 2015 due primarily to a charge-off loan that was specifically reserved for prior to June 30, 2015, as well as decreases in the allocations of existing impaired loans and reductions to the impaired loans category. The unallocated component of the allowance for loan losses was \$3.2 million at June 30, 2015 and \$3.3 million at December 31, 2014. While general trends in the overall economy and credit quality were stable or favorable, the Company believes that the unallocated component is appropriate given the uncertainty that exists regarding near term economic conditions.

Most of the Company's loan growth has been concentrated in the commercial loan portfolio, which can result in overall asset quality being influenced by a small number of credits. Management has historically considered growth and portfolio composition when determining loan loss allocations. Management believes that it is prudent to continue to provide for loan losses in a manner consistent with its historical approach due to the loan growth described above and current economic conditions.

Economic conditions in the Company's markets have generally continued to improve and stabilize, and management is cautiously optimistic that the recovery is positively impacting its borrowers. While the Company has seen indications of improved economic conditions in its markets, including commercial real estate activity and manufacturing growth, they are not wide spread or particularly strong improvements. The Company's continued growth strategy promotes diversification among industries as well as continued focus on enforcement of a strong credit environment and an aggressive position in loan work-out situations. Although the Company believes that historical industry-specific issues in the Company's markets have improved, the economic environment impacting the Company's entire geographic footprint will continue to present challenges.

#### Sources of Funds

The following table summarizes deposits and borrowings as of June 30, 2015 and December 31, 2014:

|  | June 30,           | December           | Current          |
|--|--------------------|--------------------|------------------|
| (dollars in thousands)                                   | 2015               | 31,                | Period           |
|  |                    | 2014               | Change           |
| Non-interest bearing demand deposits                     | \$602,898          | \$579,495          | \$23,403         |
| Interest bearing demand, savings & money market accounts | 1,422,200          | 1,423,035          | (835)            |
| Time deposits under \$100,000                            | 283,138            | 285,379            | (2,241)          |
| Time deposits of \$100,000 or more                       | 711,915            | 585,211            | 126,704          |
| <b>Total deposits</b>                                    | <b>3,020,151</b>   | <b>2,873,120</b>   | <b>147,031</b>   |
| Short-term borrowings                                    | 126,615            | 160,407            | (33,792)         |
| Long-term borrowings                                     | 34                 | 35                 | (1)              |
| Subordinated debentures                                  | 30,928             | 30,928             | 0                |
| <b>Total borrowings</b>                                  | <b>157,577</b>     | <b>191,370</b>     | <b>(33,793)</b>  |
| <b>Total funding sources</b>                             | <b>\$3,177,728</b> | <b>\$3,064,490</b> | <b>\$113,238</b> |

#### Deposits and Borrowings

Total deposits increased by \$147.0 million, or 5.1%, from December 31, 2014. The growth in deposits consisted of \$168.6 million in core deposit growth and a decrease of \$21.6 million in brokered deposits. Core deposit growth was concentrated in public fund certificates of deposit of \$100,000 or more, other time deposits of \$100,000 or more and non-interest bearing demand deposits. Total brokered deposits were \$120.9 million at June 30, 2015 compared to \$142.4 million at December 31, 2014. Total public funds deposits, including public funds transaction accounts, were \$874.9 million at June 30, 2015 compared to \$758.2 at December 31, 2014.

Total borrowings decreased by \$33.8 million, or 17.7%, from December 31, 2014. Most of the decrease was from a decrease in short-term advances from the Federal Home Loan Bank of Indianapolis. The Company used wholesale funding, including brokered deposits and Federal Home Loan Bank advances, to fund part of its loan growth and to help maintain its desired interest rate risk position.

### Capital

As of June 30, 2015, total stockholders' equity was \$375.7 million, an increase of \$14.4 million, or 4.0%, from \$361.3 million at December 31, 2014. In addition to net income of \$22.5 million, other significant changes in equity during the first six months of 2015 included \$7.6 million of dividends paid. The accumulated other comprehensive income component of equity decreased \$1.1 million during the six months ended June 30, 2015, driven by changes in the fair values of available-for-sale securities. The impact on equity by other comprehensive income is not included in regulatory capital. The banking regulators have established guidelines for leverage capital requirements, expressed in terms of Tier 1, or core capital, as a percentage of average assets, to measure the soundness of a financial institution. In addition, banking regulators have established risk-based capital guidelines for U.S. banking organizations. The final rules implementing the Basel Committee on Banking Supervision's ("BCBS") capital guidelines for U.S. banks (the "Basel III rules") became effective for the Company on January 1, 2015, with full compliance with all of the final rule's requirements phased in over a multi-year schedule, to be fully phased-in by January 1, 2019. As of June 30, 2015, the Company's capital levels remained characterized as "well-capitalized" under the new rules. The actual capital amounts and ratios of the Company and the Bank as of June 30, 2015 and December 31, 2014, are presented in the table below. Capital amounts and ratios for June 30, 2015 are calculated using the Basel III rules and capital amounts and ratios for December 31, 2014 are calculated using the Basel I rules:

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| (dollars in thousands)                   | Actual    |        | Minimum Required<br>For Capital<br>Adequacy Purposes |       | Minimum Required to<br>Be Well Capitalized<br>Under Prompt Corrective<br>Action Regulations |        |
|--|-----------|--------|--|-------|---|--------|
|  | Amount    | Ratio  | Amount   | Ratio | Amount  | Ratio  |
| As of June 30, 2015:                     |           |        |  |       |   |        |
| Total Capital (to Risk Weighted Assets)  |           |        |  |       |   |        |
| Consolidated                             | \$437,691 | 13.83% | \$253,146  | 8.00% | \$316,433   | 10.00% |
| Bank                                     | \$425,746 | 13.48% | \$252,700  | 8.00% | \$315,875   | 10.00% |
| Tier I Capital (to Risk Weighted Assets) |           |        |  |       |   |        |
| Consolidated                             | \$397,983 | 12.58% | \$189,860  | 6.00% | \$253,146   | 8.00%  |
| Bank                                     | \$386,107 | 12.22% | \$189,525  | 6.00% | \$252,700   | 8.00%  |
| Common Equity Tier 1 (CET1)              |           |        |  |       |   |        |
| Consolidated                             | \$367,983 | 11.63% | \$142,395  | 4.50% | \$205,681   | 6.50%  |
| Bank                                     | \$386,107 | 12.22% | \$142,144  | 4.50% | \$205,319   | 6.50%  |
| Tier I Capital (to Average Assets)       |           |        |  |       |   |        |
| Consolidated                             | \$397,983 | 11.22% | \$141,882  | 4.00% | \$177,353   | 5.00%  |
| Bank                                     | \$386,107 | 10.95% | \$141,011  | 4.00% | \$176,264   | 5.00%  |
| As of December 31, 2014:                 |           |        |  |       |   |        |
| Total Capital (to Risk Weighted Assets)  |           |        |  |       |   |        |
| Consolidated                             | \$418,827 | 14.36% | \$233,286  | 8.00% | \$291,607   | 10.00% |
| Bank                                     | \$403,454 | 13.87% | \$232,787  | 8.00% | \$290,984   | 10.00% |
| Tier I Capital (to Risk Weighted Assets) |           |        |  |       |   |        |
| Consolidated                             | \$382,254 | 13.11% | \$116,643  | 4.00% | \$174,964   | 6.00%  |
| Bank                                     | \$366,958 | 12.61% | \$116,394  | 4.00% | \$174,591   | 6.00%  |
| Common Equity Tier 1 (CET1)              |           |        |  |       |   |        |
| Consolidated                             | N/A       | N/A    | N/A  | N/A   | N/A   | N/A    |
| Bank                                     | N/A       | N/A    | N/A  | N/A   | N/A   | N/A    |
| Tier I Capital (to Average Assets)       |           |        |  |       |   |        |
| Consolidated                             | \$382,254 | 11.22% | \$136,265  | 4.00% | \$170,332   | 5.00%  |
| Bank                                     | \$366,958 | 10.84% | \$135,420  | 4.00% | \$169,276   | 5.00%  |

FORWARD-LOOKING STATEMENTS

This document (including information incorporated by reference) contains, and future oral and written statements of the Company and its management may contain, forward-looking statements, within the meaning of such term in the Private Securities Litigation Reform Act of 1995, with respect to the financial condition, results of operations, plans, objectives, future performance and business of the Company. Forward-looking statements, which may be based upon beliefs, expectations and assumptions of the Company's management and on information currently available to



management, are generally identifiable by the use of words such as “believe,” “expect,” “anticipate,” “plan,” “intend,” “estimate,” “may,” “will,” “would,” “could,” “should” or other similar expressions. Additionally, all statements in this document, including forward-looking statements, speak only as of the date they are made, and the Company undertakes no obligation to update any statement in light of new information or future events. Additional information concerning the company and its business, including factors that could materially affect the company’s financial results, is included in the Company’s filings with the Securities and Exchange Commission, including the Company’s Annual Report on Form 10-K

## ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest rate risk represents the Company's primary market risk exposure. The Company does not have a material exposure to foreign currency exchange risk, does not have any material amount of derivative financial instruments and does not maintain a trading portfolio. The Corporate Risk Committee of the Board of Directors annually reviews and approves the policy used to manage interest rate risk. The policy was last reviewed and approved in July 2014. The policy sets guidelines for balance sheet structure, which are designed to protect the Company from the impact that interest rate changes could have on net income but does not necessarily indicate the effect on future net interest income. The Company, through its Asset and Liability Committee, manages interest rate risk by monitoring the computer simulated earnings impact of various rate scenarios and general market conditions. The Company then modifies its long-term risk parameters by attempting to generate the types of loans, investments, and deposits that currently fit the Company's needs, as determined by its Asset and Liability Committee. This computer simulation analysis measures the net interest income impact of various interest rate scenario changes during the next twelve months. The Company continually evaluates the assumptions used in the model. The balance sheet structure is considered to be within acceptable risk levels.

Results for the base, falling 100 basis points, rising 25 basis points, rising 50 basis points, rising 100 basis points, and rising 300 basis points interest rate scenarios are listed below based upon the Company's rate sensitive assets and liabilities at June 30, 2015. The net interest income shown represents cumulative net interest income over a twelve-month time horizon. Balance sheet assumptions used for the base scenario are the same for the rising and falling simulations.

| (dollars in thousands)      | Base      | Falling<br>(100 Basis<br>Points) | Rising<br>(25 Basis<br>Points) | Rising<br>(50 Basis<br>Points) | Rising<br>(100 Basis<br>Points) | Rising<br>(300 Basis<br>Points) |
|-----------------------------|-----------|----------------------------------|--------------------------------|--------------------------------|---------------------------------|---------------------------------|
| Net interest income         | \$109,627 | \$106,358                        | \$111,488                      | \$113,334                      | \$117,516                       | \$134,997                       |
| Variance from Base          |           | (\$3,269)                        | \$1,861                        | \$3,707                        | \$7,889                         | \$25,370                        |
| Percent of change from Base |           | -2.98%                           | 1.70%                          | 3.38%                          | 7.20%                           | 23.14%                          |

## ITEM 4 – CONTROLS AND PROCEDURES

As required by Rules 13a-15(b) and 15d-15(b) under the Securities Exchange Act of 1934, management has evaluated, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures (as defined in Securities Exchange Act Rules 13a-15(e) and 15d-15(e)) were effective as of June 30, 2015. Disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. These disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure.

During the quarter ended June 30, 2015, there were no changes to the Company's internal control over financial reporting that have materially affected or are reasonably likely to materially affect its internal control over financial reporting.

## PART II – OTHER INFORMATION

## Item 1. Legal proceedings

There are no material pending legal proceedings to which the Company or its subsidiaries is a party other than ordinary routine litigation incidental to their respective businesses.

## Item 1A. Risk Factors

There have been no material changes to the risk factors disclosed in Item 1A. of Part I of the Company's 2014 Form 10-K. Please refer to that section of the Company's Form 10-K and Item 2 of Part I of this Form 10-Q for disclosures regarding the risks and uncertainties related to the Company's business.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information as of June 30, 2015 with respect to shares of common stock repurchased by the Company during the quarter then ended:

## Issuer Purchases of Equity Securities(a)

## ISSUER PURCHASES OF EQUITY SECURITIES

| Period     | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number (or Appropriate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs |
|------------|----------------------------------|------------------------------|--|--|
| April 1-30 | 0                                | \$0                          | 0  | \$0  |
| May 1-31   | 558                              | 39.16                        | 0  | 0  |
| June 1-30  | 0                                | 0                            | 0  | 0  |
| Total      | 558                              | \$39.16                      | 0  | \$0  |

- (a) The shares purchased during the periods were credited to the deferred share accounts of non-employee directors under the Company's directors' deferred compensation plan. These shares were purchased in the ordinary course of business and consistent with past practice.

## Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

N/A

Item 5. Other Information

None

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Item 6. Exhibits

- 31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a)
- 31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a)
- 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101 Interactive Data File

Interactive data files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheets as of June 30, 2015 and December 31, 2014; (ii) Consolidated Statements of Income for the three and six months ended June 30, 2015 and June 30, 2014; (iii) Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2015 and June 30, 2014; (iv) Consolidated Statements of Cash Flows for the six months ended June 30, 2015 and June 30, 2014; and (v) Notes to Unaudited Consolidated Financial Statements.

LAKELAND FINANCIAL CORPORATION

FORM 10-Q

June 30, 2015

Part II - Other Information

Signatures

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

LAKELAND FINANCIAL CORPORATION  
(Registrant)

Date: August 10, 2015      /s/ David M. Findlay  
David M. Findlay – President and  
Chief Executive Officer

Date: August 10, 2015      /s/ Lisa M. O’Neill  
Lisa M. O’Neill – Executive Vice President and  
Chief Financial Officer

Date: August 10, 2015      /s/ Teresa A. Bartman  
Teresa A. Bartman – Senior Vice President-  
Finance and Controller

Exhibit Index

Exhibit Number

|      |   |
|------|---|
| 31.1 | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a)   |
| 31.2 | Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a)   |
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|      | Interactive data files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheets as of June 30, 2015 and December 31, 2014; (ii) Consolidated Statements of Income for the three and six months ended June 30, 2015 and June 30, 2014; (iii) Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2015 and June 30, 2014; (iv) Consolidated Statements of Cash Flows for the six months ended June 30, 2015 and June 30, 2014; and (v) Notes to Unaudited Consolidated Financial Statements. |



