LAKELAND FINANCIAL CORP
Form 10-K
March 05, 2012

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

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) of the
Securities Exchange Act of 1934

For the fiscal year ended December 31, 2011

Commission file number 0-11487

LAKELAND FINANCIAL CORPORATION

Indiana	35-1559596
(State of incorporation)	(I.R.S. Employer Identification No.)

202 East Center Street, P.O. Box 1387, Warsaw, Indiana 46581-1387
(Address of principal executive offices)

Telephone: (574) 267-6144

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

Common Stock, no par value	NASDAQ Global Select Market
(Title of class)	(Name of each exchange on which registered)

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes __No X

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.[ ]

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

Large accelerated filer [ ]	Accelerated filer [X]	Non-accelerated filer [ ]	Smaller reporting company [ ]

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, based on the last sales price quoted on the Nasdaq Global Select Market on June 30, 2011, the last business day of the registrant’s most recently completed second fiscal quarter, was approximately $339,957,124.

Number of shares of common stock outstanding at February 22, 2012: 16,303,064

DOCUMENTS INCORPORATED BY REFERENCE

Part III - Portions of the Proxy Statement for the Annual Meeting of Stockholders to be held on April 10, 2012 are incorporated by reference into Part III hereof.

LAKELAND FINANCIAL CORPORATION
Annual Report on Form 10-K
Table of Contents

Table of Contents

PART I

ITEM 1. BUSINESS

The Company was incorporated under the laws of the State of Indiana on February 8, 1983. As used herein, the term "Company" refers to Lakeland Financial Corporation, or if the context dictates, Lakeland Financial Corporation and its wholly-owned subsidiary, Lake City Bank (the "Bank"), an Indiana state bank headquartered in Warsaw, Indiana. On December 18, 2006, LCB Investments II, Inc. was formed as a wholly-owned subsidiary of Lake City Bank incorporated in Nevada and it began managing a portion of the Bank's investment portfolio in January 2007. On December 21, 2006, LCB Funding, Inc., a real estate investment trust, incorporated in Maryland, was formed as a wholly-owned subsidiary of LCB Investments II. All intercompany transactions and balances are eliminated in consolidation.

General

Company's Business. The Company is a bank holding company as defined in the Bank Holding Company Act of 1956, as amended. The Company owns all of the outstanding stock of Lake City Bank, Warsaw, Indiana, a full-service commercial bank organized under Indiana law. The Bank recognizes a wholly-owned subsidiary, LCB Investments II, Inc., which manages a portion of the Bank's investment portfolio. The Company conducts no business except that incident to its ownership of the outstanding stock of the Bank and the operation of the Bank.

The Bank's deposits are insured by the Federal Deposit Insurance Corporation. The Bank's activities cover all phases of commercial banking, including checking accounts, savings accounts, time deposits, the sale of securities under agreements to repurchase, commercial, real estate and agricultural lending, direct and indirect consumer lending, commercial and residential real estate mortgage lending, retail and merchant credit card services, corporate treasury management services, retirement services, bond administration, safe deposit box service and wealth advisory, trust and brokerage services.

The Bank's main banking office is located at 202 East Center Street, Warsaw, Indiana. As of December 31, 2011, the Bank had 45 offices in thirteen counties throughout Northern and Central Indiana.

Bank's Business. The Bank was originally organized in 1872 and has continuously operated under the laws of the State of Indiana since its organization. The Bank's business strategy is simply focused on maintaining our traditional community banking approach while concurrently leveraging the strength and size of our consolidated balance sheet to effectively compete with larger regional and national competitors. We are focused on serving clients in the state of Indiana, with the majority of our business in Northern Indiana. While our strategy encompasses all phases of traditional community banking, including consumer lending and wealth advisory and trust services, we focus on building expansive commercial relationships and developing retail and commercial deposit gathering strategies through high levels of relationship-based client services.

The Bank competes for loans principally through a high degree of customer contact, timely loan request review and decision-making, market-driven competitive loan pricing and the Bank's reputation throughout the region. The Bank believes that its convenience, quality service and high-touch, responsive approach to banking enhances its ability to compete favorably in attracting and retaining individual and business customers. The Bank actively solicits deposit-related customers and competes for customers by offering personal attention, professional service and competitive interest rates. The interest rates for both deposits and loans, as well as the range of services provided, are consistent with those of most banks competing within the Bank's service area.

Market Overview. While the Company operates in thirteen counties, it currently defines operations by five primary geographical markets: the South Region, which includes Kosciusko County and portions of contiguous counties; the North Region, which includes portions of Elkhart and St. Joseph Counties; the Central Region, which includes portions of Elkhart County and contiguous counties; the East Region, which includes Allen County and contiguous counties; and the Indianapolis Region, which includes the metropolitan market of Indianapolis, including primarily Marion County and Hamilton County. The South Region includes the city of Warsaw, which is the location of the Company's headquarters. The Company has had a presence in the South Region since 1872. It has been in the North and Central Regions, which includes the cities of Elkhart, South Bend and Goshen, since 1990. The Company opened its first office in the East Region, which includes the cities of Fort Wayne and Auburn, in 1999. The Company operated a loan production office in Indianapolis, from 2006 to 2011 and opened a full service office there in late 2011.

The Company believes that these are well-established regions that have similar economic characteristics. The Company has sought to diversify expansion and industry throughout its markets, which include a mix of industrial and service companies, with no business or industry concentrations within both individual markets and combined markets. Furthermore, no single industry or employer dominates any of the markets. Indianapolis represents the largest population center served by the Company's full-service branch system with a population of 820,000, according to 2010 U.S. Census Bureau data. Fort Wayne, with a population of 254,000 is the second largest city served by the Company. South Bend, with a 2010 population of 101,000, is the third largest city served by the Company. Elkhart, with a 2010 population of 51,000, is the fourth largest city that the Company currently serves. As a result of the presence of offices in thirteen counties that are widely dispersed, no single city or industry represents an undue concentration. In addition, the Indianapolis market represents a substantial future opportunity given its position as the largest metropolitan market in the state.

Expansion Strategy. The Company is an Indiana institution serving primarily Indiana clients with some Michigan clients due to the closeness to the state line of our market area in Northern Indiana. Since 1990, the Company has expanded from 17 offices in four Indiana counties to 45 branches in thirteen Indiana counties primarily through de novo branching. During this period, the Company has grown its assets from $286 million to $2.9 billion today, an increase of 908%. Mergers and acquisitions have not played a substantive role in this growth as the Company’s expansion strategy has been driven primarily by organic growth. Since the decision to expand outside of the four-county home market in 1990, the Company has targeted growth in larger cities located in the Northern Indiana market and Indianapolis in Central Indiana. In 1990, the Company began an expansion strategy that the Company believes has created a well-established presence in the region directly north of the Company’s home market. This expansion was focused on the cities of Elkhart, South Bend and Goshen. In 1999, the Company expanded to the east and opened the first office in the Fort Wayne market. In 2006, the Company established a loan production office in Indianapolis and opened its first full service office there in late 2011.

The Company’s expansion strategy is driven primarily by the potential for increased penetration in existing markets where opportunities for market share growth exists. Additionally, management considers growth in new markets, including FDIC assisted transactions, with a close geographic proximity to its current operations. These markets are considered when the Company believes they would be receptive to its strategic plan to deliver broad-based financial services with a commitment to local communities. When entering new markets, the Company believes it is critical to attract experienced local management and staff with a similar philosophy in order to provide a basis for success.

While this overall expansion strategy has been guided by a focus on larger communities in Indiana, it has also been influenced by the competitive landscape in these markets. As the historically prominent community banks in these markets were acquired, in most cases by large out-of-state institutions, the Company believes that Lake City Bank’s traditional community banking strategy has become highly relevant and provides a competitive advantage to the Company because of the Bank’s strong ties to the communities in which it operates.

The Company believes that another benefit of this geographic expansion strategy into larger population centers is that the Company is exposed to more well-established and diverse economic regions. While the Company has historically operated within a relatively small Northern geographic region of the state, the Company’s expansion strategy has provided borrower diversification within a fairly diverse economic region. Further, the geographical diversification ensures that no single industry or employer dominates the Company’s markets. In addition, the Company believes that the Indianapolis market represents a substantial future opportunity given its position as the largest metropolitan market in the state. Like previous market expansions, the Company believes the Indianapolis market will provide future business opportunities as the competitive landscape in the market changes to the Company’s advantage.

The Company also considers opportunities beyond current markets when the Company’s board of directors (the “Board of Directors”) and management believe that the opportunity will provide a desirable strategic fit without posing undue risk. The Company does not currently have any definitive understandings or agreements for any acquisitions or de novo expansion.

Products and Services. The Company is a full-service commercial bank and provides commercial, retail, wealth advisory, trust and investment management services to its customers. Commercial products include commercial loans and technology-driven solutions to commercial customers' treasury management needs such as internet business banking and on-line treasury management services in addition to retirement services, bond administration and health savings account services. Retail banking clients are provided a wide array of traditional retail banking services, including lending, deposit and investment services. Retail lending programs are focused on mortgage loans, home equity lines of credit and traditional retail installment loans, including indirect automotive financing. The Company provides credit card services to retail and commercial customers through an outsourced retail card program and merchant processing activity. The Company provides wealth advisory clients with traditional personal and corporate trust and investment services. The Company also provides retail brokerage services, including an array of financial and investment products such as annuities and life insurance.

Table of Contents

Competition

The Bank competes with other local and regional banks in addition to major banks for large commercial deposit and loan accounts. As of December 31, 2011, the Bank was subject to an aggregate maximum loan limit to any single account pursuant to Indiana law of $51.3 million. The Bank currently enforces an internal maximum loan limit of $20.0 million, which is less than the amount permitted by law. This maximum might occasionally limit the Bank from providing loans to those businesses or personal accounts whose aggregate borrowing needs exceed this amount. In the event this were to occur, the Bank maintains relationships with other financial institutions. The Bank may participate with other banks in the placement of large borrowings in excess of its lending limit, although the Bank typically does not participate in such arrangements. The Bank is also a member of the Federal Home Loan Bank of Indianapolis (the "FHLB") in order to provide additional funding, as necessary, to support funding requests and to broaden its mortgage lending and investment activities.

In addition to the banks located within its service area, the Bank also competes with savings and loan associations, credit unions, farm credit services, finance companies, personal loan companies, insurance companies, money market fund, and other non-depository financial intermediaries. Also, financial intermediaries such as money market mutual funds and large retailers are not subject to the same regulations and laws that govern the operation of traditional depository institutions and, accordingly, may have an advantage in competing for funds.

Foreign Operations

The Company has no investments with any foreign entity other than one nominal demand deposit account, which is maintained with a Canadian bank in order to facilitate the clearing of checks drawn on banks located in other countries. There are no foreign loans.

Employees

At December 31, 2011, the Company, including its subsidiaries, had 482 full-time equivalent employees. Benefit programs include a 401(k) plan, group medical, dental and vision insurance, group life insurance and paid vacations. The Company also maintained a defined benefit pension plan which, effective April 1, 2000, was frozen and employees can no longer accrue new benefits under that plan. The Company also has an equity incentive plan under which stock-based incentives and compensation may be granted to employees and directors and also has an employee deferred compensation plan available to certain employees. The Bank is not a party to any collective bargaining agreement, and employee relations are considered good.

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," "estimat "may," "will," "would," "could," "should" or other similar expressions. Additionally, all statements in this document, includin 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.

The Company's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. The factors, which could have a material adverse effect on the operations and future prospects of the Company and its subsidiaries, are detailed in the "Risk Factors" section included under Item 1a. of Part I of this Form 10-K. In addition to the risk factors described in that section, there are other factors that may impact any public company, including ours, which could have a material adverse effect on the operations and future prospects of the Company and its subsidiaries. These additional factors include, but are not limited to, the following:

- the effects of future economic, business and market conditions and changes, both domestic and foreign, including seasonality;

Table of Contents

- governmental monetary and fiscal policies;
- legislative and regulatory changes, including changes in banking, securities and tax laws and regulations and their application by our regulators, such as the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”);
- changes in the scope and cost of Federal Deposit Insurance Corporation, or “FDIC”, insurance, the state of Indiana’s Public Deposit Insurance Fund and other coverages;
- changes in accounting policies, rules and practices;
- the risks of changes in interest rates on the levels, composition and costs of deposits, loan demand, and the values and liquidity of loan collateral, securities and other interest sensitive assets and liabilities;
- the failure of assumptions and estimates underlying the establishment of reserves for possible loan losses and other estimates;
- changes in borrowers’ credit risks and payment behaviors;
- changes in the availability and cost of credit and capital in the financial markets;
- changes in the prices, values and sales volumes of residential and commercial real estate;
- the effects of competition from a wide variety of local, regional, national and other providers of financial, investment and insurance services;
- the risks of mergers, acquisitions and divestitures, including, without limitation, the related time and costs of implementing such transactions, integrating operations as part of these transactions and possible failures to achieve expected gains, revenue growth and/or expense savings from such transactions;
- changes in technology or products that may be more difficult, costly or less effective than anticipated;
- the effects of war or other conflicts, acts of terrorism or other catastrophic events, including storms, droughts, tornados and flooding, that may affect general economic conditions, including agricultural production and demand and prices for agricultural goods and land used for agricultural purposes, generally and in our markets;
- the failure of assumptions and estimates used in our reviews of our loan portfolio and our analysis of our capital position; and
- other factors and risks described under “Risk Factors” herein.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. For additional information regarding these and other risks, uncertainties and other factors, please review the disclosure in this annual report under “Risk Factors.”

Internet Website

The Company maintains an internet site at www.lakecitybank.com. The Company makes available free of charge on this site its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and other reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") as soon as reasonably practicable after it electronically files such material with, or furnishes it to, the Securities and Exchange Commission (the "SEC"). The Company's Articles of Incorporation, Bylaws, Code of Conduct and the charters of its various committees of the Board of Directors are also available on the website.

Table of Contents

SUPERVISION AND REGULATION

General

Financial institutions, their holding companies and their affiliates are extensively regulated under federal and state law. As a result, the growth and earnings performance of the Company may be affected not only by management decisions and general economic conditions, but also by requirements of federal and state statutes and by the regulations and policies of various bank regulatory authorities, including the Indiana Department of Financial Institutions (the "DFI"), the Board of Governors of the Federal Reserve System (the "Federal Reserve") and the FDIC. Furthermore, taxation laws administered by the Internal Revenue Service and state taxing authorities, accounting rules developed by the Financial Accounting Standards Board (the "FASB") and securities laws administered by the SEC and state securities authorities have an impact on the business of the Company. The effect of these statutes, regulations, regulatory policies and accounting rules are significant to the operations and results of the Company and Bank, and the nature and extent of future legislative, regulatory or other changes affecting financial institutions are impossible to predict with any certainty.

Federal and state banking laws impose a comprehensive system of supervision, regulation and enforcement on the operations of financial institutions, their holding companies and affiliates that is intended primarily for the protection of the FDIC-insured deposits and depositors of banks, rather than stockholders. These federal and state laws, and the regulations of the bank regulatory authorities issued under them, affect, among other things, the scope of business, the kinds and amounts of investments banks may make, reserve requirements, capital levels relative to operations, the nature and amount of collateral for loans, the establishment of branches, the ability to merge, consolidate and acquire, dealings with insiders and affiliates and the payment of dividends.

In addition, the Company and Bank are subject to regular examination by their respective regulatory authorities, which results in examination reports and ratings (that are not publicly available) that can impact the conduct and growth of business. These examinations consider not only compliance with applicable laws and regulations, but also capital levels, asset quality and risk, management ability and performance, earnings, liquidity, and various other factors. The regulatory agencies generally have broad discretion to impose restrictions and limitations on the operations of a regulated entity where the agencies determine, among other things, that such operations are unsafe or unsound, fail to comply with applicable law or are otherwise inconsistent with laws and regulations or with the supervisory policies of these agencies.

The following is a summary of the material elements of the supervisory and regulatory framework applicable to the Company and the Bank. It does not describe all of the statutes, regulations and regulatory policies that apply, nor does it restate all of the requirements of those that are described. The descriptions are qualified in their entirety by reference to the particular statutory or regulatory provision.

Financial Regulatory Reform

On July 21, 2010, President Obama signed the Dodd-Frank Act into law. The Dodd-Frank Act represents a sweeping reform of the supervisory and regulatory framework applicable to financial institutions and capital markets in the United States, certain aspects of which are described below in more detail. The Dodd-Frank Act creates new federal governmental entities responsible for overseeing different aspects of the U.S. financial services industry, including identifying emerging systemic risks. It also shifts certain authorities and responsibilities among federal financial institution regulators, including the supervision of holding company affiliates and the regulation of consumer financial services and products. In particular, and among other things, the Dodd-Frank Act: creates a Bureau of Consumer Financial Protection authorized to regulate providers of consumer credit, savings, payment and other consumer financial products and services; narrows the scope of federal preemption of state consumer laws enjoyed by national banks and federal savings associations and expands the authority of state attorneys general to bring actions to enforce federal consumer protection legislation; imposes more stringent capital requirements on bank holding companies and subjects certain activities, including interstate mergers and acquisitions, to heightened capital conditions; significantly expands underwriting requirements applicable to loans secured by 1-4 family residential real property; restricts the interchange fees payable on debit card transactions for issuers with $10 billion in assets or greater; requires the originator of a securitized loan, or the sponsor of a securitization, to retain at least 5% of the credit risk of securitized exposures unless the underlying exposures are qualified residential mortgages or meet certain underwriting standards to be determined by regulation; creates a Financial Stability Oversight Council as part of a regulatory structure for identifying emerging systemic risks and improving interagency cooperation; provides for enhanced regulation of advisers to private funds and of the derivatives markets; enhances oversight of credit rating agencies; and prohibits banking agency requirements tied to credit ratings.

Numerous provisions of the Dodd-Frank Act are required to be implemented through rulemaking by the appropriate federal regulatory agencies. Some of the required regulations have been issued and some have been released for public comment, but many have yet to be released in any form. Furthermore, while the reforms primarily target systemically important financial service providers, their influence is expected to filter down in varying degrees to smaller institutions over time. Management of the Company and Bank will continue to evaluate the effect of the changes; however, in many respects, the ultimate impact of the Dodd-Frank Act will not be fully known for years, and no current assurance may be given that the Dodd-Frank Act, or any other new legislative changes, will not have a negative impact on the results of operations and financial condition of the Company and the Bank.

The Increasing Importance of Capital

While capital has historically been one of the key measures of the financial health of both holding companies and depository institutions, its role is becoming fundamentally more important in the wake of the financial crisis. Not only will capital requirements increase, but the type of instruments that constitute capital will also change, and, as a result of the Dodd-Frank Act, after a phase-in period, bank holding companies will have to hold capital under rules as stringent as those for insured depository institutions. Moreover, the actions of the international Basel Committee on Banking Supervision, a committee of central banks and bank supervisors, to reassess the nature and uses of capital in connection with an initiative called “Basel III,” discussed below, will have a significant impact on the capital requirements applicable to U.S. bank holding companies and depository institutions.

Required Capital Levels. The Dodd-Frank Act mandates the Federal Reserve to establish minimum capital levels for bank holding companies on a consolidated basis that are as stringent as those required for insured depository institutions. The components of Tier 1 capital will be restricted to capital instruments that are currently considered to be Tier 1 capital for insured depository institutions. As a result, the proceeds of trust preferred securities will be excluded from Tier 1 capital unless such securities were issued prior to May 19, 2010 by bank holding companies with less than $15 billion of assets. As the Company has assets of less than $15 billion, it will be able to maintain its trust preferred proceeds as capital but it will have to comply with new capital mandates in other respects, and it will not be able to raise Tier 1 capital in the future through the issuance of trust preferred securities.

Under current federal regulations, the Bank is subject to, and, after a phase-in period, the Company will be subject to, the following minimum capital standards: (i) a leverage requirement consisting of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly-rated banks with a minimum requirement of at least 4% for all others; and (ii) a risk-based capital requirement consisting of a minimum ratio of total capital to total risk-weighted assets of 8% and a minimum ratio of Tier 1 capital to total risk-weighted assets of 4%. For this purpose, Tier 1 capital consists primarily of common stock, noncumulative perpetual preferred stock and related surplus less intangible assets (other than certain loan servicing rights and purchased credit card relationships). Total capital consists primarily of Tier 1 capital plus Tier 2 capital, which includes other non-permanent capital items such as certain other debt and equity instruments that do not qualify as Tier 1 capital and a portion of the Bank’s allowance for loan and lease losses.

The capital requirements described above are minimum requirements. Federal law and regulations provide various incentives for banking organizations to maintain regulatory capital at levels in excess of minimum regulatory requirements. For example, a banking organization that is “well-capitalized;” may qualify for exemptions from prior notice or application requirements otherwise applicable to certain types of activities; may qualify for expedited processing of other required notices or applications and may accept brokered deposits. Additionally, one of the criteria that determines a bank holding company’s eligibility to operate as a financial holding company (see “—Acquisitions, Activities and Changes in Control” below) is a requirement that all of its depository institution subsidiaries be “well-capitalized.” Under the Dodd-Frank Act, that requirement is extended such that, as of July 21, 2011, bank holding companies, as well as their depository institution subsidiaries, had to be well-capitalized in order to operate as financial holding companies. Under the capital regulations of the Federal Reserve, in order to be “well-capitalized” a banking organization must maintain a ratio of total capital to total risk-weighted assets of 10% or greater, a ratio of Tier 1 capital to total risk-weighted assets of 6% or greater and a ratio of Tier 1 capital to total assets of 5% or greater.

Higher capital levels may also be required if warranted by the particular circumstances or risk profiles of individual banking organizations. For example, the Federal Reserve’s capital guidelines contemplate that additional capital may be required to take adequate account of, among other things, interest rate risk, or the risks posed by concentrations of credit, nontraditional activities or securities trading activities. Further, any banking organization experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions (i.e., Tier 1 capital less all intangible assets), well above the minimum levels.

It is important to note that certain provisions of the Dodd-Frank Act and Basel III, discussed below, will ultimately establish strengthened capital standards for banks and bank holding companies, will require more capital to be held in the form of common stock and will disallow certain funds from being included in a Tier 1 capital determination. Once fully implemented, these provisions may represent regulatory capital requirements which are meaningfully more stringent than those outlined above.

Table of Contents

Prompt Corrective Action. A banking organization's capital plays an important role in connection with regulatory enforcement as well. Federal law provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators' powers depends on whether the institution in question is "adequately capitalized," "undercapitalized," "significantly undercapitalized" or "critically undercapitalized," in each case as defined by regulation. Depending upon the capital category to which an institution is assigned, the regulators' corrective powers include: (i) requiring the institution to submit a capital restoration plan; (ii) limiting the institution's asset growth and restricting its activities; (iii) requiring the institution to issue additional capital stock (including additional voting stock) or to be acquired; (iv) restricting transactions between the institution and its affiliates; (v) restricting the interest rate the institution may pay on deposits; (vi) ordering a new election of directors of the institution; (vii) requiring that senior executive officers or directors be dismissed; (viii) prohibiting the institution from accepting deposits from correspondent banks; (ix) requiring the institution to divest certain subsidiaries; (x) prohibiting the payment of principal or interest on subordinated debt; and (xi) ultimately, appointing a receiver for the institution.

As of December 31, 2011: (i) the Bank was not subject to a directive from the Federal Reserve to increase its capital to an amount in excess of the minimum regulatory capital requirements; (ii) the Bank exceeded its minimum regulatory capital requirements under Federal Reserve capital adequacy guidelines; and (iii) the Bank was "well-capitalized," as defined by Federal Reserve regulations. As of December 31, 2011, the Company had regulatory capital in excess of the Federal Reserve's requirements and met the Dodd-Frank Act requirements.

Basel III. The current risk-based capital guidelines that apply to the Bank and will apply to the Company are based upon the 1988 capital accord of the international Basel Committee on Banking Supervision, a committee of central banks and bank supervisors, as implemented by the U.S. federal banking agencies on an interagency basis. In 2008, the banking agencies collaboratively began to phase-in capital standards based on a second capital accord, referred to as "Basel II," for large or "core" international banks (generally defined for U.S. purposes as having total assets of $250 billion or more or consolidated foreign exposures of $10 billion or more). Basel II emphasized internal assessment of credit, market and operational risk, as well as supervisory assessment and market discipline in determining minimum capital requirements.

On September 12, 2010, the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee on Banking Supervision, announced agreement to a strengthened set of capital requirements for banking organizations in the United States and around the world, known as Basel III. The agreement is currently supported by the U.S. federal banking agencies. As agreed to, Basel III is intended to be fully-phased in on a global basis on January 1, 2019. Basel III requires, among other things: (i) a new required ratio of minimum common equity equal to 7% of total assets (4.5% plus a capital conservation buffer of 2.5%); (ii) an increase in the minimum required amount of Tier 1 capital from the current level of 4% of total assets to 6% of total assets; (iii) an increase in the minimum required amount of total capital, from the current level of 8% to 10.5% (including 2.5% attributable to the capital conservation buffer). The purpose of the conservation buffer (to be phased in from January 2016 until January 1, 2019) is to ensure that banks maintain a buffer of capital that can be used to absorb losses during periods of financial and economic stress. There will also be a required countercyclical buffer to achieve the broader goal of protecting the banking sector from periods of excess aggregate credit growth.

Pursuant to Basel III, certain deductions and prudential filters, including minority interests in financial institutions, mortgage servicing rights and deferred tax assets from timing differences, would be deducted in increasing percentages beginning January 1, 2014, and would be fully deducted from common equity by January 1, 2018. Certain instruments that no longer qualify as Tier 1 capital, such as trust preferred securities, also would be subject to phase-out over a 10-year period beginning January 1, 2013.

The Basel III agreement calls for national jurisdictions to implement the new requirements beginning January 1, 2013. At that time, the U.S. federal banking agencies, including the Federal Reserve, will be expected to have implemented appropriate changes to incorporate the Basel III concepts into U.S. capital adequacy standards.

The Company

General. The Company, as the sole stockholder of the Bank, is a bank holding company. As a bank holding company, the Company is registered with, and is subject to regulation by, the Federal Reserve under the Bank Holding Company Act of 1956, as amended (the “BHCA”). In accordance with Federal Reserve policy, and as now codified by the Dodd-Frank Act, the Company is legally obligated to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances where the Company might not otherwise do so. Under the BHCA, the Company is subject to periodic examination by the Federal Reserve. The Company is required to file with the Federal Reserve periodic reports of the Company’s operations and such additional information regarding the Company and its subsidiaries as the Federal Reserve may require. The Company is also subject to regulation by the DFI under Indiana law.

Table of Contents

Acquisitions, Activities and Change in Control. The primary purpose of a bank holding company is to control and manage banks. The BHCA generally requires the prior approval of the Federal Reserve for any merger involving a bank holding company or any acquisition by a bank holding company of another bank or bank holding company. Subject to certain conditions (including deposit concentration limits established by the BHCA and the Dodd-Frank Act), the Federal Reserve may allow a bank holding company to acquire banks located in any state of the United States. In approving interstate acquisitions, the Federal Reserve is required to give effect to applicable state law limitations on the aggregate amount of deposits that may be held by the acquiring bank holding company and its insured depository institution affiliates in the state in which the target bank is located (provided that those limits do not discriminate against out-of-state depository institutions or their holding companies) and state laws that require that the target bank have been in existence for a minimum period of time (not to exceed five years) before being acquired by an out-of-state bank holding company. Furthermore, in accordance with the Dodd-Frank Act, as of July 21, 2011, bank holding companies must be well-capitalized in order to effect interstate mergers or acquisitions. For a discussion of the capital requirements, see "—The Increasing Importance of Capital" above.

The BHCA generally prohibits the Company from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company that is not a bank and from engaging in any business other than that of banking, managing and controlling banks or furnishing services to banks and their subsidiaries. This general prohibition is subject to a number of exceptions. The principal exception allows bank holding companies to engage in, and to own shares of companies engaged in, certain businesses found by the Federal Reserve prior to November 11, 1999 to be "so closely related to banking ... as to be a proper incident thereto." This authority would permit the Company to engage in a variety of banking-related businesses, including the ownership and operation of a savings association, or any entity engaged in consumer finance, equipment leasing, the operation of a computer service bureau (including software development), and mortgage banking and brokerage. The BHCA generally does not place territorial restrictions on the domestic activities of non-bank subsidiaries of bank holding companies.

Additionally, bank holding companies that meet certain eligibility requirements prescribed by the BHCA and elect to operate as financial holding companies may engage in, or own shares in companies engaged in, a wider range of nonbanking activities, including securities and insurance underwriting and sales, merchant banking and any other activity that the Federal Reserve, in consultation with the Secretary of the United States Department of the Treasury ("Treasury"), determines by regulation or order is financial in nature or incidental to any such financial activity or that the Federal Reserve determines by order to be complementary to any such financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally. As of the date of this filing, the Company has not applied for approval to operate as a financial holding company.

Federal law also prohibits any person or company from acquiring "control" of an FDIC-insured depository institution or its holding company without prior notice to the appropriate federal bank regulator. "Control" is conclusively presumed to exist upon the acquisition of 25% or more of the outstanding voting securities of a bank or bank holding company, but may arise under certain circumstances between 10% and 24.99% ownership.

Capital Requirements. Bank holding companies are required to maintain minimum levels of capital in accordance with Federal Reserve capital adequacy guidelines, as affected by the Dodd-Frank Act and Basel III. For a discussion of capital requirements, see "—The Increasing Importance of Capital" above.

Dividend Payments. The Company's ability to pay dividends to its stockholders may be affected by both general corporate law considerations and policies of the Federal Reserve applicable to bank holding companies. As an Indiana corporation, the Company is subject to the limitations of the Indiana General Business Corporation Law, which prohibit the Company from paying dividends if the Company is, or by payment of the dividend would become, insolvent, or if the payment of dividends would render the Company unable to pay its debts as they become due in the usual course of business. Consistent with the "source of strength" policy for subsidiary banks, the Federal Reserve has stated that, as a matter of prudent banking, a bank holding company generally should not maintain a rate of cash dividends unless its net income available to common stockholders has been sufficient to fully fund the dividends and the prospective rate of earnings retention appears to be consistent with the corporation's capital needs, asset quality and overall financial condition.

The Federal Reserve also possesses enforcement powers over bank holding companies and their non-bank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to proscribe the payment of dividends by banks and bank holding companies. Further, with respect to the Company's participation in the U.S. Treasury's Capital Purchase Program ("CPP") implemented under the Troubled Asset Relief Program ("TARP"), the terms of the CPP Preferred Stock provide that no dividends on any common or preferred stock that ranks equal to or junior to the CPP Preferred Stock may be paid unless and until all accrued and unpaid dividends for all past dividend periods on the CPP Preferred Stock have been fully paid.

Table of Contents

Federal Securities Regulation. The Company's common stock is registered with the SEC under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Consequently, the Company is subject to the information, proxy solicitation, insider trading and other restrictions and requirements of the SEC under the Exchange Act.

Corporate Governance. The Dodd-Frank Act addresses many investor protection, corporate governance and executive compensation matters that will affect most U.S. publicly traded companies. The Dodd-Frank Act will increase stockholder influence over boards of directors by requiring companies to give stockholders a non-binding vote on executive compensation and so-called "golden parachute" payments, and authorizing the SEC to promulgate rules that would allow stockholders to nominate and solicit voters for their own candidates using a company's proxy materials. The legislation also directs the Federal Reserve to promulgate rules prohibiting excessive compensation paid to bank holding company executives, regardless of whether the company is publicly traded.

The Bank

General. The Bank is an Indiana-chartered bank, the deposit accounts of which are insured by the FDIC's Deposit Insurance Fund ("DIF") to the maximum extent provided under federal law and FDIC regulations. The Bank is also a member of the Federal Reserve System (a "member bank"). As an Indiana-chartered, FDIC-insured member bank, the Bank is presently subject to the examination, supervision, reporting and enforcement requirements of the DFI, the chartering authority for Indiana banks, the Federal Reserve, as the primary federal regulator of member banks, and the FDIC, as administrator of the DIF.

Deposit Insurance. As an FDIC-insured institution, the Bank is required to pay deposit insurance premium assessments to the FDIC. The FDIC has adopted a risk-based assessment system whereby FDIC-insured depository institutions pay insurance premiums at rates based on their risk classification. An institution's risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to the regulators.

On November 12, 2009, the FDIC adopted a final rule that required insured depository institutions to prepay on December 30, 2009, their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011, and 2012. As such, on December 31, 2009, the Bank prepaid the FDIC its assessments based on its actual September 30, 2009 assessment base, adjusted quarterly by an estimated 5% annual growth rate through the end of 2012. The FDIC also used the institution's total base assessment rate in effect on September 30, 2009, increasing it by an annualized 3 basis points beginning in 2011. The FDIC began to offset prepaid assessments on March 30, 2010, representing payment of the regular quarterly risk-based deposit insurance assessment for the fourth quarter of 2009. Any prepaid assessment not exhausted after collection of the amount due on June 30, 2013, will be returned to the institution.

Amendments to the Federal Deposit Insurance Act also revise the assessment base against which an insured depository institution's deposit insurance premiums paid to the DIF will be calculated. Under the amendments, the assessment base will no longer be the institution's deposit base, but rather its average consolidated total assets less its average tangible equity. This may shift the burden of deposit insurance premiums toward those large depository institutions that rely on funding sources other than U.S. deposits. Additionally, the Dodd-Frank Act makes changes to the minimum designated reserve ratio of the DIF, increasing the minimum from 1.15% to 1.35% of the estimated amount of total insured deposits, and eliminating the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds. The FDIC is given until September 3, 2020 to meet the 1.35 reserve ratio target. Several of these provisions could increase the Bank's FDIC deposit insurance premiums.

The Dodd-Frank Act permanently increases the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per insured depositor, retroactive to January 1, 2009. Furthermore, the legislation provides that non-interest bearing transaction accounts have unlimited deposit insurance coverage through December 31, 2012. This temporary unlimited deposit insurance coverage replaces the Transaction Account Guarantee Program ("TAGP") that expired on December 31, 2010. It covers all depository institution noninterest-bearing transaction accounts, but not low interest-bearing accounts. Unlike TAGP, there is no special assessment associated with the temporary unlimited insurance coverage, nor may institutions opt-out of the unlimited coverage.

FICO Assessments. The Financing Corporation ("FICO") is a mixed-ownership governmental corporation chartered by the former FHLB Board pursuant to the Competitive Equality Banking Act of 1987 to function as a financing vehicle for the recapitalization of the former Federal Savings and Loan Insurance Corporation. FICO issued 30-year noncallable bonds of approximately $8.1 billion that mature in 2017 through 2019. FICO's authority to issue bonds ended on December 12, 1991. Since 1996, federal legislation has required that all FDIC-insured depository institutions pay assessments to cover interest payments on FICO's outstanding obligations. These FICO assessments are in addition to amounts assessed by the FDIC for deposit insurance. During the year ended December 31, 2011, the FICO assessment rate was approximately 0.01% of deposits. A rate reduction to .660% began with the fourth quarter of 2011 to reflect the change from an assessment base computed on deposits to an assessment base computed on assets as required by the Dodd-Frank Act.

Table of Contents

Supervisory Assessments. All Indiana banks are required to pay supervisory assessments to the DFI to fund the operations of the DFI. The amount of the assessment is calculated on the basis of the bank's total assets. During the year ended December 31, 2011, the Bank paid supervisory assessments to the DFI totaling $199,000.

Capital Requirements. Banks are generally required to maintain capital levels in excess of other businesses. For a discussion of capital requirements, see "—The Increasing Importance of Capital" above.

Dividend Payments. The primary source of funds for the Company is dividends from the Bank. Indiana law prohibits the Bank from paying dividends in an amount greater than its undivided profits. The Bank is required to obtain the approval of the DFI for the payment of any dividend if the total of all dividends declared by the Bank during the calendar year, including the proposed dividend, would exceed the sum of the Bank's net income for the year to date combined with its retained net income for the previous two years. Indiana law defines "retained net income" to mean the net income of a specified period, calculated under the consolidated report of income instructions, less the total amount of all dividends declared for the specified period. The Federal Reserve Act also imposes limitations on the amount of dividends that may be paid by state member banks, such as the Bank. Without Federal Reserve approval, a state member bank may not pay dividends in any calendar year that, in the aggregate, exceed the bank's calendar year-to-date net income plus the bank's retained net income for the two preceding calendar years.

The payment of dividends by any financial institution is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a financial institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. As described above, the Bank exceeded its minimum capital requirements under applicable guidelines as of December 31, 2011. As of December 31, 2011, approximately $37.0 million was available to be paid as dividends by the Bank. Notwithstanding the availability of funds for dividends, however, the Federal Reserve may prohibit the payment of any dividends by the Bank if the Federal Reserve determines such payment would constitute an unsafe or unsound practice.

Insider Transactions. The Bank is subject to certain restrictions imposed by federal law on "covered transactions" between the Bank and its "affiliates." The Company is an affiliate of the Bank for purposes of these restrictions, and covered transactions subject to the restrictions include extensions of credit to the Company, investments in the stock or other securities of the Company and the acceptance of the stock or other securities of the Company as collateral for loans made by the Bank. The Dodd-Frank Act enhances the requirements for certain transactions with affiliates as of July 21, 2011, including an expansion of the definition of "covered transactions" and an increase in the amount of time for which collateral requirements regarding covered transactions must be maintained.

Certain limitations and reporting requirements are also placed on extensions of credit by the Bank to its directors and officers, to directors and officers of the Company, to principal stockholders of the Company and to "related interests" of such directors, officers and principal stockholders. In addition, federal law and regulations may affect the terms upon which any person who is a director or officer of the Company or the Bank or a principal stockholder of the Company may obtain credit from banks with which the Bank maintains a correspondent relationship.

Safety and Soundness Standards. The federal banking agencies have adopted guidelines that establish operational and managerial standards to promote the safety and soundness of federally insured depository institutions. The guidelines set forth standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings.

In general, the safety and soundness guidelines prescribe the goals to be achieved in each area, and each institution is responsible for establishing its own procedures to achieve those goals. If an institution fails to comply with any of the standards set forth in the guidelines, the institution's primary federal regulator may require the institution to submit a plan for achieving and maintaining compliance. If an institution fails to submit an acceptable compliance plan, or fails in any material respect to implement a compliance plan that has been accepted by its primary federal regulator, the regulator is required to issue an order directing the institution to cure the deficiency. Until the deficiency cited in the regulator’s order is cured, the regulator may restrict the institution’s rate of growth, require the institution to increase its capital, restrict the rates the institution pays on deposits or require the institution to take any action the regulator deems appropriate under the circumstances. Noncompliance with the standards established by the safety and soundness guidelines may also constitute grounds for other enforcement action by the federal banking regulators, including cease and desist orders and civil money penalty assessments.

Table of Contents

Branching Authority. Indiana banks, such as the Bank, have the authority under Indiana law to establish branches anywhere in the State of Indiana, subject to receipt of all required regulatory approvals.

Federal law permits state and national banks to merge with banks in other states subject to: (i) regulatory approval; (ii) federal and state deposit concentration limits; and (iii) state law limitations requiring the merging bank to have been in existence for a minimum period of time (not to exceed five years) prior to the merger. The establishment of new interstate branches or the acquisition of individual branches of a bank in another state (rather than the acquisition of an out-of-state bank in its entirety) has historically been permitted only in those states the laws of which expressly authorize such expansion. However, the Dodd-Frank Act permits well-capitalized banks to establish branches across state lines without these impediments.

State Bank Investments and Activities. The Bank is permitted to make investments and engage in activities directly or through subsidiaries as authorized by Indiana law. However, under federal law and FDIC regulations, FDIC-insured state banks are prohibited, subject to certain exceptions, from making or retaining equity investments of a type, or in an amount, that are not permissible for a national bank. Federal law and FDIC regulations also prohibit FDIC-insured state banks and their subsidiaries, subject to certain exceptions, from engaging as principal in any activity that is not permitted for a national bank unless the bank meets, and continues to meet, its minimum regulatory capital requirements and the FDIC determines the activity would not pose a significant risk to the deposit insurance fund of which the bank is a member. These restrictions have not had, and are not currently expected to have, a material impact on the operations of the Bank.

Transaction Account Reserves. Federal Reserve regulations require depository institutions to maintain reserves against their transaction accounts (primarily NOW and regular checking accounts). For 2012: the first $11.5 million of otherwise reservable balances are exempt from the reserve requirements; for transaction accounts aggregating more than $11.5 million to $71.0 million, the reserve requirement is 3% of total transaction accounts; and for net transaction accounts in excess of $71.0 million, a 10% reserve ratio will be assessed. These reserve requirements are subject to annual adjustment by the Federal Reserve. The Bank is in compliance with the foregoing requirements.

Consumer Financial Services. There are numerous developments in federal and state laws regarding consumer financial products and services that impact the Bank’s business. Importantly, the current structure of federal consumer protection regulation applicable to all providers of consumer financial products and services changed significantly on July 21, 2011, when the new Consumer Financial Protection Bureau (the “Bureau”) commenced operations to supervise and enforce consumer protection laws. The Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all providers of consumer products and services, including the Bank, as well as the authority to prohibit “unfair, deceptive or abusive” acts and practices. The Bureau has examination and enforcement authority over providers with more than $10 billion in assets. Banks and savings institutions with $10 billion or less in assets, like the Bank, will continue to be examined by their applicable bank regulators. The Dodd-Frank Act also generally weakens the federal preemption available for national banks and federal savings associations, and gives state attorneys general the ability to enforce applicable federal consumer protection laws. It is unclear what changes will be promulgated by the Bureau and what effect, if any, such changes would have on the Bank.

The Dodd-Frank Act contains additional provisions that affect consumer mortgage lending. First, the new law significantly expands underwriting requirements applicable to loans secured by 1-4 residential real property and augments federal law combating predatory lending practices. In addition to numerous new disclosure requirements, the Dodd-Frank Act imposes new standards for mortgage loan originations on all lenders, including banks and savings associations, in an effort to strongly encourage lenders to verify a borrower’s ability to repay. Most significantly, the new standards limit the total points and fees that the Bank and/or a broker may charge on conforming and jumbo loans to 3% of the total loan amount. Also, the Dodd-Frank Act, in conjunction with the Federal Reserve’s final rule on loan originator compensation effective April 1, 2011, prohibits certain compensation payments to loan originators and prohibits steering consumers to loans not in their interest because it will result in greater compensation for a loan originator. These standards may result in a myriad of new system, pricing and compensation controls in order to ensure compliance and to decrease repurchase requests and foreclosure defenses. In addition, the Dodd-Frank Act generally requires lenders or securitizers to retain an economic interest in the credit risk relating to loans the lender sells and other asset-backed securities that the securitizer issues if the loans have not complied with the ability to repay standards. The risk retention requirement generally will be 5%, but could be increased or decreased by regulation.

Foreclosure and Loan Modifications. Federal and state laws further impact foreclosures and loan modifications, many of which laws have the effect of delaying or impeding the foreclosure process on real estate secured loans in default. Mortgages on commercial property can be modified, such as by reducing the principal amount of the loan or the interest rate, or by extending the term of the loan, through plans confirmed under Chapter 11 of the Bankruptcy Code. In recent years legislation has been introduced in Congress that would amend the Bankruptcy Code to permit the modification of mortgages secured by residences, although at this time the enactment of such legislation is not in prospect. The scope, duration and terms of potential future legislation with similar effect continue to be discussed. The Bank cannot predict whether any such legislation will be passed or the impact, if any, it would have on the Bank’s business.

Table of Contents

OPERATING SEGMENTS

The Company’s chief decision-makers monitor and evaluate financial performance on a Company-wide basis. All of the Company’s financial service operations are similar and considered by management to be aggregated into one reportable operating segment. While the Company has assigned certain management responsibilities by region and business-line, the Company's chief decision-makers monitor and evaluate financial performance on a Company-wide basis. The majority of the Company's revenue is from the business of banking and the Company's assigned regions have similar economic characteristics, products, services and customers. Accordingly, all of the Company’s operations are considered by management to be aggregated in one reportable operating segment.

GUIDE 3 INFORMATION

On the pages that follow are tables that set forth selected statistical information relative to the business of the Company. This data should be read in conjunction with the consolidated financial statements, related notes and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” as set forth in Items 7 and 8, below, herein incorporated by reference.

Table of Contents

DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS' EQUITY;
INTEREST RATES AND INTEREST DIFFERENTIAL
(in thousands of dollars)

	2011 Average Balance	Interest Income	Yield (1)	2010 Average Balance	Interest Income	Yield (1)
ASSETS						
Earning assets:						
Loans:						
Taxable (2)(3)	$2,137,748	$104,936	4.91 %	$2,046,974	$104,205	5.09 %
Tax exempt (1)	10,298	700	6.80	2,235	122	5.46
Investments: (1)						
Available for sale	447,620	17,686	3.95	430,615	20,453	4.75
Short-term investments	17,830	23	0.13	35,080	59	0.17
Interest bearing deposits	28,662	131	0.46	7,456	61	0.82
Total earning assets	2,642,158	123,476	4.67 %	2,522,360	124,900	4.95 %
Nonearning assets:						
Cash and due from banks	74,854	0		48,398	0	
Premises and equipment	31,260	0		29,291	0	
Other nonearning assets	94,741	0		90,900	0	
Less allowance for loan losses	(50,243)	0		(38,325)	0	
Total assets	$2,792,770	$123,476		$2,652,624	$124,900	

(1) Tax exempt income was converted to a fully taxable equivalent basis at a 35 percent tax rate for 2011 and 2010. The tax equivalent rate for tax exempt loans and tax exempt securities acquired after January 1, 1983 included the TEFRA adjustment applicable to nondeductible interest expenses.

(2) Loan fees, which are immaterial in relation to total taxable loan interest income for the years ended December 31, 2011 and 2010, are included as taxable loan interest income.

(3) Nonaccrual loans are included in the average balance of taxable loans.

Table of Contents

DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS' EQUITY;
INTEREST RATES AND INTEREST DIFFERENTIAL (Cont.)
(in thousands of dollars)

	2010 Average Balance	2010 Interest Income	2010 Yield (1)	2009 Average Balance	2009 Interest Income	2009 Yield (1)
ASSETS						
Earning assets:						
Loans:						
Taxable (2)(3)	$2,046,974	$104,205	5.09 %	$1,897,544	$96,151	5.07 %
Tax exempt (1)	2,235	122	5.46	4,202	199	4.74
Investments: (1)						
Available for sale	430,615	20,453	4.75	399,342	21,179	5.30
Short-term investments	35,080	59	0.17	22,540	35	0.16
Interest bearing deposits	7,456	61	0.82	1,631	26	1.59
Total earning assets	2,522,360	124,900	4.95 %	2,325,259	117,590	5.06 %
Nonearning assets:						
Cash and due from banks	48,398	0		39,616	0	
Premises and equipment	29,291	0		30,208	0	
Other nonearning assets	90,900	0		76,671	0	
Less allowance for loan losses	(38,325)	0		(24,801)	0	
Total assets	$2,652,624	$124,900		$2,446,953	$117,590	

(1) Tax exempt income was converted to a fully taxable equivalent basis at a 35 percent tax rate for 2010 and 2009. The tax equivalent rate for tax exempt loans and tax exempt securities acquired after January 1, 1983 included the TEFRA adjustment applicable to nondeductible interest expenses.

(2) Loan fees, which are immaterial in relation to total taxable loan interest income for the years ended December 31, 2010 and 2009, are included as taxable loan interest income.

(3) Nonaccrual loans are included in the average balance of taxable loans.

Table of Contents

DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS' EQUITY;
INTEREST RATES AND INTEREST DIFFERENTIAL (Cont.)
(in thousands of dollars)

	2011 Average Balance	Interest Expense	Yield		2010 Average Balance	Interest Expense	Yield	
LIABILITIES AND STOCKHOLDERS' EQUITY								
Interest bearing liabilities:								
Savings deposits	$168,470	$930	0.55	%	$121,844	$816	0.67	%
Interest bearing checking accounts	879,295	10,569	1.20		709,002	8,576	1.21	
Time deposits:								
In denominations under $100,000	356,286	6,960	1.95		322,479	7,283	2.26	
In denominations over $100,000	611,389	9,276	1.52		712,859	11,332	1.59	
Miscellaneous short-term borrowings	145,306	612	0.42		171,500	727	0.42	
Long-term borrowings and subordinated debentures (1)	45,968	1,465	3.19		69,667	2,138	3.07	
Total interest bearing liabilities	2,206,714	29,812	1.35	%	2,107,351	30,872	1.46	%
Noninterest bearing liabilities and stockholders' equity:								
Demand deposits	310,524	0			266,424	0		
Other liabilities	15,197	0			15,988	0		
Stockholders' equity	260,335	0			262,861	0		
Total liabilities and stockholders' equity	$2,792,770	$29,812			$2,652,624	$30,872		
Net interest differential - yield on average daily earning assets		$93,664	3.54	%		$94,028	3.73	%

(1)

Long-term borrowings and subordinated debentures interest expense was reduced by interest capitalized on construction in process for 2011 and 2010.

17

Table of Contents

DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS' EQUITY;
INTEREST RATES AND INTEREST DIFFERENTIAL (Cont.)
(in thousands of dollars)

	2010 Average Balance	Interest Expense	Yield		2009 Average Balance	Interest Expense	Yield	
LIABILITIES AND STOCKHOLDERS' EQUITY								
Interest bearing liabilities:								
Savings deposits	$121,844	$816	0.67	%	$70,202	$100	0.14	%
Interest bearing checking accounts	709,002	8,576	1.21		572,539	5,790	1.01	
Time deposits:								
In denominations under $100,000	322,479	7,283	2.26		359,526	15,356	4.27	
In denominations over $100,000	712,859	11,332	1.59		638,956	11,001	1.72	
Miscellaneous short-term borrowings	171,500	727	0.42		272,224	1,089	0.40	
Long-term borrowings and subordinated debentures (1)	69,667	2,138	3.07		72,792	2,726	3.74	
Total interest bearing liabilities	2,107,351	30,872	1.46	%	1,986,239	36,062	1.82	%
Noninterest bearing liabilities and stockholders' equity:								
Demand deposits	266,424	0			229,009	0		
Other liabilities	15,988	0			19,354	0		
Stockholders' equity	262,861	0			212,351	0		
Total liabilities and stockholders' equity	$2,652,624	$30,872			$2,446,953	$36,062		
Net interest differential - yield on average daily earning assets		$94,028	3.73	%		$81,528	3.51	%

(1)

Long-term borrowings and subordinated debentures interest expense was reduced by interest capitalized on construction in process for 2010.

Table of Contents

ANALYSIS OF CHANGES IN INTEREST DIFFERENTIALS
(fully taxable equivalent basis)
(in thousands of dollars)

YEAR ENDED DECEMBER 31,

	2011 Over (Under) 2010 (1)			2010 Over (Under) 2009 (1)		
	Volume	Rate	Total	Volume	Rate	Total
INTEREST AND LOAN FEE INCOME (2)						
Loans:						
Taxable	$4,530	$(3,799)	$731	$7,605	$449	$8,054
Tax exempt	541	37	578	(104)	27	(77)
Investments:						
Available for sale	782	(3,549)	(2,767)	1,584	(2,310)	(726)
Short-term investments	(24)	(12)	(36)	21	3	24
Interest bearing deposits	107	(37)	70	53	(18)	35
Total interest income	5,936	(7,360)	(1,424)	9,159	(1,849)	7,310
INTEREST EXPENSE						
Savings deposits	275	(161)	114	119	597	716
Interest bearing checking accounts	2,047	(54)	1,993	1,528	1,258	2,786
Time deposits:						
In denominations under $100,000	718	(1,041)	(323)	(1,449)	(6,624)	(8,073)
In denominations over $100,000	(1,557)	(499)	(2,056)	1,214	(883)	331
Miscellaneous short-term borrowings	(111)	(4)	(115)	(424)	62	(362)
Long-term borrowings and subordinated debentures	(752)	79	(673)	(113)	(475)	(588)
Total interest expense	620	(1,680)	(1,060)	875	(6,065)	(5,190)
INCREASE (DECREASE) IN INTEREST DIFFERENTIALS	$5,316	$(5,680)	$(364)	$8,284	$4,216	$12,500

(1) The earning assets and interest bearing liabilities used to calculate interest differentials are based on average daily balances for 2011, 2010 and 2009. The changes in volume represent "changes in volume times the old rate". The

changes in rate represent "changes in rate times old volume". The changes in rate/volume were also calculated by "change in rate times change in volume" and allocated consistently based upon the relative absolute values of the changes in volume and changes in rate.

(2) Tax exempt income was converted to a fully taxable equivalent basis at a 35 percent tax rate for 2011, 2010 and 2009. The tax equivalent rate for tax exempt loans and tax exempt securities acquired after January 1, 1983 included the TEFRA adjustment applicable to nondeductible interest expense.

Table of Contents

ANALYSIS OF INVESTMENT PORTFOLIO
(in thousands of dollars)

The amortized cost and the fair value of securities as of December 31, 2011, 2010 and 2009 were as follows:

	2011 Amortized Cost	Fair Value	2010 Amortized Cost	Fair Value	2009 Amortized Cost	Fair Value
Securities available for sale:						
U.S. Treasury securities	$1,003	$1,055	$1,004	$1,036	$1,005	$992
U.S. Government sponsored agencies	5,033	5,277	0	0	4,588	4,610
Agency residential mortgage-backed securities	342,036	350,102	299,266	308,851	264,276	270,796
Non-agency residential mortgage-backed securities	34,241	32,207	68,578	62,773	88,382	72,495
State and municipal securities	73,467	78,750	69,059	69,960	59,375	61,135
Total debt securities available for sale	$455,780	$467,391	$437,907	$442,620	$417,626	$410,028

At year-end 2011, 2010 and 2009, 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. See Note 2 for more information on these investments.

Table of Contents

ANALYSIS OF INVESTMENT PORTFOLIO (cont.)
(fully tax equivalent basis)
(in thousands of dollars)

The weighted average yields and maturity distribution for debt securities portfolio at December 31, 2011, were as follows:

	Within One Year	After One Year Within Five Years	After Five Years Within Ten Years	Over Ten Years
Securities available for sale:				
US Treasury securities				
Fair value	$0	$1,055	$0	$0
Yield	0 %	2.38 %	0 %	0 %
U.S. Government sponsored agencies				
Fair value	0	5,277	0	0
Yield	0 %	2.41 %	0 %	0 %
Agency residential mortgage-backed securities				
Fair value	0	4,513	48,759	296,830
Yield	0 %	5.01 %	4.91 %	4.55 %
Non-agency residential mortgage-backed securities				
Fair value	0	0	3,506	28,701
Yield	0 %	0 %	5.00 %	5.63 %
State and municipal securities				
Fair value	700	15,873	36,424	25,753
Yield	4.37 %	4.38 %	3.99 %	4.04 %
Total debt securities available for sale:				
Fair value	$700	$26,718	$88,689	$351,284
Yield	4.37 %	4.02 %	4.53 %	4.60 %

Table of Contents

ANALYSIS OF LOAN PORTFOLIO
Analysis of Loans Outstanding
(in thousands of dollars)

As a result of FASB ASU 2010-20, Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses, the Company has revised this table for the years ending December 31, 2011, 2010 and 2009 in order to present the data with greater granularity. This disaggregation will be substantially the same as those used in disclosures of credit quality. The loan portfolio by class as of December 31, 2011, 2010 and 2009 was as follows:

	2011	2010	2009
Commercial and industrial loans:			
Working capital lines of credit loans	$373,768	$281,546	$235,202
Non-working capital loans	377,388	384,138	394,408
Total commercial and industrial loans	751,156	665,684	629,610
Commercial real estate and multi-family residential loans:			
Construction and land development loans	82,284	106,980	166,959
Owner occupied loans	346,669	329,760	348,904
Nonowner occupied loans	385,090	355,393	257,373
Multifamily loans	38,477	24,158	26,558
Total commercial real estate and multi-family residential loans	852,520	816,291	799,794
Agri-business and agricultural loans:			
Loans secured by farmland	118,224	111,961	112,241
Loans for agricultural production	119,705	117,518	82,765
Total agri-business and agricultural loans	237,929	229,479	195,006
Other commercial loans	58,278	38,778	30,497
Total commercial loans	1,899,883	1,750,232	1,654,907
Consumer 1-4 family mortgage loans:			
Closed end first mortgage loans	106,999	103,118	117,619
Open end and junior lien loans	175,694	182,325	174,641
Residential construction and land development loans	5,462	4,140	7,471
Total consumer 1-4 family mortgage loans	288,155	289,583	299,731
Other consumer loans	45,999	51,123	59,179
Total consumer loans	334,154	340,706	358,910
Subtotal	2,234,037	2,090,938	2,013,817
Less: Allowance for loan losses	(53,400)	(45,007)	(32,073)
Net deferred loan fees	(328)	(979)	(1,807)
Loans, net	$2,180,309	$2,044,952	$1,979,937

The residential construction and land development loans class included construction loans totaling $4,254, $2,569 and $5,790 as of December 31, 2011, 2010 and 2009. The Bank generally sells conforming mortgage loans which it originates. These loans generally represent mortgage loans that are made to clients with long-term or substantial relationships with the Bank on terms consistent with secondary market requirements. The loan classifications are based on the nature of the loans as of the loan origination date. There were no foreign loans included in the loan portfolio for the periods presented.

Table of Contents

ANALYSIS OF LOAN PORTFOLIO (cont.)
Analysis of Loans Outstanding (cont.)
(in thousands of dollars)

The loan portfolio by basic segments as of December 31, 2008 and 2007 was as follows:

	2008	2007
Commercial loans:		
Taxable	$1,522,523	$1,238,623
Tax exempt	10,493	1,971
Total commercial loans	1,533,016	1,240,594
Residential real estate mortgage loans	117,230	124,107
Installment loans	51,174	49,185
Line of credit and credit card loans	132,147	109,760
Subtotal loans	1,833,567	1,523,646
Less: Allowance for loan losses	(18,860)	(15,801)
Net deferred loan (fees)/costs	(233)	74
Net loans	$1,814,474	$1,507,919

The residential real estate mortgage loan portfolio included construction loans totaling $6,468 and $5,252 as of December 31, 2008 and 2007. The Bank generally sells conforming mortgage loans which it originates. These loans generally represent mortgage loans that are made to clients with long-term or substantial relationships with the Bank on terms consistent with secondary market requirements. The loan classifications are based on the nature of the loans as of the loan origination date. There were no foreign loans included in the loan portfolio for the periods presented.

Table of Contents

ANALYSIS OF LOAN PORTFOLIO (cont.)
Analysis of Loans Outstanding (cont.)
(in thousands of dollars)

Repricing opportunities of the loan portfolio occur either according to predetermined adjustable rate schedules included in the related loan agreements or upon maturity of each principal payment. The following table indicates the scheduled maturities of the loan portfolio as of December 31, 2011.

	Commercial	Residential Real Estate Mortgage	Installment	Line of Credit	Total	Percent
Original maturity of one day	$ 0	$ 0	$ 0	$ 117,679	$ 117,679	5.27 %
Other within one year	1,081,416	5,355	14,100	27,866	$ 1,128,737	50.52
After one year, within five years	711,512	12,664	23,309	8,584	$ 756,069	33.84
Over five years	109,385	68,454	2,757	11,531	$ 192,127	8.60
Nonaccrual loans	38,219	714	40	452	$ 39,425	1.77
Total loans	$ 1,940,532	$ 87,187	$ 40,206	$ 166,112	$ 2,234,037	100.0 %

At maturity, credits are reviewed and, if renewed, are renewed at rates and conditions that prevail at the time of maturity.

Loans due after one year which have a predetermined interest rate and loans due after one year which have floating or adjustable interest rates as of December 31, 2011 amounted to $535,000 and $413,000.

Table of Contents

ANALYSIS OF LOAN PORTFOLIO (cont.)
Review of Nonperforming Loans
(in thousands of dollars)

The following is a summary of nonperforming loans as of December 31, 2011, 2010, 2009, 2008, and 2007.

	2011	2010	2009	2008	2007
PART A - PAST DUE ACCRUING LOANS (90 DAYS OR MORE)					
Residential real estate mortgage loans	$52	$262	$0	$126	$155
Commercial and industrial loans	0	56	0	81	65
Loans to individuals for household, family and other personal expenditures	0	12	190	271	189
Loans to finance agriculture production and other loans to farmers	0	0	0	0	0
Total past due loans	52	330	190	478	409
PART B - NONACCRUAL LOANS (1)					
Residential real estate mortgage loans	714	845	1,373	757	18
Commercial and industrial loans	37,366	34,197	28,373	20,053	7,021
Loans to individuals for household, family and other personal expenditures	492	266	0	0	0
Loans to finance agriculture production and other loans to farmers	853	1,283	772	0	0
Total nonaccrual loans	39,425	36,591	30,518	20,810	7,039
PART C - TROUBLED DEBT RESTRUCTURED LOANS	0	0	0	0	0
Total nonperforming loans	$39,477	$36,921	$30,708	$21,288	$7,448

(1) Includes nonaccrual troubled debt restructured loans.

Nonearning assets of the Company include nonperforming loans (as indicated above), nonaccrual investments and other real estate and repossessions, the total of which amounted to $41,584 and $40,658 at December 31, 2011 and 2010. In addition, the Company has $22,177 and $8,547 of troubled debt restructured loans performing under their modified terms at December 31, 2011 and 2010.

Table of Contents

ANALYSIS OF LOAN PORTFOLIO (cont.)
Comments Regarding Nonperforming Assets

CONSUMER LOANS

Consumer 1-4 family mortgage loans for which collateral is insufficient to cover all principal and accrued interest are reclassified as nonaccrual loans, on or before the date when the loan becomes 90 days delinquent. Other consumer loans are not placed on nonaccrual status since these loans are charged-off when they have been delinquent from 90 to 180 days, and when the related collateral, if any, is not sufficient to offset the indebtedness.

NONPERFORMING LOANS

It is the policy of the Bank that all loans for which the collateral is insufficient to cover all principal and accrued interest will be reclassified as nonperforming loans to the extent they are unsecured, on or before the date when the loan becomes 90 days delinquent. When a loan is classified as a nonaccrual loan, interest on the loan is no longer accrued, all unpaid accrued interest is reversed and interest income is subsequently recorded only to the extent cash payments are received. Accrual status is resumed when all contractually due payments are brought current and future payments are reasonably assured. Interest not recorded on nonaccrual loans is referenced in Footnote 4 in Item 8 below.

As of December 31, 2011, there were $39.4 million of loans on nonaccrual status, some of which were also on impaired status. There were $63.5 million of loans classified as impaired.

TROUBLED DEBT RESTRUCTURED LOANS

Loans renegotiated as troubled debt restructurings are those loans for which either the contractual interest rate has been reduced below market rates and/or other concessions are granted to the borrower because of a deterioration in the financial condition of the borrower which results in the inability of the borrower to meet the terms of the loan.

As of December 31, 2011 there were $56.4 million of loans renegotiated as troubled debt restructurings and $38.9 million were modified in 2011. Of these loans, $34.3 million were excluded from troubled debt restructured loans in the previous table because they were included in nonaccrual loans. As of December 31, 2010 there were $14.6 million of loans renegotiated as troubled debt restructurings. Of these loans, $6.1 million were excluded from troubled debt restructured loans in the previous table because they were included in nonaccrual loans.

OTHER NONPERFORMING ASSETS

Nonperforming assets include nonperforming loans, nonaccrual investments and other real estate and repossessions. Management is of the opinion that there are no significant foreseeable losses relating to nonperforming assets, except as discussed above in “Part B – Nonperforming Loans” and “Part C – Troubled Debt Restructured Loans”.

LOAN CONCENTRATIONS

There were no loan concentrations within industries not otherwise disclosed, which exceeded ten percent of total loans except commercial real estate and manufacturing. Commercial real estate was $691.0 million and manufacturing was $270.2 million at December 31, 2011. Nearly all of the Bank’s commercial, industrial, agricultural real estate mortgage, real estate construction mortgage and consumer loans are made within its basic service area.

Table of Contents

Basis For Determining Allowance For Loan Losses:

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, as well as other probable incurred losses inherent in the loan portfolio. The evaluation takes into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to 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: application of historical loss percentages, emerging market risk, emerging concentrations, commercial loan focus and large credit concentration, new industry lending activity and general economic conditions. For a more thorough discussion of the allowance for loan losses methodology see the Critical Accounting Policies section of Item 7.

Based upon these policies and objectives, $13.8 million, $23.9 million, $21.2 million, $10.2 million and $4.3 million were charged to the provision for loan losses and added to the allowance for loan losses in 2011, 2010, 2009, 2008 and 2007.

The allocation of the allowance for loan losses to the various lending areas is performed by management in relation to perceived exposure to loss in the various loan portfolios. However, the allowance for loan losses is available in its entirety to absorb losses in any particular loan category. Although management believes that the allowance for loan losses is adequate to absorb probable incurred losses on any existing loans, management cannot predict loan losses with any certainty, and the Company cannot guarantee that the allowance for loan losses will prove sufficient to cover actual losses in the future.

Table of Contents

ANALYSIS OF LOAN PORTFOLIO (cont.)
Summary of Loan Loss
(in thousands of dollars)

The following is a summary of the loan loss experience for the years ended December 31, 2011, 2010, 2009, 2008, and 2007.

	2011	2010	2009	2008	2007
Amount of loans outstanding, December 31,	$2,233,709	$2,089,959	$2,012,010	$1,833,335	$1,523,720
Average daily loans outstanding during the year ended December 31,	$2,148,046	$2,049,209	$1,901,746	$1,665,024	$1,404,068
Allowance for loan losses, January 1,	$45,007	$32,073	$18,860	$15,801	$14,463
Loans charged-off:					
Commercial	5,553	10,215	7,251	6,726	2,381
Residential real estate	388	913	337	72	16
Installment	358	507	674	805	537
Credit cards and personal credit lines	530	107	249	3	458
Total loans charged-off	6,829	11,742	8,511	7,606	3,392
Recoveries of loans previously charged-off:					
Commercial	1,201	546	337	147	252
Residential real estate	17	25	0	16	27
Installment	153	149	173	200	124
Credit cards and personal credit lines	51	9	12	95	29
Total recoveries	1,422	729	522	458	432
Net loans charged-off	5,407	11,013	7,989	7,148	2,960
Provision for loan loss charged to expense	13,800	23,947	21,202	10,207	4,298
Balance, December 31,	$53,400	$45,007	$32,073	$18,860	$15,801
Ratio of net charge-offs during the period to average daily loans outstanding:					
Commercial	0.20 %	0.47 %	0.36 %	0.40 %	0.15 %
Residential real estate	0.02	0.04	0.02	0.00	0.00
Installment	0.01	0.02	0.03	0.04	0.03
Credit cards and personal credit lines	0.02	0.01	0.01	(0.01)	0.03

Total ratio of net charge-offs	0.25	%	0.54	%	0.42	%	0.43	%	0.21	%
Ratio of allowance for loan losses to nonperforming loans	135.27	%	121.90	%	104.45	%	88.59	%	212.15	%

Table of Contents

ANALYSIS OF LOAN PORTFOLIO (cont.)
Allocation of Allowance for Loan Losses
(in thousands of dollars)

As a result of FASB ASU 2010-20, Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses, the Company has revised this table for the years ending December 31, 2011 and 2010 in order to present the data consistent with the disclosures of credit quality. The following is a summary of the allocation for loan losses as of December 31, 2011, 2010, 2009, 2008 and 2007.

	2011 Allowance For Loan Losses	Loans as Percentage of Gross Loans		2010 Allowance For Loan Losses	Loans as Percentage of Gross Loans	
Allocated allowance for loan losses:						
Commercial	$47,079	85.04	%	$38,960	83.71	%
Residential real estate	2,322	12.90		1,694	13.85	
Consumer	645	2.06		682	2.44	
Total allocated allowance for loan losses	50,046	100.00	%	41,336	100.00	%
Unallocated allowance for loan losses	3,354			3,671		
Total allowance for loan losses	$53,400			$45,007		

	2009 Allowance For Loan Losses	Loans as Percentage of Gross Loans		2008 Allowance For Loan Losses	Loans as Percentage of Gross Loans		2007 Allowance For Loan Losses	Loans as Percentage of Gross Loans	
Allocated allowance for loan losses:									
Commercial	$28,014	84.39	%	$15,738	83.61	%	$13,659	81.42	%
Residential real estate	365	4.73		292	6.39		571	8.15	
Installment	453	2.58		384	2.79		421	3.23	
Credit cards and personal credit lines	538	8.30		996	7.21		828	7.20	
Total allocated allowance for loan losses	29,370	100.00	%	17,410	100.00	%	15,479	100.00	%
Unallocated allowance for loan losses	2,703			1,450			322		
Total allowance for loan losses	$32,073			$18,860					