FIRST BUSEY CORP /NV/
Form 10-Q
August 09, 2016

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the Quarterly Period Ended 6/30/2016

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

Commission File No. 0-15950

FIRST BUSEY CORPORATION

(Exact name of registrant as specified in its charter)

Nevada (State or other jurisdiction of incorporation or organization)	**37-1078406** (I.R.S. Employer Identification No.)
100 W. University Ave. **Champaign, Illinois** (Address of principal executive offices)	**61820** (Zip code)

Registrant s telephone number, including area code: **(217) 365-4544**

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

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 o

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):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding at August 9, 2016
Common Stock, $.001 par value	38,204,559

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

FIRST BUSEY CORPORATION and Subsidiaries

CONSOLIDATED BALANCE SHEETS

June 30, 2016 and December 31, 2015

(Unaudited)

		June 30, 2016		December 31, 2015
		(dollars in thousands)		
Assets				
Cash and due from banks (interest-bearing 2016 $193,340; 2015 $250,404)	$	264,841	$	319,280
Federal funds sold		2,231		
Cash and cash equivalents	$	267,072	$	319,280
Securities available for sale, at fair value		801,349		834,838
Securities held to maturity, at amortized cost		51,031		49,832
Loans held for sale		278,125		9,351
Loans (net of allowance for loan losses 2016 $45,358; 2015 $47,487)		3,735,608		2,580,252
Premises and equipment, net		81,009		63,088
Goodwill		102,181		25,510
Other intangible assets, net		21,025		7,432
Cash surrender value of bank owned life insurance		78,876		43,103
Deferred tax asset, net		22,568		21,638
Other assets		71,355		44,652
Total assets	$	5,510,199	$	3,998,976
Liabilities and Stockholders Equity				
Liabilities				
Deposits:				
Noninterest-bearing	$	1,045,180	$	881,685
Interest-bearing		3,339,329		2,407,421
Total deposits	$	4,384,509	$	3,289,106
Securities sold under agreements to repurchase		173,726		172,972
Short-term borrowings		166,200		
Long-term debt		80,000		80,000
Junior subordinated debt owed to unconsolidated trusts		70,801		55,000
Other liabilities		46,846		28,712
Total liabilities	$	4,922,082	$	3,625,790
Commitments and contingencies (See Note 11- Outstanding Commitments and Contingent Liabilities				
Stockholders Equity				
Common stock, $.001 par value, authorized 66,666,667 shares; shares issued 2016 38,869,519; 2015 29,427,738		39		29
Additional paid-in capital		785,825		591,053
Accumulated deficit		(177,372)		(190,265)
Accumulated other comprehensive income		7,971		2,340
Total stockholders equity before treasury stock	$	616,463	$	403,157
Common stock shares held in treasury at cost, 2016 707,405; 2015 732,887		(28,346)		(29,971)
Total stockholders equity	$	588,117	$	373,186
Total liabilities and stockholders equity	$	5,510,199	$	3,998,976
Common shares outstanding at period end		38,162,114		28,694,851

See accompanying notes to unaudited Consolidated Financial Statements.

FIRST BUSEY CORPORATION and Subsidiaries

CONSOLIDATED STATEMENTS OF INCOME

For the Six Months Ended June 30, 2016 and 2015

(Unaudited)

		2016		2015
	(dollars in thousands, except per share amounts)			
Interest income:				
Interest and fees on loans	$	61,331	$	48,752
Interest and dividends on investment securities:				
Taxable interest income		7,187		6,797
Non-taxable interest income		1,544		1,624
Total interest income	$	70,062	$	57,173
Interest expense:				
Deposits	$	2,899	$	2,449
Federal funds purchased and securities sold under agreements to repurchase		172		88
Short-term borrowings		198		
Long-term debt		100		21
Junior subordinated debt owed to unconsolidated trusts		799		594
Total interest expense	$	4,168	$	3,152
Net interest income	$	65,894	$	54,021
Provision for loan losses		2,100		500
Net interest income after provision for loan losses	$	63,794	$	53,521
Non-interest income:				
Trust fees	$	10,592	$	10,843
Commissions and brokers fees, net		1,355		1,603
Remittance processing		5,755		5,475
Service charges on deposit accounts		7,044		5,980
Other service charges and fees		3,535		3,269
Gain on sales of loans		3,604		3,294
Security gains (losses), net		1,219		(21)
Other income		2,319		2,145
Total non-interest income	$	35,423	$	32,588
Non-interest expense:				
Salaries and wages	$	26,906	$	27,816
Employee benefits		6,953		4,863
Net occupancy expense of premises		4,899		4,406
Furniture and equipment expense		2,728		2,474
Data processing		8,247		6,761
Amortization of intangible assets		1,875		1,577
Regulatory expense		1,472		1,203
Other expense		10,956		9,892
Total non-interest expense	$	64,036	$	58,992
Income before income taxes	$	35,181	$	27,117
Income taxes		12,364		9,420
Net income	$	22,817	$	17,697
Preferred stock dividends				363
Net income available to common stockholders	$	22,817	$	17,334
Basic earnings per common share	$	0.72	$	0.60
Diluted earnings per common share	$	0.71	$	0.59
Dividends declared per share of common stock	$	0.34	$	0.30

See accompanying notes to unaudited Consolidated Financial Statements.

FIRST BUSEY CORPORATION and Subsidiaries

CONSOLIDATED STATEMENTS OF INCOME

For the Three Months Ended June 30, 2016 and 2015

(Unaudited)

		2016		2015
	(dollars in thousands, except per share amounts)			
Interest income:				
Interest and fees on loans	$	36,187	$	24,586
Interest and dividends on investment securities:				
Taxable interest income		3,576		3,525
Non-taxable interest income		775		799
Total interest income	$	40,538	$	28,910
Interest expense:				
Deposits	$	1,792	$	1,210
Federal funds purchased and securities sold under agreements to repurchase		90		37
Short-term borrowings		185		
Long-term debt		57		11
Junior subordinated debt owed to unconsolidated trusts		462		301
Total interest expense	$	2,586	$	1,559
Net interest income	$	37,952	$	27,351
Provision for loan losses		1,100		
Net interest income after provision for loan losses	$	36,852	$	27,351
Non-interest income:				
Trust fees	$	5,045	$	5,146
Commissions and brokers fees, net		687		819
Remittance processing		2,830		2,988
Service charges on deposit accounts		3,919		3,096
Other service charges and fees		1,954		1,685
Gain on sales of loans		3,205		1,868
Security gains (losses), net		152		(22)
Other income		785		1,043
Total non-interest income	$	18,577	$	16,623
Non-interest expense:				
Salaries and wages	$	14,507	$	13,310
Employee benefits		3,986		2,520
Net occupancy expense of premises		2,732		2,161
Furniture and equipment expense		1,644		1,283
Data processing		5,015		3,212
Amortization of intangible assets		1,109		808
Regulatory expense		884		560
Other expense		6,471		4,591
Total non-interest expense	$	36,348	$	28,445
Income before income taxes	$	19,081	$	15,529
Income taxes		6,698		5,593
Net income	$	12,383	$	9,936
Preferred stock dividends				181
Net income available to common stockholders	$	12,383	$	9,755
Basic earnings per common share	$	0.35	$	0.34
Diluted earnings per common share	$	0.35	$	0.33
Dividends declared per share of common stock	$	0.17	$	0.15

See accompanying notes to unaudited Consolidated Financial Statements.

FIRST BUSEY CORPORATION and Subsidiaries

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the Three and Six Months Ended June 30, 2016 and 2015

(Unaudited)

	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
	(dollars in thousands)			
Net income	$ 12,383	$ 9,936	$ 22,817	$ 17,697
Other comprehensive income, before tax:				
Securities available for sale:				
Unrealized net gains (losses) on securities:				
Unrealized net holding gains (losses) arising during period	$ 2,900	$ (4,882)	$ 10,599	$ (851)
Reclassification adjustment for (gains) losses included in net income	(152)	22	(1,219)	21
Other comprehensive income (loss), before tax	$ 2,748	$ (4,860)	$ 9,380	$ (830)
Income tax expense (benefit) related to items of other comprehensive income	1,094	(1,946)	3,749	(332)
Other comprehensive income (loss), net of tax	$ 1,654	$ (2,914)	$ 5,631	$ (498)
Comprehensive income	$ 14,037	$ 7,022	$ 28,448	$ 17,199

See accompanying notes to unaudited Consolidated Financial Statements.

FIRST BUSEY CORPORATION and Subsidiaries

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

For the Six Months Ended June 30, 2016 and 2015

(Unaudited)

(dollars in thousands, except per share amounts)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Treasury Stock	Total
Balance, December 31, 2014	$ 72,664	$ 29	$ 593,746	$ (210,384)	$ 5,817	$ (28,233)	$ 433,639
Net income				17,697			17,697
Other comprehensive income					(498)		(498)
Issuance of treasury stock for employee stock purchase plan			(366)			559	193
Net issuance of treasury stock for restricted stock unit vesting and related tax benefit			(238)			219	(19)
Issuance of treasury stock						34	34
Cash dividends common stock at $0.30 per share				(8,687)			(8,687)
Stock dividend equivalents restricted stock units at $0.30 per share			114	(114)			
Stock-based employee compensation			592				592
Preferred stock dividends				(363)			(363)
Balance, June 30, 2015	$ 72,664	$ 29	$ 593,848	$ (201,851)	$ 5,319	$ (27,421)	$ 442,588
Balance, December 31, 2015	$	$ 29	$ 591,053	$ (190,265)	$ 2,340	$ (29,971)	$ 373,186
Net income				22,817			22,817
Other comprehensive income					5,631		5,631
Stock issued in acquisition of Pulaski, net of stock issuance costs		10	195,188				195,198
Issuance of treasury stock for employee stock purchase plan			(462)			668	206
Net issuance of treasury stock for restricted stock unit vesting and related tax benefit			(93)			86	(7)
Net issuance of stock options exercised, net of shares redeemed and related tax benefit			(818)			871	53
Cash dividends common stock at $0.34 per share				(9,759)			(9,759)
Stock dividend equivalents restricted stock units at $0.34 per share			165	(165)			

Stock-based employee compensation			792				792
Balance, June 30, 2016	$	$ 39	$ 785,825	$ (177,372)	$ 7,971	$ (28,346)	$ 588,117

See accompanying notes to unaudited Consolidated Financial Statements.

FIRST BUSEY CORPORATION and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Six Months Ended June 30, 2016 and 2015

(Unaudited)

	2016	2015
	(dollars in thousands)	
Cash Flows from Operating Activities		
Net income	$ 22,817	$ 17,697
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock-based and non-cash compensation	792	592
Depreciation	3,218	2,825
Amortization of intangible assets	1,875	1,577
Provision for loan losses	2,100	500
Provision for deferred income taxes	(4,621)	(767)
Amortization of security premiums and discounts, net	3,722	4,238
Accretion of time deposits and trust preferred securities	(237)	
Accretion of premiums and discounts on loans, net	(1,962)	(603)
Net security (gains) losses	(1,219)	21
Gain on sales of loans, net	(3,604)	(3,294)
Net losses (gains) on disposition of premises and equipment	29	(6)
Premises and equipment impairment		670
Increase in cash surrender value of bank owned life insurance	(678)	(732)
Change in assets and liabilities:		
Decrease in other assets	7,184	894
Decrease in other liabilities	(1,997)	(2,265)
Decrease in interest payable	(43)	(79)
(Increase) decrease in income taxes receivable	(700)	3,412
Net cash provided by operating activities before activities for loans originated for sale	$ 26,676	$ 24,680
Loans originated for sale	(531,235)	(160,203)
Proceeds from sales of loans	446,662	151,829
Net cash (used in) provided by operating activities	$ (57,897)	$ 16,306
Cash Flows from Investing Activities		
Proceeds from sales of securities classified available for sale	40,189	11,781
Proceeds from sales of securities classified held to maturity	399	
Proceeds from maturities of securities classified available for sale	118,723	114,842
Proceeds from maturities of securities classified held to maturity	924	6
Purchase of securities classified available for sale	(70,686)	(181,084)
Purchase of securities classified held to maturity	(2,382)	(1,643)
Net decrease in loans	76,883	19,968
Proceeds from disposition of premises and equipment	845	15
Proceeds from sale of other real estate owned (OREO) properties	1,389	600
Purchases of premises and equipment	(4,682)	(2,331)
Net cash received in acquisitions	25,575	12,114
Proceeds from the redemption of Federal Home Loan Bank (FHLB) stock	9,960	
Purchase of FHLB stock	(9,288)	
Net cash provided by (used in) investing activities	$ 187,849	$ (25,732)

(continued on next page)

FIRST BUSEY CORPORATION and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

For the Six Months Ended June 30, 2016 and 2015

(Unaudited)

		2016		2015
		(dollars in thousands)		
Cash Flows from Financing Activities				
Net decrease in certificates of deposit	$	(71,071)	$	(44,301)
Net (decrease) increase in demand, money market and savings deposits		(61,280)		37,292
Repayment of FHLB short term advances		(12,800)		
Repayment of FHLB long term advances		(4,906)		
Cash dividends paid		(9,759)		(9,050)
Value of shares surrendered upon vesting of restricted stock units to cover tax obligations		(12)		(27)
Net decrease in securities sold under agreements to repurchase		(22,086)		(24,541)
Common stock issuance costs		(246)		
Net cash used in financing activities	$	(182,160)	$	(40,627)
Net decrease in cash and cash equivalents	$	(52,208)	$	(50,053)
Cash and cash equivalents, beginning	$	319,280	$	339,438
Cash and cash equivalents, ending	$	267,072	$	289,385
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION				
Cash payments for:				
Interest	$	4,205	$	3,197
Income taxes	$	9,300	$	5,770
Non-cash investing and financing activities:				
Other real estate acquired in settlement of loans	$	1,343	$	324

See accompanying notes to unaudited Consolidated Financial Statements.

FIRST BUSEY CORPORATION and Subsidiaries

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 1: Basis of Presentation

The accompanying unaudited Consolidated Interim Financial Statements of First Busey Corporation (First Busey or the Company), a Nevada corporation, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) for Quarterly Reports on Form 10-Q and do not include certain information and footnote disclosures required by U.S. generally accepted accounting principles (GAAP) for complete annual financial statements. Accordingly, these financial statements should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2015.

On May 20, 2015, at the Company s Annual Meeting of Stockholders, the Company s stockholders approved a resolution to authorize the board of directors to implement a reverse stock split of the Company s common stock at a ratio of one-for-three (the Reverse Stock Split). On August 17, 2015, the board of directors authorized the Reverse Stock Split, which became effective on September 8, 2015. All share and per share information has been restated for all prior periods presented in this Quarterly Report on Form 10-Q to give retroactive effect to the Reverse Stock Split.

The accompanying Consolidated Balance Sheet as of December 31, 2015, which has been derived from audited financial statements, and the unaudited Consolidated Interim Financial Statements have been prepared in accordance with GAAP and reflect all adjustments that are, in the opinion of management, necessary for the fair presentation of the financial position and results of operations as of the dates and for the periods presented. All such adjustments are of a normal recurring nature. The results of operations for the three and six months ended June 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016 or any other period.

On April 30, 2016, First Busey completed its acquisition of Pulaski Financial Corp., a Missouri Corporation (Pulaski), and Pulaski Bank, National Association (Pulaski Bank). The Consolidated Financial Statements include the accounts of the Company, Busey Bank and Busey Bank s wholly owned subsidiary FirsTech, Inc., Pulaski Bank and Pulaski Bank s wholly owned subsidiaries, Pulaski Service Corporation and Priority Property Holdings, LLC (each as of April 30, 2016) and Busey Wealth Management, Inc. and its wholly owned subsidiary Busey Trust Company. All material intercompany transactions and balances have been eliminated in consolidation. Certain prior-year amounts have been reclassified to conform to the current presentation with no effect on net income or stockholders equity.

In preparing the accompanying Consolidated Financial Statements, the Company s management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses for the reporting period. Actual results could differ from those estimates. Material estimates which are particularly susceptible to significant change in the near term relate to the fair value of investment securities and the determination of the allowance for loan losses.

Effective January 1, 2016, the Company elected to account for all loans held for sale at fair value. Prior to this change, the Company accounted for loans held for sale at the lower of cost or fair value. See Note 15 - Fair Value Measurements for further discussion.

The Company has evaluated subsequent events for potential recognition and/or disclosure through the date the consolidated financial statements included in this Quarterly Report on Form 10-Q were issued. On July 29, 2016, the Company announced its plan to close one branch in the Florida market. The closing of the branch will allow us to better deploy the Company s resources and impairment related to this closure will not have a material impact on the Consolidated Financial Statements. In addition, in early August 2016, the Company made decisions to reduce employees in other areas to improve ongoing efficiencies in its operations which will result in related restructuring expenses in the third quarter of 2016. Other than the changes noted above, there were no significant subsequent events for the quarter ended June 30, 2016 through the issuance date of these Consolidated Financial Statements that warranted adjustment to or disclosure in the Consolidated Financial Statements.

Note 2: Acquisitions

Pulaski Financial Corp.

On April 30, 2016, First Busey completed its acquisition of Pulaski. It is anticipated that Pulaski Bank, which was Pulaski s wholly owned bank subsidiary prior to the acquisition, will be merged with and into Busey Bank in the fourth quarter of 2016. At the time of the bank merger, Pulaski Bank s branches will become branches of Busey Bank. Pulaski Bank offers a full line of quality retail and commercial banking products through thirteen full-service branch offices in the St. Louis metropolitan area. Pulaski Bank also offers mortgage loan products through loan production offices in the St. Louis, Kansas City, Chicago, and Omaha-Council Bluffs metropolitan areas and other locations across the Midwest. The operating results of Pulaski are included with the Company s results of operations since the date of acquisition.

Under the terms of the definitive agreement, at the effective time of the acquisition, each share of Pulaski common stock issued and outstanding was converted into 0.79 shares of First Busey common stock and cash in lieu of fractional shares. The market value of the 9.4 million shares of First Busey common stock issued at the effective time of the acquisition was approximately $193.0 million based on First Busey s closing stock price of $20.44 on April 29, 2016. In addition, all the options to purchase shares of Pulaski common stock that were outstanding at the acquisition date were converted into options to purchase shares of First Busey common stock, adjusted for the 0.79 exchange ratio.

The acquisition of Pulaski allows the Company to significantly expand its geographic presence through a premier St. Louis banking franchise with an almost 100-year history and a strong regional residential lending presence. In addition, this transaction is strategically compelling and financially attractive because it creates a Midwest community bank with greater scale and operating efficiency, along with geographic and balance sheet diversification. It also provides cross-sale opportunities with the Company s Wealth Management operating segment. Pulaski has a deep and experienced management team to assist in post-acquisition integration and market expansion, and a similar culture to First Busey which will facilitate a successful integration process. By acquiring organizations with a similar philosophy in markets which complement the Company s existing customer base, First Busey intends to expand its franchise through balanced, integrated growth strategies that generate value.

This transaction was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed, and consideration exchanged were recorded at their estimated fair values on the date of acquisition. Fair values are subject to refinement for up to one year after the closing date of April 30, 2016 as additional information regarding the closing date fair values become available. The total consideration paid, which was used to determine the amount of goodwill resulting from the transaction, also included the fair value of outstanding Pulaski stock options that were converted into options to purchase common shares of First Busey. As the total consideration paid for Pulaski exceeded the net assets acquired, goodwill of $76.7 million was recorded on the acquisition. Goodwill recorded in the transaction, which reflects the synergies expected from the acquisition and the enhanced revenue opportunities from the Company s broader service capabilities in the St. Louis market, is not tax deductible, and was assigned to the Banking operating segment.

First Busey incurred $2.0 million and $2.3 million in pre-tax acquisition expenses related to the acquisition of Pulaski for the three and six months ended June 30, 2016, respectively, including professional and legal fees of $0.7 million and $0.9 million, respectively, to directly consummate the acquisition, all of which are reported as a component of non-interest expense in the accompanying unaudited Consolidated Interim Financial Statements. The remainder of the expenses primarily relate to data processing conversion expenses.

The following table presents the assets acquired and liabilities of Pulaski assumed as of April 30, 2016 and their initial fair value estimates *(dollars in thousands)*:

	As Recorded by Pulaski	Initial Fair Value Adjustments	As Recorded by First Busey
Assets acquired			
Cash and cash equivalents	$ 25,580	$	$ 25,580
Securities	47,895	105(a)	48,000
Loans held for sale	184,856		184,856
Loans	1,243,913	(14,452)(b)	1,229,461
Premises and equipment	17,236	95(c)	17,331
OREO	5,021	(2,512)(d)	2,509
Goodwill	3,939	(3,939)(e)	
Other intangible assets		15,468(f)	15,468
Other assets	70,366	(414)(g)	69,952
Total assets acquired	1,598,806	(5,649)	1,593,157
Liabilities assumed			
Deposits	1,226,906	1,102(h)	1,228,008
Other borrowings	205,840	906(i)	206,746
Trust preferred securities	19,589	(3,805)(j)	15,784
Other liabilities	24,594	(753)(k)	23,841
Total liabilities assumed	1,476,929	(2,550)	1,474,379
Net assets acquired	$ 121,877	$ (3,099)	$ 118,778
Consideration paid:			
Cash			$ 5
Common stock			192,990
Fair value of stock options assumed			2,454
Total consideration paid			195,449
Goodwill			$ 76,671

Explanation:

(a) Fair value adjustments of the securities portfolio as of the acquisition date.
(b) Fair value adjustments based on the Company s evaluation of the acquired loan portfolio, write-off of net deferred loan costs and elimination of the allowance for loan losses recorded by Pulaski. $16.9 million is expected to be accreted over the estimated four year remaining life of the respective loans in a manner that approximates the level yield method.
(c) Fair value adjustments based on the Company s evaluation of the acquired premises and equipment.
(d) Fair value adjustment based on the Company s evaluation of the acquired OREO portfolio.
(e) Eliminate Pulaski s existing goodwill.
(f) Recording of the core deposit intangible asset on the acquired core deposit accounts. Amount to be amortized using a sum of years digits method over a 14 year useful life.
(g) Fair value adjustment of other assets at the acquisition date.
(h) Fair value adjustment to time deposits. Amount to be accreted over two years in a manner that approximates the level yield method.
(i) Fair value adjustment to the FHLB borrowings. Such borrowings were repaid shortly after the acquisition date, so there will be no discount accretion.
(j) Fair value adjustment to the trust preferred securities at the acquisition date. Amount to be accreted over the weighted average remaining life of 18 years in a manner that approximates the level yield method.
(k) Fair value adjustment of other liabilities at the acquisition date.

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The loans acquired in this transaction were recorded at fair value with no carryover of any existing allowance for loan losses. Loans that were not deemed to be credit-impaired at the acquisition date were accounted for under FASB ASC 310-20, *Receivables-Nonrefundable Fees and Other Costs* and were subsequently considered as part of the Company s determination of the adequacy of the allowance for loan losses. Purchased credit-impaired (PCI) loans, loans with evidence of credit quality deterioration, were accounted for under FASB ASC 310-30, *Receivables Loans and Debt Securities Acquired with Deteriorated Credit Quality*. As of the acquisition date, the principal outstanding and fair value of the acquired performing loans, including loans held for sale, totaled $1.4 billion. The difference between the principal outstanding and fair value of $16.6 million is expected to be accreted over the estimated four year remaining life of the respective loans in a manner that approximates the level yield method. As of the acquisition date, the principal outstanding of PCI loans totaled $21.2 million and the fair value of PCI loans totaled $9.7 million. For PCI loans, the difference between contractually required payments at acquisition and the cash flow expected to be collected is referred to as the non-accretable difference. Further, the excess of cash flows expected at acquisition over the fair value is referred to as the accretable yield. The accretable yield of $0.3 million on PCI loans is expected to be recognized over the estimated four year remaining life of the respective loans in a manner that approximates the level yield method.

Since the acquisition date, Pulaski earned total revenues of $13.7 million and net income of $3.8 million, which are included in the Company s Consolidated Statements of Income for the three and six months ended June 30, 2016. The following table provides the unaudited pro forma information for the results of operations for the three and six months ended June 30, 2016 and 2015, as if the acquisition had occurred on January 1, 2015. The pro forma results combine the historical results of Pulaski with the Company s Consolidated Statements of Income, adjusted for the impact of the application of the acquisition method of accounting including loan discount accretion, intangible assets amortization, and deposit and trust preferred securities premium accretion, net of taxes. The pro forma results have been prepared for comparative purposes only and are not necessarily indicative of the results that would have been obtained had the acquisition actually occurred on January 1, 2015. No assumptions have been applied to the pro forma results of operations regarding possible revenue enhancements, expense efficiencies or asset dispositions. Only the acquisition related expenses that have been incurred as of June 30, 2016 are included in net income in the table below. Acquisition related expenses, pre-tax, that were recognized and are included in the pro forma net income for the three and six months ended June 30, 2016 totaled $6.7 million and $7.3 million, respectively. Such expenses consisted primarily of professional fees to transact the acquisition, data processing conversion expenses and compensation to certain officers required under employment agreements.

	Pro Forma Three Months Ended June 30,		Pro Forma Six Months Ended June 30,	
	2016	**2015**	**2016**	**2015**
	(dollars in thousands)			
Total revenues (net interest income plus non-interest income)	$ 61,344	$ 63,897	$ 123,237	$ 123,060
Net income	9,239	15,572	23,165	27,536
Diluted earnings per common share	0.24	0.40	0.60	0.70

Herget Financial Corp.

On January 8, 2015, First Busey acquired Herget Financial Corp. (Herget Financial), headquartered in Pekin, Illinois and its wholly owned bank subsidiary, Herget Bank, National Association (Herget Bank). First Busey operated Herget Bank as a separate banking subsidiary from January 9, 2015 until March 13, 2015, when it was merged with and into Busey Bank, the Company s wholly owned bank subsidiary. At that time, Herget Bank s branches in Pekin, Illinois became branches of Busey Bank. The operating results of Herget Financial are included with the Company s results of operations since the date of acquisition. This transaction was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed, and consideration exchanged were recorded at estimated fair values on the date of acquisition.

Expenses related to the acquisition of Herget Financial for the first six months of 2016 were insignificant. During the first six months of 2015, pre-tax expenses related to the acquisition of Herget Financial totaled $1.0 million. The 2015 expenses were comprised primarily of system conversion, restructuring, legal, consulting, regulatory and marketing costs, all of which are reported as a component of non-interest expense in the accompanying unaudited Consolidated Interim Financial Statements.

Note 3: Recent Accounting Pronouncements

Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 outlines a single model for companies to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. ASU 2014-09 will require that companies recognize revenue based on the value of transferred goods or services as they occur in the contract and will also require additional disclosures. The new authoritative guidance was originally effective for reporting periods after December 15, 2016. In August 2015, *ASU 2015-14, Revenue from Contracts with Customers (Topic 606)* was issued to delay the effective date of ASU 2014-09 by one year. The Company is evaluating the impact this guidance will have on its Consolidated Financial Statements and related disclosures.

ASU 2016-01, Financial Instruments Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 is intended to improve the recognition and measurement of financial instruments by, among other things, requiring: equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income; public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; separate presentation of financial assets and financial liabilities by measurement category and form of financial assets on the balance sheet or the accompanying notes to the financial statements; eliminating the requirement for public business entities to disclose the method and significant assumptions used to estimate the fair value that is to be required to be disclosed for financial instruments measured at amortized cost on the balance sheet; and requiring an entity to present separately in other comprehensive income the portion of the total change in fair value of a liability resulting from the change in the instrument-specific credit risk when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. ASU 2016-01 will be effective on January 1, 2018 and the Company is evaluating the impact this guidance will have on its Consolidated Financial Statements and related disclosures.

ASU 2016-02, Leases (Topic 842). ASU 2016-02 intends to increase transparency and comparability among organizations by recognizing all lease transactions (with terms in excess of 12 months) on the balance sheet as a lease liability and a right-of-use asset. The guidance also requires qualitative and quantitative disclosures designed to assess the amount, timing and uncertainty of cash flows arising from leases. This guidance is effective for annual reporting periods beginning after December 15, 2018, including interim periods within those fiscal years. Upon adoption, the lessee will apply the new standard retrospectively to all periods presented or retrospectively using a cumulative effect adjustment in the year of adoption. The Company is evaluating the impact this guidance will have on its Consolidated Financial Statements and related disclosures.

ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. ASU 2016-09 is intended to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. This guidance is effective for reporting periods after December 15, 2016, and interim periods within those fiscal years with early adoption permitted. The Company is evaluating the impact this guidance will have on its Consolidated Financial Statements and related disclosures.

ASU 2016-13, Financial Instruments Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. ASU 2016-13 implements a comprehensive change in estimating the allowances for loan losses from the current model of losses inherent in the loan portfolio to a current expected credit loss model that generally is expected to result in earlier recognition of allowances for losses. Further, purchase accounting rules have been modified as well as credit losses on held to maturity debt securities. ASU 2016-13 will be effective in the first quarter of 2020. The Company is evaluating the impact this guidance will have on its Consolidated Financial Statements and related disclosures.

Note 4: Securities

Securities are classified as held to maturity when First Busey has the ability and management has the intent to hold those securities to maturity. Accordingly, they are stated at cost, adjusted for amortization of premiums and accretion of discounts. Securities are classified as available for sale when First Busey may decide to sell those securities due to changes in market interest rates, liquidity needs, changes in yields on alternative investments, and for other reasons. They are carried at fair value with unrealized gains and losses, net of taxes, reported in other comprehensive income.

The amortized cost, unrealized gains and losses and fair values of securities are summarized as follows:

June 30, 2016:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(dollars in thousands)		
Available for sale				
U.S. Treasury securities	$ 64,882	$ 628	$	$ 65,510
Obligations of U.S. government corporations and agencies	140,428	753	(4)	141,177
Obligations of states and political subdivisions	165,098	3,087	(10)	168,175
Residential mortgage-backed securities	265,706	5,789		271,495
Corporate debt securities	149,144	2,936	(307)	151,773
Total debt securities	785,258	13,193	(321)	798,130
Mutual funds and other equity securities	2,808	411		3,219
Total	$ 788,066	$ 13,604	$ (321)	$ 801,349
Held to maturity				
Obligations of states and political subdivisions	$ 47,511	$ 1,250	$	$ 48,761
Commercial mortgage-backed securities	3,520	90		3,610
Total	$ 51,031	$ 1,340	$	$ 52,371

December 31, 2015:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(dollars in thousands)		
Available for sale				
U.S. Treasury securities	$ 65,003	$ 189	$ (1)	$ 65,191
Obligations of U.S. government corporations and agencies	132,547	211	(153)	132,605
Obligations of states and political subdivisions	176,764	2,154	(306)	178,612
Residential mortgage-backed securities	304,978	2,922	(351)	307,549
Corporate debt securities	150,001	307	(1,503)	148,805
Total debt securities	829,293	5,783	(2,314)	832,762
Mutual funds and other equity securities	1,642	434		2,076
Total	$ 830,935	$ 6,217	$ (2,314)	$ 834,838
Held to maturity				
Obligations of states and political subdivisions	$ 48,835	$ 449	$ (34)	$ 49,250
Commercial mortgage-backed securities	997	24		1,021
Total	$ 49,832	$ 473	$ (34)	$ 50,271

The amortized cost and fair value of debt securities as of June 30, 2016, by contractual maturity or pre-refunded date, are shown below. Mutual funds and other equity securities do not have stated maturity dates and therefore are not included in the following maturity summary. Mortgages underlying mortgage-backed securities may be called or prepaid; therefore, actual maturities could differ from the contractual maturities. All mortgage-backed securities were issued by U.S. government agencies and corporations.

	Available for sale		Held to maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(dollars in thousands)			
Due in one year or less	$ 120,900	$ 121,290	$ 3,969	$ 3,976
Due after one year through five years	369,627	374,852	17,894	18,242
Due after five years through ten years	63,523	65,999	25,619	26,497
Due after ten years	231,208	235,989	3,549	3,656
Total	$ 785,258	$ 798,130	$ 51,031	$ 52,371

Realized gains and losses related to sales of securities are summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(dollars in thousands)			
Gross security gains	$ 171	$	$ 1,245	$ 1
Gross security (losses)	(19)	(22)	(26)	(22)
Net security (losses) gains	$ 152	$ (22)	$ 1,219	$ (21)

The tax provision for the net realized gains and losses was $0.1 million and $0.4 million for the three and six months ended June 30, 2016, respectively. The tax provision for the net realized gains and losses was insignificant for the three and six months ended June 30, 2015.

During the second quarter of 2016, the Company sold one held to maturity security, which was an obligation of state and political subdivisions, with a fair value of $0.4 million due to significant credit deterioration. The sale resulted in an insignificant loss during the quarter.

Investment securities with carrying amounts of $604.5 million and $627.4 million on June 30, 2016 and December 31, 2015, respectively, were pledged as collateral for public deposits, securities sold under agreements to repurchase and for other purposes as required or permitted by law.

Information pertaining to securities with gross unrealized losses at June 30, 2016 and December 31, 2015 aggregated by investment category and length of time that individual securities have been in a continuous loss position follows:

	Continuous unrealized losses existing for less than 12 months, gross		Continuous unrealized losses existing for greater than 12 months, gross		Total, gross	
June 30, 2016:	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
			(dollars in thousands)			
Available for sale						
Obligations of U.S. government corporations and agencies	$ 10,001	$ (4)	$	$	$ 10,001	$ (4)
Obligations of states and political subdivisions	3,701	(7)	1,803	(3)	5,504	(10)
Residential mortgage-backed securities(1)	118				118	
Corporate debt securities	473	(14)	4,773	(293)	5,246	(307)
Total temporarily impaired securities	$ 14,293	$ (25)	$ 6,576	$ (296)	$ 20,869	$ (321)
Held to maturity						
Obligations of states and political subdivisions(1)	$ 599	$	$	$	$ 599	$
Total temporarily impaired securities	$ 599	$	$	$	$ 599	$

(1)Unrealized losses existing for less than 12 months, gross, was less than one thousand dollars.

	Continuous unrealized losses existing for less than 12 months, gross		Continuous unrealized losses existing for greater than 12 months, gross		Total, gross	
December 31, 2015:	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
			(dollars in thousands)			
Available for sale						
U.S. Treasury securities	$ 364	$ (1)	$	$	$ 364	$ (1)
Obligations of U.S. government corporations and agencies	52,154	(153)			52,154	(153)
Obligations of states and political subdivisions	40,026	(159)	11,419	(147)	51,445	(306)
Residential mortgage-backed securities	93,608	(351)			93,608	(351)
Corporate debt securities	99,148	(1,503)			99,148	(1,503)
Total temporarily impaired securities	$ 285,300	$ (2,167)	$ 11,419	$ (147)	$ 296,719	$ (2,314)
Held to maturity						
Obligations of states and political subdivisions(2)	$ 8,451	$ (34)	$ 91	$	$ 8,542	$ (34)
Total temporarily impaired securities	$ 8,451	$ (34)	$ 91	$	$ 8,542	$ (34)

(2)Unrealized losses existing for greater than 12 months, gross, was less than one thousand dollars.

Securities are periodically evaluated for other-than-temporary impairment (OTTI). The total number of securities in the investment portfolio in an unrealized loss position as of June 30, 2016 was 23, and represented a loss of 1.47% of the aggregate carrying value. As of June 30, 2016, the Company does not intend to sell such securities and it is more-likely-than-not that the Company will recover the amortized cost prior to being required to sell the securities. Full collection of the amounts due according to the contractual terms of the securities is expected; therefore, the Company does not consider these investments to be OTTI at June 30, 2016.

The Company had available for sale obligations of state and political subdivisions with aggregate fair values of $168.2 million and $178.6 million as of June 30, 2016 and December 31, 2015, respectively. In addition, the Company had held to maturity obligations of state and political subdivisions with aggregate fair values of $48.7 million and $49.3 million as of June 30, 2016 and December 31, 2015, respectively.

As of June 30, 2016, the aggregate fair value of the Company s obligations of state and political subdivisions portfolio was comprised of $180.7 million of general obligation bonds and $36.2 million of revenue bonds issued by 266 issuers, primarily consisting of states, counties, cities, towns, villages and school districts. The Company held investments in general obligation bonds in 29 states (including the District of Columbia), including seven states in which the aggregate fair value exceeded $5.0 million. The Company held investments in revenue bonds in 16 states, including two states where the aggregate fair value exceeded $5.0 million.

As of December 31, 2015, the aggregate fair value of the Company s obligations of state and political subdivisions portfolio was comprised of $193.4 million of general obligation bonds and $34.4 million of revenue bonds issued by 278 issuers, primarily consisting of states, counties, cities, towns, villages and school districts. The Company held investments in general obligation bonds in 29 states (including the District of Columbia), including seven states in which the aggregate fair value exceeded $5.0 million. The Company held investments in revenue bonds in 17 states, including two states where the aggregate fair value exceeded $5.0 million.

The amortized cost and fair values of the Company s portfolio of general obligation bonds are summarized in the following tables by the issuers state:

June 30, 2016:	**Number of Issuers**	**Amortized Cost**	**Fair Value**	**Average Exposure Per Issuer (Fair Value)**
		(dollars in thousands)		
U.S. State				
Illinois	74	$ 65,584	$ 67,236	$ 909
Wisconsin	33	24,000	24,324	737
Michigan	38	24,742	25,385	668
Pennsylvania	10	11,069	11,195	1,120
Texas	17	11,646	11,854	697
Ohio	10	10,681	10,830	1,083
Iowa	3	5,333	5,385	1,795
Other	45	23,841	24,514	545
Total general obligations bonds	230	$ 176,896	$ 180,723	$ 786

December 31, 2015:	**Number of Issuers**	**Amortized Cost**	**Fair Value**	**Average Exposure Per Issuer (Fair Value)**
		(dollars in thousands)		
U.S. State				
Illinois	77	$ 64,455	$ 65,557	$ 851

Wisconsin	36	30,889	31,079	863
Michigan	39	27,923	28,339	727
Pennsylvania	10	12,601	12,650	1,265
Texas	18	12,117	12,165	676
Ohio	10	10,723	10,705	1,071
Iowa	3	5,550	5,571	1,857
Other	48	26,938	27,375	570
Total general obligations bonds	241	$ 191,196	$ 193,441	$ 803

The general obligation bonds are diversified across many issuers, with $3.5 million and $3.4 million being the largest exposure to a single issuer at June 30, 2016 and December 31, 2015, respectively. Accordingly, as of June 30, 2016 and December 31, 2015, the Company did not hold general obligation bonds of any single issuer, the aggregate book or market value of which exceeded 10% of the Company s stockholders equity. Of the general obligation bonds in the Company s portfolio, 98.3% had been rated by at least one nationally recognized statistical rating organization and 1.7% were unrated, based on the aggregate fair value as of June 30, 2016. Of the general obligation bonds in the Company s portfolio, 97.6% had been rated by at least one nationally recognized statistical rating organization and 2.4% were unrated, based on the aggregate fair value as of December 31, 2015.

The amortized cost and fair values of the Company s portfolio of revenue bonds are summarized in the following tables by the issuers state:

June 30, 2016:	**Number of Issuers**	**Amortized Cost**	**Fair Value**	**Average Exposure Per Issuer (Fair Value)**
		(dollars in thousands)		
U.S. State				
Indiana	8	$ 9,393	$ 9,506	$ 1,188
Illinois	7	7,983	8,181	1,169
Other	21	18,337	18,526	882
Total revenue bonds	36	$ 35,713	$ 36,213	$ 1,006

December 31, 2015:	**Number of Issuers**	**Amortized Cost**	**Fair Value**	**Average Exposure Per Issuer (Fair Value)**
		(dollars in thousands)		
U.S. State				
Indiana	9	$ 10,187	$ 10,173	$ 1,130
Illinois	7	8,450	8,478	1,211
Other	21	15,766	15,770	751
Total revenue bonds	37	$ 34,403	$ 34,421	$ 930

The revenue bonds are diversified across many issuers and revenue sources with $3.8 million and $3.0 million being the largest exposure to a single issuer at each of June 30, 2016 and December 31, 2015, respectively. Accordingly, as of June 30, 2016 and December 31, 2015, the Company did not hold revenue bonds of any single issuer, the aggregate book or market value of which exceeded 10% of the Company s stockholders equity. Of the revenue bonds in the Company s portfolio, 97.0% had been rated by at least one nationally recognized statistical rating organization and 3.0% were unrated, based on the fair value as of June 30, 2016. All of the revenue bonds in the Company s portfolio had been rated by at least one nationally recognized statistical rating organization as of December 31, 2015. Some of the primary types of revenue bonds held in the Company s portfolio include: primary education or government building lease rentals secured by ad valorem taxes, utility systems secured by utility system net revenues, housing authorities secured by mortgage loans or principal receipts on mortgage loans, secondary education secured by student fees/tuitions, and pooled issuances (i.e. bond bank) consisting of multiple underlying municipal obligors.

Substantially all of the Company s obligations of state and political subdivision securities are owned by its subsidiary banks**,** which have adopted First Busey s investment policy requiring that state and political subdivision securities purchased be investment grade. Such investment policy also limits the amount of rated state and political subdivision securities to an aggregate 100% of the subsidiary banks Total Capital (as defined by federal regulations) at the time of purchase and an aggregate 15% of Total Capital for unrated state and political subdivision securities issued by municipalities having taxing authority or located in counties/micropolitan statistical areas/metropolitan statistical areas in which an office is located. The investment policy states fixed income investments that are not Office of the Comptroller of the Currency Type 1 securities (U.S. Treasuries, agencies, municipal government general obligation and, for well-capitalized institutions, most municipal revenue bonds) should be analyzed prior to acquisition to determine that (1) the security has low risk of default by the obligor, and (2) the full and timely repayment of principal and interest is expected over the expected life of the investment. All securities in First Busey s obligations of state and political

subdivision securities portfolio are subject to ongoing review. Factors that may be considered as part of ongoing monitoring of state and political subdivision securities include credit rating changes by nationally recognized statistical rating organizations, market valuations, third-party municipal credit analysis, which may include indicative information regarding the issuer s capacity to pay, market and economic data and such other factors as are available and relevant to the security or the issuer such as its budgetary position and sources, strength and stability of taxes and/or other revenue.

Note 5: Loans

Distributions of loans were as follows:

		June 30, 2016		December 31, 2015
		(dollars in thousands)		
Commercial	$	886,298	$	656,576
Commercial real estate		1,624,129		1,208,429
Real estate construction		175,506		96,568
Retail real estate		1,357,445		660,542
Retail other		15,713		14,975
Total gross loans	$	4,059,091	$	2,637,090
Less held for sale(1)		278,125		9,351
	$	3,780,966	$	2,627,739
Less allowance for loan losses		45,358		47,487
Net loans	$	3,735,608	$	2,580,252

(1)Loans held for sale are included in retail real estate.

Net loans increased $1.2 billion as of June 30, 2016 as compared to December 31, 2015 primarily as a result of the Pulaski acquisition. Net deferred loan origination costs included in the tables above were $1.8 million as of June 30, 2016 and $0.9 million as of December 31, 2015.

The Company believes that making sound loans is a necessary and desirable means of employing funds available for investment. Recognizing the Company s obligations to its stockholders, depositors, and to the communities it serves, authorized personnel are expected to seek to develop and make sound, profitable loans that resources permit and that opportunity affords. The Company maintains lending policies and procedures designed to focus lending efforts on the types, locations and duration of loans most appropriate for its business model and markets. While not specifically limited, the Company attempts to focus its lending on short to intermediate-term (0-7 years) loans in geographic areas within 125 miles of its lending offices. Loans might be originated outside of these areas, but such loans are generally residential mortgage loans originated for sale in the secondary market. The Company attempts to utilize government-assisted lending programs, such as the Small Business Administration and United States Department of Agriculture lending programs, when prudent. Generally, loans are collateralized by assets, primarily real estate, of the borrowers and guaranteed by individuals. The loans are expected to be repaid primarily from cash flows of the borrowers, or from proceeds from the sale of selected assets of the borrowers.

Management reviews and approves the Company s lending policies and procedures on a routine basis. The policies for legacy Pulaski loans are similar in nature to Busey Bank s policies and the Company is migrating Pulaski s loan production towards the Busey Bank policies. Management routinely (at least quarterly) reviews the Company s allowance for loan losses and reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing and potential problem loans. The Company s underwriting standards are designed to encourage relationship banking rather than transactional banking. Relationship banking implies a primary banking relationship with the borrower that includes, at a minimum, an active deposit banking relationship in addition to the lending relationship. The integrity and character of the borrower are significant factors in the Company s loan underwriting. As a part of underwriting, tangible positive or negative evidence of the borrower s integrity and character are sought out. Additional significant underwriting factors beyond location, duration, a sound

and profitable cash flow basis and the borrower s character are the quality of the borrower s financial history, the liquidity of the underlying collateral and the reliability of the valuation of the underlying collateral.

At no time is a borrower s total borrowing relationship permitted to exceed the Company s regulatory lending limit and the Company generally limits such relationships to amounts substantially less than the regulatory limit. Loans to related parties, including executive officers and directors of the Company and its subsidiaries, are reviewed for compliance with regulatory guidelines by the Company s board of directors at least annually.

The Company maintains an independent loan review department that reviews the loans for compliance with the Company s loan policy on a periodic basis. In addition, the loan review department reviews the risk assessments made by the Company s credit department, lenders and loan committees. Results of these reviews are presented to management and the audit committee at least quarterly.

The Company s lending can be summarized into five primary areas: commercial loans, commercial real estate loans, real estate construction loans, retail real estate loans, and other retail loans. A description of each of the lending areas can be found in the Company s Annual Report on Form 10-K for the year ended December 31, 2015. The significant majority of the Company s portfolio lending activity occurs in its Illinois and Missouri markets, with the remainder in the Indiana and Florida markets.

The Company utilizes a loan grading scale to assign a risk grade to all of its loans. A description of the general characteristics of each grade is as follows:

- *Pass*- This category includes loans which are all considered strong credits, from investment or near investment grade to loans comprised of borrowers that exhibit credit fundamentals that exceed industry standards and loan policy guidelines and loans that exhibit acceptable credit fundamentals.

- *Watch*- This category includes loans on management s Watch List and is intended to be utilized on a temporary basis for a pass grade borrower where a significant risk-modifying action is anticipated in the near future.

- *Special mention*- This category is for Other Assets Specially Mentioned loans that have potential weaknesses which may, if not checked or corrected, weaken the asset or inadequately protect the Company s credit position at some future date.

- *Substandard*- This category includes Substandard loans, determined in accordance with regulatory guidelines, for which the accrual of interest has not been stopped. Assets so classified must 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*- This category includes Doubtful loans that have all the characteristics of a Substandard loan with additional factors that make collection in full highly questionable and improbable. Such loans are placed on non-accrual status and may be dependent on collateral with a value that is difficult to determine.

All loans are graded at their inception. Most commercial lending relationships that are $1.0 million or less are processed through an expedited underwriting process. If the credit receives a pass grade it is aggregated into a homogenous pool of either: $0.35 million or less or $0.35 million to $1.0 million. These pools are monitored on a regular basis and reviewed annually. Most commercial loans greater than $1.0 million are included in a portfolio review at least annually. Commercial loans greater than $0.35 million that have a grading of special mention or worse are

reviewed on a quarterly basis. Interim reviews may take place if circumstances of the borrower warrant a more timely review.

Loans in the highest grades, represented by the pass and watch categories, totaled $3.6 billion at June 30, 2016, compared to $2.5 billion at December 31, 2015. Loans in the lowest grades, represented by the special mention, substandard and doubtful, totaled $183.9 million at June 30, 2016, compared to $166.8 million at December 31, 2015.

The following table is a summary of risk grades segregated by category of loans (excluding held for sale, accretable carrying value adjustments, and non-posted and clearings):

June 30, 2016 (dollars in thousands)	Pass	Watch	Special Mention	Substandard	Doubtful
Commercial	$ 749,909	$ 85,558	$ 31,680	$ 14,578	$ 7,645
Commercial real estate	1,462,988	74,937	57,453	30,442	3,133
Real estate construction	132,426	34,675	9,375	1,076	413
Retail real estate	1,038,330	19,700	12,793	3,569	11,077
Retail other	15,060	49	496	13	175
Total	$ 3,398,713	$ 214,919	$ 111,797	$ 49,678	$ 22,443

December 31, 2015 (dollars in thousands)	Pass	Watch	Special Mention	Substandard	Doubtful
Commercial	$ 553,294	$ 57,703	$ 27,142	$ 10,966	$ 7,617
Commercial real estate	1,068,568	58,238	51,418	29,781	1,496
Real estate construction	65,284	15,053	14,755	1,157	366
Retail real estate	607,398	21,637	13,974	4,204	3,139
Retail other	14,172	64	644		130
Total	$ 2,308,716	$ 152,695	$ 107,933	$ 46,108	$ 12,748

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management s opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of the principal due. Loans may be returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

An analysis of past due loans that are still accruing and non-accrual loans is as follows:

June 30, 2016 (dollars in thousands)	Loans past due, still accruing			Non-accrual
	30-59 Days	60-89 Days	90+Days	Loans
Commercial	$ 1,070	$ 1,206	$	$ 7,645
Commercial real estate	1,383	280	334	3,133
Real estate construction	2,017			413
Retail real estate	2,706	997		11,077
Retail other	87	8		175
Total	$ 7,263	$ 2,491	$ 334	$ 22,443

	December 31, 2015			
	Loans past due, still accruing			Non-accrual
	30-59 Days	60-89 Days	90+Days	Loans
	(dollars in thousands)			
Commercial	$ 598	$ 162	$ 15	$ 7,617
Commercial real estate	1,037	27		1,496
Real estate construction				366
Retail real estate	1,278	160		3,139
Retail other	19	1		130
Total	$ 2,932	$ 350	$ 15	$ 12,748

A loan is classified as impaired when, based on current information and events, it is probable the Company will be unable to collect scheduled principal and interest payments when due according to the terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Loans graded substandard or doubtful and loans classified as a troubled debt restructuring (TDR) are assessed for impairment by the Company.

Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of the expected future cash flows discounted at the loan s effective interest rate, the loan s observable market price, or the fair value of the collateral if the loan is collateral dependent. PCI loans are considered impaired. Large groups of smaller balance homogenous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment disclosures unless such loans are the subject of a restructuring agreement.

The gross interest income that would have been recorded in the three and six months ended June 30, 2016 if impaired loans had been current in accordance with their original terms was $0.2 million and $0.4 million, respectively. The amount of interest collected on those loans and recognized on a cash basis that was included in interest income was insignificant for the three and six months ended June 30, 2016.

The Company s loan portfolio includes certain loans that have been modified in a TDR, where concessions have been granted to borrowers who have experienced financial difficulties. The Company will restructure a loan for its customer after evaluating whether the borrower is able to meet the terms of the loan over the long term, but who may be unable to meet the terms of the loan in the near term due to individual circumstances.

The Company considers the customer s past performance, previous and current credit history, the individual circumstances surrounding the current difficulties and the customer s plan to meet the terms of the loan in the future prior to restructuring the terms of the loan. Generally, all five primary areas of lending are restructured through short-term interest rate relief, short-term principal payment relief, short-term principal and interest payment relief or forbearance (debt forgiveness). Once a restructured loan exceeds 90 days past due or is placed on non-accrual status, it is classified as non-performing loan totals. A summary of restructured loans as of June 30, 2016 and December 31, 2015 is as follows:

	June 30, 2016	December 31, 2015
	(dollars in thousands)	
Restructured loans:		
In compliance with modified terms	$ 8,184	$ 8,770
30 89 days past due	59	60

Included in non-performing loans		1,631		643
Total	$	9,874	$	9,473

All TDRs are considered to be impaired for purposes of assessing the adequacy of the allowance for loan losses and for financial reporting purposes. When the Company modifies a loan in a TDR, it evaluates any possible impairment similar to other impaired loans based on present value of the expected future cash flows discounted at the loan s effective interest rate, the loan s observable market price, or the fair value of the collateral if the loan is collateral dependent. If the Company determines that the fair value of the TDR is less than the recorded investment in the loan, impairment is recognized through an allowance estimate in the period of the modification and in periods subsequent to the modification.

Performing loans classified as TDRs during the three months ended June 30, 2016 included four retail real estate modifications for short-term principal payment relief, with a recorded investment of $0.1 million. Performing loans classified as TDRs during the six months ended June 30, 2016 included three commercial real estate modifications for short-term principal payment relief, with a recorded investment of $0.3 million and six retail real estate modifications for short-term principal payment relief, with a recorded investment of $0.4 million.

Performing loans classified as TDRs during the three months ended June 30, 2015 included one retail real estate modification for short-term interest rate relief, with a recorded investment of $0.1 million. Performing loans classified as TDRs during the six months ended June 30, 2015 included one retail real estate modification for short-term interest rate relief, with a recorded investment of $0.1 million and four retail real estate modifications for short-term principal payment relief, with a recorded investment of $0.4 million.

The gross interest income that would have been recorded in the three and six months ended June 30, 2016 and 2015 if performing TDRs had been performing in accordance with their original terms compared with their modified terms was insignificant.

TDRs that were entered into during the last twelve months that were subsequently classified as non-performing and had payment defaults (a default occurs when a loan is 90 days or more past due or transferred to non-accrual) during the three months ended June 30, 2016 consisted of three retail real estate modifications totaling $0.2 million. TDRs that were entered into during the last twelve months that were subsequently classified as non-performing and had payment defaults during the six months ended June 30, 2016 consisted of four retail real estate modifications totaling $0.2 million and one retail other modification totaling $0.1 million.

TDRs that were entered into during the prior twelve months that were subsequently classified as non-performing and had payment defaults during the three months ended June 30, 2015 consisted of one commercial real estate modification totaling $1.0 million. TDRs that were entered into during the last twelve months that were subsequently classified as non-performing and had payment defaults during the six months ended June 30, 2015 consisted of one commercial real estate modification totaling $1.0 million and one commercial modification totaling $1.0 million.

The following tables provide details of impaired loans, segregated by category. The unpaid contractual principal balance represents the recorded balance prior to any partial charge-offs. The recorded investment represents customer balances net of any partial charge-offs recognized on the loan. The average recorded investment is calculated using the most recent four quarters.

	June 30, 2016					
	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
	(dollars in thousands)					
Commercial	$ 15,736	$ 7,208	$ 628	$ 7,836	$ 359	$ 7,115
Commercial real estate	8,583	5,363	2,165	7,528	882	7,511

Real estate construction	1,550	858	25	883	25	878
Retail real estate	24,462	18,609	403	19,012	131	13,023
Retail other	282	195	4	199	4	241
Total	$ 50,613	$ 32,233	$ 3,225	$ 35,458	$ 1,401	$ 28,768

	December 31, 2015					
	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
	(dollars in thousands)					
Commercial	$ 14,302	$ 3,362	$ 8,238	$ 11,600	$ 3,304	$ 4,482
Commercial real estate	5,865	4,018	1,363	5,381	459	8,700
Real estate construction	1,569	830	29	859	29	833
Retail real estate	12,378	11,108	452	11,560	152	12,070
Retail other	272	233	5	238	5	261
Total	$ 34,386	$ 19,551	$ 10,087	$ 29,638	$ 3,949	$ 26,346

Management s evaluation as to the ultimate collectability of loans includes estimates regarding future cash flows from operations and the value of property, real and personal, pledged as collateral. These estimates are affected by changing economic conditions and the economic prospects of borrowers.

Allowance for Loan Losses

The allowance for loan losses represents an estimate of the amount of losses believed to be inherent in the Company s loan portfolio at the balance sheet date. The allowance for loan losses is evaluated geographically, by class of loans. The allowance calculation involves a high degree of estimation that management attempts to mitigate through the use of objective historical data where available. Loan losses are charged against the allowance for loan losses when management believes the uncollectibility of the loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Overall, the Company believes the allowance methodology is consistent with prior periods and the balance was adequate to cover the estimated losses in the Company s loan portfolio at June 30, 2016 and December 31, 2015.

The general portion of the Company s allowance contains two components: (i) a component for historical loss ratios, and (ii) a component for adversely graded loans. The historical loss ratio component is an annualized loss rate calculated using a sum-of-years digits weighted 20-quarter historical average.

The Company s component for adversely graded loans attempts to quantify the additional risk of loss inherent in the special mention and substandard portfolios. The substandard portfolio has an additional allocation of 3.00% placed on such loans, which is an estimate of the additional loss inherent in these loan grades based upon a review of overall historical charge-offs. As of June 30, 2016, the Company believed this reserve remained adequate. Special mention loans have an additional allocation of 1.00% placed on such loans, which is an estimate of the additional loss inherent in these loan grades. As of June 30, 2016, the Company believed this reserve remained adequate.

The specific portion of the Company s allowance relates to loans that are impaired, which includes non-performing loans, TDRs and other loans determined to be impaired. Impaired loans are excluded from the determination of the general allowance for non-impaired loans and are allocated specific reserves as discussed above.

Impaired loans are reported at the fair value of the underlying collateral, less estimated costs to sell, if repayment is expected solely from the collateral. Collateral values are estimated using a combination of observable inputs, including recent appraisals discounted for collateral specific changes and current market conditions, and unobservable inputs based on customized discounting criteria.

The general reserve quantitative allocation that is based upon historical charge off rates is adjusted for qualitative factors based on current general economic conditions and other qualitative risk factors both internal and external to the Company. In general, such valuation allowances are determined by evaluating, among other things: (i) Management & Staff; (ii) Loan Underwriting, Policy and Procedures; (iii) Internal/External Audit & Loan Review; (iv) Valuation of Underlying Collateral; (v) Macro and Local Economic Factors; (vi) Impact of Competition, Legal & Regulatory Issues; (vii) Nature and Volume of Loan Portfolio; (viii) Concentrations of Credit; (ix) Net Charge-Off Trends; and (x) Non-Accrual, Past Due and Classified Trends. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis.

Based on each component s risk factor, a qualitative adjustment to the reserve may be applied to the appropriate loan categories. During the second quarter of 2016, the Company adjusted qualitative factors relating to Impact of Competition, Legal & Regulatory Issues. The adjustment of these factors increased our allowance requirements by $1.9 million at June 30, 2016 compared to the method used for March 31, 2016. Adjustments to increase these qualitative factors were made to recognize perceived changing degrees of risk, offset decreasing quantitative factors and reflect management s evaluation of risk. The Company will continue to monitor its qualitative factors on a quarterly basis.

The Company holds acquired loans from business combinations with uncollected principal balances. These loans are carried net of a fair value adjustment for credit risk and interest rates and are only included in the allowance calculation to the extent that the reserve requirement exceeds the fair value adjustment. However, as the acquired loans renew, it is necessary to establish an allowance which represents an amount that, in management s opinion, will be adequate to absorb probable credit losses inherent in such loans.

The following table details activity in the allowance for loan losses. Allocation of a portion of the allowance to one category does not preclude its availability to absorb losses in other categories.

As of and for the Three Months Ended June 30, 2016

	Commercial	Commercial Real Estate	Real Estate Construction	Retail Real Estate	Retail Other	Total
			(dollars in thousands)			
Beginning balance	$ 13,323	$ 18,240	$ 1,836	$ 11,487	$ 285	$ 45,171
Provision for loan loss	(2,166)	2,275	(306)	1,204	93	1,100
Charged-off	(1,322)	(282)	(86)	(187)	(92)	(1,969)
Recoveries	311	42	117	535	51	1,056
Ending Balance	$ 10,146	$ 20,275	$ 1,561	$ 13,039	$ 337	$ 45,358

As of and for the Six Months Ended June 30, 2016

	Commercial	Commercial Real Estate	Real Estate Construction	Retail Real Estate	Retail Other	Total
			(dollars in thousands)			
Beginning balance	$ 13,115	$ 18,604	$ 1,763	$ 13,714	$ 291	$ 47,487
Provision for loan loss	1,245	1,896	(295)	(898)	152	2,100
Charged-off	(4,874)	(282)	(86)	(385)	(213)	(5,840)
Recoveries	660	57	179	608	107	1,611
Ending Balance	$ 10,146	$ 20,275	$ 1,561	$ 13,039	$ 337	$ 45,358

As of and for the Three Months Ended June 30, 2015

	Commercial	Commercial Real Estate	Real Estate Construction	Retail Real Estate	Retail Other	Total
			(dollars in thousands)			
Beginning balance	$ 9,528	$ 20,513	$ 2,096	$ 15,207	$ 308	$ 47,652
Provision for loan loss	344	287	111	(824)	82	
Charged-off	(76)			(282)	(178)	(536)
Recoveries	159	145	14	177	109	604
Ending Balance	$ 9,955	$ 20,945	$ 2,221	$ 14,278	$ 321	$ 47,720

As of and for the Six Months Ended June 30, 2015

	Commercial	Commercial Real Estate	Real Estate Construction	Retail Real Estate	Retail Other	Total
			(dollars in thousands)			
Beginning balance	$ 10,041	$ 20,639	$ 2,795	$ 13,662	$ 316	$ 47,453

Provision for loan loss	(250)	625	(746)	816	55	500
Charged-off	(77)	(708)		(598)	(185)	(1,568)
Recoveries	241	389	172	398	135	1,335
Ending Balance	$ 9,955	$ 20,945	$ 2,221	$ 14,278	$ 321	$ 47,720

The following table presents the allowance for loan losses and recorded investments in loans, excluding loans held for sale, by category:

	As of June 30, 2016 (dollars in thousands)					
	Commercial	Commercial Real Estate	Real Estate Construction	Retail Real Estate	Retail Other	Total
Amount allocated to:						
Loans individually evaluated for impairment	$ 359	$ 882	$ 25	$ 131	$ 4	$ 1,401
Loans collectively evaluated for impairment	9,787	19,393	1,536	12,908	333	43,957
Ending Balance	$ 10,146	$ 20,275	$ 1,561	$ 13,039	$ 337	$ 45,358
Loans:						
Loans individually evaluated for impairment	$ 5,954	$ 6,415	$ 535	$ 12,108	$ 199	$ 25,211
Loans collectively evaluated for impairment	878,462	1,616,601	174,623	1,060,308	15,514	3,745,508
PCI loans evaluated for Impairment	1,882	1,113	348	6,904		10,247
Ending Balance	$ 886,298	$ 1,624,129	$ 175,506	$ 1,079,320	$ 15,713	$ 3,780,966

	As of December 31, 2015 (dollars in thousands)					
	Commercial	Commercial Real Estate	Real Estate Construction	Retail Real Estate	Retail Other	Total
Amount allocated to:						
Loans individually evaluated for impairment	$ 3,304	$ 459	$ 29	$ 152	$ 5	$ 3,949
Loans collectively evaluated for impairment	9,811	18,145	1,734	13,562	286	43,538
Ending Balance	$ 13,115	$ 18,604	$ 1,763	$ 13,714	$ 291	$ 47,487
Loans:						