

LAKELAND FINANCIAL CORP

Form 10-Q

August 09, 2013

---

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

FORM 10-Q

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

For the quarterly period ended June 30, 2013

OR

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

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

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

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

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

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

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

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

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

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

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

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

Number of shares of common stock outstanding at July 31, 2013: 16,449,756

---

LAKELAND FINANCIAL CORPORATION  
Form 10-Q Quarterly Report  
Table of Contents

PART I.

|   | Page Number |
|---|-------------|
| <u>Item 1.</u> <u>Financial Statements</u>  | 1           |
| <u>Item 2.</u> <u>Management's Discussion and Analysis of</u><br><u>Financial Condition and Results of Operations</u> | 51          |
| <u>Item 3.</u> <u>Quantitative and Qualitative Disclosures About Market Risk</u>                                      | 68          |
| <u>Item 4.</u> <u>Controls and Procedures</u>   | 68          |

PART II.

|   | Page Number |
|---|-------------|
| <u>Item 1.</u> <u>Legal Proceedings</u>   | 69          |
| <u>Item 1A.</u> <u>Risk Factors</u>   | 69          |
| <u>Item 2.</u> <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 69          |
| <u>Item 3.</u> <u>Defaults Upon Senior Securities</u>                             | 69          |
| <u>Item 4.</u> <u>Mine Safety Disclosures</u>                                     | 70          |
| <u>Item 5.</u> <u>Other Information</u>   | 70          |
| <u>Item 6.</u> <u>Exhibits</u>  | 70          |
| <u>Form 10-Q</u> <u>Signature Page</u>  | 71          |

---

PART I  
LAKELAND FINANCIAL CORPORATION  
ITEM 1 – FINANCIAL STATEMENTS

LAKELAND FINANCIAL CORPORATION  
CONSOLIDATED BALANCE SHEETS  
As of June 30, 2013 and December 31, 2012  
(in thousands except for share data)

(Page 1 of 2)

|  | June 30,<br>2013<br>(Unaudited) | December 31,<br>2012 |
|--|---------------------------------|----------------------|
| <b>ASSETS</b>  |                                 |                      |
| Cash and due from banks  | \$ 55,814                       | \$ 156,666           |
| Short-term investments   | 7,741                           | 75,571               |
| Total cash and cash equivalents                                  | 63,555                          | 232,237              |
| Securities available for sale (carried at fair value)            | 472,976                         | 467,021              |
| Real estate mortgage loans held for sale                         | 5,486                           | 9,452                |
| Loans, net of allowance for loan losses of \$50,635 and \$51,445 | 2,284,065                       | 2,206,075            |
| Land, premises and equipment, net                                | 35,346                          | 34,840               |
| Bank owned life insurance  | 62,008                          | 61,112               |
| Accrued income receivable  | 9,214                           | 8,491                |
| Goodwill   | 4,970                           | 4,970                |
| Other intangible assets  | 24                              | 47                   |
| Other assets   | 37,818                          | 39,899               |
| Total assets   | \$ 2,975,462                    | \$ 3,064,144         |

(continued)



LAKELAND FINANCIAL CORPORATION  
CONSOLIDATED BALANCE SHEETS  
As of June 30, 2013 and December 31, 2012  
(in thousands except for share data)

(Page 2 of 2)

|   | June 30,<br>2013<br>(Unaudited) | December 31,<br>2012 |
|---|---------------------------------|----------------------|
| <b>LIABILITIES AND EQUITY</b>   |                                 |                      |
| <b>LIABILITIES</b>  |                                 |                      |
| Noninterest bearing deposits  | \$ 397,610                      | \$ 407,926           |
| Interest bearing deposits   | 2,085,882                       | 2,173,830            |
| Total deposits  | 2,483,492                       | 2,581,756            |
| <b>Short-term borrowings</b>  |                                 |                      |
| Federal funds purchased   | 37,000                          | 0                    |
| Securities sold under agreements to repurchase                              | 102,655                         | 121,883              |
| Total short-term borrowings   | 139,655                         | 121,883              |
| Accrued expenses payable  | 11,685                          | 15,321               |
| Other liabilities   | 2,057                           | 1,390                |
| Long-term borrowings  | 37                              | 15,038               |
| Subordinated debentures   | 30,928                          | 30,928               |
| Total liabilities   | 2,667,854                       | 2,766,316            |
| <b>EQUITY</b>   |                                 |                      |
| Common stock: 90,000,000 shares authorized, no par value                    |                                 |                      |
| 16,431,881 shares issued and 16,340,697 outstanding as of June 30, 2013     |                                 |                      |
| 16,377,247 shares issued and 16,290,136 outstanding as of December 31, 2012 | 90,921                          | 90,039               |
| Retained earnings   | 219,002                         | 203,654              |
| Accumulated other comprehensive income (loss)                               | (625)                           | 5,689                |
| Treasury stock, at cost (2013 - 91,184 shares, 2012 - 87,111 shares)        | (1,779)                         | (1,643)              |
| Total stockholders' equity  | 307,519                         | 297,739              |
| Noncontrolling interest   | 89                              | 89                   |
| Total equity  | 307,608                         | 297,828              |
| Total liabilities and equity  | \$ 2,975,462                    | \$ 3,064,144         |

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



**LAKELAND FINANCIAL CORPORATION**  
**CONSOLIDATED STATEMENTS OF INCOME**  
For the Three Months and Six Months Ended June 30, 2013 and 2012  
(in thousands except for share and per share data)

(Unaudited)

(Page 1 of 2)

|  | Three Months Ended<br>June 30, |               | Six Months Ended<br>June 30, |               |
|--|--------------------------------|---------------|------------------------------|---------------|
|  | 2013                           | 2012          | 2013                         | 2012          |
| <b>NET INTEREST INCOME</b>   |                                |               |                              |               |
| Interest and fees on loans   |                                |               |                              |               |
| Taxable  | \$ 24,388                      | \$ 25,795     | \$ 48,874                    | \$ 51,986     |
| Tax exempt   | 102                            | 112           | 204                          | 224           |
| Interest and dividends on securities                               |                                |               |                              |               |
| Taxable  | 1,152                          | 2,627         | 2,097                        | 5,391         |
| Tax exempt   | 770                            | 699           | 1,505                        | 1,396         |
| Interest on short-term investments                                 | 12                             | 16            | 36                           | 27            |
| Total interest income  | 26,424                         | 29,249        | 52,716                       | 59,024        |
| Interest on deposits   | 4,139                          | 6,602         | 8,776                        | 13,363        |
| Interest on borrowings   |                                |               |                              |               |
| Short-term   | 112                            | 104           | 203                          | 217           |
| Long-term  | 261                            | 395           | 568                          | 799           |
| Total interest expense   | 4,512                          | 7,101         | 9,547                        | 14,379        |
| <b>NET INTEREST INCOME</b>   | <b>21,912</b>                  | <b>22,148</b> | <b>43,169</b>                | <b>44,645</b> |
| Provision for loan losses  | 0                              | 500           | 0                            | 1,299         |
| <b>NET INTEREST INCOME AFTER<br/>PROVISION FOR<br/>LOAN LOSSES</b> |                                |               |                              |               |
|  | 21,912                         | 21,648        | 43,169                       | 43,346        |
| <b>NONINTEREST INCOME</b>  |                                |               |                              |               |
| Wealth advisory fees   | 971                            | 897           | 1,915                        | 1,811         |
| Investment brokerage fees  | 997                            | 940           | 1,946                        | 1,740         |
| Service charges on deposit accounts                                | 2,252                          | 2,011         | 4,223                        | 3,892         |
| Loan, insurance and service fees                                   | 1,812                          | 1,452         | 3,268                        | 2,641         |
| Merchant card fee income   | 293                            | 289           | 569                          | 605           |
| Other income   | 706                            | 280           | 2,081                        | 945           |
| Mortgage banking income  | 538                            | 392           | 1,047                        | 984           |
| Net securities gains   | 0                              | 0             | 1                            | 3             |

|  |       |       |        |        |
|--|-------|-------|--------|--------|
| Other than temporary impairment loss on available-for-sale securities: |       |       |        |        |
| Total impairment losses recognized on securities                       | 0     | (475) | 0      | (985)  |
| Loss recognized in other comprehensive income                          | 0     | 26    | 0      | 26     |
| Net impairment loss recognized in earnings                             | 0     | (449) | 0      | (959)  |
| Total noninterest income   | 7,569 | 5,812 | 15,050 | 11,662 |

(continued)

LAKELAND FINANCIAL CORPORATION  
 CONSOLIDATED STATEMENTS OF INCOME  
 For the Three Months and Six Months Ended June 30, 2013 and 2012  
 (in thousands except for share and per share data)

(Unaudited)

(Page 2 of 2)

|   | Three Months Ended<br>June 30, |                 | Six Months Ended<br>June 30, |                  |
|---|--------------------------------|-----------------|------------------------------|------------------|
|   | 2013                           | 2012            | 2013                         | 2012             |
| <b>NONINTEREST EXPENSE</b>                        |                                |                 |                              |                  |
| Salaries and employee benefits                    | 8,891                          | 8,363           | 18,056                       | 17,438           |
| Net occupancy expense                             | 873                            | 831             | 1,719                        | 1,716            |
| Equipment costs                                   | 654                            | 596             | 1,263                        | 1,213            |
| Data processing fees and supplies                 | 1,379                          | 1,060           | 2,672                        | 1,901            |
| Other expense                                     | 3,294                          | 3,399           | 6,274                        | 6,661            |
| Total noninterest expense                         | 15,091                         | 14,249          | 29,984                       | 28,929           |
| <b>INCOME BEFORE INCOME TAX<br/>EXPENSE</b>       |                                |                 |                              |                  |
|   | 14,390                         | 13,211          | 28,235                       | 26,079           |
| Income tax expense                                | 5,154                          | 4,392           | 9,753                        | 8,634            |
| <b>NET INCOME</b>                                 | <b>\$ 9,236</b>                | <b>\$ 8,819</b> | <b>\$ 18,482</b>             | <b>\$ 17,445</b> |
| <b>BASIC WEIGHTED AVERAGE COMMON<br/>SHARES</b>   |                                |                 |                              |                  |
|   | 16,425,382                     | 16,324,928      | 16,411,695                   | 16,298,981       |
| <b>BASIC EARNINGS PER COMMON<br/>SHARE</b>        |                                |                 |                              |                  |
|   | <b>\$ 0.56</b>                 | <b>\$ 0.54</b>  | <b>\$ 1.13</b>               | <b>\$ 1.07</b>   |
| <b>DILUTED WEIGHTED AVERAGE<br/>COMMON SHARES</b> |                                |                 |                              |                  |
|   | 16,546,547                     | 16,453,561      | 16,524,250                   | 16,450,832       |
| <b>DILUTED EARNINGS PER COMMON<br/>SHARE</b>      |                                |                 |                              |                  |
|   | <b>\$ 0.56</b>                 | <b>\$ 0.54</b>  | <b>\$ 1.12</b>               | <b>\$ 1.06</b>   |

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



LAKELAND FINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
For the Three Months and Six Months Ended June 30, 2013 and 2012  
(in thousands)

(Unaudited)

|   | Three months ended June 30, |          | Six months ended June 30, |           |
|---|-----------------------------|----------|---------------------------|-----------|
|   | 2013                        | 2012     | 2013                      | 2012      |
| Net income  | \$ 9,236                    | \$ 8,819 | \$ 18,482                 | \$ 17,445 |
| Other comprehensive income (loss)                               |                             |          |                           |           |
| Change in securities available for sale:                        |                             |          |                           |           |
| Unrealized holding gain (loss) on securities available for sale |                             |          |                           |           |
| arising during the period                                       | (9,358)                     | (181)    | (10,399)                  | 1,069     |
| Reclassification adjustment for (gains) included in net income  | 0                           | 0        | (1)                       | (3)       |
| Reclassification adjustment for other than temporary impairment | 0                           | 449      | 0                         | 959       |
| Net securities gain (loss) activity during the period           | (9,358)                     | 268      | (10,400)                  | 2,025     |
| Tax effect  | 3,705                       | (58)     | 4,104                     | (804)     |
| Net of tax amount   | (5,653)                     | 210      | (6,296)                   | 1,221     |
| Defined benefit pension plans:                                  |                             |          |                           |           |
| Net gain (loss) on defined benefit pension plans                | 0                           | 0        | (151)                     | 110       |
| Amortization of net actuarial loss                              | 66                          | 66       | 121                       | 110       |
| Net gain (loss) activity during the period                      | 66                          | 66       | (30)                      | 220       |
| Tax effect  | (26)                        | (26)     | 12                        | (89)      |
| Net of tax amount   | 40                          | 40       | (18)                      | 131       |
| Total other comprehensive income (loss), net of tax             | (5,613)                     | 250      | (6,314)                   | 1,352     |
| Comprehensive income  | \$ 3,623                    | \$ 9,069 | \$ 12,168                 | \$ 18,797 |

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

5

---

LAKELAND FINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
For the Six Months Ended June 30, 2013 and 2012  
(in thousands except for share and per share data)  
(Unaudited)

|  | Common<br>Stock | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Treasury<br>Stock | Total<br>Stockholders'<br>Equity |
|--|-----------------|----------------------|--|-------------------|----------------------------------|
| Balance at January 1,<br>2012  | \$ 87,380       | \$ 181,903           | \$ 5,139   | \$ (1,222)        | \$ 273,200                       |
| Net income   |                 | 17,445               |  |                   | 17,445                           |
| Other comprehensive<br>income (loss), net of tax   |                 |                      | 1,352  |                   | 1,352                            |
| Common stock cash<br>dividends declared,<br>\$0.325 per share                              |                 | (5,302)              |  |                   | (5,302)                          |
| Treasury shares<br>purchased under<br>deferred directors' plan<br>(7,204 shares)           | 186             |                      |  | (186)             | 0                                |
| Stock activity under<br>stock compensation<br>plans (114,928 shares)                       | 185             |                      |  |                   | 185                              |
| Stock compensation<br>expense  | 689             |                      |  |                   | 689                              |
| Balance at June 30, 2012   | \$ 88,440       | \$ 194,046           | \$ 6,491   | \$ (1,408)        | \$ 287,569                       |
| Balance at January 1,<br>2013  | \$ 90,039       | \$ 203,654           | \$ 5,689   | \$ (1,643)        | \$ 297,739                       |
| Net income   |                 | 18,482               |  |                   | 18,482                           |
| Other comprehensive<br>income (loss), net of tax   |                 |                      | (6,314)  |                   | (6,314)                          |
| Common stock cash<br>dividends declared,<br>\$0.19 per share                               |                 | (3,134)              |  |                   | (3,134)                          |
| Treasury shares<br>purchased under<br>deferred directors' plan<br>(7,091 shares)           | 190             |                      |  | (190)             | 0                                |
| Treasury stock sold and<br>distributed under<br>deferred directors' plan<br>(3,018 shares) | (54)            |                      |  | 54                | 0                                |
| Stock activity under<br>stock compensation   | 18              |                      |  |                   | 18                               |

plans, net of taxes  
(47,234 shares)

Stock compensation  
expense

|                          |    |        |    |         |    |       |    |         |    |         |
|--------------------------|----|--------|----|---------|----|-------|----|---------|----|---------|
|                          |    | 728    |    |         |    |       |    | 728     |    |         |
| Balance at June 30, 2013 | \$ | 90,921 | \$ | 219,002 | \$ | (625) | \$ | (1,779) | \$ | 307,519 |

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



LAKELAND FINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Six Months Ended June 30, 2013 and 2012

(in thousands)

(Unaudited)

(Page 1 of 2)

|   | 2013      | 2012      |
|---|-----------|-----------|
| Cash flows from operating activities:   |           |           |
| Net income  | \$ 18,482 | \$ 17,445 |
| Adjustments to reconcile net income to net cash from operating activities:              |           |           |
| Depreciation  | 1,384     | 1,338     |
| Provision for loan losses   | 0         | 1,299     |
| Loss on sale and write down of other real estate owned                                  | 95        | 103       |
| Amortization of intangible assets   | 23        | 26        |
| Amortization of loan servicing rights   | 324       | 347       |
| Net change in loan servicing rights valuation allowance                                 | (39)      | (22)      |
| Loans originated for sale   | (51,639)  | (64,807)  |
| Net gain on sales of loans  | (1,676)   | (1,140)   |
| Proceeds from sale of loans   | 56,748    | 63,365    |
| Net gain on sales of premises and equipment   | (1)       | 0         |
| Net (gain) loss on sales and calls of securities available for sale                     | (1)       | (3)       |
| Impairment on available for sale securities   | 0         | 959       |
| Net securities amortization   | 5,139     | 3,143     |
| Stock compensation expense  | 728       | 689       |
| Earnings on life insurance  | (797)     | (459)     |
| Tax benefit of stock option exercises   | (39)      | (432)     |
| Net change:   |           |           |
| Accrued income receivable   | (723)     | 166       |
| Accrued expenses payable  | (3,654)   | 1,383     |
| Other assets  | 5,990     | 998       |
| Other liabilities   | 857       | (178)     |
| Total adjustments   | 12,719    | 6,775     |
| Net cash from operating activities  | 31,201    | 24,220    |
| Cash flows from investing activities:   |           |           |
| Proceeds from maturities, calls and principal paydowns of securities available for sale | 69,675    | 48,098    |
| Purchases of securities available for sale  | (91,167)  | (61,221)  |
| Purchase of life insurance  | (99)      | (14)      |
| Net (increase) decrease in total loans  | (77,990)  | 16,283    |
| Proceeds from sales of land, premises and equipment                                     | 1         | 0         |
| Purchases of land, premises and equipment   | (1,890)   | (1,564)   |
| Proceeds from sales of other real estate  | 386       | 373       |
| Net cash from investing activities  | (101,084) | 1,955     |

(Continued)

7

---

LAKELAND FINANCIAL CORPORATION  
 CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Six Months Ended June 30, 2013 and 2012

(in thousands)

(Unaudited)

(Page 2 of 2)

|  | 2013      | 2012       |
|--|-----------|------------|
| Cash flows from financing activities:                |           |            |
| Net increase (decrease) in total deposits            | (98,264)  | 112,789    |
| Net increase (decrease) in short-term borrowings     | 17,772    | (43,294)   |
| Payments on long-term borrowings                     | (15,001)  | (2)        |
| Common dividends paid                                | (3,121)   | (5,289)    |
| Preferred dividends paid                             | (13)      | (13)       |
| Proceeds from stock option exercise                  | 18        | 185        |
| Purchase of treasury stock                           | (190)     | (186)      |
| Net cash from financing activities                   | (98,799)  | 64,190     |
| Net change in cash and cash equivalents              | (168,682) | 90,365     |
| Cash and cash equivalents at beginning of the period | 232,237   | 104,584    |
| Cash and cash equivalents at end of the period       | \$ 63,555 | \$ 194,949 |
| Cash paid during the period for:                     |           |            |
| Interest   | \$ 9,900  | \$ 12,560  |
| Income taxes   | 8,330     | 7,050      |
| Supplemental non-cash disclosures:                   |           |            |
| Loans transferred to other real estate               | 0         | 144        |

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



LAKELAND FINANCIAL CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
June 30, 2013

(Table amounts in thousands except for share and per share data)

(Unaudited)

NOTE 1. BASIS OF PRESENTATION

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

The unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions for Form 10-Q. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements and are unaudited. In the opinion of management, all adjustments (all of which are normal and recurring in nature) considered necessary for a fair presentation have been included. Operating results for the three-month and six-month periods ending June 30, 2013 are not necessarily indicative of the results that may be expected for any subsequent reporting periods, including the year ending December 31, 2013. The 2012 Lakeland Financial Corporation Annual Report on Form 10-K should be read in conjunction with these statements.

NOTE 2. EARNINGS PER SHARE

Basic earnings per common share is net income available to common shareholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable under stock options, stock awards and warrants.

|   | Three Months Ended June 30, |            | Six Months Ended June 30, |            |
|---|-----------------------------|------------|---------------------------|------------|
|   | 2013                        | 2012       | 2013                      | 2012       |
| Weighted average shares outstanding for basic earnings per common share   | 16,425,382                  | 16,324,928 | 16,411,695                | 16,298,981 |
| Dilutive effect of stock options, awards and warrants                     | 121,165                     | 128,633    | 112,555                   | 151,851    |
| Weighted average shares outstanding for diluted earnings per common share | 16,546,547                  | 16,453,561 | 16,524,250                | 16,450,832 |
| Basic earnings per common share   | \$ 0.56                     | \$ 0.54    | \$ 1.13                   | \$ 1.07    |
| Diluted earnings per common share   | \$ 0.56                     | \$ 0.54    | \$ 1.12                   | \$ 1.06    |



## NOTE 3. LOANS

|   | June 30,<br>2013 |       |   | December 31,<br>2012 |       |   |
|---|------------------|-------|---|----------------------|-------|---|
| Commercial and industrial loans:                                |                  |       |   |                      |       |   |
| Working capital lines of credit loans                           | \$ 462,137       | 19.8  | % | \$ 439,638           | 19.5  | % |
| Non-working capital loans                                       | 425,958          | 18.2  |   | 407,184              | 18.0  |   |
| Total commercial and industrial loans                           | 888,095          | 38.0  |   | 846,822              | 37.5  |   |
| Commercial real estate and multi-family residential loans:      |                  |       |   |                      |       |   |
| Construction and land development loans                         | 108,695          | 4.7   |   | 82,494               | 3.7   |   |
| Owner occupied loans  | 365,071          | 15.6  |   | 358,617              | 15.9  |   |
| Nonowner occupied loans   | 373,696          | 16.0  |   | 314,889              | 13.9  |   |
| Multifamily loans   | 37,422           | 1.6   |   | 45,011               | 2.0   |   |
| Total commercial real estate and multi-family residential loans | 884,884          | 37.9  |   | 801,011              | 35.5  |   |
| Agri-business and agricultural loans:                           |                  |       |   |                      |       |   |
| Loans secured by farmland                                       | 100,571          | 4.3   |   | 109,147              | 4.8   |   |
| Loans for agricultural production                               | 97,729           | 4.2   |   | 115,572              | 5.1   |   |
| Total agri-business and agricultural loans                      | 198,300          | 8.5   |   | 224,719              | 10.0  |   |
| Other commercial loans  | 46,501           | 2.0   |   | 56,807               | 2.5   |   |
| Total commercial loans  | 2,017,780        | 86.4  |   | 1,929,359            | 85.5  |   |
| Consumer 1-4 family mortgage loans:                             |                  |       |   |                      |       |   |
| Closed end first mortgage loans                                 | 116,247          | 5.0   |   | 109,823              | 4.9   |   |
| Open end and junior lien loans                                  | 152,571          | 6.5   |   | 161,366              | 7.1   |   |
| Residential construction and land development loans             | 5,263            | 0.2   |   | 11,541               | 0.5   |   |
| Total consumer 1-4 family mortgage loans                        | 274,081          | 11.7  |   | 282,730              | 12.5  |   |
| Other consumer loans  | 43,470           | 1.9   |   | 45,755               | 2.0   |   |
| Total consumer loans  | 317,551          | 13.6  |   | 328,485              | 14.5  |   |
| Subtotal  | 2,335,331        | 100.0 | % | 2,257,844            | 100.0 | % |
| Less: Allowance for loan losses                                 | (50,635)         |       |   | (51,445)             |       |   |
| Net deferred loan fees  | (631)            |       |   | (324)                |       |   |
| Loans, net  | \$2,284,065      |       |   | \$2,206,075          |       |   |

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

The following table presents the activity in the allowance for loan losses by portfolio segment for the three-month and six-month periods ended June 30, 2013, and the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of June 30, 2013:

|   | Commercial<br>and Industrial | Commercial<br>Real Estate<br>and Multifamily<br>Residential | Agri-business<br>and Agricultural | Other<br>Commercial | Consumer<br>1-4 Family<br>Mortgage | Other<br>Consumer |
|---|------------------------------|---|-----------------------------------|---------------------|------------------------------------|-------------------|
| Three Months<br>Ended June<br>30, 2013                      |                              |   |                                   |                     |                                    |                   |
| Balance April<br>1,   | \$ 22,113                    | \$ 20,420   | \$ 1,263                          | \$ 223              | \$ 2,866                           | \$ 5,000          |
| Provision for<br>loan losses                                | (348)                        | (336)   | 452                               | 41                  | 30                                 | 0                 |
| Loans<br>charged-off  | (10)                         | 0   | (200)                             | 0                   | (81)                               | (7)               |
| Recoveries  | 124                          | 14  | 2                                 | 0                   | 8                                  | 3                 |
| Net loans<br>charged-off                                    | 114                          | 14  | (198)                             | 0                   | (73)                               | (4)               |
| Balance June<br>30,   | \$ 21,879                    | \$ 20,098   | \$ 1,517                          | \$ 264              | \$ 2,823                           | \$ 5,000          |
| Six Months<br>Ended June<br>30, 2013                        |                              |   |                                   |                     |                                    |                   |
| Balance<br>January 1,                                       | \$ 22,342                    | \$ 20,812   | \$ 1,403                          | \$ 240              | \$ 2,682                           | \$ 6,000          |
| Provision for<br>loan losses                                | (707)                        | (83)  | 310                               | 24                  | 300                                | 4                 |
| Loans<br>charged-off  | (143)                        | (906)   | (200)                             | 0                   | (189)                              | (13)              |
| Recoveries  | 387                          | 275   | 4                                 | 0                   | 30                                 | 6                 |
| Net loans<br>charged-off                                    | 244                          | (631)   | (196)                             | 0                   | (159)                              | (6)               |
| Balance June<br>30,   | \$ 21,879                    | \$ 20,098   | \$ 1,517                          | \$ 264              | \$ 2,823                           | \$ 5,000          |
| Allowance for<br>loan losses:                               |                              |   |                                   |                     |                                    |                   |
| Ending<br>allowance<br>balance<br>attributable to<br>loans: |                              |   |                                   |                     |                                    |                   |
| Individually \$<br>evaluated for                            | 4,469                        | 6,103   | 40                                | 0                   | 445                                | 2                 |



|   |            |            |            |           |            |         |
|---|------------|------------|------------|-----------|------------|---------|
| impairment                                  |            |            |            |           |            |         |
| Collectively evaluated for impairment       | 17,410     | 13,995     | 1,477      | 264       | 2,378      | 55      |
| Total ending allowance balance              | \$ 21,879  | \$ 20,098  | \$ 1,517   | \$ 264    | \$ 2,823   | \$ 55   |
| Loans:                                      |            |            |            |           |            |         |
| Loans individually evaluated for impairment | \$ 16,882  | \$ 26,540  | \$ 757     | \$ 0      | \$ 2,654   | \$ 8    |
| Loans collectively evaluated for impairment | 871,458    | 857,114    | 197,643    | 46,499    | 271,730    | 43,3    |
| Total ending loans balance                  | \$ 888,340 | \$ 883,654 | \$ 198,400 | \$ 46,499 | \$ 274,384 | \$ 43,4 |

The recorded investment in loans does not include accrued interest.

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

The following table presents the activity in the allowance for loan losses by portfolio segment for the three-month and six-month periods ended June 30, 2012:

|                                  | Commercial<br>and Industrial | Commercial<br>Real Estate<br>and Multifamily<br>Residential | Agri-business<br>and Agricultural | Other<br>Commercial | Consumer<br>1-4 Family<br>Mortgage | Other<br>Consumer |
|----------------------------------|------------------------------|---|-----------------------------------|---------------------|------------------------------------|-------------------|
| Three Months Ended June 30, 2012 |                              |   |                                   |                     |                                    |                   |
| Balance April 1,                 | \$ 22,134                    | \$ 23,236   | \$ 538                            | \$ 186              | \$ 2,527                           | \$ 523            |
| Provision for loan losses        | (1,048)                      | 829   | 881                               | (12)                | (110)                              | 65                |
| Loans charged-off                | (1,676)                      | 0   | 0                                 | 0                   | (78)                               | (97)              |
| Recoveries                       | 286                          | 18  | 0                                 | 2                   | 73                                 | 32                |
| Net loans charged-off            | (1,390)                      | 18  | 0                                 | 2                   | (5)                                | (65)              |
| Balance June 30,                 | \$ 19,696                    | \$ 24,083   | \$ 1,419                          | \$ 176              | \$ 2,412                           | \$ 523            |
| Six Months Ended June 30, 2012   |                              |   |                                   |                     |                                    |                   |
| Balance January 1,               | \$ 22,830                    | \$ 23,489   | \$ 695                            | \$ 65               | \$ 2,322                           | \$ 645            |
| Provision for loan losses        | (1,152)                      | 1,394   | 724                               | 107                 | 61                                 | 11                |
| Loans charged-off                | (2,454)                      | (847)   | 0                                 | 0                   | (92)                               | (191)             |
| Recoveries                       | 472                          | 47  | 0                                 | 4                   | 121                                | 58                |
| Net loans charged-off            | (1,982)                      | (800)   | 0                                 | 4                   | 29                                 | (133)             |
| Balance June 30,                 | \$ 19,696                    | \$ 24,083   | \$ 1,419                          | \$ 176              | \$ 2,412                           | \$ 523            |

The recorded investment in loans does not include accrued interest.

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2012:

|   | Commercial<br>and Industrial | Commercial<br>Real Estate<br>and Multifamily<br>Residential | Agri-business<br>and Agricultural | Other<br>Commercial | Consumer<br>1-4 Family<br>Mortgage | Other<br>Consumer |
|---|------------------------------|---|-----------------------------------|---------------------|------------------------------------|-------------------|
| Allowance for<br>loan losses:                               |                              |   |                                   |                     |                                    |                   |
| Ending<br>allowance<br>balance<br>attributable to<br>loans: |                              |   |                                   |                     |                                    |                   |
| Individually<br>evaluated for<br>impairment                 | \$ 5,542                     | \$ 8,559  | \$ 63                             | \$ 0                | \$ 607                             | \$ 3              |
| Collectively<br>evaluated for<br>impairment                 | 16,800                       | 12,253  | 1,340                             | 240                 | 2,075                              | 5                 |
| Total ending<br>allowance<br>balance                        | \$ 22,342                    | \$ 20,812   | \$ 1,403                          | \$ 240              | \$ 2,682                           | \$ 60             |
| Loans:  |                              |   |                                   |                     |                                    |                   |
| Loans<br>individually<br>evaluated for<br>impairment        | \$ 18,281                    | \$ 36,919   | \$ 797                            | \$ 0                | \$ 2,853                           | \$ 9              |
| Loans<br>collectively<br>evaluated for<br>impairment        | 828,728                      | 763,279   | 224,008                           | 56,810              | 280,141                            | 45,6              |
| Total ending<br>loans balance                               | \$ 847,009                   | \$ 800,198  | \$ 224,805                        | \$ 56,810           | \$ 282,994                         | \$ 45,70          |

The recorded investment in loans does not include accrued interest.

The allowance for loan losses to total loans at June 30, 2013 and 2012 was 2.17% and 2.34%, respectively. The allowance for loan losses to total loans at December 31, 2012 was 2.28%.

The following table presents loans individually evaluated for impairment by class of loans as of and for the three-month and six-month periods ended June 30, 2013:

|  | Three Months Ended June 30, 2013 |                     |                                     |                             |                            |                                       |
|--|----------------------------------|---------------------|-------------------------------------|-----------------------------|----------------------------|---------------------------------------|
|  | Unpaid Principal Balance         | Recorded Investment | Allowance for Loan Losses Allocated | Average Recorded Investment | Interest Income Recognized | Cash Basis Interest Income Recognized |
| With no related allowance recorded:                        |                                  |                     |                                     |                             |                            |                                       |
| Commercial and industrial loans:                           |                                  |                     |                                     |                             |                            |                                       |
| Working capital lines of credit loans                      | \$ 65                            | \$ 65               | \$ 0                                | \$ 65                       | \$ 0                       | \$ 0                                  |
| Non-working capital loans                                  | 0                                | 0                   | 0                                   | 0                           | 0                          | 0                                     |
| Commercial real estate and multi-family residential loans: |                                  |                     |                                     |                             |                            |                                       |
| Owner occupied loans                                       | 716                              | 536                 | 0                                   | 543                         | 0                          | 0                                     |
| Agri-business and agricultural loans:                      |                                  |                     |                                     |                             |                            |                                       |
| Loans secured by farmland                                  | 612                              | 434                 | 0                                   | 440                         | 0                          | 0                                     |
| Consumer 1-4 family loans:                                 |                                  |                     |                                     |                             |                            |                                       |
| Closed end first mortgage loans                            | 49                               | 49                  | 0                                   | 49                          | 0                          | 0                                     |
| Open end and junior lien loans                             | 0                                | 0                   | 0                                   | 0                           | 0                          | 0                                     |
|  | 1                                | 1                   | 0                                   | 1                           | 0                          | 0                                     |

Other  
consumer loansWith an  
allowance  
recorded:Commercial  
and industrial  
loans:Working  
capital lines of  
credit loans

|       |       |       |       |    |
|-------|-------|-------|-------|----|
| 5,492 | 2,883 | 1,123 | 2,898 | 14 |
|-------|-------|-------|-------|----|

Non-working  
capital loans

|        |        |       |        |     |
|--------|--------|-------|--------|-----|
| 15,789 | 13,934 | 3,346 | 13,815 | 136 |
|--------|--------|-------|--------|-----|

Commercial  
real estate and  
multi-family  
residential  
loans:Construction  
and land  
development  
loans

|       |       |     |       |   |
|-------|-------|-----|-------|---|
| 3,459 | 3,070 | 653 | 4,203 | 7 |
|-------|-------|-----|-------|---|

Owner  
occupied loans

|       |       |     |       |    |
|-------|-------|-----|-------|----|
| 3,629 | 3,629 | 715 | 2,768 | 39 |
|-------|-------|-----|-------|----|

Nonowner  
occupied loans

|        |        |       |        |    |
|--------|--------|-------|--------|----|
| 19,296 | 19,305 | 4,735 | 19,399 | 84 |
|--------|--------|-------|--------|----|

Multifamily  
loans

|   |   |   |   |   |
|---|---|---|---|---|
| 0 | 0 | 0 | 0 | 0 |
|---|---|---|---|---|

Agri-business  
and agricultural  
loans:Loans  
secured by  
farmland

|     |     |    |     |   |
|-----|-----|----|-----|---|
| 644 | 323 | 40 | 391 | 0 |
|-----|-----|----|-----|---|

Consumer 1-4  
family  
mortgage  
loans:Closed end  
first mortgage  
loans

|       |       |     |       |    |
|-------|-------|-----|-------|----|
| 3,570 | 2,571 | 436 | 2,537 | 23 |
|-------|-------|-----|-------|----|

Open end  
and junior lien  
loans

|    |    |   |    |   |
|----|----|---|----|---|
| 34 | 34 | 9 | 58 | 0 |
|----|----|---|----|---|

Other  
consumer loans

|    |    |    |    |   |
|----|----|----|----|---|
| 79 | 79 | 28 | 79 | 1 |
|----|----|----|----|---|

|       |    |        |    |        |    |        |    |        |    |     |    |   |
|-------|----|--------|----|--------|----|--------|----|--------|----|-----|----|---|
| Total | \$ | 53,435 | \$ | 46,913 | \$ | 11,085 | \$ | 47,246 | \$ | 304 | \$ | 2 |
|-------|----|--------|----|--------|----|--------|----|--------|----|-----|----|---|

The recorded investment in loans does not include accrued interest.

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

The following table presents loans individually evaluated for impairment by class of loans as of and for the three-month and six-month periods ended June 30, 2012:

|  | Three Months Ended June 30, 2012 |                     |                                     |                             |                            |                                       |
|--|----------------------------------|---------------------|-------------------------------------|-----------------------------|----------------------------|---------------------------------------|
|  | Unpaid Principal Balance         | Recorded Investment | Allowance for Loan Losses Allocated | Average Recorded Investment | Interest Income Recognized | Cash Basis Interest Income Recognized |
| With no related allowance recorded:                        |                                  |                     |                                     |                             |                            |                                       |
| Commercial and industrial loans:                           |                                  |                     |                                     |                             |                            |                                       |
| Non-working capital loans                                  | \$ 505                           | \$ 166              | \$ 0                                | \$ 168                      | \$ 0                       | \$ 0                                  |
| Commercial real estate and multi-family residential loans: |                                  |                     |                                     |                             |                            |                                       |
| Owner occupied loans                                       | 654                              | 629                 | 0                                   | 637                         | 0                          | 0                                     |
| Nonowner occupied loans                                    | 391                              | 391                 | 0                                   | 265                         | 0                          | 0                                     |
| Agri-business and agricultural loans:                      |                                  |                     |                                     |                             |                            |                                       |
| Loans secured by farmland                                  | 443                              | 265                 | 0                                   | 266                         | 0                          | 0                                     |
| Loans for ag production                                    | 203                              | 203                 | 0                                   | 204                         | 0                          | 0                                     |
| Consumer 1-4 family loans:                                 |                                  |                     |                                     |                             |                            |                                       |
| Closed end first mortgage loans                            | 580                              | 580                 | 0                                   | 583                         | 0                          | 0                                     |
| Open end and junior lien loans                             | 20                               | 20                  | 0                                   | 20                          | 0                          | 0                                     |
| With an allowance recorded:                                |                                  |                     |                                     |                             |                            |                                       |
| Commercial and industrial loans:                           |                                  |                     |                                     |                             |                            |                                       |
| Working capital lines of                                   | 5,598                            | 2,989               | 1,450                               | 4,395                       | 13                         |                                       |



## Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

|  |           |           |           |           |        |
|--|-----------|-----------|-----------|-----------|--------|
| credit loans   |           |           |           |           |        |
| Non-working capital loans                                  | 17,954    | 17,265    | 5,271     | 17,264    | 177    |
| Commercial real estate and multi-family residential loans: |           |           |           |           |        |
| Construction and land development loans                    | 2,386     | 1,996     | 510       | 2,036     | 17     |
| Owner occupied loans                                       | 5,405     | 4,636     | 1,500     | 4,288     | 6      |
| Nonowner occupied loans                                    | 28,184    | 27,582    | 6,936     | 27,561    | 104    |
| Multifamily loans  | 0         | 0         | 0         | 0         | 0      |
| Agri-business and agricultural loans:                      |           |           |           |           |        |
| Loans secured by farmland                                  | 1,735     | 341       | 75        | 345       | 0      |
| Loans for agricultural production                          | 0         | 0         | 0         | 0         | 0      |
| Other commercial loans                                     | 0         | 0         | 0         | 0         | 0      |
| Consumer 1-4 family mortgage loans:                        |           |           |           |           |        |
| Closed end first mortgage loans                            | 1,875     | 1,877     | 312       | 1,833     | 9      |
| Open end and junior lien loans                             | 310       | 310       | 169       | 312       | 0      |
| Residential construction loans                             | 0         | 0         | 0         | 0         | 0      |
| Other consumer loans                                       | 6         | 6         | 5         | 6         | 0      |
| Total  | \$ 66,249 | \$ 59,256 | \$ 16,228 | \$ 59,378 | \$ 326 |

The recorded investment in loans does not include accrued interest.



The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2012:

|   | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Allowance for<br>Loan Losses<br>Allocated |
|---|--------------------------------|------------------------|---|
| With no related allowance recorded:                           |                                |                        |   |
| Commercial and industrial loans:                              |                                |                        |   |
| Working capital lines of credit loans                         | \$ 61                          | \$ 61                  | \$ 0                                      |
| Non-working capital loans                                     | 0                              | 0                      | 0   |
| Commercial real estate and multi-family residential<br>loans: |                                |                        |   |
| Construction and land development loans                       |                                |                        |   |
| Owner occupied loans  | 754                            | 574                    | 0   |
| Nonowner occupied loans                                       | 385                            | 385                    | 0   |
| Multifamily loans   | 410                            | 286                    | 0   |
| Agri-business and agricultural loans:                         |                                |                        |   |
| Loans secured by farmland                                     | 645                            | 466                    | 0   |
| Loans for ag production                                       | 0                              | 0                      | 0   |
| Other commercial loans  | 0                              | 0                      | 0   |
| Consumer 1-4 family loans:                                    |                                |                        |   |
| Closed end first mortgage loans                               | 59                             | 59                     | 0   |
| Open end and junior lien loans                                | 41                             | 41                     | 0   |
| Residential construction loans                                |                                |                        |   |
| Other consumer loans  | 1                              | 1                      | 0   |
| With an allowance recorded:                                   |                                |                        |   |
| Commercial and industrial loans:                              |                                |                        |   |
| Working capital lines of credit loans                         | 5,833                          | 3,224                  | 1,516                                     |
| Non-working capital loans                                     | 16,763                         | 14,996                 | 4,026                                     |
| Commercial real estate and multi-family residential<br>loans: |                                |                        |   |
| Construction and land development loans                       |                                |                        |   |
| Owner occupied loans  | 5,869                          | 5,869                  | 1,476                                     |
| Nonowner occupied loans                                       | 26,835                         | 26,845                 | 6,149                                     |
| Multifamily loans   | 0                              | 0                      | 0   |
| Agri-business and agricultural loans:                         |                                |                        |   |
| Loans secured by farmland                                     | 651                            | 331                    | 63  |
| Loans for agricultural production                             | 0                              | 0                      | 0   |
| Other commercial loans  | 0                              | 0                      | 0   |
| Consumer 1-4 family mortgage loans:                           |                                |                        |   |
| Closed end first mortgage loans                               | 3,387                          | 2,403                  | 415                                       |
| Open end and junior lien loans                                | 379                            | 350                    | 192                                       |
| Residential construction loans                                | 0                              | 0                      | 0   |

|                      |    |        |    |        |    |        |
|----------------------|----|--------|----|--------|----|--------|
| Other consumer loans |    | 91     |    | 91     |    | 34     |
| Total                | \$ | 65,516 | \$ | 58,942 | \$ | 14,805 |

The recorded investment in loans does not include accrued interest.

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

The following table presents the recorded investment in nonaccrual and loans past due over 90 days still on accrual by class of loans as of June 30, 2013 and December 31, 2012:

|  | June 30, 2013    |   | December 31, 2012 |   |
|--|------------------|---|-------------------|---|
|  | Nonaccrual       | Loans Past Due<br>Over 90 Days<br>Still<br>Accruing | Nonaccrual        | Loans Past Due<br>Over 90 Days<br>Still<br>Accruing |
| Commercial and industrial loans:                           |                  |   |                   |   |
| Working capital lines of credit loans                      | \$ 1,812         | \$ 0  | \$ 1,899          | \$ 0  |
| Non-working capital loans                                  | 3,786            | 104   | 4,812             | 50  |
| Commercial real estate and multi-family residential loans: |                  |   |                   |   |
| Construction and land development loans                    | 383              | 0   | 398               | 0   |
| Owner occupied loans                                       | 2,424            | 0   | 2,461             | 0   |
| Nonowner occupied loans                                    | 11,718           | 0   | 19,200            | 0   |
| Multifamily loans  | 0                | 0   | 286               | 0   |
| Agri-business and agricultural loans:                      |                  |   |                   |   |
| Loans secured by farmland                                  | 757              | 0   | 797               | 0   |
| Loans for agricultural production                          | 0                | 0   | 0                 | 0   |
| Other commercial loans                                     | 0                | 0   | 0                 | 0   |
| Consumer 1-4 family mortgage loans:                        |                  |   |                   |   |
| Closed end first mortgage loans                            | 560              | 0   | 504               | 0   |
| Open end and junior lien loans                             | 34               | 0   | 391               | 0   |
| Residential construction loans                             | 0                | 0   | 0                 | 0   |
| Other consumer loans                                       | 65               | 0   | 77                | 0   |
| <b>Total</b>   | <b>\$ 21,539</b> | <b>\$ 104</b>                                       | <b>\$ 30,825</b>  | <b>\$ 50</b>  |

The recorded investment in loans does not include accrued interest.



Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

The following table presents the aging of the recorded investment in past due loans as of June 30, 2013 by class of loans:

|  | 30-89<br>Days<br>Past Due | Greater than<br>90 Days<br>Past Due | Total<br>Past Due | Loans Not<br>Past Due | Total               |
|--|---------------------------|-------------------------------------|-------------------|-----------------------|---------------------|
| Commercial and industrial loans:                           |                           |                                     |                   |                       |                     |
| Working capital lines of credit loans                      | \$ 642                    | \$ 1,812                            | \$ 2,454          | \$ 459,931            | \$ 462,385          |
| Non-working capital loans                                  | 343                       | 3,890                               | 4,233             | 421,722               | 425,955             |
| Commercial real estate and multi-family residential loans: |                           |                                     |                   |                       |                     |
| Construction and land development loans                    | 0                         | 383                                 | 383               | 107,907               | 108,290             |
| Owner occupied loans                                       | 126                       | 2,424                               | 2,550             | 362,287               | 364,837             |
| Nonowner occupied loans                                    | 1,406                     | 11,718                              | 13,124            | 360,038               | 373,162             |
| Multifamily loans  | 0                         | 0                                   | 0                 | 37,365                | 37,365              |
| Agri-business and agricultural loans:                      |                           |                                     |                   |                       |                     |
| Loans secured by farmland                                  | 0                         | 757                                 | 757               | 99,818                | 100,575             |
| Loans for agricultural production                          | 18                        | 0                                   | 18                | 97,807                | 97,825              |
| Other commercial loans                                     | 0                         | 0                                   | 0                 | 46,499                | 46,499              |
| Consumer 1-4 family mortgage loans:                        |                           |                                     |                   |                       |                     |
| Closed end first mortgage loans                            | 2,399                     | 560                                 | 2,959             | 113,031               | 115,990             |
| Open end and junior lien loans                             | 248                       | 34                                  | 282               | 152,859               | 153,141             |
| Residential construction loans                             | 8                         | 0                                   | 8                 | 5,245                 | 5,253               |
| Other consumer loans                                       | 165                       | 65                                  | 230               | 43,193                | 43,423              |
| <b>Total</b>   | <b>\$ 5,355</b>           | <b>\$ 21,643</b>                    | <b>\$ 26,998</b>  | <b>\$ 2,307,702</b>   | <b>\$ 2,334,700</b> |

The recorded investment in loans does not include accrued interest.





Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

The following table presents the aging of the recorded investment in past due loans as of December 31, 2012 by class of loans:

|  | 30-89<br>Days<br>Past Due | Greater than<br>90 Days<br>Past Due | Total<br>Past Due | Loans Not<br>Past Due | Total               |
|--|---------------------------|-------------------------------------|-------------------|-----------------------|---------------------|
| Commercial and industrial loans:                           |                           |                                     |                   |                       |                     |
| Working capital lines of credit loans                      | \$ 233                    | \$ 1,899                            | \$ 2,132          | \$ 437,705            | \$ 439,837          |
| Non-working capital loans                                  | 48                        | 4,862                               | 4,910             | 402,262               | 407,172             |
| Commercial real estate and multi-family residential loans: |                           |                                     |                   |                       |                     |
| Construction and land development loans                    | 998                       | 398                                 | 1,396             | 80,954                | 82,350              |
| Owner occupied loans                                       | 1,023                     | 2,461                               | 3,484             | 354,921               | 358,405             |
| Nonowner occupied loans                                    | 38                        | 19,200                              | 19,238            | 295,243               | 314,481             |
| Multifamily loans  | 0                         | 286                                 | 286               | 44,676                | 44,962              |
| Agri-business and agricultural loans:                      |                           |                                     |                   |                       |                     |
| Loans secured by farmland                                  | 0                         | 797                                 | 797               | 108,359               | 109,156             |
| Loans for agricultural production                          | 0                         | 0                                   | 0                 | 115,649               | 115,649             |
| Other commercial loans                                     | 0                         | 0                                   | 0                 | 56,810                | 56,810              |
| Consumer 1-4 family mortgage loans:                        |                           |                                     |                   |                       |                     |
| Closed end first mortgage loans                            | 1,475                     | 504                                 | 1,979             | 107,583               | 109,562             |
| Open end and junior lien loans                             | 361                       | 391                                 | 752               | 161,172               | 161,924             |
| Residential construction loans                             | 0                         | 0                                   | 0                 | 11,508                | 11,508              |
| Other consumer loans                                       | 81                        | 77                                  | 158               | 45,546                | 45,704              |
| <b>Total</b>   | <b>\$ 4,257</b>           | <b>\$ 30,875</b>                    | <b>\$ 35,132</b>  | <b>\$ 2,222,388</b>   | <b>\$ 2,257,520</b> |

The recorded investment in loans does not include accrued interest.



Troubled Debt Restructurings:

Troubled debt restructured loans are included in the totals for impaired loans. The Company has allocated \$10.2 million and \$12.5 million of specific reserves to loans whose terms have been modified in troubled debt restructurings as of June 30, 2013 and December 31, 2012. The Company is not committed to lending additional funds to customers whose loans have been modified in a troubled debt restructuring.

|   | June 30,<br>2013 | December 31,<br>2012 |
|---|------------------|----------------------|
| Accruing troubled debt restructured loans   | \$ 23,017        | \$ 22,332            |
| Nonaccrual troubled debt restructured loans | 19,398           | 28,506               |
| Total troubled debt restructured loans      | \$ 42,415        | \$ 50,838            |

During the quarter ending June 30, 2013, loans totaling \$328,000 were modified as troubled debt restructured loans. Concessions granted during the modifications included reduction in the interest rates to rates that would not be readily available in the marketplace for borrowers with a similar risk profile and/or capitalizing past due interest and other expenses into the principal balance of the loan. The troubled debt restructured loans during the quarter were all granted to consumer mortgage borrowers.

During the quarter ending March 31, 2013, loans totaling \$2.2 million were modified as troubled debt restructurings. The modified terms of the loans included reductions in the interest rates to one that would not be readily available in the marketplace for borrowers with a similar risk profile and modifications of the repayment terms. These restructured loans were provided to related borrowers who are engaged in land development.

The following table presents loans by class modified as troubled debt restructurings that occurred during the three-month and six-month periods ending June 30, 2013:

Modifications  
Three Months Ended June 30, 2013

|                                 | Number<br>of<br>Loans | All Modifications   |  |
|---------------------------------|-----------------------|---|--|
|                                 |                       | Pre-Modification<br>Outstanding<br><br>Recorded<br>Investment | Post-Modification<br>Outstanding<br><br>Recorded<br>Investment |
| Troubled Debt Restructurings    |                       |   |  |
| Consumer 1-4 family loans:      |                       |   |  |
| Closed end first mortgage loans | 4                     | \$ 317  | \$ 328   |
| Total                           | 4                     | \$ 317  | \$ 328   |

Interest Rate Reductions

Principal and Interest Forgiveness

|                                 | Number<br>of<br>Loans | Interest at<br>Pre-Modification<br>Rate | Interest at<br>Post-Modification<br>Rate | Number<br>of<br>Loans | Principal at<br>Pre-Modification | Principal at<br>Post-Modification | Interest<br>Pre-Modifi<br>Rate |
|---------------------------------|-----------------------|---|--|-----------------------|----------------------------------|-----------------------------------|--------------------------------|
|                                 |                       |   |  |                       |                                  |                                   |                                |
| Consumer 1-4 family loans:      |                       |   |  |                       |                                  |                                   |                                |
| Closed end first mortgage loans | 2                     | \$ 142                                  | 158                                      | 2                     | \$ 156                           | 161                               | \$                             |

|       |      |        |     |      |        |        |
|-------|------|--------|-----|------|--------|--------|
| Total | 2 \$ | 142 \$ | 158 | 2 \$ | 156 \$ | 161 \$ |
|-------|------|--------|-----|------|--------|--------|

21

---

Modifications  
Six Months Ended June 30, 2013

All Modifications

|  | Number<br>of<br>Loans | Pre-Modification<br>Outstanding<br><br>Recorded<br>Investment | Post-Modification<br>Outstanding<br><br>Recorded<br>Investment |
|--|-----------------------|---|--|
| Troubled Debt Restructurings                               |                       |   |  |
| Commercial real estate and multi-family residential loans: |                       |   |  |
| Construction and land development loans                    | 6                     | \$ 2,198  | \$ 2,198   |
| Consumer 1-4 family loans:                                 |                       |   |  |
| Closed end first mortgage loans                            | 4                     | 317   | 328  |
| <b>Total</b>   | <b>10</b>             | <b>\$ 2,515</b>   | <b>\$ 2,526</b>  |

Interest Rate Reductions

Principal and Interest Forgiveness

|  | Number<br>of<br>Loans | Interest at<br>Pre-Modification<br>Rate | Interest at<br>Post-Modification<br>Rate | Number<br>of<br>Loans | Principal at<br>Pre-Modification | Principal at<br>Post-Modification | Interest<br>Pre-Modification |
|--|-----------------------|---|--|-----------------------|----------------------------------|-----------------------------------|------------------------------|
| Troubled Debt Restructurings                               |                       |   |  |                       |                                  |                                   |                              |
| Commercial real estate and multi-family residential loans: |                       |   |  |                       |                                  |                                   |                              |
| Construction and land                                      | 6                     | \$ 85                                   | 63                                       | 0                     | \$ 0                             | \$ 0                              | \$ 0                         |

development  
loans

Consumer  
1-4 family  
loans:

Closed end  
first mortgage  
loans

|       |      |        |     |      |        |        |
|-------|------|--------|-----|------|--------|--------|
|       | 2    | 142    | 158 | 2    | 156    | 161    |
| Total | 8 \$ | 227 \$ | 221 | 2 \$ | 156 \$ | 161 \$ |

For the three-month period ending June 30, 2013 the commercial real estate and multi-family residential loan troubled debt restructuring described above decreased the allowance for loan losses by \$86,000 and the consumer 1-4 family loan troubled debt restructurings described above increased the allowance for loan losses by \$42,000.

For the six-month period ending June 30, 2012, the commercial real estate and multi-family residential loan troubled debt restructurings described above decreased the allowance for loan losses by \$373,000 and the consumer 1-4 family loan troubled debt restructurings described above increased the allowance for loan losses by \$65,000.

The troubled debt restructurings described above had charge-offs of \$0 and \$365,000, respectively, during the three-month and six-month periods ending June 30, 2013.

The following table presents loans by class modified as troubled debt restructurings that occurred during the six-month and three-month periods ending June 30, 2012:

|  | Modifications<br>Six Months Ended June 30, 2012              |   |  |
|--|--|---|--|
|  | All Modifications Classified as Troubled Debt Restructurings |   |  |
|  | Number<br>of<br>Loans  | Pre-Modification<br>Outstanding<br><br>Recorded<br>Investment | Post-Modification<br>Outstanding<br><br>Recorded<br>Investment |
| Troubled Debt Restructurings                               |  |   |  |
| Commercial and industrial loans:                           |  |   |  |
| Non-working capital loans                                  | 1  | \$ 942  | \$ 1,060   |
| Commercial real estate and multi-family residential loans: |  |   |  |
| Construction and land development loans                    | 5  | 1,638   | 1,638  |
| Owner occupied loans                                       | 1  | 849   | 849  |
| Nonowner occupied loans                                    | 1  | 385   | 385  |
| Consumer 1-4 family loans:                                 |  |   |  |
| Closed end first mortgage loans                            | 1  | 39  | 39   |
| Total  | 9  | \$ 3,853  | \$ 3,971   |



|  | Interest Rate Reductions |                                   |                                    |                 | Principal and Interest Forgiveness |                                |                  |
|--|--------------------------|-----------------------------------|------------------------------------|-----------------|------------------------------------|--------------------------------|------------------|
|  | Number of Loans          | Interest at Pre-Modification Rate | Interest at Post-Modification Rate | Number of Loans | Principal at Pre-Modification      | Principal at Post-Modification | Pre-Modification |
| Troubled Debt Restructurings                               |                          |                                   |                                    |                 |                                    |                                |                  |
| Commercial and industrial loans:                           |                          |                                   |                                    |                 |                                    |                                |                  |
| Non-working capital loans                                  | 0                        | \$ 0                              | \$ 0                               | 0               | \$ 0                               | \$ 0                           | \$ 0             |
| Commercial real estate and multi-family residential loans: |                          |                                   |                                    |                 |                                    |                                |                  |
| Construction and land development loans                    | 0                        | 0                                 | 0                                  | 0               | 0                                  | 0                              | 0                |
| Owner occupied loans                                       | 1                        | 440                               | 117                                | 0               | 0                                  | 0                              | 0                |
| Nonowner occupied loans                                    | 0                        | 0                                 | 0                                  | 0               | 0                                  | 0                              | 0                |
| Consumer 1-4 family loans:                                 |                          |                                   |                                    |                 |                                    |                                |                  |
| Closed end first mortgage loans                            | 1                        | 76                                | 15                                 | 0               | 0                                  | 0                              | 0                |
| <b>Total</b>   | <b>2</b>                 | <b>\$ 516</b>                     | <b>\$ 132</b>                      | <b>0</b>        | <b>\$ 0</b>                        | <b>\$ 0</b>                    | <b>\$ 0</b>      |



Modifications  
Three Months Ended June 30, 2012

All Modifications Classified as Troubled Debt Restructurings

|  | Number<br>of<br>Loans | Pre-Modification<br>Outstanding<br>Recorded<br>Investment | Post-Modification<br>Outstanding<br>Recorded<br>Investment |
|--|-----------------------|---|--|
| Troubled Debt Restructurings                               |                       |   |  |
| Commercial and industrial loans:                           |                       |   |  |
| Non-working capital loans                                  | 1                     | \$ 942  | \$ 1,060   |
| Commercial real estate and multi-family residential loans: |                       |   |  |
| Owner occupied loans                                       | 1                     | 849   | 849  |
| Nonowner occupied loans                                    | 1                     | 385   | 385  |
| Consumer 1-4 family loans:                                 |                       |   |  |
| Closed end first mortgage loans                            | 1                     | 39  | 39   |
| Total  | 4                     | \$ 2,215  | \$ 2,333   |

|  | Interest Rate Reductions |                                   |                                    |                 | Principal and Interest Forgiveness |                                |                                   |
|--|--------------------------|-----------------------------------|------------------------------------|-----------------|------------------------------------|--------------------------------|-----------------------------------|
|  | Number of Loans          | Interest at Pre-Modification Rate | Interest at Post-Modification Rate | Number of Loans | Principal at Pre-Modification      | Principal at Post-Modification | Interest at Pre-Modification Rate |
| Troubled Debt Restructurings                               |                          |                                   |                                    |                 |                                    |                                |                                   |
| Commercial and industrial loans:                           |                          |                                   |                                    |                 |                                    |                                |                                   |
| Non-working capital loans                                  | 0                        | \$ 0                              | \$ 0                               | 0               | \$ 0                               | \$ 0                           | \$ 0                              |
| Commercial real estate and multi-family residential loans: |                          |                                   |                                    |                 |                                    |                                |                                   |
| Owner occupied loans                                       | 1                        | 440                               | 117                                | 0               | 0                                  | 0                              | 0                                 |
| Nonowner occupied loans                                    | 0                        | 0                                 | 0                                  | 0               | 0                                  | 0                              | 0                                 |
| Consumer 1-4 family loans:                                 |                          |                                   |                                    |                 |                                    |                                |                                   |
| Closed end first mortgage loans                            | 1                        | 76                                | 15                                 | 0               | 0                                  | 0                              | 0                                 |
| <b>Total</b>   | <b>2</b>                 | <b>\$ 516</b>                     | <b>\$ 132</b>                      | <b>0</b>        | <b>\$ 0</b>                        | <b>\$ 0</b>                    | <b>\$ 0</b>                       |

For the three month period ending June 30, 2012, the commercial and industrial troubled debt restructured loans described above increased the allowance for loan losses by \$690,000, the commercial real estate and multi-family

residential loan troubled debt restructurings described above increased the allowance for loan losses by \$290,000 and the consumer 1-4 family loan troubled debt restructurings described above increased the allowance for loan losses by \$6,000. For the six-month period ending June 30, 2012, the commercial and industrial troubled debt restructured loans described above increased the allowance for loan losses by \$690,000, the commercial real estate and multi-family residential troubled debt restructured loans described above increased the allowance for loan losses by \$790,000 and the consumer 1-4 family loan troubled debt restructurings described above increased the allowance for loan losses by \$6,000.

No charge offs resulted from any troubled debt restructurings described above during the three and six month periods ending June 30, 2012.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification which occurred during the three month and six month periods ending June 30, 2013:

|  | Modifications                    |                     |                                |                     |
|--|----------------------------------|---------------------|--------------------------------|---------------------|
|  | Three Months Ended June 30, 2013 |                     | Six Months Ended June 30, 2013 |                     |
|  | Number of Loans                  | Recorded Investment | Number of Loans                | Recorded Investment |
| Troubled Debt Restructurings that Subsequently Defaulted |                                  |                     |                                |                     |
| Consumer 1-4 family loans:                               |                                  |                     |                                |                     |
| Closed end first mortgage loans                          | 0                                | \$ 0                | 1                              | \$ 946              |
| Total  | 0                                | \$ 0                | 1                              | \$ 946              |

A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms.

The troubled debt restructurings described above that subsequently defaulted made a large principal payment during the second quarter of 2013, which decreased the allowance for loan losses by \$80,000 and did not result in any charge offs during the three and six month periods ending June 30, 2013.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification which occurred during the three month and six month periods ending June 30, 2012:

|  | Number of Loans | Recorded Investment |
|--|-----------------|---------------------|
| Troubled Debt Restructurings that Subsequently Defaulted |                 |                     |
| Consumer 1-4 family loans:                               |                 |                     |
| Closed end first mortgage loans                          | 1               | \$ 65               |
| Total  | 1               | \$ 65               |

A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms.

The troubled debt restructurings that subsequently defaulted described above increased the allowance for loan losses by \$1,000 and did not result in any charge offs during the three and six month periods ending June 30, 2012.

Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes commercial loans individually by classifying the loans as to credit risk. This analysis is performed on a quarterly basis for Special Mention, Substandard and Doubtful grade loans and annually on Pass grade loans over \$250,000.

The Company uses the following definitions for risk ratings:

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

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

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



Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be Pass rated loans with the exception of consumer troubled debt restructurings, which are evaluated and listed with Substandard commercial grade loans. Loans listed as Not Rated are consumer loans included in groups of homogenous loans which are analyzed for credit quality indicators utilizing delinquency status. As of June 30, 2013 and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

|  | Pass                | Special<br>Mention | Substandard      | Doubtful     | Not<br>Rated      |
|--|---------------------|--------------------|------------------|--------------|-------------------|
| Commercial and industrial loans:                           |                     |                    |                  |              |                   |
| Working capital lines of credit loans                      | \$ 424,540          | \$ 23,755          | \$ 14,090        | \$ 0         | \$ 0              |
| Non-working capital loans                                  | 378,380             | 22,086             | 25,425           | 64           | 0                 |
| Commercial real estate and multi-family residential loans: |                     |                    |                  |              |                   |
| Construction and land development loans                    | 94,229              | 4,140              | 9,921            | 0            | 0                 |
| Owner occupied loans                                       | 325,524             | 22,302             | 17,011           | 0            | 0                 |
| Nonowner occupied loans                                    | 339,563             | 14,652             | 18,947           | 0            | 0                 |
| Multifamily loans  | 37,028              | 337                | 0                | 0            | 0                 |
| Agri-business and agricultural loans:                      |                     |                    |                  |              |                   |
| Loans secured by farmland                                  | 99,229              | 0                  | 1,346            | 0            | 0                 |
| Loans for agricultural production                          | 97,825              | 0                  | 0                | 0            | 0                 |
| Other commercial loans                                     | 46,381              | 0                  | 118              | 0            | 0                 |
| Consumer 1-4 family mortgage loans:                        |                     |                    |                  |              |                   |
| Closed end first mortgage loans                            | 23,717              | 847                | 1,816            | 0            | 89,610            |
| Open end and junior lien loans                             | 5,820               | 2,124              | 0                | 0            | 145,197           |
| Residential construction loans                             | 0                   | 0                  | 0                | 0            | 5,253             |
| Other consumer loans                                       | 8,261               | 460                | 293              | 0            | 34,409            |
| <b>Total</b>   | <b>\$ 1,880,497</b> | <b>\$ 90,703</b>   | <b>\$ 88,967</b> | <b>\$ 64</b> | <b>\$ 274,469</b> |

The recorded investment in loans does not include accrued interest.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be Pass rated loans with the exception of consumer troubled debt restructurings which are evaluated and listed with Substandard commercial grade loans. Loans listed as Not Rated are consumer loans included in groups of homogenous loans which are analyzed for credit quality indicators utilizing delinquency status. As of December 31, 2012 and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

|  | Pass                | Special<br>Mention | Substandard<br>(in thousands) | Doubtful     | Not<br>Rated      |
|--|---------------------|--------------------|-------------------------------|--------------|-------------------|
| Commercial and industrial loans:                           |                     |                    |                               |              |                   |
| Working capital lines of credit loans                      | \$ 403,778          | \$ 22,591          | \$ 13,468                     | \$ 0         | \$ 0              |
| Non-working capital loans                                  | 355,772             | 23,192             | 26,857                        | 66           | 1,285             |
| Commercial real estate and multi-family residential loans: |                     |                    |                               |              |                   |
| Construction and land development loans                    | 67,002              | 4,595              | 10,753                        | 0            | 0                 |
| Owner occupied loans                                       | 315,672             | 24,589             | 18,144                        | 0            | 0                 |
| Nonowner occupied loans                                    | 282,108             | 6,345              | 26,028                        | 0            | 0                 |
| Multifamily loans  | 43,425              | 345                | 1,192                         | 0            | 0                 |
| Agri-business and agricultural loans:                      |                     |                    |                               |              |                   |
| Loans secured by farmland                                  | 107,734             | 0                  | 1,404                         | 0            | 18                |
| Loans for agricultural production                          | 115,649             | 0                  | 0                             | 0            | 0                 |
| Other commercial loans                                     | 56,692              | 0                  | 118                           | 0            | 0                 |
| Consumer 1-4 family mortgage loans:                        |                     |                    |                               |              |                   |
| Closed end first mortgage loans                            | 18,685              | 343                | 729                           | 0            | 89,805            |
| Open end and junior lien loans                             | 7,932               | 300                | 0                             | 0            | 153,692           |
| Residential construction loans                             | 0                   | 0                  | 0                             | 0            | 11,508            |
| Other consumer loans                                       | 10,168              | 378                | 497                           | 0            | 34,661            |
| <b>Total</b>   | <b>\$ 1,784,617</b> | <b>\$ 82,678</b>   | <b>\$ 99,190</b>              | <b>\$ 66</b> | <b>\$ 290,969</b> |

The recorded investment in loans does not include accrued interest.



## NOTE 5. SECURITIES

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

|   | Fair Value | Gross Unrealized Gain | Gross Unrealized Losses | Amortized Cost |
|---|------------|-----------------------|-------------------------|----------------|
| June 30, 2013                                     |            |                       |                         |                |
| U.S. Treasury securities                          | \$ 1,027   | \$ 26                 | \$ 0                    | \$ 1,001       |
| U.S. government sponsored agencies                | 5,224      | 202                   | 0                       | 5,022          |
| Agency residential mortgage-backed securities     | 366,418    | 5,790                 | (6,555)                 | 367,183        |
| Non-agency residential mortgage-backed securities | 5,392      | 167                   | 0                       | 5,225          |
| State and municipal securities                    | 94,915     | 3,730                 | (1,566)                 | 92,751         |
| Total   | \$ 472,976 | \$ 9,915              | \$ (8,121)              | \$ 471,182     |
| December 31, 2012                                 |            |                       |                         |                |
| U.S. Treasury securities                          | \$ 1,037   | \$ 35                 | \$ 0                    | \$ 1,002       |
| U.S. government sponsored agencies                | 5,304      | 278                   | 0                       | 5,026          |
| Agency residential mortgage-backed securities     | 365,644    | 7,813                 | (1,495)                 | 359,326        |
| Non-agency residential mortgage-backed securities | 6,453      | 242                   | 0                       | 6,211          |
| State and municipal securities                    | 88,583     | 5,509                 | (189)                   | 83,263         |
| Total   | \$ 467,021 | \$ 13,877             | \$ (1,684)              | \$ 454,828     |

Information regarding the fair value and amortized cost of available for sale debt securities by maturity as of June 30, 2013 is presented below. Maturity information is based on contractual maturity for all securities other than mortgage-backed securities. Actual maturities of securities may differ from contractual maturities because borrowers may have the right to prepay the obligation without a prepayment penalty.

|  | Amortized Cost | Fair Value |
|--|----------------|------------|
| Due in one year or less                | \$ 3,192       | \$ 3,259   |
| Due after one year through five years  | 26,030         | 27,527     |
| Due after five years through ten years | 39,306         | 40,700     |
| Due after ten years                    | 30,246         | 29,680     |
|  | 98,774         | 101,166    |
| Mortgage-backed securities             | 372,408        | 371,810    |
| Total debt securities                  | \$ 471,182     | \$ 472,976 |

There were no securities sales during the first six months of 2013 and 2012. All of the gains in 2013 and 2012 were from calls.



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

Securities with carrying values of \$171.9 million and \$216.5 million were pledged as of June 30, 2013 and 2012, as collateral for deposits of public funds, securities sold under agreements to repurchase, borrowings from the Federal Home Loan Bank and for other purposes as permitted or required by law.

Information regarding securities with unrealized losses as of June 30, 2013 and December 31, 2012 is presented below. The tables divide the securities between those with unrealized losses for less than twelve months and those with unrealized losses for twelve months or more.

|   | Less than 12 months |                   | 12 months or more |                   | Total      |                   |
|---|---------------------|-------------------|-------------------|-------------------|------------|-------------------|
|   | Fair Value          | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value | Unrealized Losses |
| June 30, 2013                                 |                     |                   |                   |                   |            |                   |
| Agency residential mortgage-backed securities | \$ 168,399          | \$ (6,118)        | \$ 23,900         | \$ (437)          | \$ 192,299 | \$ (6,555)        |
| State and municipal securities                | 22,860              | (1,566)           | 0                 | 0                 | 22,860     | (1,566)           |
| Total temporarily impaired                    | \$ 191,259          | \$ (7,684)        | \$ 23,900         | \$ (437)          | \$ 215,159 | \$ (8,121)        |
| December 31, 2012                             |                     |                   |                   |                   |            |                   |
| Agency residential mortgage-backed securities | \$ 92,974           | \$ (1,066)        | \$ 20,422         | \$ (429)          | \$ 113,396 | \$ (1,495)        |
| State and municipal securities                | 10,791              | (188)             | 50                | (1)               | 10,841     | (189)             |
| Total temporarily impaired                    | \$ 103,765          | \$ (1,254)        | \$ 20,472         | \$ (430)          | \$ 124,237 | \$ (1,684)        |

The number of securities with unrealized losses as of June 30, 2013 and December 31, 2012 is presented below.

|   | Less than 12 months | 12 months or more | Total |
|---|---------------------|-------------------|-------|
| June 30, 2013                                 |                     |                   |       |
| Agency residential mortgage-backed securities | 43                  | 10                | 53    |
| State and municipal securities                | 49                  | 0                 | 49    |
| Total temporarily impaired                    | 92                  | 10                | 102   |

|                   | Less than 12 months | 12 months or more | Total |
|-------------------|---------------------|-------------------|-------|
| December 31, 2012 |                     |                   |       |

|   |    |    |    |
|---|----|----|----|
| Agency residential mortgage-backed securities | 29 | 9  | 38 |
| State and municipal securities                | 29 | 1  | 30 |
| Total temporarily impaired                    | 58 | 10 | 68 |



The following factors are considered to determine whether or not the impairment of these securities is other-than-temporary. Ninety-eight percent of the securities are backed by the U.S. government, government agencies, government sponsored agencies or are A- rated or better by Moody's, S&P or Fitch, except for certain non-local or local municipal securities, which are not rated. Mortgage-backed securities, which are not issued by the U.S. government or government sponsored agencies (non-agency residential mortgage-backed securities), met specific criteria set by the Asset Liability Management Committee at their time of purchase, including having the highest rating available by either Moody's, S&P or Fitch. None of the securities have call provisions (with the exception of the municipal securities) and all payments as originally agreed are being received on their original terms. For the government, government-sponsored agency and municipal securities, management did not have concerns of credit losses, and there was nothing to indicate that full principal will not be received. Management considered the unrealized losses on these securities to be primarily interest rate driven and does not expect material losses given current market conditions unless the securities are sold. However, at this time management does not have the intent to sell, and it is more likely than not that it will not be required to sell these securities before the recovery of their amortized cost basis.

As of June 30, 2013, the Company had \$5.4 million of non-agency residential mortgage-backed securities which were not issued by the U.S. government or government sponsored agencies, but which were rated AAA by S&P or Fitch and/or Aaa by Moody's at the time of purchase. As of December 31, 2012, the Company had \$6.5 million of non-agency residential mortgage-backed securities which were not issued by the federal government or government sponsored agencies, but which were rated AAA by S&P and/or Aaa by Moody's at the time of purchase. None of the four non-agency residential mortgage-backed securities were still rated AAA/Aaa as of June 30, 2013 by at least one of the rating agencies and one had been downgraded to below investment grade by at least one of those rating agencies.

For these non-agency residential mortgage-backed securities, additional analysis is performed to determine if any impairment is temporary or other-than-temporary, in which case impairment would need to be recorded for these securities. The Company performs an independent analysis of the cash flows of the individual securities based upon assumptions as to collateral defaults, prepayment speeds, expected losses and the severity of potential losses. Based upon the initial review, securities may be identified for further analysis by computing the net present value using an appropriate discount rate (the current accounting yield) and comparing it to the book value of the security to determine if there is any other-than-temporary impairment that must be recorded. Based on this analysis of the non-agency residential mortgage-backed securities, none of the four non-agency mortgage-backed securities had any unrealized losses or other-than-temporary impairment at June 30, 2013.

The following table provides information about debt securities for which only a credit loss was recognized in income and for which other losses are recorded in other comprehensive income. There were no securities with other than temporary impairment during the three and six months ended June 30, 2013. All securities with other than temporary impairment were sold during 2012. The table represents the three months and six months ended June 30, 2013 and 2012.

|   | Three Months Ended June 30, |          |
|---|-----------------------------|----------|
|   | 2013                        | 2012     |
| Balance April 1,  | \$ 0                        | \$ 869   |
| Additions related to other-than-temporary impairment losses not previously recognized                                 | 0                           | 198      |
| Additional increases to the amount of credit loss for which other-than-temporary impairment was previously recognized | 0                           | 251      |
| Reductions for previous credit losses realized on securities sold during the year                                     | 0                           | 0        |
| Balance June 30,  | \$ 0                        | \$ 1,318 |

|   | Six Months Ended June 30, |          |
|---|---------------------------|----------|
|   | 2013                      | 2012     |
| Balance January 1,  | \$ 0                      | \$ 359   |
| Additions related to other-than-temporary impairment losses not previously recognized                                 | 0                         | 747      |
| Additional increases to the amount of credit loss for which other-than-temporary impairment was previously recognized | 0                         | 212      |
| Reductions for previous credit losses realized on securities sold during the year                                     | 0                         | 0        |
| Balance June 30,  | \$ 0                      | \$ 1,318 |

Information on securities with at least one rating below investment grade at June 30, 2013 is presented below.

| Description | CUSIP     | Other Than<br>Temporary<br>Impairment | Par<br>Value | June 30, 2013     |               | Unrealized<br>Gain/(Loss) | 6/30/2013 1-Month<br>Lowest<br>Credit<br>Rating | Constant<br>Default<br>Rate |
|-------------|-----------|---------------------------------------|--------------|-------------------|---------------|---------------------------|---|-----------------------------|
|             |           |                                       |              | Amortized<br>Cost | Fair<br>Value |                           |   |                             |
| RALI        |           |                                       |              |                   |               |                           |   |                             |
| 2004-QS7    |           |                                       |              |                   |               |                           |   |                             |
| A3          | 76110HTX7 | \$ 0                                  | \$ 2,567     | \$ 2,551          | \$ 2,591      | \$ 40                     | BB+   | 2.97                        |

This security is a super senior/senior tranche non-agency residential mortgage-backed security. The credit support is the credit support percentage for a tranche from other subordinated tranches, which is the amount of principal in the subordinated tranches expressed as a percentage of the remaining principal in the super senior/senior tranche. The super senior/senior tranches receive the prepayments and the subordinate tranches absorb the losses. The super senior/senior tranches do not absorb losses until the subordinate tranches are extinguished.

The Company does not have a history of actively trading securities but continues to hold securities available for sale should liquidity or other needs develop that would warrant the sale of securities. While these securities are held in the available for sale portfolio, it is management's current intent to hold them until a recovery in fair value or maturity.

## NOTE 6. EMPLOYEE BENEFIT PLANS

Components of net periodic benefit cost:

|                                      | Six Months Ended June 30, |       |               |       |
|--------------------------------------|---------------------------|-------|---------------|-------|
|                                      | Pension Benefits          |       | SERP Benefits |       |
|                                      | 2013                      | 2012  | 2013          | 2012  |
| Interest cost                        | \$ 58                     | \$ 64 | \$ 23         | \$ 26 |
| Expected return on plan assets       | (60)                      | (69)  | (37)          | (38)  |
| Recognized net actuarial (gain) loss | 75                        | 68    | 46            | 42    |
| Net pension expense (benefit)        | \$ 73                     | \$ 63 | \$ 32         | \$ 30 |

|                                      | Three Months Ended June 30, |       |               |       |
|--------------------------------------|-----------------------------|-------|---------------|-------|
|                                      | Pension Benefits            |       | SERP Benefits |       |
|                                      | 2013                        | 2012  | 2013          | 2012  |
| Interest cost                        | \$ 26                       | \$ 29 | \$ 10         | \$ 10 |
| Expected return on plan assets       | (25)                        | (29)  | (18)          | (18)  |
| Recognized net actuarial (gain) loss | 41                          | 41    | 25            | 25    |
| Net pension expense (benefit)        | \$ 42                       | \$ 41 | \$ 17         | \$ 17 |

The Company previously disclosed in its financial statements for the year ended December 31, 2012 that it expected to contribute \$211,000 to its pension plan and \$80,000 to its SERP plan in 2013. The Company has contributed \$110,000 to its pension plan and \$80,000 to its SERP plan as of June 30, 2013. The Company expects to contribute an additional \$101,000 to its pension plan during the remainder of 2013. The Company does not expect to make any additional contributions to its SERP plan during the remainder of 2013.

## NOTE 7. NEW ACCOUNTING PRONOUNCEMENTS

In February 2013, the Financial Accounting Standards Board (FASB) issued updated guidance related to disclosure of reclassification amounts out of other comprehensive income. The standard requires that companies present, either in a single note or parenthetically on the face of their financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source and the income statement line items affected by the reclassification. The new requirements will take effect for public companies in fiscal years, and interim periods within those years, beginning after December 15, 2012. The Company adopted this standard on January 1, 2013. Adopting this standard did not have a significant impact on the Company's financial condition or results of operations.

## NOTE 8. FAIR VALUE DISCLOSURES

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

|         |  |
|---------|--|
| Level 1 | Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date. |
| Level 2 | Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that   |

are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3

Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

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

**Securities:** Securities available for sale are valued primarily by a third party pricing service. The fair values of securities available for sale are determined on a recurring basis by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or pricing models which utilize significant observable inputs such as matrix pricing. This is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). These models utilize the market approach with standard inputs that include, but are not limited to, benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data. For certain non-agency residential mortgage-backed securities where observable inputs about the specific issuer are not available, fair values are estimated using observable data from other non-agency residential mortgage-backed securities presumed to be similar or other market data on other non-agency residential mortgage-backed securities (Level 3 inputs). For certain municipal securities that are not rated and observable inputs about the specific issuer are not available, fair values are estimated using observable data from other municipal securities presumed to be similar or other market data on other non-rated municipal securities (Level 3 inputs). There were no transfers between Level 1 and Level 2 during the first six months of 2013.

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

**Interest rate swap derivatives:** The Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Currently, none of the Company's derivatives are designated in qualifying hedging relationships, as the derivatives are not used to manage risks within the Company's assets or liabilities. As such, all changes in fair value of the Company's derivatives are recognized directly in earnings. The fair value of interest rate swap derivatives is determined by pricing or valuation models using observable market data as of the measurement date (Level 2).

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

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

**Mortgage servicing rights:** As of June 30, 2013 the fair value of the Company's Level 3 servicing assets for residential mortgage loans was \$3.0 million, some of which are not currently impaired and therefore carried at amortized cost. These residential mortgage loans have a weighted average interest rate of 4.18%, a weighted average maturity of 19 years and are secured by homes generally within the Company's market area, which is primarily Northern Indiana. A valuation model is used to estimate fair value, which is based on an income approach. The inputs used include estimates of prepayment speeds, discount rate, cost to service, escrow account earnings, contractual servicing fee income, ancillary income, late fees, and float income. The most significant assumption used to value mortgage servicing rights is prepayment rate. Prepayment rates are estimated based on published industry consensus prepayment rates. The most significant unobservable assumption is the discount rate. At June 30, 2013, the constant prepayment speed (PSA) used was 229 and the discount rate used was 9.3%. At December 31, 2012, the constant prepayment speed (PSA) used was 392 and the discount rate used was 9.2%.

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

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



Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

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

|   | June 30, 2013   |  |                 | Assets<br>at Fair Value |
|---|-----------------|--|-----------------|-------------------------|
|   | Level 1         | Fair Value Measurements Using<br>Level 2 | Level 3         |                         |
| <b>Assets</b>                                     |                 |  |                 |                         |
| U.S. Treasury securities                          | \$ 1,027        | \$ 0                                     | \$ 0            | \$ 1,027                |
| U.S. Government sponsored agencies                | 0               | 5,224                                    | 0               | 5,224                   |
| Mortgage-backed securities                        | 0               | 366,418                                  | 0               | 366,418                 |
| Non-agency residential mortgage-backed securities | 0               | 0  | 5,392           | 5,392                   |
| State and municipal securities                    | 0               | 93,936                                   | 979             | 94,915                  |
| <b>Total Securities</b>                           | <b>1,027</b>    | <b>465,578</b>                           | <b>6,371</b>    | <b>472,976</b>          |
| Mortgage banking derivative                       | 0               | 417                                      | 0               | 417                     |
| Interest rate swap derivative                     | 0               | 314                                      | 0               | 314                     |
| <b>Total assets</b>                               | <b>\$ 1,027</b> | <b>\$ 466,309</b>                        | <b>\$ 6,371</b> | <b>\$ 473,707</b>       |
| <b>Liabilities</b>                                |                 |  |                 |                         |
| Mortgage banking derivative                       | \$ 0            | \$ 34                                    | \$ 0            | \$ 34                   |
| Interest rate swap derivative                     | 0               | 242                                      | 0               | 242                     |
| <b>Total liabilities</b>                          | <b>\$ 0</b>     | <b>\$ 276</b>                            | <b>\$ 0</b>     | <b>\$ 276</b>           |

|   | December 31, 2012 |  |                 | Assets<br>at Fair Value |
|---|-------------------|--|-----------------|-------------------------|
|   | Level 1           | Fair Value Measurements Using<br>Level 2 | Level 3         |                         |
| <b>Assets</b>                                     |                   |  |                 |                         |
| U.S. Treasury securities                          | \$ 1,037          | \$ 0                                     | \$ 0            | \$ 1,037                |
| U.S. Government sponsored agencies                | 0                 | 5,304                                    | 0               | 5,304                   |
| Mortgage-backed securities                        | 0                 | 365,644                                  | 0               | 365,644                 |
| Non-agency residential mortgage-backed securities | 0                 | 3,594                                    | 2,859           | 6,453                   |
| State and municipal securities                    | 0                 | 87,595                                   | 988             | 88,583                  |
| <b>Total Securities</b>                           | <b>1,037</b>      | <b>462,137</b>                           | <b>3,847</b>    | <b>467,021</b>          |
| Mortgage banking derivative                       | 0                 | 739                                      | 0               | 739                     |
| <b>Total assets</b>                               | <b>\$ 1,037</b>   | <b>\$ 462,876</b>                        | <b>\$ 3,847</b> | <b>\$ 467,760</b>       |
| <b>Liabilities</b>                                |                   |  |                 |                         |
| Mortgage banking derivative                       | \$ 0              | \$ 12                                    | \$ 0            | \$ 12                   |

There were no transfers between Level 1 and Level 2 during the six months ended June 30, 2013 and there were no transfers between Level 1 and Level 2 during 2012.

The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the six months ended June 30, 2013 and 2012:

|  | Non-Agency Residential<br>Mortgage-Backed Securities |      | State and Municipal Securities |        |
|--|--|------|--------------------------------|--------|
|  | 2013   | 2012 | 2013                           | 2012   |
| Balance of recurring Level 3 assets at January 1 | \$ 2,859   | \$ 0 | \$ 988                         | \$ 686 |
| Transfers into Level 3                           | 3,334  | 0    | 0                              | 0      |
| Changes in fair value of securities              | (52)   | 0    | (9)                            | 0      |
| Principal payments                               | (749)  | 0    | 0                              | (45)   |
| Balance of recurring Level 3 assets at June 30   | \$ 5,392   | \$ 0 | \$ 979                         | \$ 641 |

The fair value of two non-agency residential mortgage-backed securities with a fair value of \$3.3 million as of March 31, 2013 were transferred out of Level 2 and into Level 3 because of a lack of observable market data for these investments. The Company's policy is to recognize transfers as of the end of the reporting period. As a result, the fair value for these non-agency residential mortgage-backed securities and state and municipal securities was transferred into Level 3 on March 31, 2013.

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

#### Quantitative Information about Level 3 Fair Value Measurements

|  | Fair Value at<br>June 30, 2013 | Valuation<br>Technique      | Unobservable Input             | Range of<br>Inputs   |                     |
|--|--------------------------------|-----------------------------|--------------------------------|----------------------|---------------------|
|  |                                |                             |                                | (Average)            |                     |
| Non-agency<br>residential<br>mortgage-backed<br>securities | \$ 5,392                       | Discounted cash<br>flow     | Constant<br>prepayment rate    | 5.00-30.00<br>(9.56) |                     |
|  |                                |                             |                                | Average life         | 0.57-2.66<br>(1.44) |
|  |                                |                             |                                | Swap/EDSF spread     | 242-327<br>(297)    |
|  |                                |                             |                                |                      |                     |
| State and<br>municipal<br>securities                       | \$ 979                         | Price to type, par,<br>call | Discount to<br>benchmark index | 1-7%<br>(2.57%)      |                     |



## Quantitative Information about Level 3 Fair Value Measurements

|  | Fair Value at<br>December 31,<br>2012 | Valuation<br>Technique      | Unobservable Input             | Range of<br>Inputs<br>(Average) |
|--|---------------------------------------|-----------------------------|--------------------------------|---------------------------------|
| Non-agency<br>residential<br>mortgage-backed<br>securities | \$ 2,859                              | Discounted cash<br>flow     | Constant<br>prepayment rate    | 5.00-9.00<br>(6.00)             |
|  |                                       |                             | Average life (years)           | 0.20-2.86<br>(2.70)             |
|  |                                       |                             | Swap/EDSF spread               | 297-339<br>(328)                |
| State and<br>municipal<br>securities                       | \$ 988                                | Price to type, par,<br>call | Discount to<br>benchmark index | 1-11%<br>(4%)                   |

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

Securities pricing is obtained from a third party pricing service and is tested at least annually against prices from another third party provider and reviewed with a market value tolerance variance of 3%. If any securities fall above this tolerance threshold, they are reviewed in more detail to determine why the variance exists. Changes in market value are reviewed monthly in aggregate yield by security type and any material differences are reviewed to determine why they exist. At least annually, the pricing methodology of the pricing service is received and reviewed to support the fair value levels used by the Company. A detailed pricing evaluation is requested and reviewed on any security determined to be fair valued using unobservable inputs by the pricing service.

The significant unobservable inputs used in the fair value measurement of the Company's non-agency residential mortgage-backed securities classified as Level 3 are constant prepayment rates, average life, and a Swap/EDSF spread. Significant increases/(decreases) in any of those inputs in isolation would result in a significantly lower/(higher) fair value measurement.



Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

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

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

| Assets   | June 30, 2013  |                               |           | Assets<br>at Fair Value |
|--|----------------|-------------------------------|-----------|-------------------------|
|  | Level 1        | Fair Value Measurements Using |           |                         |
|  |                | Level 2                       | Level 3   |                         |
|  | (in thousands) |                               |           |                         |
| Impaired loans:  |                |                               |           |                         |
| Commercial and industrial loans:                           |                |                               |           |                         |
| Working capital lines of credit loans                      | \$ 0           | \$ 0                          | \$ 978    | \$ 978                  |
| Non-working capital loans                                  | 0              | 0                             | 3,265     | 3,265                   |
| Commercial real estate and multi-family residential loans: |                |                               |           |                         |
| Construction and land development loans                    | 0              | 0                             | 2,417     | 2,417                   |
| Owner occupied loans                                       | 0              | 0                             | 2,914     | 2,914                   |
| Nonowner occupied loans                                    | 0              | 0                             | 12,450    | 12,450                  |
| Multifamily loans  | 0              | 0                             | 0         | 0                       |
| Agri-business and agricultural loans:                      |                |                               |           |                         |
| Loans secured by farmland                                  | 0              | 0                             | 283       | 283                     |
| Loans for agricultural production                          | 0              | 0                             | 0         | 0                       |
| Other commercial loans                                     | 0              | 0                             | 0         | 0                       |
| Consumer 1-4 family mortgage loans:                        |                |                               |           |                         |
| Closed end first mortgage loans                            | 0              | 0                             | 404       | 404                     |
| Open end and junior lien loans                             | 0              | 0                             | 25        | 25                      |
| Residential construction loans                             | 0              | 0                             | 0         | 0                       |
| Other consumer loans                                       | 0              | 0                             | 40        | 40                      |
| Total impaired loans                                       | \$ 0           | \$ 0                          | \$ 22,776 | \$ 22,776               |
| Mortgage servicing rights                                  | 0              | 0                             | 8         | 8                       |
| Other real estate owned                                    | 0              | 0                             | 75        | 75                      |
| Total assets   | \$ 0           | \$ 0                          | \$ 22,859 | \$ 22,859               |





The following table presents the valuation methodology and unobservable inputs for Level 3 assets measured at fair value on a non-recurring basis at June 30, 2013:

|                                | Fair Value | Valuation Methodology         | Unobservable Inputs   | Average | Range of Inputs |
|--------------------------------|------------|-------------------------------|---|---------|-----------------|
| <b>Impaired Loans:</b>         |            |                               |   |         |                 |
| Commercial and industrial      | \$ 4,243   | Collateral based measurements | Discount to reflect current market conditions and ultimate collectability | 31%     | (8% - 90%)      |
| <b>Impaired loans:</b>         |            |                               |   |         |                 |
| Commercial real estate         | 17,781     | Collateral based measurements | Discount to reflect current market conditions and ultimate collectability | 23%     | (3% - 42%)      |
| <b>Impaired loans:</b>         |            |                               |   |         |                 |
| Agri-business and agricultural | 283        | Collateral based measurements | Discount to reflect current market conditions and ultimate collectability | 13%     |                 |
| <b>Impaired loans:</b>         |            |                               |   |         |                 |
| Consumer 1-4 family mortgage   | 429        | Collateral based measurements | Discount to reflect current market conditions and ultimate collectability | 22%     | (8% - 59%)      |
| <b>Impaired loans:</b>         |            |                               |   |         |                 |
| Other consumer                 | 40         | Collateral based measurements | Discount to reflect current market conditions and ultimate collectability | 39%     | (33% - 79%)     |

|                           |   |                       |               |       |
|---------------------------|---|-----------------------|---------------|-------|
| Mortgage servicing rights | 8 | Discounted cash flows | Discount rate | 9.50% |
|---------------------------|---|-----------------------|---------------|-------|

|                         |    |           |   |     |
|-------------------------|----|-----------|---|-----|
| Other real estate owned | 75 | Appraisal | Discount to reflect current market conditions | 49% |
|-------------------------|----|-----------|---|-----|

The following table presents the valuation methodology and unobservable inputs for Level 3 assets measured at fair value on a non-recurring basis at December 31, 2012:

|                                | Fair Value | Valuation Methodology         | Unobservable Inputs   | Average | Range of Inputs |
|--------------------------------|------------|-------------------------------|---|---------|-----------------|
| <b>Impaired Loans:</b>         |            |                               |   |         |                 |
| Commercial and industrial      | \$ 3,980   | Collateral based measurements | Discount to reflect current market conditions and ultimate collectability | 35%     | (10% - 99%)     |
| <b>Impaired loans:</b>         |            |                               |   |         |                 |
| Commercial real estate         | 24,560     | Collateral based measurements | Discount to reflect current market conditions and ultimate collectability | 23%     | (4% - 57%)      |
| <b>Impaired loans:</b>         |            |                               |   |         |                 |
| Agri-business and agricultural | 268        | Collateral based measurements | Discount to reflect current market conditions and ultimate collectability | 19%     |                 |
| <b>Impaired loans:</b>         |            |                               |   |         |                 |
| Consumer 1-4 family mortgage   | 510        | Collateral based measurements | Discount to reflect current market conditions and ultimate collectability | 39%     | (8% - 100%)     |
| <b>Impaired loans:</b>         |            |                               |   |         |                 |
| Other consumer                 | 46         | Collateral based measurements | Discount to reflect   | 40%     | (29% - 100%)    |

current market  
conditions  
and ultimate  
collectability

|                           |       |                       |               |       |                 |
|---------------------------|-------|-----------------------|---------------|-------|-----------------|
| Mortgage servicing rights | 1,906 | Discounted cash flows | Discount rate | 9.20% | (9.10% - 9.50%) |
|---------------------------|-------|-----------------------|---------------|-------|-----------------|

|                         |    |            |   |     |
|-------------------------|----|------------|---|-----|
| Other real estate owned | 75 | Appraisals | Discount to reflect current market conditions | 49% |
|-------------------------|----|------------|---|-----|

| Assets   | December 31, 2012 |  |           | Assets<br>at Fair Value |
|--|-------------------|--|-----------|-------------------------|
|  | Level 1           | Fair Value Measurements Using<br>Level 2 | Level 3   |                         |
|  | (in thousands)    |  |           |                         |
| Impaired loans:  |                   |  |           |                         |
| Commercial and industrial loans:                           |                   |  |           |                         |
| Working capital lines of credit loans                      | \$ 0              | \$ 0                                     | \$ 990    | \$ 990                  |
| Non-working capital loans                                  | 0                 | 0  | 2,990     | 2,990                   |
| Commercial real estate and multi-family residential loans: |                   |  |           |                         |
| Construction and land development loans                    | 0                 | 0  | 2,026     | 2,026                   |
| Owner occupied loans                                       | 0                 | 0  | 3,892     | 3,892                   |
| Nonowner occupied loans                                    | 0                 | 0  | 18,642    | 18,642                  |
| Multifamily loans  | 0                 | 0  | 0         | 0                       |
| Agri-business and agricultural loans:                      |                   |  |           |                         |
| Loans secured by farmland                                  | 0                 | 0  | 268       | 268                     |
| Loans for agricultural production                          | 0                 | 0  | 0         | 0                       |
| Other commercial loans                                     | 0                 | 0  | 0         | 0                       |
| Consumer 1-4 family mortgage loans:                        |                   |  |           |                         |
| Closed end first mortgage loans                            | 0                 | 0  | 352       | 352                     |
| Open end and junior lien loans                             | 0                 | 0  | 158       | 158                     |
| Residential construction loans                             | 0                 | 0  | 0         | 0                       |
| Other consumer loans                                       | 0                 | 0  | 46        | 46                      |
| Total impaired loans                                       | \$ 0              | \$ 0                                     | \$ 29,364 | \$ 29,364               |
| Mortgage servicing rights                                  | 0                 | 0  | 1,906     | 1,906                   |
| Other real estate owned                                    | 0                 | 0  | 75        | 75                      |
| Total assets   | \$ 0              | \$ 0                                     | \$ 31,345 | \$ 31,345               |

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a gross carrying amount of \$30.3 million, with a valuation allowance of \$7.5 million at June 30, 2013, resulting in a net recovery in the provision for loan losses of \$2.5 million and \$200,000, respectively, for the six months and three months ended June 30, 2013. At June 30, 2012, impaired loans had a carrying amount of had a gross carrying amount of \$47.6 million, with a valuation allowance of \$14.7 million, resulting in a net recovery in the provision for loan losses of \$1.8 million and \$3.5 million, respectively, for the three months and six months ended June 30, 2012.

Mortgage servicing rights, which are carried at the lower of cost or fair value, included a portion carried at their fair value of \$8,000, which is made up of the outstanding balance of \$11,000, net of a valuation allowance of \$3,000 at June 30, 2013, resulting in a net recovery of \$39,000 in impairment for the six months ended June 30, 2013. The Company realized a net recovery of impairment of \$22,000 for the six months ended June 30, 2012.

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

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

|  | Carrying Value | June 30, 2013 |                      |           | Total       |
|--|----------------|---------------|----------------------|-----------|-------------|
|  |                | Level 1       | Estimated Fair Value |           |             |
|  |                |               | Level 2              | Level 3   |             |
| <b>Financial Assets:</b>                       |                |               |                      |           |             |
| Cash and cash equivalents                      | \$ 63,555      | \$ 63,555     | \$ 0                 | \$ 0      | \$ 63,555   |
| Securities available for sale                  | 472,976        | 1,027         | 465,578              | 6,371     | 472,976     |
| Real estate mortgages held for sale            | 5,486          | 0             | 5,567                | 0         | 5,567       |
| Loans, net                                     | 2,284,065      | 0             | 0                    | 2,285,426 | 2,285,426   |
| Federal Home Loan Bank stock                   | 7,313          | N/A           | N/A                  | N/A       | N/A         |
| Federal Reserve Bank stock                     | 3,420          | N/A           | N/A                  | N/A       | N/A         |
| Accrued interest receivable                    | 9,208          | 6             | 2,266                | 6,936     | 9,208       |
| <b>Financial Liabilities:</b>                  |                |               |                      |           |             |
| Certificates of deposit                        | (804,564)      | 0             | (815,860)            | 0         | (815,860)   |
| All other deposits                             | (1,678,928)    | (1,678,928)   | 0                    | 0         | (1,678,928) |
| Securities sold under agreements to repurchase | (102,655)      | 0             | (102,655)            | 0         | (102,655)   |
| Federal funds purchased                        | (37,000)       | 0             | (37,000)             | 0         | (37,000)    |
| Long-term borrowings                           | (37)           | 0             | (44)                 | 0         | (44)        |
| Subordinated debentures                        | (30,928)       | 0             | 0                    | (31,230)  | (31,230)    |
| Standby letters of credit                      | (316)          | 0             | 0                    | (316)     | (316)       |
| Accrued interest payable                       | (4,405)        | (135)         | (4,267)              | (3)       | (4,405)     |

|                                     | Carrying Value | December 31, 2012 |                      |           | Total      |
|-------------------------------------|----------------|-------------------|----------------------|-----------|------------|
|                                     |                | Level 1           | Estimated Fair Value |           |            |
|                                     |                |                   | Level 2              | Level 3   |            |
| <b>Financial Assets:</b>            |                |                   |                      |           |            |
| Cash and cash equivalents           | \$ 232,237     | \$ 232,237        | \$ 0                 | \$ 0      | \$ 232,237 |
| Securities available for sale       | 467,021        | 1,037             | 462,137              | 3,847     | 467,021    |
| Real estate mortgages held for sale | 9,452          | 0                 | 9,663                | 0         | 9,663      |
| Loans, net                          | 2,206,075      | 0                 | 0                    | 2,230,993 | 2,230,993  |
| Federal Home Loan Bank stock        | 7,313          | N/A               | N/A                  | N/A       | N/A        |
| Federal Reserve Bank stock          | 3,420          | N/A               | N/A                  | N/A       | N/A        |

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

|                             |             |             |           |          |             |
|-----------------------------|-------------|-------------|-----------|----------|-------------|
| Accrued interest receivable | 8,485       | 6           | 2,215     | 6,264    | 8,485       |
| Financial Liabilities:      |             |             |           |          |             |
| Certificates of deposit     | (907,505)   | 0           | (922,397) | 0        | (922,397)   |
| All other deposits          | (1,674,251) | (1,674,251) | 0         | 0        | (1,674,251) |
| Securities sold under       |             |             |           |          |             |
| agreements to repurchase    | (121,883)   | 0           | (121,883) | 0        | (121,883)   |
| Long-term borrowings        | (15,038)    | 0           | (15,607)  | 0        | (15,607)    |
| Subordinated debentures     | (30,928)    | 0           | 0         | (31,223) | (31,223)    |
| Standby letters of credit   | (262)       | 0           | 0         | (262)    | (262)       |
| Accrued interest payable    | (4,757)     | (298)       | (4,456)   | (3)      | (4,757)     |



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

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

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

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

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

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

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

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

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

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

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

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

## NOTE 9. ACCUMULATED OTHER COMPREHENSIVE INCOME

The following tables summarize the changes within each classification of accumulated other comprehensive income for the six months ended June 30, 2013 and 2012:

## CHANGES IN ACCUMULATED OTHER COMPREHENSIVE INCOME BY COMPONENT(a)

|  | Unrealized<br>Gains and<br>Losses on<br>Available-<br>for-Sales<br>Securities | Defined<br>Benefit<br>Pension<br>Items | Total    |
|--|---|--|----------|
| Balance at December 31, 2012   | \$ 7,517  | \$ (1,828)                             | \$ 5,689 |
| Other comprehensive income<br>before reclassification                  | (6,295)   | (90)                                   | (6,385)  |
| Amounts reclassified from<br>accumulated other<br>comprehensive income | (1)   | 72                                     | 71       |
| Net current period other<br>comprehensive income                       | (6,296)   | (18)                                   | (6,314)  |
| Balance at June 30, 2013   | \$ 1,221  | \$ (1,846)                             | \$ (625) |

(a) All amounts are net of tax. Amounts in parenthesis indicate debits.

|   | Balance<br>at December 31, 2011 | Current<br>Period<br>Change | Balance<br>at June 30, 2012 |
|---|---------------------------------|-----------------------------|-----------------------------|
| Unrealized loss on securities available for<br>sale       |                                 |                             |                             |
| without other than temporary impairment                   | \$ 7,688                        | \$ 886                      | \$ 8,574                    |
| Unrealized loss on securities available for<br>sale       |                                 |                             |                             |
| with other than temporary impairment                      | (523)                           | 335                         | (188)                       |
| Total unrealized loss on securities available<br>for sale | 7,165                           | 1,221                       | 8,386                       |
|   | (2,026)                         | 131                         | (1,895)                     |

Unrealized loss on defined benefit pension plans

|       |    |       |    |       |    |       |
|-------|----|-------|----|-------|----|-------|
| Total | \$ | 5,139 | \$ | 1,352 | \$ | 6,491 |
|-------|----|-------|----|-------|----|-------|

Reclassifications out of accumulated comprehensive income for the six months ended June 30, 2013 are as follows:

RELCLASSIFICATIONS OUT OF ACCUMULATED OTHER COMPREHENSIVE INCOME(a)

| Details about Accumulated other Comprehensive Income Components | Amount Reclassified From Accumulated Other Comprehensive Income | Affected Line Item in the Statement Where Net Income is Presented |
|---|---|---|
| Unrealized gains and losses on available-for-sale securities    |   |   |
|   | \$ 1  | Net securities gains (losses)                                     |
|   | 0   | Income tax expense  |
|   | \$ 1  | Net of tax  |
| Amortization of defined benefit pension items                   |   |   |
|   | \$ (121)(b)   | Salaries and employee benefits                                    |
|   | 49  | Income tax expense  |
|   | \$ (72)   | Net of tax  |
| total reclassifications for the period                          | \$ (71)   | Net of tax  |

(a) Amounts in parenthesis indicate debits to profit/loss.

(b) Included in the computation of net periodic benefit cost (see employee benefit plans footnote for additional details).

NOTE 10. OFFSETTING ASSETS AND LIABILITIES

On January 1, 2013, the Company adopted changes issued by the FASB to the disclosure of offsetting assets and liabilities. These changes require an entity to disclose both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions

subject to an agreement similar to a master netting arrangement. The enhanced disclosures will enable users of an entity's financial statements to understand and evaluate the effect or potential effect of master netting arrangements on an entity's financial position, including the effect or potential effect of rights of setoff associated with certain financial instruments and derivative instruments. Other than the additional disclosure requirements, the adoption of these changes had no impact on the Consolidated Financial Statements.

Offsetting of Financial Assets and Derivative Assets

| Description                    | June 30, 2013<br>(in thousands)    |   |  |   |                          |            |
|--------------------------------|------------------------------------|---|--|---|--------------------------|------------|
|                                | Gross Amounts of Recognized Assets | Gross Amounts Offset in the Statement of Financial Position | Net Amounts of Assets presented in the Statement of Financial Position | Gross Amounts Not Offset in the Statement of Financial Position |                          |            |
|                                |                                    |   |  | Financial Instruments   | Cash Collateral Received | Net Amount |
| Interest Rate Swap Derivatives | \$ 314                             | \$ 0  | \$ 314   | \$ 0  | (290)                    | \$ 24      |
| Total                          | \$ 314                             | \$ 0  | \$ 314   | \$ 0  | (290)                    | \$ 24      |

## Offsetting of Financial Liabilities and Derivative Liabilities

| Description                    | June 30, 2013<br>(in thousands)         |   |   |   |                         |               |
|--------------------------------|---|---|---|---|-------------------------|---------------|
|                                | Gross Amounts of Recognized Liabilities | Gross Amounts Offset in the Statement of Financial Position | Net Amounts of Liabilities presented in the Statement of Financial Position | Gross Amounts Not Offset in the Statement of Financial Position |                         |               |
|                                |   |   |   | Financial Instruments   | Cash Collateral Pledged | Net Amount    |
| Interest Rate Swap Derivatives | \$ 242                                  | \$ 0  | \$ 242  | \$ 0  | \$ 0                    | \$ 242        |
| Repurchase Agreements          | 102,655                                 | 0   | 102,655   | (102,655)   | 0                       | 0             |
| <b>Total</b>                   | <b>\$ 102,897</b>                       | <b>\$ 0</b>   | <b>\$ 102,897</b>   | <b>\$ (102,655)</b>   | <b>\$ 0</b>             | <b>\$ 242</b> |

## Offsetting of Financial Liabilities and Derivative Liabilities

| Description           | December 31, 2012<br>(in thousands)     |   |   |   |                         |             |
|-----------------------|---|---|---|---|-------------------------|-------------|
|                       | Gross Amounts of Recognized Liabilities | Gross Amounts Offset in the Statement of Financial Position | Net Amounts of Liabilities presented in the Statement of Financial Position | Gross Amounts Not Offset in the Statement of Financial Position |                         |             |
|                       |   |   |   | Financial Instruments   | Cash Collateral Pledged | Net Amount  |
| Repurchase Agreements | \$ 121,883                              | \$ 0  | \$ 121,883  | \$ (121,883)  | \$ 0                    | \$ 0        |
| <b>Total</b>          | <b>\$ 121,883</b>                       | <b>\$ 0</b>   | <b>\$ 121,883</b>   | <b>\$ (121,883)</b>   | <b>\$ 0</b>             | <b>\$ 0</b> |

There were no interest rate swap derivatives as of December 31, 2012.

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

## NOTE 11. SUBSEQUENT EVENTS

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

## NOTE 12. RECLASSIFICATIONS

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

Part 1  
LAKELAND FINANCIAL CORPORATION  
ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION  
and  
RESULTS OF OPERATIONS

June 30, 2013

OVERVIEW

Lakeland Financial Corporation is the holding company for Lake City Bank. The Company is headquartered in Warsaw, Indiana and operates 45 offices in 13 counties in Northern and Central Indiana. The Company earned \$18.5 million for the first six months of 2013, versus \$17.4 million in the same period of 2012, an increase of 5.9%. Net income was positively impacted by an increase in noninterest income of \$3.4 million and a \$1.3 million decrease in the provision for loan losses. Offsetting these positive impacts were a decrease in net interest income of \$1.5 million and an increase of \$1.1 million in noninterest expense. Basic earnings per common share for the first six months of 2013 were \$1.13 per share versus \$1.07 per share for the first six months of 2012, an increase of 5.6%. Diluted earnings per common share reflect the potential dilutive impact of stock options, stock awards and warrants. Diluted earnings per common share for the first six months of 2013 were \$1.12 per share versus \$1.06 for the first six months of 2012, an increase of 5.7%.

Net income for the second quarter of 2013 was \$9.2 million, an increase of 4.7% versus \$8.8 million for the comparable period of 2012. The increase was driven by a \$1.8 million increase in noninterest income and a \$500,000 decrease in the provision for loan losses. Offsetting this positive impact was an increase in noninterest expense of \$842,000 and a decrease in net interest income of \$236,000. Basic earnings per common share for the second quarter of 2013 were \$0.56 per share, versus \$0.54 per share for the second quarter of 2012. Diluted earnings per common share for the second quarter of 2013 were \$0.56 per share, versus \$0.54 per share for the second quarter of 2012, an increase of 3.7%.

Earnings for the three month and six month periods ended June 30, 2013 were negatively impacted by a \$465,000 provision for state income tax expense due to a revaluation of the Company's deferred tax items relating to state income tax. During the second quarter of 2013, the Indiana legislature enacted new, lower tax rates for financial institutions which will take effect beginning in 2014. One effect of the lower, future rates is to reduce the benefit which will be provided by the Company's existing deferred tax items requiring the non-cash adjustment. Excluding the effect of the adjustment, net income for the three months and six months ended June 30, 2013 would have been \$9.7 million and \$18.9 million, respectively, representing increases of 10% and 9% over the comparable periods of 2012.

RESULTS OF OPERATIONS

Net Interest Income

For the six-month period ended June 30, 2013, net interest income totaled \$43.2 million, a decrease of 3.3%, or \$1.5 million, versus the first six months of 2012. This decrease was primarily due to a 24 basis point decrease in the



Company's net interest margin to 3.19% for the six month period ended June 30, 2013, versus 3.37% for the comparable period of 2012. During the six-month period ended June 30, 2013, average earning assets increased by \$65.2 million, or 2.4%, to \$2.782 billion. For the second quarter of 2013, net interest income totaled \$21.9 million, a decrease of 1.1%, or \$236,000, versus the second quarter of 2012. This decrease was primarily due to a 12 basis point decrease in the Company's net interest margin to 3.20% for the second quarter of 2013, versus 3.32% for the second quarter of 2012. Average earning assets increased \$65.5 million, or 2.4%, to \$2.796 billion in the second quarter of 2013, versus the second quarter of 2012.

Given the Company's mix of interest earning assets and interest bearing liabilities at June 30, 2013, the Company would generally be considered to have a relatively neutral balance sheet structure. The Company's balance sheet structure would normally be expected to produce a stable or declining net interest margin in a declining rate environment. As the Company's balance sheet has become more neutral in structure, management believes rate movements and other factors such as deposit mix, market deposit rate pricing and non-bank deposit products could have an impact on net interest margin. As a result of the prolonged and unprecedented low interest rate environment, and given ongoing indications by the Federal Reserve Bank regarding its intentions to maintain current target rate levels, the Company expects to experience continued pressure on its net interest margin. Also contributing to this net interest margin compression is a recent trend of aggressive loan pricing by the Company's competitors in its markets on both variable and fixed rate commercial loans. As a result of this competitive pricing influence, the Company believes that its yields on the commercial loan portfolio will continue to experience downward pressure. Over time, the Company's mix of deposits has shifted to more reliance on transaction accounts such as Rewards Checking, as well as Rewards Savings and corporate and public fund money market and repurchase agreements, which generally carry a higher interest rate cost than other types of interest bearing deposits. The Company believes that this deposit strategy provides for an appropriate funding strategy.

During the first six months of 2013, total interest and dividend income decreased by \$6.3 million, or 10.7%, to \$52.7 million, versus \$59.0 million during the first six months of 2012. This decrease was primarily the result of a 55 basis point decrease in the tax equivalent yield on average earning assets to 3.9%, versus 4.4% for the same period of 2012. Average earning assets increased by \$65.2 million, or 2.4%, during the first six months of 2013 versus the same period of 2012. During the second quarter of 2013, total interest and dividend income decreased by \$2.8 million, or 9.7%, to \$26.4 million, versus \$29.2 million during the second quarter of 2012. This decrease was primarily the result of a 52 basis point decrease in the tax equivalent yield on average earning assets to 3.9% in the second quarter of 2013, versus 4.4% for the same period of 2012. Average earning assets increased by \$65.5 million, or 2.4%, in the second quarter of 2013 versus the same period of 2012.

During the first six months of 2013, loan interest income decreased by \$3.1 million, or 6.0%, to \$49.1 million, versus \$52.2 million during the first six months of 2012. The decrease was driven by a 39 basis point decrease in the tax equivalent yield on loans, to 4.4%, versus 4.7% in the first three months of 2012. During the second quarter of 2013, loan interest income decreased by \$1.4 million, or 5.5%, to \$24.5 million, versus \$25.9 million during the second quarter of 2012. The decrease was driven by a 43 basis point decrease in the tax equivalent yield on loans, to 4.3%, versus 4.7% in the second quarter of 2012.

The average daily securities balances for the first six months of 2013 increased \$5.8 million, or 1.2%, to \$480.4 million, versus \$474.6 million for the same period of 2012. During the same periods, income from securities decreased by \$3.2 million, or 46.9%, to \$3.6 million versus \$6.8 million during the first six months of 2012. The decrease was primarily the result of a 134 basis point decrease in the tax equivalent yield on securities, to 1.8%, versus 3.2% in the first six months of 2012. The average daily securities balances for the second quarter of 2013 increased \$3.4 million, or 0.7%, to \$482.6 million, versus \$479.2 million for the same period of 2012. During the same periods, income from securities decreased by \$1.4 million, or 42.2%, to \$1.9 million versus \$3.3 million during the second quarter of 2012. The decrease was primarily the result of a 116 basis point decrease in the tax equivalent yield on securities, to 1.9%, versus 3.1% in the second quarter of 2012. The prolonged low interest rate environment has driven accelerated prepayments in the Company's portfolio of mortgage backed securities. Those prepayments must then be reinvested in securities at current, lower market yields, resulting in less income from securities despite the higher average securities balances. In addition, the prepayments have the effect of accelerating premium amortization of those mortgage backed securities which were purchased at a premium. Due to the unprecedented low interest rate environment, the Company is actively considering and implementing changes in its investment strategy. The plan includes considering the purchase of good quality, higher yielding alternative investments. Given the strength of the Company's balance sheet and the likelihood of the low interest rate environment persisting into the future, the Company believes that this would be an appropriate and prudent strategy, although the Company does not expect this

will result in a significant change in strategy.

52

---

Total interest expense decreased \$4.8 million, or 33.6%, to \$9.5 million for the six-month period ended June 30, 2013, from \$14.4 million for the comparable period in 2012. The decrease was primarily the result of a 36 basis point decrease in the Company's daily cost of funds to 0.7%, versus 1.1% for the same period of 2012. Total interest expense decreased \$2.6 million, or 36.5%, to \$4.5 million for the second quarter of 2013, versus \$7.1 million for the second quarter of 2012. The decrease was primarily the result of a 37 basis point decrease in the Company's cost of funds to 0.7%, from 1.1% for the same period of 2012.

On an average daily basis, total deposits (including demand deposits) decreased \$94.2 million, or 0.4%, to \$2.482 billion for the six-month period ended June 30, 2013, versus \$2.491 billion during the same period in 2012. The average daily balances for the second quarter of 2013 decreased \$63.9 million, or 2.5%, to \$2.490 billion from \$2.554 billion during the second quarter of 2012. On an average daily basis, noninterest bearing demand deposits were \$384.0 million for the six-month period ended June 30, 2013, versus \$340.0 million for the same period in 2012. The average daily noninterest bearing demand deposit balances for the second quarter of 2013 were \$387.2 million, versus \$345.7 million for the second quarter of 2012. On an average daily basis, interest bearing transaction accounts increased \$23.5 million, or 2.4%, to \$1.021 billion for the six-month period ended June 30, 2013, versus the same period in 2012. Average daily interest bearing transaction accounts decreased \$568,000, or 0.1%, to \$1.042 billion for the second quarter of 2013, versus \$1.042 billion for the second quarter of 2012. When comparing the six months ended June 30, 2013 with the same period of 2012, the average daily balance of time deposits, which pay a higher rate of interest compared to demand deposits and non-Rewards Checking transaction accounts, decreased \$109.5 million. The average rate paid on time deposit accounts decreased 41 basis points to 1.3% for the six-month period ended June 30, 2013, versus the same period in 2012. During the second quarter of 2013, the average daily balance of time deposits decreased \$141.5 million, and the rate paid decreased 41 basis points to 1.2%, versus the second quarter of 2012. Despite the low interest rate environment, the Company has been able to attract and retain retail deposit customers through offering innovative deposit products such as Rewards Checking and Savings. These products pay somewhat higher interest rates but also encourage certain customer behaviors such as using debit cards and electronic statements, which have the effect of generating additional related fee income and reducing the Company's processing costs.

The Company's funding strategy is generally focused on leveraging its retail branch network to grow traditional retail deposits and on its presence with commercial customers and public fund entities in its Indiana markets to generate deposits. In addition, the Company has utilized the Certificate of Deposit Account Registry Service (CDARS) program and out-of-market brokered certificates of deposit. Due to the Company's historical loan growth, the Company sought these deposits and has expanded its funding strategy over time to include these types of non-core deposit programs although its reliance on these types of deposits has reduced significantly over the past several years. The Company believes that these deposit programs represent an appropriate tool in the overall liquidity and funding strategy but will continue to focus on funding loan and investment growth with in-market deposits whenever possible. On an average daily basis, total brokered certificates of deposit decreased \$30.2 million to \$18.4 million for the six-month period ended June 30, 2013, versus \$48.6 million for the same period in 2012. During the second quarter of 2013, average daily brokered certificates of deposit were \$8.9 million, versus \$42.7 million during the second quarter of 2012. On an average daily basis, total public fund certificates of deposit increased \$30.2 million to \$122.8 million for the six-month period ended June 30, 2013, versus \$92.6 million for the same period in 2012. During the second quarter of 2013, average daily public fund certificates of deposit were \$130.7 million, versus \$102.0 million during the second quarter of 2012. In addition, the Company had average public fund interest bearing transaction accounts of \$192.7 million and \$192.2 million, respectively, in the six months and three months ended June 30, 2013, versus \$191.1 million and \$189.5 million for the comparable periods of 2012. Availability of public fund deposits can be cyclical, primarily due to the timing differences between when real estate property taxes are collected versus when those tax revenues are spent, as well as the intense competition for these funds.

Average daily balances of borrowings were \$158.1 million during the six months ended June 30, 2013, versus \$165.1 million during the same period of 2012, and the rate paid on borrowings decreased 26 basis points to 1.0%. During the second quarter of 2013, the average daily balances of borrowings increased \$7.6 million to \$165.3 million, versus \$157.7 million for the same period of 2012, and the rate paid on borrowings decreased 37 basis points to 0.9%. On an average daily basis, total deposits (including demand deposits) and purchased funds decreased 0.4% and 1.9%, respectively, during the six-month and three-month periods ended June 30, 2013 versus the same periods in 2012.

The Board of Directors and management recognize the importance of liquidity during times of normal operations and in times of stress. In 2010, the Company formalized and expanded upon its extensive Contingency Funding Plan ("CFP"). The formal CFP was developed to help ensure that the multiple liquidity sources available to the Company are detailed. The CFP identifies the potential funding sources, which include the Federal Home Loan Bank of Indianapolis, The Federal Reserve Bank, brokered certificates of deposit, certificates of deposit available from the CDARS program, repurchase agreements, and Fed Funds. The CFP also addresses the role of the securities portfolio in liquidity.

Further, the plan identifies CFP team members and expressly details their respective roles. Potential risk scenarios are identified and the plan includes multiple scenarios, including short-term and long-term funding crisis situations. Under the long-term funding crisis, two additional scenarios are identified: a moderate risk scenario and a highly stressed scenario. The CFP indicates the responsibilities and the actions to be taken by the CFP team under each scenario. Monthly reports to management and the Board of Directors under the CFP include an early warning indicator matrix and pro forma cash flows for the various scenarios. The Company will continue to carefully monitor its liquidity planning and will consider adjusting its plans as circumstances warrant.

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

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

|                                      | Six Months Ended June 30, |                            |              |                    |                            |              |
|--------------------------------------|---------------------------|----------------------------|--------------|--------------------|----------------------------|--------------|
|                                      | Average<br>Balance        | 2013<br>Interest<br>Income | Yield<br>(1) | Average<br>Balance | 2012<br>Interest<br>Income | Yield<br>(1) |
| <b>ASSETS</b>                        |                           |                            |              |                    |                            |              |
| Earning assets:                      |                           |                            |              |                    |                            |              |
| Loans:                               |                           |                            |              |                    |                            |              |
| Taxable<br>(2)(3)                    | \$ 2,271,373              | \$ 48,874                  | 4.34%        | \$ 2,208,374       | \$ 51,986                  | 4.73         |
| Tax<br>exempt<br>(1)                 | 8,750                     | 308                        | 7.09         | 9,749              | 334                        | 6.89         |
| Investments:<br>(1)                  |                           |                            |              |                    |                            |              |
| Available<br>for sale                | 480,376                   | 4,359                      | 1.83         | 474,555            | 7,492                      | 3.17         |
| Short-term<br>investments            | 7,291                     | 3                          | 0.08         | 22,030             | 10                         | 0.09         |
| Interest<br>bearing<br>deposits      | 14,214                    | 33                         | 0.47         | 2,082              | 17                         | 1.64         |
| Total<br>earning<br>assets           | 2,782,004                 | 53,577                     | 3.88%        | 2,716,790          | 59,839                     | 4.43         |
| Nonearning assets:                   |                           |                            |              |                    |                            |              |
| Cash and<br>due from<br>banks        | 86,994                    | 0                          |              | 160,696            | 0                          |              |
| Premises<br>and<br>equipment         | 34,645                    | 0                          |              | 34,941             | 0                          |              |
| Other<br>nonearning<br>assets        | 110,610                   | 0                          |              | 95,653             | 0                          |              |
| Less<br>allowance for<br>loan losses | (51,188)                  | 0                          |              | (53,596)           | 0                          |              |
|                                      | \$ 2,963,065              | \$ 53,577                  |              | \$ 2,954,484       | \$ 59,839                  |              |

Total  
assets

- (1) Tax exempt income was converted to a fully taxable equivalent basis at a 35 percent tax rate for 2013 and 2012. The tax equivalent rate for tax exempt loans and tax exempt securities 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 six months ended June 30, 2013 and 2012, are included as taxable loan interest income.
- (3) Nonaccrual loans are included in the average balance of taxable loans.

55

---

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

|   | Six Months Ended June 30, |                             |       |                    |                             |       |
|---|---------------------------|-----------------------------|-------|--------------------|-----------------------------|-------|
|   | Average<br>Balance        | 2013<br>Interest<br>Expense | Yield | Average<br>Balance | 2012<br>Interest<br>Expense | Yield |
| <b>LIABILITIES<br/>AND<br/>STOCKHOLDERS'<br/>EQUITY</b> |                           |                             |       |                    |                             |       |
| Interest bearing liabilities:                           |                           |                             |       |                    |                             |       |
| Savings deposits  | \$ 223,625                | \$ 351                      | 0.32% | \$ 190,768         | \$ 369                      | 0.39% |
| Interest bearing checking accounts                      | 1,020,736                 | 3,058                       | 0.60  | 997,239            | 4,966                       | 1.00  |
| Time deposits:  |                           |                             |       |                    |                             |       |
| In denominations under \$100,000                        | 344,720                   | 2,498                       | 1.46  | 399,492            | 3,700                       | 1.86  |
| In denominations over \$100,000                         | 508,607                   | 2,869                       | 1.14  | 563,321            | 4,328                       | 1.55  |
| Miscellaneous short-term borrowings                     | 124,279                   | 203                         | 0.33  | 119,166            | 217                         | 0.37  |
| Long-term borrowings and subordinated debentures        | 33,865                    | 568                         | 3.38  | 45,966             | 799                         | 3.50  |
| Total interest bearing liabilities                      | 2,255,832                 | 9,547                       | 0.85% | 2,315,952          | 14,379                      | 1.25% |
| Noninterest bearing liabilities                         |                           |                             |       |                    |                             |       |



|   |              |           |              |           |       |
|---|--------------|-----------|--------------|-----------|-------|
| and<br>stockholders'<br>equity:   |              |           |              |           |       |
| Demand<br>deposits  | 383,993      | 0         | 340,041      | 0         |       |
| Other<br>liabilities  | 16,901       | 0         | 17,578       | 0         |       |
| Stockholders'<br>equity   | 306,339      | 0         | 280,913      | 0         |       |
| Total<br>liabilities and<br>stockholders'<br>equity                                 | \$ 2,963,065 | \$ 9,547  | \$ 2,954,484 | \$ 14,379 |       |
| Net interest<br>differential -<br>yield on<br>average<br>daily<br>earning<br>assets |              | \$ 44,030 | 3.19%        | \$ 45,460 | 3.37% |

DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS' EQUITY;  
INTEREST RATES AND INTEREST DIFFERENTIAL

(in thousands of dollars)

|                                | Three Months Ended June 30, |           |       |              |           |       |
|--------------------------------|-----------------------------|-----------|-------|--------------|-----------|-------|
|                                | Average                     | 2013      |       |              |           | 2012  |
|                                | Balance                     | Interest  | Yield | Average      | Interest  | Yield |
|                                | Balance                     | Income    | (1)   | Balance      | Income    | (1)   |
| <b>ASSETS</b>                  |                             |           |       |              |           |       |
| Earning assets:                |                             |           |       |              |           |       |
| Loans:                         |                             |           |       |              |           |       |
| Taxable                        |                             |           |       |              |           |       |
| (2)(3)                         | \$ 2,295,787                | \$ 24,388 | 4.26% | \$ 2,210,973 | \$ 25,795 | 4.69% |
| Tax exempt                     |                             |           |       |              |           |       |
| (1)                            | 8,684                       | 153       | 7.08  | 9,668        | 166       | 6.89  |
| Investments:                   |                             |           |       |              |           |       |
| (1)                            |                             |           |       |              |           |       |
| Available for sale             | 482,628                     | 2,310     | 1.92  | 479,131      | 3,675     | 3.08  |
| Short-term investments         | 5,446                       | 1         | 0.07  | 27,996       | 7         | 0.10  |
| Interest bearing deposits      | 3,380                       | 11        | 1.31  | 2,588        | 9         | 1.40  |
| Total earning assets           | 2,795,925                   | 26,864    | 3.85% | 2,730,356    | 29,652    | 4.37% |
| Nonearning assets:             |                             |           |       |              |           |       |
| Cash and due from banks        | 91,725                      | 0         |       | 208,016      | 0         |       |
| Premises and equipment         | 34,574                      | 0         |       | 35,014       | 0         |       |
| Other nonearning assets        | 110,662                     | 0         |       | 95,329       | 0         |       |
| Less allowance for loan losses | (50,736)                    | 0         |       | (53,074)     | 0         |       |
| Total assets                   | \$ 2,982,150                | \$ 26,864 |       | \$ 3,015,641 | \$ 29,652 |       |

- (1) Tax exempt income was converted to a fully taxable equivalent basis at a 35 percent tax rate for 2013 and 2012. The tax equivalent rate for tax exempt loans and tax exempt securities 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 three months ended June 30, 2013 and 2012, are included as taxable loan interest income.
- (3) Nonaccrual loans are included in the average balance of taxable loans.

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

|   | Three Months Ended June 30, |                             |       |                    |                             |       |
|---|-----------------------------|-----------------------------|-------|--------------------|-----------------------------|-------|
|   | Average<br>Balance          | 2013<br>Interest<br>Expense | Yield | Average<br>Balance | 2012<br>Interest<br>Expense | Yield |
| <b>LIABILITIES<br/>AND<br/>STOCKHOLDERS'<br/>EQUITY</b> |                             |                             |       |                    |                             |       |
| Interest bearing liabilities:                           |                             |                             |       |                    |                             |       |
| Savings deposits  | \$ 230,348                  | \$ 179                      | 0.31% | \$ 193,646         | \$ 158                      | 0.33% |
| Interest bearing checking accounts                      | 1,041,918                   | 1,418                       | 0.55  | 1,042,486          | 2,483                       | 0.96  |
| Time deposits:  |                             |                             |       |                    |                             |       |
| In denominations under \$100,000                        | 337,016                     | 1,198                       | 1.43  | 401,574            | 1,830                       | 1.83  |
| In denominations over \$100,000                         | 493,642                     | 1,344                       | 1.09  | 570,586            | 2,131                       | 1.50  |
| Miscellaneous short-term borrowings                     | 134,341                     | 112                         | 0.33  | 111,703            | 104                         | 0.37  |
| Long-term borrowings and subordinated debentures        | 30,965                      | 261                         | 3.38  | 45,967             | 395                         | 3.46  |
| Total interest bearing liabilities                      | 2,268,230                   | 4,512                       | 0.80% | 2,365,962          | 7,101                       | 1.21% |
| Noninterest bearing liabilities                         |                             |                             |       |                    |                             |       |

|   |              |           |              |           |       |
|---|--------------|-----------|--------------|-----------|-------|
| and<br>stockholders'<br>equity:   |              |           |              |           |       |
| Demand<br>deposits  | 387,191      | 0         | 345,721      | 0         |       |
| Other<br>liabilities  | 17,312       | 0         | 19,320       | 0         |       |
| Stockholders'<br>equity   | 309,417      | 0         | 284,638      | 0         |       |
| Total<br>liabilities and<br>stockholders'<br>equity                                 | \$ 2,982,150 | \$ 4,512  | \$ 3,015,641 | \$ 7,101  |       |
| Net interest<br>differential -<br>yield on<br>average<br>daily<br>earning<br>assets |              | \$ 22,352 | 3.20%        | \$ 22,551 | 3.32% |

## Provision for Loan Losses

Based on management's review of the adequacy of the allowance for loan losses, no provisions for loan losses were recorded during the six-month and three-month periods ended June 30, 2013, versus provisions of \$1.3 million and \$500,000 recorded during the same periods of 2012. Factors impacting the provision included the amount and status of classified and watch list credits, the level of charge-offs, management's overall view on current credit quality and the regional and national economic conditions impacting credit quality, the amount and status of impaired loans, the amount and status of past due accruing loans (90 days or more), and overall loan growth as discussed in more detail below in the analysis relating to the Company's financial condition.

## Noninterest Income

Noninterest income categories for the six-month and three-month periods ended June 30, 2013 and 2012 are shown in the following table:

|   | Six Months Ended<br>June 30, |                  | Percent<br>Change |
|---|------------------------------|------------------|-------------------|
|   | 2013                         | 2012             |                   |
| Wealth advisory fees  | \$ 1,915                     | \$ 1,811         | 5.7%              |
| Investment brokerage fees   | 1,946                        | 1,740            | 11.8              |
| Service charges on deposit accounts   | 4,223                        | 3,892            | 8.5               |
| Loan, insurance and service fees  | 3,268                        | 2,641            | 23.7              |
| Merchant card fee income  | 569                          | 605              | (6.0)             |
| Other income  | 2,081                        | 945              | 120.2             |
| Mortgage banking income   | 1,047                        | 984              | 6.4               |
| Net securities gains  | 1                            | 3                | (66.7)            |
| Impairment on available-for-sale securities (includes total losses of \$0 and \$985, net of \$0 and \$26 recognized in other comprehensive income, pre-tax) | 0                            | (959)            | N/A               |
| <b>Total noninterest income</b>   | <b>\$ 15,050</b>             | <b>\$ 11,662</b> | <b>29.1%</b>      |

|                                     | Three Months Ended<br>June 30, |        | Percent<br>Change |
|-------------------------------------|--------------------------------|--------|-------------------|
|                                     | 2013                           | 2012   |                   |
| Wealth advisory fees                | \$ 971                         | \$ 897 | 8.2%              |
| Investment brokerage fees           | 997                            | 940    | 6.1               |
| Service charges on deposit accounts | 2,252                          | 2,011  | 12.0              |
| Loan, insurance and service fees    | 1,812                          | 1,452  | 24.8              |
| Merchant card fee income            | 293                            | 289    | 1.4               |
| Other income                        | 706                            | 280    | 152.1             |
| Mortgage banking income             | 538                            | 392    | 37.2              |
| Net securities gains                | 0                              | 0      | 0                 |

Impairment on available-for-sale securities (includes total losses of \$0 and \$475

net of \$0 and \$26 recognized in other comprehensive income, pre-tax)

|                          |          |          |       |
|--------------------------|----------|----------|-------|
|                          | 0        | (449)    | N/A   |
| Total noninterest income | \$ 7,569 | \$ 5,812 | 30.2% |

Noninterest income increased \$3.4 million and \$1.7 million, respectively, for the six-month and three-month periods ended June 30, 2013 versus the same periods in 2012. Other income increased by \$1.1 million and \$426,000, respectively, driven by income on bank owned life insurance as well as fees related to the Company's interest rate swap program for clients. During the first quarter, the Company introduced a new swap derivative product, which is offered to certain commercial banking customers. Loan, insurance and service fees increased by \$627,000 and \$360,000, respectively, and were driven by higher fee income on increased debit card activity. In addition, noninterest income in the six-months and three-months ended June 30, 2012 was negatively impacted by \$959,000 and \$449,000, respectively, in other-than-temporary impairment on several non-agency mortgage backed securities.

## Noninterest Expense

Noninterest expense categories for the six-month and three-month periods ended June 30, 2013 and 2012 are shown in the following table:

|                                   | Six Months Ended<br>June 30, |           | Percent<br>Change |
|-----------------------------------|------------------------------|-----------|-------------------|
|                                   | 2013                         | 2012      |                   |
| Salaries and employee benefits    | \$ 18,056                    | \$ 17,438 | 3.5%              |
| Occupancy expense                 | 1,719                        | 1,716     | 0.2               |
| Equipment costs                   | 1,263                        | 1,213     | 4.1               |
| Data processing fees and supplies | 2,672                        | 1,901     | 40.6              |
| Other expense                     | 6,274                        | 6,661     | (5.8)             |
| Total noninterest expense         | \$ 29,984                    | \$ 28,929 | 3.6%              |

  

|                                   | Three Months Ended<br>June 30, |           | Percent<br>Change |
|-----------------------------------|--------------------------------|-----------|-------------------|
|                                   | 2013                           | 2012      |                   |
| Salaries and employee benefits    | \$ 8,891                       | \$ 8,363  | 6.3%              |
| Occupancy expense                 | 873                            | 831       | 5.1               |
| Equipment costs                   | 654                            | 596       | 9.7               |
| Data processing fees and supplies | 1,379                          | 1,060     | 30.1              |
| Other expense                     | 3,294                          | 3,399     | (3.1)             |
| Total noninterest expense         | \$ 15,091                      | \$ 14,249 | 5.9%              |

The Company's noninterest expense increased \$1.1 million and \$842,000, respectively, in the six-month and three-month periods ended June 30, 2013 versus the same periods of 2012. Data processing fees increased by \$771,000 and \$319,000, respectively, driven by a larger customer base as well as greater utilization of services from the Company's core processor, which the Company believes will improve marketing and cross-selling initiatives. Salaries and employee benefits increased by \$618,000 and \$528,000, respectively, driven by normal merit increases and higher incentive based compensation costs. Other expenses decreased by \$387,000 and \$105,000, respectively, driven by lower FDIC deposit insurance premiums as well as lower professional fees.

## Income Tax Expense

Income tax expense increased \$1.1 million, or 13.0%, for the first six months of 2013, compared to the same period in 2012. The combined state franchise tax expense and the federal income tax expense, as a percentage of income before income tax expense, increased to 34.5% during the first six months of 2013 compared to 33.1% during the same period of 2012. The combined tax expense increased to 35.8% in the second quarter of 2013, versus 33.2% during the same period of 2012. The changes were driven by a \$465,000 provision for state income tax expense due to a revaluation of the Company's deferred tax items relating to state income tax. During the second quarter of 2013, the Indiana legislature enacted new, lower tax rates for financial institutions, which will take effect beginning in 2014. One effect of the lower, future rates is to reduce the benefit which will be provided by the Company's existing deferred tax items requiring the non-cash adjustment. Excluding the effect of the adjustment, income taxes for the six months and three months ended June 30, 2013 would have been \$9.3 million and \$4.7 million, respectively, representing 32.9% and 32.6%, of pretax net income.





## CRITICAL ACCOUNTING POLICIES

Certain of the Company's accounting policies are important to the portrayal of the Company's financial condition, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Estimates associated with these policies are susceptible to material changes as a result of changes in facts and circumstances. Some of the facts and circumstances which could affect these judgments include changes in interest rates, in the performance of the economy or in the financial condition of borrowers. Management believes that its critical accounting policies include determining the allowance for loan losses, the valuation of mortgage servicing rights and the valuation and other-than-temporary impairment of investment securities. The Company's critical accounting policies are discussed in detail in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

## FINANCIAL CONDITION

Total assets of the Company were \$2.975 billion as of June 30, 2013, a decrease of \$88.9 million, or 2.9%, when compared to \$3.064 billion as of December 31, 2012.

Total cash and cash equivalents decreased by \$168.7 million, or 72.3%, to \$63.6 million at June 30, 2013 from \$232.2 million at December 31, 2012. The decrease resulted from a decrease in total deposits as well as loan growth. Historically, the Company maintained higher compensating balances with correspondent financial institutions in order to avoid certain service fees. During a periodic review of this strategy during the first quarter of 2013, the Company determined that it would be more beneficial to maintain lower compensating balances although this may result in paying slightly higher service fees. The reduction in the compensating balances resulted in a lower level of cash and cash equivalents at June 30, 2013 compared to December 31, 2012.

Total securities available-for-sale increased by \$6.0 million, or 1.3%, to \$473.0 million at June 30, 2013 from \$467.0 million at December 31, 2012. The increase was a result of a number of transactions in the securities portfolio. Securities purchases totaled \$91.2 million. Offsetting this increase were securities paydowns totaling \$65.5 million, maturities and calls of securities totaling \$4.2 million and securities amortization net of accretion was \$5.1 million. In addition, the net unrealized gain of the securities portfolio decreased by \$10.4 million. The decrease in fair market value was primarily driven by rising interest rates during the second quarter, which led to lower market values for agency residential mortgage-backed securities and state and municipal securities. The investment portfolio is generally managed to limit the Company's exposure to credit risk by containing mostly mortgage-backed securities backed by the federal government, other securities which are either directly or indirectly backed by the federal government or a local municipal government and collateralized mortgage obligations rated AAA by S&P and/or Aaa by Moody's at the time of purchase. As of June 30, 2013, the Company had \$5.4 million of non-agency residential mortgage-backed securities which were not backed by the federal government, but were rated AAA by S&P and/or Aaa by Moody's at the time of purchase.

None of the four non-agency residential mortgage backed securities were still rated AAA/Aaa as of June 30, 2013 by at least one of the rating agencies, S&P, Moody's and Fitch, and one had been downgraded to below investment grade by at least one rating agency. The Company performs an analysis of the cash flows of these securities on a monthly basis based on assumptions as to collateral defaults, prepayment speeds, expected losses and the severity of potential losses. Based upon the initial review, securities may be identified for further analysis by computing the net present value using an appropriate discount rate (the current accounting yield) and comparing it to the book value to determine if there is any other-than-temporary impairment to be recorded. Based on this analysis of the non-agency residential mortgage-backed securities, there was no other-than-temporary impairment or any unrealized loss on any of the four remaining non-agency residential mortgage-backed securities at June 30, 2013.

Real estate mortgage loans held-for-sale decreased by \$4.0 million, or 42.0%, to \$5.5 million at June 30, 2013 from \$9.5 million at December 31, 2012. The balance of this asset category is subject to a high degree of variability depending on, among other things, recent mortgage loan rates and the timing of loan sales into the secondary market. During the six months ended June 30, 2013, \$51.6 million in real estate mortgages were originated for sale and \$55.1 million in mortgages were sold.

Total loans, excluding real estate mortgage loans held for sale, increased by \$77.2 million to \$2.335 billion at June 30, 2013 from \$2.258 billion at December 31, 2012. Management expects loan growth to be moderate as the economic recovery moves along. The loan portfolio at June 30, 2013 consisted of 86% commercial and industrial, including commercial real estate and agri-business, 12% residential real estate and home equity and 2% consumer loans, versus 85% commercial and industrial, including commercial real estate and agri-business, 13% residential real estate and home equity and 2% consumer loans at December 31, 2012.

The Company has a relatively high percentage of commercial and commercial real estate loans, most of which are extended to small or medium-sized businesses from a wide variety of industries. Commercial loans represent higher dollar amount loans to fewer customers and therefore higher credit risk than other types of loans. Pricing is adjusted to manage the higher credit risk associated with these types of loans. The majority of fixed-rate residential mortgage loans, which represent increased interest rate risk, are sold in the secondary market, as well as some variable rate residential mortgage loans. The remainder of the variable rate residential mortgage loans and a small number of fixed-rate residential mortgage loans are retained. Management believes the allowance for loan losses is at a level commensurate with the overall risk exposure of the loan portfolio. However, if economic conditions do not continue to improve, certain borrowers may experience difficulty and the level of nonperforming loans, charge-offs and delinquencies could rise and require further increases in the provision for loan losses.

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

At June 30, 2013, on the basis of management's review of the loan portfolio, the Company had 101 credits totaling \$179.7 million on the classified loan list versus 104 credits totaling \$181.9 million on December 31, 2012. As of June 30, 2013, the Company had \$90.7 million of assets classified as Special Mention, \$89.0 million classified as Substandard, \$64,000 classified as Doubtful and \$0 classified as Loss as compared to \$82.7 million, \$99.2 million, \$66,000 and \$0, respectively at December 31, 2012. As of June 30, 2013, the Company had 38 loans totaling \$42.4 million accounted for as troubled debt restructurings. Included in the classified loan amounts above were 17 mortgage loans totaling \$1.6 million with total allocations of \$280,000, and 21 commercial loans totaling \$40.8 million with total allocations of \$9.9 million. The Company has no commitments to lend additional funds to any of the borrowers. At December 31, 2012, the Company had 41 loans totaling \$50.8 million accounted for as troubled debt restructurings - one installment loan totaling \$16,000 with an allocation of \$4,000, 12 mortgage loans totaling \$1.4 million with total allocations of \$247,000, and 28 commercial loans totaling \$49.4 million with total allocations of \$12.2 million. The \$8.4 million decrease of loans accounted for as troubled debt restructurings at June 30, 2013, as compared to December 31, 2012, was primarily due to the removal of two commercial credits totaling \$8.4 million since these loans were modified at a market rate and were performing as of December 31, 2012. Offsetting this decrease was the addition of a \$920,000 commercial credit to the impaired category.

Allowance estimates are developed by management taking into account actual loss experience, adjusted for current economic conditions. The Company generally has regular discussions regarding this methodology with regulatory authorities. Allowance estimates are considered a prudent measurement of the risk in the Company's loan portfolio and are applied to individual loans based on loan type. In accordance with current accounting guidance, the allowance is provided for losses that have been incurred as of the balance sheet date and is based on past events and current economic conditions, and does not include the effects of expected losses on specific loans or groups of loans that are related to future events or expected changes in economic conditions.

Net charge-offs totaled \$183,000 in the second quarter of 2013, versus net charge-offs of \$1.4 million during the second quarter of 2012 and \$626,000 during the first quarter of 2013.

The allowance for loan losses decreased 1.6%, or \$810,000, from \$51.4 million at December 31, 2012 to \$50.6 million at June 30, 2013. Pooled loan allocations increased from \$36.6 million at December 31, 2012 to \$39.6 million at June 30, 2013, which was primarily a result of management's overall view on current credit quality and the current economic environment, which included a change at March 31, 2013 in the lookback period for the determination of the qualitative factors from a three year lookback to a higher of a three year or five year lookback. Management believes it is prudent when determining the qualitative factors to consider the higher historical loss periods included in the five year lookback period that are now running off in the three year lookback period. Impaired loan allocations decreased \$3.8 million from \$14.8 million at December 31, 2012 to \$11.0 million at June 30, 2013. This decrease in impaired allocations was primarily due to decreases in the allocations of existing impaired loans as well as reductions to the impaired loans category. The unallocated component of the allowance for loan losses was \$3.5 million at June 30, 2013 compared to \$3.4 million at December 31, 2012 primarily due to stabilization in the current economic conditions and improvement in our borrowers' performance and future prospects. While general trends in credit quality were stable or favorable, the Company believes that the unallocated component is appropriate given the uncertainty that exists regarding near term economic conditions, including the slow economic recovery. Management believes the allowance for loan losses at June 30, 2013 was at a level commensurate with the overall risk exposure of the loan portfolio. However, if economic conditions do not continue to improve, certain borrowers may experience difficulty and the level of nonperforming loans, charge-offs and delinquencies could rise and require further increases in the provision for loan losses.

Total impaired loans decreased by \$12.0 million, or 20.4%, to \$46.9 million at June 30, 2013 from \$58.9 million at December 31, 2012. A loan is impaired when full payment under the original loan terms is not expected. Impairment is evaluated in the aggregate for smaller-balance loans of similar nature such as residential mortgage, and consumer loans, and on an individual loan basis for other loans. If a loan is impaired, a portion of the allowance may be allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. The decrease in the impaired loans category was primarily due to the removal of three commercial credits totaling \$10.5 million from the impaired category. The following table summarizes nonperforming assets at June 30, 2013 and December 31, 2012.

|   | June 30,<br>2013 | December 31,<br>2012 |
|---|------------------|----------------------|
|   | (in thousands)   |                      |
| <b>NONPERFORMING ASSETS:</b>  |                  |                      |
| Nonaccrual loans including nonaccrual troubled debt restructured loans        | \$ 21,542        | \$ 30,829            |
| Loans past due over 90 days and still accruing                                | 104              | 50                   |
| Total nonperforming loans   | \$ 21,646        | \$ 30,879            |
| Other real estate owned   | 171              | 667                  |
| Repossessions   | 5                | 23                   |
| Total nonperforming assets  | \$ 21,822        | \$ 31,569            |
| Impaired loans including troubled debt restructurings                         | \$ 46,906        | \$ 58,935            |
| Nonperforming loans to total loans  | 0.93%            | 1.37%                |
| Nonperforming assets to total assets  | 0.73%            | 1.03%                |
| Nonperforming troubled debt restructured loans (included in nonaccrual loans) | \$ 19,398        | \$ 28,506            |
| Performing troubled debt restructured loans                                   | 23,017           | 22,332               |
| Total troubled debt restructured loans  | \$ 42,415        | \$ 50,838            |

Total nonperforming assets decreased by \$9.7 million, or 30.8%, to \$21.8 million during the six-month period ended June 30, 2013. The decrease was primarily due to the aforementioned reclassification of three commercial credits from impaired to non-impaired. The loan upgrades also shifted two of the loans from the troubled debt restructured loan category. The third loan was never a troubled debt restructuring. In addition, the Company sold \$496,000 in other real estate owned during the second quarter of 2013.

Three commercial relationships represented 72.4% of total nonperforming loans. A commercial relationship consisting of three loans totaling \$6.8 million represented the largest exposure in the nonperforming category. These loans were classified as nonperforming in the fourth quarter of 2011. The borrower is engaged in commercial real estate development. Borrower collateral, including real estate and the personal guarantees of its principals, support the credit. The Company has not taken any charge-offs related to this credit.

A \$5.2 million commercial relationship consisting of three loans represents the second largest exposure in the nonperforming category. These loans were classified as nonperforming in the fourth quarter of 2009. The borrower is engaged in real estate development. Borrower collateral, including real estate and the personal guarantees of its principals, support the credit. The Company took a \$1.7 million charge-off related to this credit in the fourth quarter of 2009, and no charge-offs were taken in 2010 or 2011. The Company took a \$601,000 charge-off related to this credit in the first quarter of 2012.

A \$3.7 million credit to a manufacturer tied to the housing industry represented the third largest exposure in the nonperforming category. This loan was classified as nonperforming in the second quarter of 2008. The credit is accounted for as a troubled debt restructuring. Borrower collateral including real estate, receivables, inventory and equipment support the credit, however, there are no guarantors. The Company took a \$906,000 charge-off related to this credit in 2008, a \$1.7 million charge-off related to this credit in 2012 and an \$88,000 charge-off related to this credit in the first quarter of 2013.

There can be no assurances that full repayment of the loans discussed above will occur. Although economic conditions in the Company's markets have stabilized and in some areas improved, management has not observed a rapid recovery in certain industries, including residential and commercial real estate development and recreational vehicle and mobile home manufacturing, although each of these sectors has improved. The Company's growth strategy has promoted diversification among industries as well as a continued focus on enforcement of a strong credit environment and an aggressive position on loan work-out situations. While the Company believes that the impact on the Company of these industry-specific issues will be somewhat mitigated by the Company's overall growth strategy, the economic factors impacting its entire geographic market will continue to present challenges. Additionally, the Company's overall asset quality position can be influenced by a small number of credits due to the focus on commercial lending activity and the granularity inherent in this strategy.

The Company has begun offering a new derivative product to certain commercial banking customers. This product allows the commercial banking customers to enter into an agreement with the Company to swap a variable rate loan to a fixed rate. These derivative products are designed to reduce, eliminate or modify the borrower's interest rate exposure. The extension of credit incurred in connection with these derivative products is subject to the same approval and underwriting standards as traditional credit products. The Company limits its risk exposure by simultaneously entering into a similar, offsetting swap agreement with a separate, well-capitalized and highly rated counterparty previously approved by the Asset Liability Committee. By using these interest rate swap arrangements, the Company is also better insulated from the interest rate risk associated with underwriting fixed-rate loans and is better able to meet customer demand for fixed rate loans. These derivative contracts are not designated against specific assets or liabilities and, therefore, do not qualify for hedge accounting. The derivatives are recorded as assets and liabilities on the balance sheet at fair value with changes in fair value recorded in non-interest income for both the commercial banking customer swaps and the related offsetting swaps.

Total deposits decreased by \$98.3 million, or 3.8%, to \$2.483 billion at June 30, 2013 from \$2.582 billion at December 31, 2012. The decrease resulted from decreases of \$48.0 million in interest bearing transaction accounts, \$32.3 million in other certificates of deposit, \$30.8 million in certificates of deposit of \$100,000 and over, \$28.0 million in brokered certificates of deposit, \$10.3 million in demand deposits, \$9.8 in CDARS certificates of deposit and \$2.1 million in public fund certificates of deposit of \$100,000 or more. Offsetting these decreases were increases of \$42.1 million in money market accounts and \$20.9 million in savings accounts.

Total short-term borrowings increased by \$17.8 million, or 14.6%, to \$139.7 million at June 30, 2013 from \$121.9 million at December 31, 2012. The increase resulted from increases of \$37.0 million in federal funds purchased offset by decreases of \$19.2 million in securities sold under agreements to repurchase.

Total equity increased by \$9.8 million, or 3.3%, to \$307.6 million at June 30, 2013 from \$297.8 million at December 31, 2012. The increase in total equity resulted from net income of \$18.5 million, minus the decrease in the accumulated other comprehensive income of \$6.3 million, minus dividends of \$3.1 million, plus \$728,000 in stock compensation expense, plus \$18,000 related to stock options exercises (including tax benefit).

The FDIC's risk-based capital regulations require that all insured banking organizations maintain an 8.0% total risk-based capital ratio. The FDIC has also established definitions of "well capitalized" as a 5.0% Tier I leverage capital ratio, a 6.0% Tier I risk-based capital ratio and a 10.0% total risk-based capital ratio. As of June 30, 2013, the Bank had regulatory capital in excess of these minimum requirements with a Tier 1 leverage capital ratio, Tier 1 risk-based capital ratio and total risk-based capital ratio of 10.8%, 13.1% and 14.4%, respectively. The Federal Reserve also has established minimum "well capitalized" regulatory capital requirements for bank holding companies. As of June 30, 2013, the Company had a Tier 1 leverage capital ratio, Tier 1 risk-based capital ratio and total risk-based capital ratio of 11.0%, 13.4% and 14.7%, respectively. These ratios exceeded the Federal Reserve's "well capitalized" minimums of 5.0%, 6.0% and 10.0%, respectively

Beginning January 1, 2015 the Company and Bank will be subject to the new capital regulations of Basel III. The new regulations establish higher minimum risk-based capital ratio requirements, a new common equity Tier 1 risk-based capital ratio and a new capital conservation buffer. The new regulations also include revisions to the definition of capital and changes in the risk-weighting of certain assets. The new regulations establish definitions of "well capitalized" including the capital conservation buffer as a 7.0% common equity Tier 1 risk-based capital ratio, an 8.5% Tier 1 risk-based capital ratio and a 10.5% total risk-based capital ratio. The Tier 1 leverage ratio is unchanged from current regulations. Management has completed a preliminary analysis of the impact of these new regulations to the capital ratios of both the Company and the Bank and estimates that the ratios for both the Company and the Bank will comfortably exceed the new minimum capital ratio requirements for "well-capitalized" including the capital conservation buffer under Basel III when effective.

#### FORWARD-LOOKING STATEMENTS

This document (including information incorporated by reference) contains, and future oral and written statements of the Company and its management may contain, forward-looking statements, within the meaning of such term in the Private Securities Litigation Reform Act of 1995, with respect to the financial condition, results of operations, plans, objectives, future performance and business of the Company. Forward-looking statements, which may be based upon beliefs, expectations and assumptions of the Company's management and on information currently available to management, are generally identifiable by the use of words such as "believe," "expect," "anticipate," "plan," "intend," "estimate," "may," "will," "would," "could," "should" or other similar expressions. Additionally, all statements in this document, including forward-looking statements, speak only as of the date they are made, and the Company undertakes no obligation to update any statement in light of new information or future events.

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 our 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:



- Legislative or regulatory changes or actions, including the “Dodd-Frank Wall Street Reform and Consumer Protection Act” and the regulations required to be promulgated thereunder, as well as rules recently implemented by the federal banking regulatory agencies concerning certain increased capital requirements, among other items, which may adversely affect the business of the Company and its subsidiaries.
  - The costs, effects and outcomes of existing or future litigation.
- Changes in accounting policies and practices, as may be adopted by state and federal regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission and the Public Company Accounting Oversight Board.
  - The ability of the Company to manage risks associated with the foregoing as well as anticipated.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

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

Interest rate risk represents the Company’s primary market risk exposure. The Company does not have a material exposure to foreign currency exchange risk, does not have any material amount of derivative financial instruments and does not maintain a trading portfolio. The board of directors annually reviews and approves the policy used to manage interest rate risk. The policy was last reviewed and approved in May 2013. The policy sets guidelines for balance sheet structure, which are designed to protect the Company from the impact that interest rate changes could have on net income, but does not necessarily indicate the effect on future net interest income. The Company, through its Asset and Liability Committee, manages interest rate risk by monitoring the computer simulated earnings impact of various rate scenarios and general market conditions. The Company then modifies its long-term risk parameters by attempting to generate the types of loans, investments, and deposits that currently fit the Company’s needs, as determined by the Asset and Liability Committee. This computer simulation analysis measures the net interest income impact of various interest rate scenario changes during the next twelve months. If the change in net interest income is less than 3% of primary capital, the balance sheet structure is considered to be within acceptable risk levels. As of June 30, 2013, the Company’s potential pretax exposure was within the Company’s policy limit and not significantly different from the potential pretax exposure from December 31, 2012.

### ITEM 4 – CONTROLS AND PROCEDURES

As required by Rules 13a-15(b) and 15d-15(b) under the Securities Exchange Act of 1934, management has evaluated, with the participation of the Company’s Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company’s disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, the Company’s Chief Executive Officer and Chief Financial Officer have concluded that the Company’s disclosure controls and procedures (as defined in Securities Exchange Act Rules 13a-15(e) and 15d-15(e)) were effective as of June 30, 2013. Disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. These disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to management, including the Company’s Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure.

During the quarter ended June 30, 2013, there were no changes to the Company’s internal control over financial reporting that have materially affected or are reasonably likely to materially affect its internal control over financial reporting.



## LAKELAND FINANCIAL CORPORATION

## FORM 10-Q

June 30, 2013

## Part II - Other Information

## Item 1. Legal proceedings

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

## Item 1A. Risk Factors

There have been no material changes to the risk factors disclosed in Item 1A. of Part I of the Company's 2012 Form 10-K. Please refer to that section of the Company's Form 10-K for disclosures regarding the risks and uncertainties related to the Company's business.

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

The following table provides information as of June 30, 2013 with respect to shares of common stock repurchased by the Company during the quarter then ended:

## Issuer Purchases of Equity Securities(a)

| Period       | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number (or Appropriate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs |
|--------------|----------------------------------|------------------------------|--|--|
| April 1-30   | 0                                | \$ 0                         | 0  | \$ 0   |
| May 1-31     | 625                              | 27.51                        | 0  | 0  |
| June 1-30    | 0                                | 0                            | 0  | 0  |
| <b>Total</b> | <b>625</b>                       | <b>\$ 27.51</b>              | <b>0</b>   | <b>\$ 0</b>  |

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

## Item 3. Defaults Upon Senior Securities



None

Item 4. Mine Safety Disclosures

N/A

Item 5. Other Information

None

Item 6. Exhibits

31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a)

31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a)

32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101\* Interactive Data File

Interactive data files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheets as of June 30, 2013 and December 31, 2012; (ii) Consolidated Statements of Income for the three and six months ended June 30, 2013 and June 30, 2012; (iii) Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2013 and June 30, 2012; (iv) Consolidated Statements of Cash Flows for the six months ended June 30, 2013 and June 30, 2012; and (v) Notes to Unaudited Consolidated Financial Statements.

\*As provided in Rule 406T of Regulation S-T, this information shall not be deemed “filed” for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934, or otherwise subject to liability under those sections.

LAKELAND FINANCIAL CORPORATION

FORM 10-Q

June 30, 2013

Part II - Other Information

Signatures

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

LAKELAND FINANCIAL CORPORATION  
(Registrant)

Date: August 9, 2013                      /s/ Michael L. Kubacki  
Michael L. Kubacki – Chief Executive Officer

Date: August 9, 2013                      /s/ David M. Findlay  
David M. Findlay –President  
and Chief Financial Officer

Date: August 9, 2013                      /s/ Teresa A. Bartman  
Teresa A. Bartman – Senior Vice President-  
Finance and Controller

