LAKELAND FINANCIAL CORP
Form 10-K
March 10, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K

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

For the fiscal year ended December 31, 2008

Commission file number 0-11487

LAKELAND FINANCIAL CORPORATION

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

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

Telephone (574) 267-6144

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

Common Stock, no par value	**NASDAQ Global Select Market**
(Title of class)	(Name of Each Exchange on which Registered)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No x

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

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

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

Large accelerated filer o	Accelerated filer x	Non-accelerated filer o

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, based on the last sales price quoted on the Nasdaq Global Select Market on June 30, 2008, the last business day of the registrant's most recently completed second fiscal quarter, was approximately $218,127,216.

Number of shares of common stock outstanding at February 25, 2009: 12,414,130

DOCUMENTS INCORPORATED BY REFERENCE

Part III - Portions of the Proxy Statement for the Annual Meeting of Shareholders to be held on April 14, 2009 are incorporated by reference into Part III hereof.

LAKELAND FINANCIAL CORPORATION
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PART I

ITEM 1. BUSINESS

The Company was incorporated under the laws of the State of Indiana on February 8, 1983. As used herein, the term "Company" refers to Lakeland Financial Corporation, or if the context dictates, Lakeland Financial Corporation and its wholly-owned subsidiary, Lake City Bank (the "Bank"), an Indiana state bank headquartered in Warsaw, Indiana. Also included in the consolidated financial statements prior to December 27, 2006 is LCB Investments, Limited, a wholly-owned subsidiary of Lake City Bank, which is a Bermuda corporation that managed a portion of the Bank's investment portfolio. On December 27, 2006, all securities were transferred to Lake City Bank from LCB Investments, Limited, and LCB Investments, Limited was dissolved. On December 18, 2006, LCB Investments II, Inc. was formed as a wholly-owned subsidiary of Lake City Bank incorporated in Nevada and it began managing a portion of the Bank's investment portfolio in January 2007. On December 21, 2006, LCB Funding, Inc., a real estate investment trust, incorporated in Maryland was formed as a wholly-owned subsidiary of LCB Investments II. All intercompany transactions and balances are eliminated in consolidation.

General

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

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

The Bank's main banking office is located at 202 East Center Street, Warsaw, Indiana. As of December 31, 2008, the Bank had 43 offices in twelve counties throughout northern Indiana.

Bank's Business. The Bank was originally organized in 1872 and has continuously operated under the laws of the State of Indiana since its organization. The Bank's activities cover all phases of commercial banking, including checking accounts, savings accounts, time deposits, the sale of securities under agreements to repurchase, commercial, real estate and agricultural lending, direct and indirect consumer lending, commercial and residential real estate mortgage lending, retail and merchant credit card services, corporate cash management services, retirement services, bond administration, safe deposit box services and trust and brokerage services. The interest rates for both deposits and loans, as well as the range of services provided, are consistent with those of most banks competing within the Bank's service area.

The Bank competes for loans principally through a high degree of customer contact, timely loan review and approval, market-driven competitive loan pricing and the Bank's reputation throughout the region. The Bank believes that its convenience, quality service and high touch, responsive approach to banking enhances its ability to compete favorably in attracting and retaining individual and business customers. The Bank actively solicits deposit-related customers and competes for customers by offering personal attention, professional service and competitive interest rates.

Market Overview. While the Company operates in twelve counties, it currently defines operations by four primary geographical markets. They are the South Region, which includes Kosciusko County and portions of contiguous counties; the North Region, which includes portions of Elkhart and St. Joseph Counties, the Central Region, which includes portions of Elkhart County and contiguous counties; and the East Region, which includes Allen and contiguous counties. The South Region includes the city of Warsaw, which is the location of the Company's headquarters. The Company has had a presence in this region since 1872. It has been in the North and Central Regions, which includes the cities of Elkhart, South Bend and Goshen, since 1990. The Company opened its first office in the East Region, which includes the cities of Fort Wayne and Auburn, in 1999. The Company also operates a loan production office in Indianapolis, which is staffed with commercial lending officers and was opened in 2006.

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The Company believes that these are well-established and fairly diverse economic regions. The Company has sought to diversify expansion and industry throughout its markets, which include a mix of industrial and service companies with no business or industry concentrations within individual markets and combined. Furthermore, no single industry or employer dominates any of the markets. Fort Wayne represents the largest population center served by the Company's full-service branch system with a population of 206,000, according to 2000 U.S. Census Bureau data. South Bend, with a 2000 population of 108,000, is the second largest city served by the Company. Elkhart, with a 2000 population of 52,000, is the third largest city that the Company currently serves. As a result of the presence of offices in twelve counties that are widely dispersed, no single city or industry represents an undue concentration. In addition, the Indianapolis market represents a substantial future opportunity given its position as the largest metropolitan market in the state.

Expansion Strategy. The Company's expansion strategy is driven primarily by the potential for increased penetration in existing markets where opportunities for market share growth exists. Additionally, management considers growth in new markets with a close geographic proximity to its current operations. These markets are considered when the Company believes they would be receptive to its strategic plan to deliver broad based financial services with a commitment to local communities. When entering new markets, the Company believes it is critical to attract experienced local management with a similar philosophy in order to provide a basis for success. Since the early 1990's, the Company has focused on growth through de novo branching in locations that management believes have potential for creating new market opportunities or for further penetrating existing markets. The Company opened a new branch facility in Fort Wayne, Indiana in late 2007 to house the Company's Fort Wayne based Wealth Advisory Services and to serve the southwestern market of Fort Wayne. The location is a full-service branch facility. As noted earlier, the Company entered the Indianapolis market in 2006 and anticipates that it will expand in the future with full-service banking locations, although no timetable has been established.

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

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

Competition

Within its four primary geographical markets, the Bank competes with other local and regional banks in addition to major banks for large commercial deposit and loan accounts. The Bank is presently subject to an aggregate maximum loan limit to any single account pursuant to Indiana law of $30.5 million. The Bank currently enforces an internal limit of $20.0 million, which is less than the amount permitted by law. This maximum might occasionally limit the Bank from providing loans to those businesses or personal accounts whose borrowings periodically exceed this amount. In the event this were to occur, the Bank maintains correspondent relationships with other financial institutions. The Bank may participate with other banks in the placement of large borrowings in excess of its lending limit, although the Bank typically does not participate in such arrangements. The Bank is also a member of the Federal Home Loan Bank of Indianapolis in order to broaden its mortgage lending and investment activities and to provide additional funding, as necessary, to support these activities.

In addition to the banks located within its service area, the Bank also competes with savings and loan associations, credit unions, farm credit services, finance companies, personal loan companies, insurance companies, money market funds, and other non-depository financial intermediaries. Also, financial intermediaries such as

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money market mutual funds and large retailers are not subject to the same regulations and laws that govern the operation of traditional depository institutions and accordingly may have an advantage in competing for funds.

Foreign Operations

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

Employees

At December 31, 2008, the Company, including its subsidiaries, had 446 full-time equivalent employees. Benefit programs include a 401(k) plan, group medical insurance, group life insurance and paid vacations. The Company also maintained a defined benefit pension plan which, effective April 1, 2000, was frozen and employees can no longer accrue new benefits under that plan. The Company also has an equity incentive plan under which stock-based incentives may be granted to employees and directors. The Company also has an employee deferred compensation plan available to certain employees. The Bank is not a party to any collective bargaining agreement, and employee relations are considered good.

Forward-looking Statements

This document (including information incorporated by reference) contains, and future oral and written statements of the Company and its management may contain, forward-looking statements, within the meaning of such term in the Private Securities Litigation Reform Act of 1995, with respect to the financial condition, results of operations, plans, objectives, future performance and business of the Company. Forward-looking statements, which may be based upon beliefs, expectations and assumptions of the Company's management and on information currently available to management, are generally identifiable by the use of words such as "believe," "expect," "anticipate," "plan," "intend," "estimate," "m "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 this Form 10-K. In addition to the risk factors described in that section, there are other factors that may impact any public company, including ours, which could have a material adverse effect on the operations and future prospects of the Company and its subsidiaries. These additional factors include, but are not limited to, the following:

- Changes in accounting standards and practices, as may be adopted by state and federal regulatory agencies, the Financial Accounting Standards Board and the Securities and Exchange Commission.
- Changes in state or federal tax laws.
- The costs, effects and outcomes of existing or future litigation.
- The economic impact of past and any future terrorist attacks, acts of war or threats thereof and the response of the United States to any such threats and attacks.
- The ability of the Company to manage the 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. For additional information regarding these and other risks, uncertainties and other factors, please review the disclosure in this annual report under "Risk Factors".

Internet Website

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

SUPERVISION AND REGULATION

General

Financial institutions, their holding companies and their affiliates are extensively regulated under federal and state law. As a result, the growth and earnings performance of the Company may be affected not only by management decisions and general economic conditions, but also by the requirements of federal and state statutes and by the regulations and policies of various bank regulatory authorities, including the Indiana Department of Financial Institutions (the "DFI"), the Board of Governors of the Federal Reserve System (the "Federal Reserve") and the Federal Deposit Insurance Corporation (the "FDIC"). Furthermore, taxation laws administered by the Internal Revenue Service and state taxing authorities and securities laws administered by the Securities and Exchange Commission (the "SEC") and state securities authorities have an impact on the business of the Company. The effect of these statutes, regulations and regulatory policies may be significant, and cannot be predicted with a high degree of certainty.

Federal and state laws and regulations generally applicable to financial institutions regulate, among other things, the scope of business, the kinds and amounts of investments, reserve requirements, capital levels relative to operations, the nature and amount of collateral for loans, the establishment of branches, mergers and consolidations and the payment of dividends. This system of supervision and regulation establishes a comprehensive framework for the respective operations of the Company and its subsidiaries and is intended primarily for the protection of the FDIC-insured deposits and depositors of the Bank, rather than shareholders. In addition to this generally applicable regulatory framework, recent turmoil in the credit markets prompted the enactment of unprecedented legislation that has allowed the U.S. Treasury to make equity capital available to qualifying financial institutions to help restore confidence and stability in the U.S. financial markets, which imposes additional requirements on institutions in which the U.S. Treasury Department invests.

The following is a summary of the material elements of the regulatory framework that applies to the Company and its subsidiaries. It does not describe all of the statutes, regulations and regulatory policies that apply, nor does it restate all of the requirements of those that are described. As such, the following is qualified in its entirety by reference to applicable law. Any change in statutes, regulations or regulatory policies may have a material effect on the business of the Company and its subsidiaries.

The Company

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

Acquisitions, Activities and Change in Control. The primary purpose of a bank holding company is to control and manage banks. The BHCA generally requires the prior approval of the Federal Reserve for any merger involving a bank holding company or any acquisition by a bank holding company of another bank or bank holding company. Subject to certain conditions (including deposit concentration limits established by the BHCA), the Federal Reserve may allow a bank holding company to acquire banks located in any state of the United States. In approving interstate acquisitions, the Federal Reserve is required to give effect to applicable state law limitations on the aggregate amount of deposits that may be held by the acquiring bank holding company and its insured depository institution affiliates in the state in which the target bank is located (provided that those limits do not discriminate against out-of-state depository institutions or their holding companies) and state laws that require that

the target bank have been in existence for a minimum period of time (not to exceed five years) before being acquired by an out-of-state bank holding company.

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

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

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

Capital Requirements. Bank holding companies are required to maintain minimum levels of capital in accordance with Federal Reserve capital adequacy guidelines. If capital levels fall below the minimum required levels, a bank holding company, among other things, may be denied approval to acquire or establish additional banks or non-bank businesses.

The Federal Reserve's capital guidelines establish the following minimum regulatory capital requirements for bank holding companies: (i) a risk-based requirement expressed as a percentage of total assets weighted according to risk; and (ii) a leverage requirement expressed as a percentage of total assets. The risk-based requirement consists of a minimum ratio of total capital to total risk-weighted assets of 8% and a minimum ratio of Tier 1 capital to total risk-weighted assets of 4%. The leverage requirement consists of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly rated companies, with a minimum requirement of 4% for all others. For purposes of these capital standards, Tier 1 capital consists primarily of permanent stockholders' equity less intangible assets (other than certain loan servicing rights and purchased credit card relationships). Total capital consists primarily of Tier 1 capital plus certain other debt and equity instruments that do not qualify as Tier 1 capital and a portion of the company's allowance for loan and lease losses.

The risk-based and leverage standards described above are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual banking organizations. For example, the Federal Reserve's capital guidelines contemplate that additional capital may be required to take adequate account of, among other things, interest rate risk, or the risks posed by concentrations of credit, nontraditional activities or securities trading activities. Further, any banking organization experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions (*i.e.*, Tier 1 capital less all intangible assets), well above the minimum levels. As of December 31, 2008, the Company had regulatory capital in excess of the Federal Reserve's minimum requirements.

Emergency Economic Stabilization Act of 2008. Recent events in the U.S. and global financial markets, including the deterioration of the worldwide credit markets, have created significant challenges for financial institutions throughout the country. Dramatic declines in the housing market during the past year, marked by falling home prices and increasing levels of mortgage foreclosures, have resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities and major commercial and investment banks. In addition, many lenders and institutional investors have reduced, and in some cases, ceased to provide funding to borrowers, including other financial institutions, as a result of concern about the stability of the financial markets and the strength of counterparties.

In response to the crises affecting the U.S. banking system and financial markets and to bolster the distressed economy and improve consumer confidence in the financial system, on October 3, 2008, the U.S. Congress passed, and the President signed into law, the Emergency Economic Stabilization Act of 2008 (the “EESA”). The EESA authorizes the Secretary of the United States Department of Treasury (“Treasury”) to implement various temporary emergency programs designed to strengthen the capital positions of financial institutions and stimulate the availability of credit within the U.S. financial system. Financial institutions participating in certain of the programs established under the EESA will be required to adopt Treasury’s standards for executive compensation and corporate governance.

The TARP Capital Purchase Program. On October 14, 2008, Treasury announced that it will provide Tier 1 capital (in the form of perpetual preferred stock) to eligible financial institutions. This program, known as the TARP Capital Purchase Program (the “CPP”), allocates $250 billion from the $700 billion authorized by the EESA to Treasury for the purchase of senior preferred shares from qualifying financial institutions (the “CPP Preferred Stock”). Under the program, eligible institutions are able to sell equity interests to the Treasury in amounts equal to between 1% and 3% of the institution’s risk-weighted assets. The CPP Preferred Stock will generally be non-voting and will pay dividends at the rate of 5% per annum for the first five years and thereafter at a rate of 9% per annum. In conjunction with the purchase of the CPP Preferred Stock, the Treasury will receive warrants to purchase common stock from the participating public institutions with an aggregate market price equal to 15% of the preferred stock investment. Participating financial institutions will be required to adopt Treasury’s standards for executive compensation and corporate governance for the period during which Treasury holds equity issued under the CPP.

Pursuant to the CPP, on February 27, 2009, The Company entered into a Letter Agreement with Treasury, pursuant to which the Company issued (i) 56,044 shares of the Company’s Fixed Rate Cumulative Perpetual Preferred Stock, Series A and (ii) a warrant to purchase 396,538 shares of the Company’s common stock, no par value, for an aggregate purchase price of $56,044,000 in cash. The Company also expects that its federal regulators and the Treasury will maintain significant oversight over the Company as a participating institution, to evaluate how it uses the capital provided and to ensure that it strengthens its efforts to help its borrowers avoid foreclosure, which is one of the core aspects of the EESA.

Dividend Payments. The Company’s ability to pay dividends to its shareholders may be affected by both general corporate law considerations and policies of the Federal Reserve applicable to bank holding companies. As an Indiana corporation, the Company is subject to the limitations of the Indiana General Business Corporation Law, which prohibit the Company from paying dividends if the Company is, or by payment of the dividend would become, insolvent, or if the payment of dividends would render the Company unable to pay its debts as they become due in the usual course of business. Additionally, policies of the Federal Reserve caution that a bank holding company should not pay cash dividends unless its net income available to common shareholders over the past year has been sufficient to fully fund the dividends and the prospective rate of earnings retention appears consistent with its capital needs, asset quality, and overall financial condition. The Federal Reserve also possesses enforcement powers over bank holding companies and their non-bank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to proscribe the payment of dividends by banks and bank holding companies. Further, if the Company participates in the CPP, the Company anticipates that the terms of the CPP Preferred Stock will provide that no dividends on any common or preferred stock that ranks equal to or junior to the CPP Preferred Stock may be paid unless and until all accrued and unpaid dividends for all past dividend periods on the CPP Preferred Stock have been fully paid.

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

The Bank

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

Deposit Insurance. As an FDIC-insured institution, the Bank is required to pay deposit insurance premium assessments to the FDIC. The FDIC has adopted a risk-based assessment system whereby FDIC-insured depository institutions pay insurance premiums at rates based on their risk classification. An institution's risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to the regulators. Under the regulations of the FDIC, as presently in effect, insurance assessments range from 0.12% to 0.50% of total deposits for the first quarter 2009 assessment period only (subject to the application of assessment credits, if any, issued by the FDIC in 2008). Effective April 1, 2009, insurance assessments will range from 0.07% to 0.78%, depending on an institution's risk classification, as well as its unsecured debt, secured liability and brokered deposits. In addition, under an interim rule, the FDIC plans to impose a 20 basis point emergency special assessment on insured depository institutions on June 30, 2009. The emergency special assessment will be collected on September 30, 2009. The interim rule also authorizes the FDIC to impose an additional emergency special assessment after June 30, 2009, of up to 10 basis points, if necessary to maintain public confidence in federal deposit insurance.

FDIC Temporary Liquidity Guarantee Program. In connection with the recently enacted EESA and in conjunction with the Treasury's actions to address the current credit and liquidity crisis in financial markets, the FDIC announced the Temporary Liquidity Guarantee Program, which will temporarily provide to participating institutions unlimited deposit insurance coverage for non-interest bearing transaction accounts maintained at FDIC insured institutions (the "transaction account guarantee program"), and provide a limited guarantee on certain newly-issued senior unsecured debt (the "debt guarantee program"). For an initial 30-day period, all eligible financial institutions were automatically covered under this program without incurring any fees. Institutions that did not opt out by December 5, 2008, will be subject to the following potential assessments for participation: (i) for the debt guarantee program, between 50 and 100 basis points per annum for eligible senior unsecured debt (depending on the maturity date) issued between October 14, 2008 and June 30, 2009; and (ii) for the transaction account guarantee program, 10 basis points per annum on amounts in excess of $250,000 in non-interest bearing transaction accounts from November 13, 2008 through and including December 31, 2009. The Bank decided to continue to participate in these programs and did not opt out. As a result, the Bank expects to incur fees associated with the programs.

FICO Assessments. The Financing Corporation ("FICO") is a mixed-ownership governmental corporation chartered by the former Federal Home Loan Bank Board pursuant to the Federal Savings and Loan Insurance Corporation Recapitalization Act of 1987 to function as a financing vehicle for the recapitalization of the former Federal Savings and Loan Insurance Corporation. FICO issued 30-year non-callable bonds of approximately $8.2 billion that mature by 2019. Since 1996, federal legislation has required that all FDIC-insured depository institutions pay assessments to cover interest payments on FICO's outstanding obligations. These FICO assessments are in addition to amounts assessed by the FDIC for deposit insurance. During the year ended December 31, 2008, the FICO assessment rate was approximately 0.01% of deposits.

Supervisory Assessments. All Indiana banks are required to pay supervisory assessments to the DFI to fund the operations of the DFI. The amount of the assessment is calculated on the basis of the bank's total assets. During the year ended December 31, 2008, the Bank paid supervisory assessments to the DFI totaling $178,000.

Capital Requirements. Banks are generally required to maintain capital levels in excess of other businesses. Under federal regulations, the Bank is subject to the following minimum capital standards: (i) a leverage requirement consisting of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly-rated banks with a minimum requirement of at least 4% for all others; and (ii) a risk-based capital requirement consisting of a minimum ratio of total capital to total risk-weighted assets of 8% and a minimum ratio of Tier 1 capital to total risk-weighted assets of 4%. In general, the components of Tier 1 capital and total capital are the same as those for bank holding companies discussed above.

The capital requirements described above are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual institutions. For example, federal regulations provide that additional capital may be required to take adequate account of, among other things, interest rate risk or the risks posed by concentrations of credit, nontraditional activities or securities trading activities.

Further, federal law and regulations provide various incentives for financial institutions to maintain regulatory capital at levels in excess of minimum regulatory requirements. For example, a financial institution that is "well-capitalized" may qualify for exemptions from prior notice or application requirements otherwise applicable to certain types of activities and may qualify for expedited processing of other required notices or applications. Additionally, one of the criteria that determines a bank holding company's eligibility to operate as a financial holding company is a requirement that all of its financial institution subsidiaries be "well-capitalized." Under the

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regulations of the Federal Reserve, in order to be "well-capitalized" a financial institution must maintain a ratio of total capital to total risk-weighted assets of 10% or greater, a ratio of Tier 1 capital to total risk-weighted assets of 6% or greater and a ratio of Tier 1 capital to total assets of 5% or greater.

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

As of December 31, 2008: (i) the Bank was not subject to a directive from the Federal Reserve to increase its capital to an amount in excess of the minimum regulatory capital requirements; (ii) the Bank exceeded its minimum regulatory capital requirements under Federal Reserve capital adequacy guidelines; and (iii) the Bank was "well-capitalized," as defined by Federal Reserve regulations.

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

The payment of dividends by any financial institution is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a financial institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. As described above, the Bank exceeded its minimum capital requirements under applicable guidelines as of December 31, 2008. As of December 31, 2008, approximately $2.0 million was available to be paid as dividends by the Bank. Notwithstanding the availability of funds for dividends, however, the Federal Reserve may prohibit the payment of any dividends by the Bank if the Federal Reserve determines such payment would constitute an unsafe or unsound practice.

Insider Transactions. The Bank is subject to certain restrictions imposed by federal law on extensions of credit to the Company, on investments in the stock or other securities of the Company and the acceptance of the stock or other securities of the Company as collateral for loans made by the Bank. Certain limitations and reporting requirements are also placed on extensions of credit by the Bank to its directors and officers, to directors and officers of the Company, to principal shareholders of the Company and to "related interests" of such directors, officers and principal shareholders. In addition, federal law and regulations may affect the terms upon which any person who is a director or officer of the Company or the Bank or a principal shareholder of the Company may obtain credit from banks with which the Bank maintains a correspondent relationship.

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

In general, the safety and soundness guidelines prescribe the goals to be achieved in each area, and each institution is responsible for establishing its own procedures to achieve those goals. If an institution fails to comply with any of the standards set forth in the guidelines, the institution's primary federal regulator may require the

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

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

Federal law permits state and national banks to merge with banks in other states subject to: (i) regulatory approval; (ii) federal and state deposit concentration limits; and (iii) state law limitations requiring the merging bank to have been in existence for a minimum period of time (not to exceed five years) prior to the merger. The establishment of new interstate branches or the acquisition of individual branches of a bank in another state (rather than the acquisition of an out-of-state bank in its entirety) is permitted only in those states the laws of which expressly authorize such expansion.

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

Federal Reserve System. Federal Reserve regulations, as presently in effect, require depository institutions to maintain reserves against their transaction accounts (primarily NOW and regular checking accounts), as follows: for transaction accounts aggregating $44.4 million or less, the reserve requirement is 3% of total transaction accounts; and for transaction accounts aggregating in excess of $44.4 million, the reserve requirement is $1.023 million plus 10% of the aggregate amount of total transaction accounts in excess of $44.4 million. The first $10.3 million of otherwise reservable balances are exempted from the reserve requirements. These reserve requirements are subject to annual adjustment by the Federal Reserve. The Bank is in compliance with the foregoing requirements.

INDUSTRY SEGMENTS

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

GUIDE 3 INFORMATION

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

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

	2008			2007		
	Average Balance	Interest Income	Yield (1)	Average Balance	Interest Income	Yield (1)
ASSETS						
Earning assets:						
Loans:						
Taxable (2)(3)	$ 1,662,355	$ 99,538	5.99%	$ 1,401,480	$ 102,840	7.34%
Tax exempt (1)	2,669	147	5.51	2,588	166	6.41
Investments: (1)						
Available for sale	368,578	19,731	5.35	306,293	15,140	4.94
Short-term investments	12,136	171	1.41	17,412	863	4.96
Interest bearing deposits	2,045	49	2.40	1,486	68	4.58
Total earning assets	2,047,783	119,636	5.84%	1,729,259	119,077	6.89%
Nonearning assets:						
Cash and due from banks	41,302	0		44,565	0	
Premises and equipment	28,200	0		26,042	0	
Other nonearning assets	70,986	0		54,220	0	
Less allowance for loan losses	(17,597)	0		(15,045)	0	
Total assets	$ 2,170,674	$ 119,636		$ 1,839,041	$ 119,077	

(1) Tax exempt income was converted to a fully taxable equivalent basis at a 35 percent tax rate for 2008 and 2007. The tax equivalent rate for tax exempt loans and tax exempt securities acquired after January 1, 1983 included the TEFRA adjustment applicable to nondeductible interest expenses.

(2) Loan fees, which are immaterial in relation to total taxable loan interest income for the years ended December 31, 2008 and 2007, are included as taxable loan interest income.

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

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

	2007			2006		
	Average Balance	Interest Income	Yield (1)	Average Balance	Interest Income	Yield (1)
ASSETS						
Earning assets:						
Loans:						
Taxable (2)(3)	$ 1,401,480	$ 102,840	7.34%	$ 1,264,490	$ 91,946	7.27%
Tax exempt (1)	2,588	166	6.41	5,995	328	5.47
Investments: (1)						
Available for sale	306,293	15,140	4.94	293,931	13,609	4.63
Short-term investments	17,412	863	4.96	12,896	647	5.02
Interest bearing deposits	1,486	68	4.58	3,269	151	4.62
Total earning assets	1,729,259	119,077	6.89%	1,580,581	106,681	6.75%
Nonearning assets:						
Cash and due from banks	44,565	0		56,235	0	
Premises and equipment	26,042	0		24,750	0	
Other nonearning assets	54,220	0		50,597	0	
Less allowance for loan losses	(15,045)	0		(13,692)	0	
Total assets	$ 1,839,041	$ 119,077		$ 1,698,471	$ 106,681	

(1) Tax exempt income was converted to a fully taxable equivalent basis at a 35 percent tax rate for 2007 and 2006. The tax equivalent rate for tax exempt loans and tax exempt securities acquired after January 1, 1983 included the TEFRA adjustment applicable to nondeductible interest expenses.

(2) Loan fees, which are immaterial in relation to total taxable loan interest income for the years ended December 31, 2007 and 2006, are included as taxable loan interest income.

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

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

	2008			2007		
	Average Balance	Interest Expense	Yield	Average Balance	Interest Expense	Yield
LIABILITIES AND STOCKHOLDERS' EQUITY						
Interest bearing liabilities:						
Savings deposits	$ 64,877	$ 64	0.10%	$ 67,104	$ 133	0.20%
Interest bearing checking accounts	495,057	9,979	2.02	425,753	14,854	3.49
Time deposits:						
In denominations under $100,000	329,783	13,924	4.22	295,328	14,289	4.84
In denominations over $100,000	528,316	20,613	3.90	462,056	24,338	5.27
Miscellaneous short-term borrowings	278,451	5,620	2.02	177,343	7,239	4.08
Long-term borrowings and subordinated debentures (1)	86,230	5,016	5.82	30,972	2,628	8.49
Total interest bearing liabilities	1,782,714	55,216	3.10%	1,458,556	63,481	4.35%
Noninterest bearing liabilities and stockholders' equity:						
Demand deposits	219,762	0		226,484	0	
Other liabilities	17,138	0		16,234	0	
Stockholders' equity	151,060	0		137,767	0	
Total liabilities and stockholders' equity	$ 2,170,674	$ 55,216		$ 1,839,041	$ 63,481	

(1) Long-term borrowings and subordinated debentures interest expense was reduced by interest capitalized on construction in process for 2007.

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

	2007			2006		
	Average Balance	Interest Expense	Yield	Average Balance	Interest Expense	Yield
LIABILITIES AND STOCKHOLDERS' EQUITY						
Interest bearing liabilities:						
Savings deposits	$ 67,104	$ 133	0.20%	$ 67,818	$ 143	0.21%
Interest bearing checking accounts	425,753	14,854	3.49	405,209	12,789	3.16
Time deposits:						
In denominations under $100,000	295,328	14,289	4.84	264,087	10,787	4.08
In denominations over $100,000	462,056	24,338	5.27	430,378	21,382	4.97
Miscellaneous short-term borrowings	177,343	7,239	4.08	144,637	5,594	3.87
Long-term borrowings and subordinated debentures (1)	30,972	2,628	8.49	30,973	2,529	8.17
Total interest bearing liabilities	1,458,556	63,481	4.35%	1,343,102	53,224	3.96%
Noninterest bearing liabilities and stockholders' equity:						
Demand deposits	226,484	0		219,997	0	
Other liabilities	16,234	0		13,418	0	
Stockholders' equity	137,767	0		121,954	0	
Total liabilities and stockholders' equity	$ 1,839,041	$ 63,481		$ 1,698,471	$ 53,224	
Net interest differential - yield on average daily earning assets		$ 55,596	3.22%		$ 53,457	3.38%

(1) Long-term borrowings and subordinated debentures interest expense was reduced by interest capitalized on construction in process for 2007.

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

YEAR ENDED DECEMBER 31,

	2008 Over (Under) 2007 (1)			2007 Over (Under) 2006 (1)		
	Volume	Rate	Total	Volume	Rate	Total
INTEREST AND LOAN FEE INCOME (2)						
Loans:						
Taxable	$ 17,372	$ (20,674)	$ (3,302)	$ 10,045	$ 849	$ 10,894
Tax exempt	5	(24)	(19)	(211)	49	(162)
Investments:						
Available for sale	3,260	1,331	4,591	587	944	1,531
Short-term investments	(206)	(486)	(692)	224	(8)	216
Interest bearing deposits	20	(39)	(19)	(82)	(1)	(83)
Total interest income	20,451	(19,892)	559	10,563	1,833	12,396
INTEREST EXPENSE						
Savings deposits	(4)	(65)	(69)	(1)	(9)	(10)
Interest bearing checking accounts	2,134	(7,009)	(4,875)	671	1,394	2,065
Time deposits:						
In denominations under $100,000	1,566	(1,931)	(365)	1,368	2,134	3,502
In denominations over $100,000	3,168	(6,893)	(3,725)	1,626	1,330	2,956
Miscellaneous short-term borrowings	3,021	(4,640)	(1,619)	1,321	324	1,645
Long-term borrowings and subordinated debentures	3,435	(1,047)	2,388	0	99	99
Total interest expense	13,320	(21,585)	(8,265)	4,985	5,272	10,257
INCREASE (DECREASE) IN INTEREST DIFFERENTIALS	$ 7,131	$ 1,693	$ 8,824	$ 5,578	$ (3,439)	$ 2,139

(1)

The earning assets and interest bearing liabilities used to calculate interest differentials are based on average daily balances for 2008, 2007 and 2006. The changes in volume represent “changes in volume times the old rate”. The changes in rate represent “changes in rate times old volume”. The changes in rate/volume were also calculated by “change in rate times change in volume” and allocated consistently based upon the relative absolute values of the changes in volume and changes in rate.

(2) Tax exempt income was converted to a fully taxable equivalent basis at a 35 percent tax rate for 2008, 2007 and 2006. The tax equivalent rate for tax exempt loans and tax exempt securities acquired after January 1, 1983 included the TEFRA adjustment applicable to nondeductible interest expense.

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ANALYSIS OF SECURITIES
(in thousands of dollars)

The amortized cost and the fair value of securities as of December 31, 2008, 2007 and 2006 were as follows:

	2008		2007		2006	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Securities available for sale:						
U.S. Treasury securities	$ 1,001	$ 1,025	$ 1,201	$ 1,206	$ 1,002	$ 965
U.S. Government agencies	15,453	15,685	18,539	18,555	31,249	30,525
Mortgage-backed securities	332,682	314,669	251,158	250,495	213,053	210,000
State and municipal securities	55,081	55,651	56,613	57,501	53,824	54,701
Total debt securities available for sale	$ 404,217	$ 387,030	$ 327,511	$ 327,757	$ 299,128	$ 296,191

At year-end 2008, there were no holdings of securities of any one issuer, other than the U.S. Government, government agencies and government sponsored agencies, in an amount greater than 10% of stockholders’ equity with the exception of Residential Accredit Loans, Inc., which had a book value of $21.3 million and a market value of $15.8 million, Countrywide Home Loans Alternative Loan Trust, which had a book value of $19.9 million and a market value of $15.1 million and Chase Mortgage Finance Trust, which had a book value of $17.4 million and a market value of $7.5 million. These are all Alt A or Whole Loan securities in the Super Senior tranches, which are the highest rated tranches with very high credit standards. In addition, the collateral of the Alt A or Whole Loan securities purchased must meet certain criteria set by the Company’s Asset Liability Management Committee including maximum loan-to-value and minimum FICO scores, consist of only fixed-rate mortgages and must be AAA rated at the time of purchase. See Note 2 for more information on these investments. At year-end 2007, there were no holdings of securities of any one issuer, other than the U.S. Government, government agencies and government sponsored agencies, in an amount greater than 10% of stockholders’ equity with the exception of Residential Accredit Loans, Inc., which had a book value of $22.6 million and a market value of $22.3 million. At year-end 2006, there were no holdings of securities of any one issuer, other than the U.S. Government, government agencies and government sponsored agencies, in an amount greater than 10% of stockholders’ equity.

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

The weighted average yields and maturity distribution for debt securities portfolio at December 31, 2008, were as follows:

	Within One Year	After One Year Within Five Years	After Five Years Within Ten Years	Over Ten Years
Securities available for sale:				
US Treasury securities				
Fair value	$ 1,025	$ 0	$ 0	$ 0
Yield	3.38%	0%	0%	0%
Government agencies and corporations				
Fair value	10,943	4,742	0	0
Yield	4.61%	3.88%	0%	0%
Mortgage-backed securities				
Fair value	177	18,653	82,152	213,687
Yield	6.47%	3.72%	4.87%	5.25%
State and municipal securities				
Fair value	578	3,442	33,618	18,013
Yield	3.63%	4.15%	4.54%	4.35%
Total debt securities available for sale:				
Fair value	$ 12,723	$ 26,837	$ 115,770	$ 231,700
Yield	4.49%	3.81%	4.77%	5.18%

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

The Company segregates its loan portfolio into four basic segments: commercial (including agricultural loans), residential real estate mortgages, installment and personal line of credit loans (including credit card loans). The loan portfolio as of December 31, 2008, 2007, 2006, 2005 and 2004 was as follows:

	2008	2007	2006	2005	2004
Commercial loans:					
Taxable	$ 1,522,523	$ 1,238,623	$ 1,081,420	$ 960,046	$ 784,591
Tax exempt	10,493	1,971	4,991	4,512	6,369
Total commercial loans	1,533,016	1,240,594	1,086,411	964,558	790,960
Residential real estate mortgage loans	117,230	124,107	109,176	74,820	54,361
Installment loans	51,174	49,185	52,548	67,964	53,138
Line of credit and credit card loans	132,147	109,760	105,762	91,426	104,927
Subtotal loans	1,833,567	1,523,646	1,353,897	1,198,768	1,003,386
Less: Allowance for loan losses	(18,860)	(15,801)	(14,463)	(12,774)	(10,754)
Net deferred loan (fees)/costs	(233)	74	(60)	(38)	(167)
Net loans	$ 1,814,474	$ 1,507,919	$ 1,339,374	$ 1,185,956	$ 992,465

The residential real estate mortgage loan portfolio included construction loans totaling $6,468, $5,252, $8,636, $7,987 and $6,719 as of December 31, 2008, 2007, 2006, 2005 and 2004. The Bank generally sells conforming mortgage loans which it originates. These loans generally represent mortgage loans that are made to clients with long-term or substantial relationships with the Bank on terms consistent with secondary market requirements. The loan classifications are based on the nature of the loans as of the loan origination date. There were no foreign loans included in the loan portfolio for the periods presented.

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

Repricing opportunities of the loan portfolio occur either according to predetermined adjustable rate schedules included in the related loan agreements or upon maturity of each principal payment. The following table indicates the scheduled maturities of the loan portfolio as of December 31, 2008.

	Commercial	Residential Real Estate Mortgage	Installment	Line of Credit	Total	Percent
Original maturity of one day	$ 546,097	$ 0	$ 0	$ 86,500	$ 632,597	34.50%
Other within one year	160,015	21,879	17,217	37,912	$ 237,023	12.93
After one year, within five years	684,267	24,074	31,632	3,682	$ 743,655	40.56
Over five years	122,584	70,520	2,325	4,053	$ 199,482	10.88
Nonaccrual loans	20,053	757	0	0	$ 20,810	1.13
Total loans	$ 1,533,016	$ 117,230	$ 51,174	$ 132,147	$ 1,833,567	100.0%

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

Loans due after one year which have a predetermined interest rate and loans due after one year which have floating or adjustable interest rates as of December 31, 2008 amounted to $631,822 and $311,315.

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

The following is a summary of nonperforming loans as of December 31, 2008, 2007, 2006, 2005 and 2004.

	2008	2007	2006	2005	2004
PART A - PAST DUE ACCRUING LOANS (90 DAYS OR MORE)					
Residential real estate mortgage loans	$ 126	$ 155	$ 0	$ 89	$ 117
Commercial and industrial loans	81	65	154	0	2,633
Loans to individuals for household, family and other personal expenditures	271	189	145	85	28
Loans to finance agriculture production and other loans to farmers	0	0	0	0	0
Total past due loans	478	409	299	174	2,778
PART B - NONACCRUAL LOANS					
Residential real estate mortgage loans	757	18	132	132	60
Commercial and industrial loans	20,053	7,021	13,688	7,189	7,152
Loans to individuals for household, family and other personal expenditures	0	0	0	0	0
Loans to finance agriculture production and other loans to farmers	0	0	0	0	0
Total nonaccrual loans	20,810	7,039	13,820	7,321	7,212
PART C - TROUBLED DEBT RESTRUCTURED LOANS	0	0	0	0	0
Total nonperforming loans	$ 21,288	$ 7,448	$ 14,119	$ 7,495	$ 9,990

Nonearning assets of the Company include nonperforming loans (as indicated above), nonaccrual investments, other real estate and repossessions, which amounted to $22,391 at December 31, 2008.

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

PART A - CONSUMER LOANS

Consumer installment loans, except those loans that are secured by real estate, are not placed on nonaccrual status since these loans are charged-off when they have been delinquent from 90 to 180 days, and when the related collateral, if any, is not sufficient to offset the indebtedness. Advances under consumer line of credit programs, are charged-off when collection appears doubtful.

PART B - NONPERFORMING LOANS

When a loan is classified as a nonaccrual loan, interest on the loan is no longer accrued and all accrued interest receivable is charged-off. It is the policy of the Bank that all loans for which the collateral is insufficient to cover all principal and accrued interest will be reclassified as nonperforming loans to the extent they are unsecured, on or before the date when the loan becomes 90 days delinquent. Thereafter, interest is recognized and included in income only when received. Interest not recorded on nonaccrual loans is referenced in Footnote 4 in Item 8 below.

As of December 31, 2008, there were $20.8 million of loans on nonaccrual status, some of which were also on impaired status. There were $20.3 million of loans classified as impaired.

PART C - TROUBLED DEBT RESTRUCTURED LOANS

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

As of December 31, 2008 and 2007, there were no loans renegotiated as troubled debt restructurings.

PART D - OTHER NONPERFORMING ASSETS

Management is of the opinion that there are no significant foreseeable losses relating to nonperforming assets, as defined in the preceding table, or classified loans, except as discussed above in Part B – Nonperforming Loans and Part C – Troubled Debt Restructured Loans.

PART E - LOAN CONCENTRATIONS

There were no loan concentrations within industries not otherwise disclosed, which exceeded ten percent of total loans except commercial real estate. Commercial real estate was $532.5 million at December 31, 2008. Nearly all of the Bank’s commercial, industrial, agricultural real estate mortgage, real estate construction mortgage and consumer loans are made within its basic service area.

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Basis For Determining Allowance For Loan Losses:

The allowance is an amount that management believes will be adequate to absorb probable incurred credit losses relating to specifically identified loans based on an evaluation, as well as other probable incurred losses inherent in the loan portfolio. The 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: application of historical loss percentages, emerging market risk, emerging concentrations, commercial loan focus and large credit concentration, new industry lending activity and general economic conditions. For a more thorough discussion of the allowance for loan losses methodology see the Critical Accounting Policies section of Item 7.

Based upon these policies and objectives, $10.2 million, $4.3 million and $2.6 million were charged to the provision for loan losses and added to the allowance for loan losses in 2008, 2007 and 2006.

The allocation of the allowance for loan losses to the various lending areas is performed by management in relation to perceived exposure to loss in the various loan portfolios. However, the allowance for loan losses is available in its entirety to absorb losses in any particular loan category.

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

The following is a summary of the loan loss experience for the years ended December 31, 2008, 2007, 2006, 2005 and 2004.

	2008	2007	2006	2005	2004
Amount of loans outstanding, December 31,	$ 1,833,335	$ 1,523,720	$ 1,353,837	$ 1,198,730	$ 1,003,219
Average daily loans outstanding during the year ended December 31,	$ 1,665,024	$ 1,404,068	$ 1,270,484	$ 1,088,788	$ 930,934
Allowance for loan losses, January 1,	$ 15,801	$ 14,463	$ 12,774	$ 10,754	$ 10,234
Loans charged-off:					
Commercial	6,726	2,381	905	317	630
Real estate	72	16	0	8	20
Installment	805	537	145	164	271
Credit cards and personal credit lines	3	458	22	112	73
Total loans charged-off	7,606	3,392	1,072	601	994
Recoveries of loans previously charged-off:					
Commercial	147	252	53	37	121
Real estate	16	27	0	0	13
Installment	200	124	52	89	129
Credit cards and personal credit lines	95	29	12	15	28
Total recoveries	458	432	117	141	291
Net loans charged-off	7,148	2,960	955	460	703
Provision for loan loss charged to expense	10,207	4,298	2,644	2,480	1,223
Balance, December 31,	$ 18,860	$ 15,801	$ 14,463	$ 12,774	$ 10,754
Ratio of net charge-offs during the period to average daily loans outstanding:					
Commercial	0.40%	0.15%	0.07%	0.02%	0.05%
Real estate	0.00	0.00	0.00	0.00	0.00
Installment	0.04	0.03	0.01	0.01	0.02

Credit cards and personal credit lines	(0.01)	0.03	0.00	0.01	0.01
Total ratio of net charge-offs	0.43%	0.21%	0.08%	0.04%	0.08%
Ratio of allowance for loan losses to nonperforming assets	84.23%	160.27%	101.67%	169.87%	104.76%

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

The following is a summary of the allocation for loan losses as of December 31, 2008, 2007, 2006, 2005 and 2004.

	2008		2007		2006	
	Allowance For Loan Losses	Loans as Percentage of Gross Loans	Allowance For Loan Losses	Loans as Percentage of Gross Loans	Allowance For Loan Losses	Loans as Percentage of Gross Loans
Allocated allowance for loan losses:						
Commercial	$ 15,738	83.61%	$ 13,659	81.42%	$ 12,185	80.24%
Real estate	292	6.39	571	8.15	389	8.07
Installment	384	2.79	421	3.23	690	6.20
Credit cards and personal credit lines	996	7.21	828	7.20	561	5.49
Total allocated allowance for loan losses	17,410	100.00%	15,479	100.00%	13,825	100.00%
Unallocated allowance for loan losses	1,450		322		638	
Total allowance for loan losses	$ 18,860		$ 15,801		$ 14,463	

	2005		2004	
	Allowance For Loan Losses	Loans as Percentage of Gross Loans	Allowance For Loan Losses	Loans as Percentage of Gross Loans
Allocated allowance for loan losses:				
Commercial	$ 10,870	80.46%	$ 8,696	78.84%
Real estate	187	6.24	136	5.40
Installment	509	5.67	398	5.29
Credit cards and personal credit lines	688	7.63	789	10.47
Total allocated allowance for loan losses	12,254	100.00%	10,019	100.00%

Unallocated allowance for loan losses	520	735
Total allowance for loan losses	$ 12,774	$ 10,754

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ANALYSIS OF DEPOSITS
(in thousands of dollars)

The average daily deposits for the years ended December 31, 2008, 2007 and 2006, and the average rates paid on those deposits are summarized in the following table:

	2008		2007		2006	
	Average Daily Balance	Average Rate Paid	Average Daily Balance	Average Rate Paid	Average Daily Balance	Average Rate Paid
Demand deposits	$ 219,762	0.00%	$ 226,484	0.00%	$ 219,997	0.00%
Savings and transaction accounts:						
Regular savings	64,877	0.10	67,104	0.20	67,818	0.21
Interest bearing checking	495,057	2.02	425,753	3.49	405,209	3.16
Time deposits:						
Deposits of $100,000 or more	528,316	3.90	462,056	5.27	430,378	4.97
Other time deposits	329,783	4.22	295,328	4.84	264,087	4.08
Total deposits	$ 1,637,795	2.72%	$ 1,476,725	3.63%	$ 1,387,489	3.25%

As of December 31, 2008, time certificates of deposit will mature as follows:

	$ 100,000 or more	% of Total	Other	% of Total
Within three months	$ 316,149	49.59%	$ 61,943	17.17%
Over three months, within six months	129,300	20.28	65,282	18.10
Over six months, within twelve months	133,336	20.91	143,025	39.64
Over twelve months	58,788	9.22	90,521	25.09
Total time certificates of deposit	$ 637,573	100.00%	$ 360,771	100.00%

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QUALITATIVE MARKET RISK DISCLOSURE

Management's market risk disclosure appears under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7, below, and is incorporated herein by reference in response to this item. The Company's primary market risk exposure is interest rate risk. The Company does not have a material exposure to foreign currency exchange rate risk, does not own any material derivative financial instruments and does not maintain a trading portfolio.

RETURN ON EQUITY AND OTHER RATIOS

The rates of return on average daily assets and stockholders' equity, the dividend payout ratio, and the average daily stockholders' equity to average daily assets for the years ended December 31, 2008, 2007 and 2006 were as follows:

	2008	2007	2006
Percent of net income to:			
Average daily total assets	0.91%	1.04%	1.10%
Average daily stockholders' equity	13.04%	13.94%	15.35%
Percentage of dividends declared per common share to basic earnings per weighted average number of common shares outstanding (12,271,927 shares in 2008, 12,188,594 shares in 2007 and 12,069,300 shares in 2006)	37.58%	34.49%	24.19%
Percentage of average daily stockholders' equity to average daily total assets	6.96%	7.49%	7.18%

Cash dividends were declared on April 8, July 8, October 14, 2008 and January 13, 2009 for each quarter of 2008, April 10, July 10, October 9, 2007 and January 8, 2008 for each quarter of 2007 and April 11, July 11 and October 10, 2006 and January 9, 2007 for each quarter of 2006.

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SHORT-TERM BORROWINGS
(in thousands of dollars)

The following is a schedule, at the end of the year indicated, of statistical information relating to securities sold under agreement to repurchase maturing within one year and secured by either U.S. Government agency securities or mortgage-backed securities classified as other debt securities and other short-term borrowings maturing within one year. There were no other categories of short-term borrowings for which the average balance outstanding during the period was 30 percent or more of stockholders' equity at the end of each period.

	2008	2007	2006
Outstanding at year end:			
Federal funds purchased	$ 19,000	$ 70,010	$ 0
Securities sold under agreements to repurchase	$ 137,769	$ 154,913	$ 106,670
Other short-term borrowings	$ 45,000	$ 90,000	$ 80,000
Approximate average interest rate at year end:			
Federal funds purchased	0.50%	4.07%	0.00%
Securities sold under agreements to repurchase	0.43%	3.20%	3.59%
Other short-term borrowings	0.65%	4.31%	5.36%
Highest amount outstanding as of any month end during the year:			
Federal funds purchased	$ 126,700	$ 96,850	$ 53,000
Securities sold under agreements to repurchase	$ 175,427	$ 154,913	$ 106,670
Other short-term borrowings	$ 163,700	$ 90,000	$ 80,000
Approximate average outstanding during the year:			
Federal funds purchased	$ 50,171	$ 22,950	$ 19,119
Securities sold under agreements to repurchase	$ 153,363	$ 121,372	$ 92,870
Other short-term borrowings	$ 73,981	$ 32,247	$ 31,726
Approximate average interest rate during the year:			
Federal funds purchased	2.53%	5.33%	5.22%
Securities sold under agreements to repurchase	1.85%	3.52%	3.20%
Other short-term borrowings	2.09%	5.09%	5.13%

Securities sold under agreements to repurchase include fixed rate, term transactions initiated by the Bank, as well as corporate sweep accounts. Other short-term borrowings consist of Federal Home Loan Bank advances.

ITEM 1a. RISK FACTORS

In addition to the other information in this Annual Report on Form 10-K, shareholders or prospective investors should carefully consider the following risk factors:

Our business may be adversely affected by conditions in the financial markets and economic conditions generally.

The United States has been in a recession since December, 2007. Business activity across a wide range of industries and regions is greatly reduced and many businesses and local governments are experiencing serious difficulty in remaining profitable and providing services due to the lack of consumer spending and the lack of liquidity in the credit markets. Unemployment has increased significantly. Since mid-2007, and particularly during the second half of 2008, the financial services industry and the securities markets generally were materially and adversely affected by significant declines in the values of nearly all asset classes and by a serious lack of liquidity. This was initially triggered by declines in home prices and the values of subprime mortgages, but spread to all mortgage and real estate asset classes, to leveraged bank loans and to nearly all asset classes, including equities. The global markets have been characterized by substantially increased volatility and short-selling and an overall loss of investor confidence, initially in financial institutions, but more recently in companies in a number of other industries and in the broader markets.

Market conditions have also led to the failure or merger of a number of prominent financial institutions. Financial institution failures or near-failures have resulted in further losses as a consequence of defaults on securities issued by them and defaults under contracts entered into with such entities as counterparties. Furthermore, declining asset values, defaults on mortgages and consumer loans, and the lack of market and investor confidence, as well as other factors, have all combined to increase credit default swap spreads, to cause rating agencies to lower credit ratings, and to otherwise increase the cost and decrease the availability of liquidity, despite very significant declines in Federal Reserve borrowing rates and other government actions. Some banks and other lenders have suffered significant losses and have become reluctant to lend, even on a secured basis, due to the increased risk of default and the impact of declining asset values on the value of collateral. The foregoing has significantly weakened the strength and liquidity of some financial institutions worldwide. In 2008, the U.S. government, the Federal Reserve and other regulators have taken numerous steps to increase liquidity and to restore investor confidence, including committing to invest at least $250 billion in the equity of other banking organizations, but asset values have continued to decline and access to liquidity for many organizations continues to be very limited.

As a result of these financial economic crises, many lending institutions, including us, have experienced declines in the performance of their loans, including commercial loans, commercial real estate loans and consumer loans. Moreover, competition among depository institutions for deposits and quality loans has increased significantly. In addition, the values of real estate collateral supporting many commercial loans and home mortgages have declined and may continue to decline. Bank and bank holding company stock prices have been negatively affected, as has the ability of banks and bank holding companies to raise capital or borrow in the debt markets has become more difficult compared to recent years. As a result, there is a potential for new federal or state laws and regulations regarding lending and funding practices and liquidity standards, and bank regulatory agencies are expected to be very aggressive in responding to concerns and trends identified in examinations, including the expected issuance of many formal or informal enforcement actions or orders. The impact of new legislation in response to those developments, may negatively impact our operations by restricting our business operations, including our ability to originate or sell loans, and adversely impact our financial performance or our stock price.

In addition, further negative market developments may affect consumer confidence levels and may cause adverse changes in payment patterns, causing increases in delinquencies and default rates, which may impact our charge-offs and provision for credit losses. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions on us and others in the financial services industry.

Overall, during the past year, the general business environment has had an adverse effect on our business, and there can be no assurance that the environment will improve in the near term. Until conditions improve, we expect our business, financial condition and results of operations to be adversely affected.

Our business is concentrated in and dependent upon the continued growth and welfare of our primary market areas.

We operate primarily in four geographical markets, all of which are located in Northern Indiana and are further described in the “Business” section included under Item 1 of Part I of this Form 10-K. We have developed a particularly strong presence in the South Region, which includes Kosciusko County and portions of contiguous

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counties, the North Region, which includes portions of Elkhart and St. Joseph County, and the Central Region, which includes portions of Elkhart County and contiguous counties. These regions represent the more mature markets. In addition, we have experienced rapid growth in the East Region, which includes Allen and DeKalb Counties. The Company also operates a loan production office in Indianapolis, which is staffed by commercial lending officers and consider our presence in this market as more mature and strong than in previous years. Our success depends upon the business activity, population, income levels, deposits and real estate activity in these markets. Although our customers' business and financial interests may extend well beyond these market areas, adverse economic conditions that affect these market areas could reduce our growth rate, affect the ability of our customers to repay their loans to us and generally affect our financial condition and results of operations. Areas of our geographical market have seen notably worse economic conditions than those suffered by the country at-large. In particular, Elkhart County has suffered from adverse business and economic conditions that have resulted in levels of unemployment well above the national average. Because of our geographic concentration, we are less able than other regional or national financial institutions to diversify our credit risks across multiple markets.

Our continued pace of growth may require us to raise additional capital in the future, but that capital may not be available when it is needed.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. We anticipate that our existing capital resources will satisfy our capital requirements for the foreseeable future. We have accepted a capital investment of $56.0 million under the Department of Treasury's Troubled Asset Repurchase Program's Capital Purchase Plan, which will further strengthen our capital position. However, we may at some point need to raise additional capital to support our continued growth. Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time, which are outside our control, and on our financial performance. Accordingly, we cannot assure you of our ability to raise additional capital, if needed, on terms acceptable to us. If we cannot raise additional capital when needed, our ability to further expand our operations through internal growth, de novo branching and/or acquisitions could be materially impaired.

Interest rates and other conditions impact our results of operations.

Our profitability is significantly driven by the spread between the interest rates earned on investments and loans and the interest rates paid on deposits and other interest-bearing liabilities. Like most banking institutions, our net interest spread and margin will be affected by general economic conditions and other factors, including fiscal and monetary policies of the federal government, that influence market interest rates and our ability to respond to changes in such rates. At any given time, our assets and liabilities will be such that they are affected differently by a given change in interest rates. As a result, an increase or decrease in rates, the length of loan terms or the mix of adjustable and fixed rate loans in our portfolio could have a positive or negative effect on our net income, capital and liquidity. We measure interest rate risk under various rate scenarios and using specific criteria and assumptions. A summary of this process, along with the results of our net interest income simulations is presented at "Quantitative and Qualitative Disclosures About Market Risk" included under Item 7a of Part II of this Form 10-K. Although we believe our current level of interest rate sensitivity is reasonable and effectively managed, significant fluctuations in interest rates may have an adverse effect on our business, financial condition and results of operations.

Our allowance for loan losses may prove to be insufficient to absorb potential losses in our loan portfolio.

We established our allowance for loan losses pursuant to our established guidelines and practices and maintain it at a level considered adequate by management to absorb loan losses that are inherent in the portfolio. The amount of future loan losses is susceptible to changes in economic, operating and other conditions (in our market as well as the United States), including changes in interest rates, which may be beyond our control, and such losses may exceed current estimates. At December 31, 2008, our allowance for loan losses as a percentage of total loans was 1.03% and as a percentage of total non-performing loans was 89%. Although management believes that the allowance for loan losses is adequate to absorb probable incurred losses on any existing loans, we cannot predict loan losses with certainty, and we cannot assure you that our allowance for loan losses will prove sufficient to cover actual loan losses in the future. Loan losses in excess of our reserves may adversely affect our business, financial condition and results of operations. Additional information regarding our allowance for loan losses and the methodology we use to determine an appropriate level of reserves is located in the "Management's Discussion and Analysis" section included under Item 7 of Part II of this Form 10-K.

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We may experience difficulties in managing our growth and our growth strategy involves risks that may negatively impact our net income.

As part of our general growth strategy, we may expand into additional communities or attempt to strengthen our position in our current markets by opening new branches and acquiring existing branches of other financial institutions. To the extent that we undertake additional branch openings and acquisitions, we are likely to continue to experience the effects of higher operating expenses relative to operating income from the new operations, which may have an adverse effect on our levels of reported net income, return on average equity and return on average assets. Other effects of engaging in such growth strategies may include potential diversion of our management's time and attention and general disruption to our business.

Although we do not have any current plans to do so, we may also acquire banks and related businesses that we believe provide a strategic fit with our business. We may also engage in de novo branching as we have in the past and intend to do in the Indianapolis market in the future. To the extent that we grow through acquisitions and de novo bank formations, we cannot assure you that we will be able to adequately and profitably manage this growth. Acquiring other banks and businesses will involve similar risks to those commonly associated with branching, but may also involve additional risks, including:

- potential exposure to unknown or contingent liabilities of banks and businesses we acquire;
- exposure to potential asset quality issues of the acquired bank or related business;
- difficulty and expense of integrating the operations and personnel of banks and businesses we acquire; and
- the possible loss of key employees and customers of the banks and businesses we acquire.

We face intense competition in all phases of our business from other banks and financial institutions.

The banking and financial services business in our market is highly competitive. Our competitors include large regional banks, local community banks, savings and loan associations, securities and brokerage companies, mortgage companies, insurance companies, finance companies, money market mutual funds, credit unions, farm credit services and other non-bank financial service providers. Many of these competitors are not subject to the same regulatory restrictions as we are and are able to provide customers with a feasible alternative to traditional banking services.

Increased competition in our market may also result in a decrease in the amounts of our loans and deposits, reduced spreads between loan rates and deposit rates or loan terms that are more favorable to the borrower. Any of these results could have a material adverse effect on our ability to grow and remain profitable. If increased competition causes us to significantly discount the interest rates we offer on loans or increase the amount we pay on deposits, our net interest income could be adversely impacted. If increased competition causes us to relax our underwriting standards, we could be exposed to higher losses from lending activities. Additionally, many of our competitors are much larger in total assets and capitalization, have greater access to capital markets and larger lending limits and offer a broader range of financial services than we can offer.

We must effectively manage our credit risk.

There are risks inherent in making any loan, including risks inherent in dealing with individual borrowers, risks of nonpayment, risks resulting from uncertainties as to the future value of collateral and risks resulting from changes in economic and industry conditions. We attempt to minimize our credit risk through prudent loan application approval procedures, careful monitoring of the concentration of our loans within specific industries, a centralized credit administration department and periodic independent reviews of outstanding loans by our loan review department. However, we cannot assure you that such approval and monitoring procedures will reduce these credit risks.

The majority of the Bank's loan portfolio is invested in commercial and commercial real estate loans. These loans represent higher dollar volumes to fewer customers. As a result, we may assume greater lending risks than other community banking-type financial institutions that have a lesser concentration of such loans and are more retail oriented. Our lending activity and the risks commonly associated with such lending are further described in the "Management's Discussion and Analysis" section included under Item 7 of Part II of this Form 10-K.

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Commercial and industrial and agri-business loans make up a significant portion of our loan portfolio.

Commercial and industrial and agri-business loans were $1.533 billion, or approximately 84% of our total loan portfolio as of December 31, 2008. Our commercial loans are primarily made based on the identified cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. Most often, this collateral is accounts receivable, inventory, machinery or real estate. Credit support provided by the borrower for most of these loans and the probability of repayment is based on the liquidation of the pledged collateral and enforcement of a personal guarantee, if any exists. Whenever possible, we require a personal guarantee on commercial loans. As a result, in the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers. The collateral securing other loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business.

Our loan portfolio has a large concentration of commercial real estate loans, which involve risks specific to real estate value.

Real estate lending (including commercial, construction, and, to a much lesser extent, residential) is a large portion of our loan portfolio. The market value of real estate can fluctuate significantly in a short period of time as a result of market conditions in the geographic area in which the real estate is located. Although a significant portion of such loans are secured by real estate as a secondary form of collateral, continued adverse developments affecting real estate values in one or more of our markets could increase the credit risk associated with our loan portfolio. Additionally, real estate lending typically involves higher loan principal amounts and the repayment of the loans generally is dependent, in large part, on sufficient income from the properties securing the loans to cover operating expenses and debt service. Economic events or governmental regulations outside of the control of the borrower or lender could negatively impact the future cash flow and market values of the affected properties.

If the loans that are collateralized by real estate become troubled during a time when market conditions are declining or have declined, then we may not be able to realize the amount of security that we anticipated at the time of originating the loan, which could cause us to increase our provision for loan losses and adversely affect our operating results and financial condition.

Our consumer loans generally have a higher degree of risk of default than our other loans.

At December 31, 2008, consumer loans totaled $55.1 million, or 3%, of our total loan and lease portfolio. Consumer loans typically have shorter terms and lower balances with higher yields as compared to one-to-four family residential loans, but generally carry higher risks of default. Consumer loan collections are dependent on the borrower’s continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on these loans.

Our community banking strategy relies heavily on our management team, and the unexpected loss of key managers may adversely affect our operations.

Much of our success to date has been influenced strongly by our ability to attract and to retain senior management experienced in banking and financial services and familiar with the communities in our market areas. Our ability to retain executive officers, the current management teams, branch managers and loan officers of our bank subsidiary will continue to be important to the successful implementation of our strategy. It is also critical, as we grow, to be able to attract and retain qualified additional management and loan officers with the appropriate level of experience and knowledge about our market areas to implement our community-based operating strategy. The unexpected loss of services of any key management personnel, or the inability to recruit and retain qualified personnel in the future, could have an adverse effect on our business, financial condition and results of operations.

Government regulation can result in limitations on our operations.

We operate in a highly regulated environment and are subject to supervision and regulation by a number of governmental regulatory agencies, including the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Indiana Department of Financial Institutions. Regulations adopted by these agencies, which are generally intended to provide protection for depositors and customers rather than for the benefit of shareholders, govern a comprehensive range of matters relating to ownership and control of our shares, our acquisition of other companies and businesses, permissible activities for us to engage in, maintenance of adequate capital levels and other aspects of our operations. These bank regulators possess broad authority to prevent or

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remedy unsafe or unsound practices or violations of law. The laws and regulations applicable to the banking industry could change at any time and we cannot predict the effects of these changes on our business and profitability. Increased regulation could increase our cost of compliance and adversely affect profitability. For example, new legislation or regulation may limit the manner in which we may conduct our business, including our ability to offer new products, obtain financing, attract deposits, make loans and achieve satisfactory interest spreads.

We have a continuing need for technological change and we may not have the resources to effectively implement new technology.

The financial services industry is constantly undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to better serving customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend in part upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience as well as to create additional efficiencies in our operations as we continue to grow and expand our market areas. Many of our larger competitors have substantially greater resources to invest in technological improvements. As a result, they may be able to offer additional or superior products to those that we will be able to offer, which would put us at a competitive disadvantage. Accordingly, we cannot provide you with assurance that we will be able to effectively implement new technology-driven products and services or be successful in marketing such products and services to our customers.

There is a limited trading market for our common shares, and you may not be able to resell your shares at or above the price you paid for them.

Although our common shares are listed for trading on the Global Select Market of the NASDAQ Stock Market, the trading in our common shares has less liquidity than many other companies quoted on the NASDAQ Global Select Market. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the market of willing buyers and sellers of our common shares at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. We cannot assure you that volume of trading in our common shares will increase in the future. Additionally, general market forces may have a negative effect on our stock price, independent of factors affecting our stock specifically.

System failure or breaches of our network security could subject us to increased operating costs as well as litigation and other liabilities.

The computer systems and network infrastructure we use could be vulnerable to unforeseen problems. Our operations are dependent upon our ability to protect our computer equipment against damage from physical theft, fire, power loss, telecommunications failure or a similar catastrophic event, as well as from security breaches, denial of service attacks, viruses, worms and other disruptive problems caused by hackers. Any damage or failure that causes an interruption in our operations could have a material adverse effect on our financial condition and results of operations. Computer break-ins, phishing and other disruptions could also jeopardize the security of information stored in and transmitted through our computer systems and network infrastructure, which may result in significant liability to us and may cause existing and potential customers to refrain from doing business with us. Although we, with the help of third-party service providers, intend to continue to implement security technology and establish operational procedures to prevent such damage, there can be no assurance that these security measures will be successful. In addition, advances in computer capabilities, new discoveries in the field of cryptography or other developments could result in a compromise or breach of the algorithms we and our third-party service providers use to encrypt and protect customer transaction data. A failure of such security measures could have a material adverse effect on our financial condition and results of operations.

We are subject to certain operational risks, including, but not limited to, customer or employee fraud and data processing system failures and errors.

Employee errors and misconduct could subject us to financial losses or regulatory sanctions and seriously harm our reputation. Misconduct by our employees could include hiding unauthorized activities from us, improper or unauthorized activities on behalf of our customers or improper use of confidential information. It is not always possible to prevent employee errors and misconduct, and the precautions we take to prevent and detect this activity may not be effective in all cases. Employee errors could also subject us to financial claims for negligence.

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We maintain a system of internal controls and insurance coverage to mitigate operational risks, including data processing system failures and errors and customer or employee fraud. Should our internal controls fail to prevent or detect an occurrence, or if any resulting loss is not insured or exceeds applicable insurance limits, it could have a material adverse effect on our business, financial condition and results of operations.

If LCB Funding, Inc. fails to qualify as a real estate investment trust, we may be subject to a higher consolidated effective tax rate.

The Bank holds certain commercial real estate loans, residential real estate loans and other loans in a real estate investment trust through its wholly-owned subsidiary LCB Investments II, Inc., which is incorporated in Nevada. Qualification as a real estate investment trust involves application of specific provisions of the Internal Revenue Code relating to various asset tests. If LCB Funding, Inc. fails to meet any of the required provisions for real estate investment trusts, or there are changes in tax laws or interpretations thereof, it could no longer qualify as a real estate investment trust and the resulting tax consequences would increase our effective tax rate or cause us to have a tax liability for prior years.

ITEM 1b. UNRESOLVED STAFF COMMENTS

We have no unresolved SEC staff comments.

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ITEM 2. PROPERTIES

The Company conducts its operations from the following locations:

Location			
Main/Headquarters	202 East Center St.	Warsaw	IN
Warsaw Drive-up	East Center St.	Warsaw	IN
Akron	102 East Rochester	Akron	IN
Argos	100 North Michigan	Argos	IN
Auburn	1220 East 7th St.	Auburn	IN
Bremen	1600 State Road 331	Bremen	IN
Columbia City	601 Countryside Dr.	Columbia City	IN
Concord	4202 Elkhart Rd.	Goshen	IN
Cromwell	111 North Jefferson St.	Cromwell	IN
Elkhart Beardsley	864 East Beardsley St.	Elkhart	IN
Elkhart East	22050 State Road 120	Elkhart	IN
Elkhart Hubbard Hill	58404 State Road 19	Elkhart	IN
Elkhart Northwest	1208 North Nappanee St.	Elkhart	IN
Fort Wayne North	302 East DuPont Rd.	Fort Wayne	IN
Fort Wayne Northeast	10411 Maysville Rd.	Fort Wayne	IN
Fort Wayne Southwest	10429 Illinois Rd.	Fort Wayne	IN
Fort Wayne Jefferson Blvd	6851 West Jefferson Blvd.	Fort Wayne	IN
Goshen Downtown	102 North Main St.	Goshen	IN
Goshen South	2513 South Main St.	Goshen	IN
Granger	12830 State Road 23	Granger	IN
Huntington	1501 North Jefferson St.	Huntington	IN
Kendallville East	631 Professional Way	Kendallville	IN
LaGrange	901 South Detroit	LaGrange	IN
Ligonier Downtown	222 South Cavin St.	Ligonier	IN
Ligonier South	1470 U.S. Highway 33 South	Ligonier	IN
Medaryville	Main St.	Medaryville	IN
Mentone	202 East Main St.	Mentone	IN
Middlebury	712 Wayne Ave.	Middlebury	IN
Milford	State Road 15 North	Milford	IN
Mishawaka	5015 North Main St.	Mishawaka	IN
Nappanee	202 West Market St.	Nappanee	IN
North Webster	644 North Main St.	North Webster	IN
Pierceton	202 South First St.	Pierceton	IN
Plymouth	862 East Jefferson St.	Plymouth	IN
Rochester	507 East 9th St.	Rochester	IN
Shipshewana	895 North Van Buren St.	Shipshewana	IN
Silver Lake	102 Main St.	Silver Lake	IN
South Bend Northwest	21113 Cleveland Rd.	South Bend	IN
Syracuse	502 South Huntington	Syracuse	IN
Warsaw East	3601 Commerce Dr.	Warsaw	IN
Warsaw North	420 Chevy Way	Warsaw	IN
Warsaw West	1221 West Lake St.	Warsaw	IN

Winona Lake	99 Chestnut St.	Winona Lake	IN
Winona Lake East	1324 Wooster Rd.	Winona Lake	IN

The Company leases from third parties the real estate and buildings for its Milford and Winona Lake East offices. In addition, the Company leases the real estate for its four freestanding ATMs. All the other branch facilities are owned by the Company. The Company also owns parking lots in downtown Warsaw for the use and convenience of Company employees and customers, as well as leasehold improvements, equipment, furniture and fixtures necessary to operate the banking facilities.

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In addition, the Company owns buildings at 110 South High St., Warsaw, Indiana, and 114-118 East Market St., Warsaw, Indiana, which it uses for various offices, a building at 113 East Market St., Warsaw, Indiana, which it uses for office and computer facilities, and a building at 109 South Buffalo St., Warsaw, Indiana, which it uses for training and development. The Company also leases from third parties office space in Indianapolis, Indiana, for a loan production office.

None of the Company's assets are the subject of any material encumbrances.

ITEM 3. LEGAL PROCEEDINGS

There are no material pending legal proceedings other than ordinary routine litigation incidental to the business to which the Company and the Bank are a party or of which any of their property is subject.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matter was submitted to a vote of security holders during the fourth quarter of 2008.

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PART II

ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

	4th Quarter	3rd Quarter	2nd Quarter	1st Quarter
2008				
Trading prices (per share)*				
Low	**$ 14.93**	**$ 18.52**	**$ 19.00**	**$ 16.87**
High	**$ 24.10**	**$ 30.09**	**$ 25.00**	**$ 23.97**
Dividends declared (per share)	**$ 0.155**	**$ 0.155**	**$ 0.155**	**$ 0.140**
2007				
Trading prices (per share)*				
Low	$ 18.25	$ 20.05	$ 20.71	$ 21.85
High	$ 25.00	$ 25.98	$ 23.81	$ 25.92
Dividends declared (per share)	$ 0.140	$ 0.140	$ 0.140	$ 0.125

* *The trading ranges are the high and low prices as obtained from The Nasdaq Stock Market.*

The common stock of the Company began being quoted on The Nasdaq Stock Market under the symbol LKFN in August, 1997. Currently, the Company’s common stock is listed for trading on the Nasdaq Global Select market. On December 31, 2008, the Company had approximately 439 shareholders of record and estimates that it has approximately 2,300 shareholders in total.

The Company paid dividends as set forth in the table above. The Company’s ability to pay dividends to shareholders is largely dependent upon the dividends it receives from the Bank, and the Bank is subject to regulatory limitations on the amount of cash dividends it may pay. In addition, as a result of the Company’s participation in the TARP Capital Purchase Program, the Company may not increase the quarterly dividends it pays on the Company’s common stock above $0.155 per share for three years, without the consent of Treasury, unless Treasury no longer holds shares of the Series A Preferred Stock. See “Business – Supervision and Regulation – The Company – Dividend Payments” and “Business - Supervision and Regulation – The Bank – Dividend Payments” for a more detailed description of these limitations.

The following table provides information about purchases by the Company and its affiliates during the quarter ended December 31, 2008 of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Appropriate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs

10/01/08-10/31/08	0	$ 0.00	0	$ 0.00
11/01/08-11/30/08	758	21.57	0	0.00
12/01/08-12/31/08	0	0.00	0	0.00
Total	758	$ 21.57	0	$ 0.00

The shares purchased during the periods were credited to the deferred share accounts of eight non-employee directors under the Company's directors' deferred compensation plan.

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STOCK PRICE PERFORMANCE GRAPH

The graph below compares the cumulative total return of the Company, the Nasdaq Market Index and a peer group index.

INDEX	2003	2004	2005	2006	2007	2008
Lakeland Financial Corporation	$ 100.00	$ 115.12	$ 119.82	$ 154.78	$ 129.79	$ 152.27
NASDAQ Market Index	100.00	108.59	110.08	120.56	132.39	78.72
Peer Group Index	100.00	119.17	118.45	134.88	95.73	73.33

* Assumes $100 invested on December 31, 2003 and dividends were reinvested.

The peer group index is comprised of all financial institution holding companies in the United States with total assets as of December 31, 2008 between $1.0 billion and $3.0 billion dollars whose equity securities were traded on an exchange or national quotation service.

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ITEM 6. SELECTED FINANCIAL DATA

	2008	2007	2006	2005	2004
	(in thousands except share and per share data)				
Interest income	**$ 118,484**	$ 117,973	$ 105,551	$ 80,616	$ 60,182
Interest expense	**55,216**	63,417	53,224	30,353	16,833
Net interest income	**63,268**	54,556	52,327	50,263	43,349
Provision for loan losses	**10,207**	4,298	2,644	2,480	1,223
Net interest income after provision for loan losses	**53,061**	50,258	49,683	47,783	42,126
Other noninterest income	**21,861**	19,477	18,281	16,358	15,693
Gain on sale of credit card portfolio	**0**	0	0	863	0
Gain on redemption of Visa shares	**642**	0	0	0	0
Net gains on sale of real estate mortgages held for sale	**786**	676	581	934	987
Net securities gains (losses)	**39**	89	(68)	(69)	0
Noninterest expense	**(47,481)**	(42,923)	(40,242)	(38,432)	(36,959)
Income before income tax expense	**28,908**	27,577	28,235	27,437	21,847
Income tax expense	**9,207**	8,366	9,514	9,479	7,302
Net income	**$ 19,701**	$ 19,211	$ 18,721	$ 17,958	$ 14,545
Basic weighted average common shares outstanding*	**12,271,927**	12,188,594	12,069,300	11,927,756	11,735,410
Basic earnings per common share*	**$ 1.61**	$ 1.58	$ 1.55	$ 1.51	$ 1.24
Diluted weighted average common shares outstanding*	**12,459,802**	12,424,137	12,375,467	12,289,466	12,128,154
Diluted earnings per common share*	**$ 1.58**	$ 1.55	$ 1.51	$ 1.46	$ 1.20

Cash dividends declared*	**$ 0.61**	$ 0.55	$ 0.38	$ 0.46	$ 0.42

** Share and per share data have been adjusted for a 2-for-1 stock split on April 28, 2006.*

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ITEM 6. SELECTED FINANCIAL DATA (continued)

	2008	2007	2006	2005	2004
			(in thousands)		
Balances at December 31,					
Total assets	**$ 2,377,445**	$ 1,989,133	$ 1,836,706	$ 1,634,613	$ 1,453,122
Total loans	**$ 1,833,334**	$ 1,523,720	$ 1,353,837	$ 1,198,730	$ 1,003,219
Total deposits	**$ 1,885,299**	$ 1,478,918	$ 1,475,765	$ 1,266,245	$ 1,115,399
Total short-term borrowings	**$ 202,609**	$ 316,165	$ 187,484	$ 211,542	$ 185,650
Long-term borrowings	**$ 90,043**	$ 44	$ 45	$ 46	$ 10,046
Subordinated debentures	**$ 30,928**	$ 30,928	$ 30,928	$ 30,928	$ 30,928
Total stockholders' equity	**$ 149,880**	$ 146,270	$ 130,187	$ 113,334	$ 101,765

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

Lakeland Financial Corporation is the holding company for Lake City Bank. The Company is headquartered in Warsaw, Indiana and operates 43 offices in twelve counties in northern Indiana and a loan production office in Indianapolis, Indiana. The Company earned $19.7 million for the year 2008 versus $19.2 million for 2007, an increase of 2.6%. The increase was driven primarily by an $8.7 million increase in net interest income and a $3.1 million increase in noninterest income. Offsetting these positive impacts was a $5.9 million increase in the provision for loan losses and a $4.6 million increase in noninterest expense. The Company earned $19.2 million for the year 2007 versus $18.7 million for 2006, an increase of 2.6%. The increase was driven primarily by a $2.2 million increase in net interest income and a $1.3 million increase in noninterest income. In addition, the Company's effective tax rate decreased to 30.3% for 2007 compared to 33.7% for 2006. Offsetting these positive impacts was a $2.5 million increase in noninterest expense and a $1.7 million increase in the provision for loan losses.

Basic earnings per share for the year 2008 was $1.61 per share versus $1.58 per share for 2007 and $1.55 for 2006. Diluted earnings per share for the year ended 2008 was $1.58 per share versus $1.55 per share for the year ended 2007 and $1.51 for the year ended 2006. Diluted earnings per share reflect the potential dilutive impact of stock options granted under employee stock option plans.

The Company's total assets were $2.377 billion as of December 31, 2008 versus $1.989 billion as of December 31, 2007, an increase of $388.3 million or 19.5%. This increase was primarily due to a $292.4 million increase in commercial loans from $1.241 billion at December 31, 2007 to $1.533 billion at December 31, 2008.

RESULTS OF OPERATIONS

2008 versus 2007

The Company reported record net income of $19.7 million in 2008, an increase of $490,000, or 2.6%, versus net income of $19.2 million in 2007. Net interest income increased $8.7 million, or 16.0%, to $63.3 million versus $54.6 million in 2007. Net interest income increased primarily due to increases in average earning assets, particularly a 22.4% increase in commercial loans as a result of our continued strategic focus on commercial lending as a key driver of the business. Interest income increased $511,000, or 0.4%, from $118.0 million in 2007 to $118.5 million in 2008. The increase was driven primarily by increases in average earning assets. Interest expense decreased $8.2 million, or 12.9%, from $63.4 million in 2007 to $55.2 million in 2008. The decrease was primarily the result of a 101 basis point decrease in the Company's daily cost of funds over the year due to a decrease in market rates over the same time period. The Company had a net interest margin of 3.14% in 2008 versus 3.22% in

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2007, primarily due to a decline in the prime rate from 7.25% to 3.25% during 2008, which was led by changes in the Fed Fund rate by the Federal Open Market Committee. Average earning assets increased by $318.5 million from $1.7 billion in 2007 to $2.0 billion in 2008. This increase was due primarily to loan growth led by significant growth in five counties: St. Joseph, Kosciusko, Allen, Hamilton and Elkhart and with balanced growth in the Bank's other regions. Deposits increased to fund the loan growth during 2008, driven primarily by increases of $69.3 million in interest bearing transaction accounts, $37.3 million in average brokered deposit balances and $36.9 million in average other time deposit account balances. The increase in interest bearing transaction accounts was driven primarily by the addition of a new product, which pays a higher interest rate on balances up to a maximum balance amount when certain conditions are met during each interest cycle. In addition, loan growth was funded by a $97.0 million increase in the average balance in Federal Home Loan Bank advances. Management believes that the growth in the loan portfolio will likely continue in a measured, but prudent fashion as a result of our strategic focus on commercial lending and in conjunction with the general expansion and penetration of the geographical markets the Company serves, as well as our expansion in the Indianapolis market and the continued progress that we are making in that relatively new market.

Nonaccrual loans were $20.8 million, or 1.14% of total loans, at year end versus $7.0 million, or 0.46% of total loans, at the end of 2007. There were 22 relationships totaling $20.3 million classified as impaired as of December 31, 2008 versus five relationships totaling $6.7 million at the end of 2007. The increase in impaired and nonperforming loans resulted primarily from the addition of four commercial relationships totaling $14.4 million. Net charge-offs were $7.1 million in 2008 versus $3.0 million in 2007, representing 0.43% and 0.21% of average daily loans in 2008 and 2007. Total nonperforming loans were $21.3 million, or 1.16% of total loans, at year end 2008 versus $7.4 million, or 0.49% of total loans, at the end of 2007. The provision for loan loss expense was $10.2 million in 2008, resulting in an allowance for loan losses at December 31, 2008 of $18.9 million, which represented 1.03% of the loan portfolio, versus a provision for loan loss expense of $4.3 million in 2007 and an allowance for loan losses of $15.8 million at the end of 2007, or 1.04% of the loan portfolio. The higher provision in 2008 versus 2007 was attributable to a number of factors, but was primarily a result of an increase in net charge-offs, general growth in the loan portfolio, as well as higher allocations on specific watch list credits. The level of loan loss provision was also influenced by other factors related to the growth in the loan portfolio, such as the continued emerging market risk, the continued emerging concentration risk, commercial loan focus and large credit concentration, new industry lending activity, general economic conditions and historical loss percentages. In addition, management gave consideration to changes in the allocation for specific watch list credits in determining the appropriate level of the loan loss provision. Management's overall view on current credit quality was also a factor in the determination of the provision for loan losses. The Company's management continues to monitor the adequacy of the provision based on loan levels, asset quality, economic conditions and other factors that may influence the assessment of the collectability of loans.

Noninterest income was $23.3 million in 2008 versus $20.2 million in 2007, an increase of $3.1 million, or 15.3%. The 2008 increase was driven by a $1.4 million, or 18.9%, increase in service charges on deposit accounts. The increase was due primarily to increases in retail NSF fees and account analysis service charges on commercial checking accounts, which are generally higher when the earnings allowance credit rate is lower. Additionally, noninterest income increased due to a nonrecurring gain of $642,000 related to the VISA initial public offering and the redemption of some of the shares we owned in connection with the offering. Investment brokerage fees increased $381,000, or 25.6%, due to increased trade volume. Loan, insurance and service fees increased $328,000, or 13.2%, driven by higher fee income on debit card activity.

Noninterest expense increased $4.6 million, or 10.6%, from $42.9 million in 2007 to $47.5 million in 2008. Other expense increased by $1.8 million, or 20.1%, driven by regulatory expenses which increased by $1.5 million due to the Company's resumption of regular FDIC insurance premiums, as prior credits expired early in 2008. We expect our premiums to continue to increase as we increase our deposit base and as the FDIC will charge higher assessments due to the current troubled economy. Salaries and employee benefits increased by $1.7 million, or 7.0%, driven by normal salary increases, increased health insurance and performance-based incentive expense, the addition of revenue producing staff and enhanced staff in administrative positions. Data processing fees and supplies increased $549,000, or 17.7%, driven by the implementation of a new corporate treasury management platform and contractual increases in existing operating services. Net occupancy expense increased by $348,000, or 12.7%, primarily as a result of higher maintenance and repair costs and higher property tax expense that resulted from the Indiana property tax reapportionment process.

As a result of these factors, income before income tax expense increased $1.3 million, or 4.8%, from $27.6 million in 2007 to $28.9 million in 2008. Income tax expense was $9.2 million in 2008 versus $8.4 million in 2007. Income tax as a percentage of income before tax was 31.8% in 2008 versus 30.3% in 2007. The increase in the tax rate was driven by a lower percentage of revenue being derived from tax-advantaged sources in 2008 versus 2007. Net income increased $490,000, or 2.6%, to $19.7 million in 2008 versus $19.2 million in 2007. Basic earnings per

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share in 2008 was $1.61, an increase of 1.9%, versus $1.58 in 2007. The Company's net income performance represented a 13.5% return on January 1, 2008, stockholders' equity versus 14.8% in 2007. The net income performance resulted in a 0.91% return on average daily assets in 2008 versus 1.04% in 2007.

RESULTS OF OPERATIONS

2007 versus 2006

The Company reported record net income of $19.2 million in 2007, an increase of $490,000, or 2.6%, versus net income of $18.7 million in 2006. Net interest income increased $2.2 million, or 4.3%, to $54.6 million versus $52.3 million in 2006. Net interest income increased primarily due to increases in average earning assets, particularly a 14% increase in commercial loans as a result of our strategic focus on commercial lending. Interest income increased $12.4 million, or 11.8%, from $105.6 million in 2006 to $118.0 million in 2007. The increase was driven primarily by increases in average earning assets, as well as a 14 basis point increase in the tax equivalent yield on average earning assets over the year. Interest expense increased $10.2 million, or 19.2%, from $53.2 million in 2006 to $63.4 million in 2007. The increase was primarily the result of a 36 basis point increase in the Company's daily cost of funds over the year. The Company had a net interest margin of 3.22% in 2007 versus 3.38% in 2006. Average earning assets increased by $148.7 million from $1.6 billion in 2006 to $1.7 billion in 2007. This loan growth was led by significant growth in Elkhart and Allen Counties and with balanced growth in the Bank's other regions. Deposits increased to fund the loan growth during 2007, driven primarily by increases of $23.9 million in average brokered deposit balances, $20.5 million in interest bearing transaction accounts and $39.1 million in average other time deposit account balances.

Nonaccrual loans were $7.0 million, or 0.46% of total loans, at year end versus $13.8 million, or 1.02% of total loans, at the end of 2006. There were five relationships totaling $6.7 million classified as impaired as of December 31, 2007 versus five relationships totaling $13.3 million at the end of 2006. The decrease in impaired and nonperforming loans resulted from the transfer to other real estate of a single borrowing relationship, a residential and commercial real estate developer. Net charge-offs were $3.0 million in 2007 versus $955,000 in 2006, representing 0.21% and 0.08% of average daily loans in 2007 and 2006. Total nonperforming loans were $7.4 million, or 0.49% of total loans, at year end 2007 versus $14.1 million, or 1.04% of total loans, at the end of 2006. The provision for loan loss expense was $4.3 million in 2007, resulting in an allowance for loan losses at December 31, 2007 of $15.8 million, which represented 1.04% of the loan portfolio, versus a provision for loan loss expense of $2.6 million in 2006 and an allowance for loan losses of $14.5 million at the end of 2006, or 1.07% of the loan portfolio. The higher provision in 2007 versus 2006 was attributable to a number of factors, but was primarily a result of an increase in net charge-offs, general growth in the loan portfolio, as well as higher allocations on specific watch list credits. The level of loan loss provision was also influenced by other factors related to the growth in the loan portfolio, such as emerging market risk, commercial loan focus and large credit concentration, new industry lending activity, general economic conditions and historical loss percentages. In addition, management gave consideration to changes in the allocation for specific watch list credits in determining the appropriate level of the loan loss provision. Management's overall view on current credit quality was also a factor in the determination of the provision for loan losses. The Company's management continued to monitor the adequacy of the provision based on loan levels, asset quality, economic conditions and other factors that may influence the assessment of the collectability of loans.

Noninterest income was $20.2 million in 2007 versus $18.8 million in 2006, an increase of $1.4 million, or 7.7%. The 2007 increase was driven by a $592,000, or 23.2%, increase in wealth advisory fees. Additionally, noninterest income increased due to a $201,000, or 15.6%, increase in investment brokerage fees. Merchant card fee income increased due to higher volume activity in interchange and merchant fees as well as new business generation. Loan, insurance and service fees increased $191,000, or 8.3%, driven by higher fee income on debit card activity. Offsetting these increases was a decrease of $109,000, or 5.6%, in other income.

Noninterest expense increased $2.7 million, or 6.7%, from $40.2 million in 2006 to $42.9 million in 2007. Salaries and employee benefits increased by $1.4 million, or 6.4%, driven by normal salary increases and higher health care cost, which represented approximately $542,000 of the total increase. Data processing fees and supplies increased $449,000, or 18.3%, driven by higher data processing fees, software license fees and maintenance fees related to new services offered to clients. Net occupancy expense increased from $2.5 million in 2006 to $2.7 million in 2007, primarily as a result of higher maintenance and repair costs and higher property tax expense.

As a result of these factors, income before income tax expense decreased $658,000, or 2.3%, from $28.2 million in 2006 to $27.6 million in 2007. Income tax expense was $8.4 million in 2007 versus $9.5 million in 2006. Income tax as a percentage of income before tax was 30.3% in 2007 versus 33.7% in 2006. The decrease in the tax rate was driven by the formation of a captive real estate investment trust in the fourth quarter of 2006, which

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provides the Company with an alternative vehicle for raising capital should the need arise. Additionally, the ownership structure of this real estate investment trust provided certain state income tax benefits which also lowered the Company's effective tax rate. Net income increased $490,000, or 2.6%, to $19.2 million in 2007 versus $18.7 million in 2006. Basic earnings per share in 2007 was $1.58, an increase of 1.9%, versus $1.55 in 2006. The Company's net income performance represented a 14.8% return on January 1, 2007, stockholders' equity versus 16.5% in 2006. The net income performance resulted in a 1.04% return on average daily assets in 2007 versus 1.10% in 2006.

FINANCIAL CONDITION

As of December 31, 2008, the Company had 43 offices serving twelve counties in northern Indiana and one loan production office in Indianapolis. Since 1996, the Company has added seventeen new offices through acquisition and internal growth. The Company will consider future acquisition and expansion opportunities with an emphasis on markets that it believes would be receptive to its business philosophy of client-focused, independent banking, as well as increased penetration in existing markets where opportunities for market share growth exist.

Total assets of the Company were $2.377 billion as of December 31, 2008, an increase of $388.3 million, or 19.5%, when compared to $1.989 billion as of December 31, 2007.

Total cash and cash equivalents decreased by $3.7 million, or 5.4%, to $64.0 million at December 31, 2008 from $67.7 million at December 31, 2007.

Total securities available for sale increased by $59.3 million, or 18.1%, to $387.0 million at December 31, 2008 from $327.8 million at December 31, 2007. The portfolio contains mostly collateralized mortgage obligations and 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 or Aaa by Moody's at the time of purchase. As of December 31, 2008, the Company had $85.1 million of collateralized mortgage obligations which were not issued by the federal government or government sponsored agencies, but were rated AAA by S&P and/or Aaa by Moody's at the time of purchase. The investment portfolio did not contain any corporate debt instruments or trust preferred instruments as of December 31, 2008. The increase was a result of a number of activities in the securities portfolio. Paydowns from prepayments of $51.7 million were received, and the amortization of premiums, net of the accretion of discounts, was $41,000. Maturities and calls of securities totaled $14.8 million. These portfolio decreases were offset by securities purchases totaling $143.2 million. The fair value of the securities decreased $17.4 million due to the liquidity crisis that affected financial markets in 2008 and the current unsettled economic situation which resulted in lower market values for securities which were not backed directly or indirectly by the federal government (private label MBS). The investment portfolio is managed to provide for an appropriate balance between credit risk and investment return and to limit the Company's exposure to risk to an acceptable level.

Fourteen of the 24 private label MBS were still rated AAA/Aaa as of December 31, 2008, but ten were downgraded by S&P, Fitch and/or Moody's, including four which were ranked below investment grade by one or more rating agencies. The Company, with the assistance of an outside expert, analyzes projections for all of these securities that includes projections of future performance in the underlying collateral under various scenarios and under various prepayment assumptions. Based on the analyses as of December 31, 2008, the projections indicate that principal and interest payments expected to be collected over the life of the securities equaled or exceeded the current book value of these securities including interest, and no other than temporary impairment had been recorded as of the end of the year.

Real estate mortgages held for sale decreased by $136,000, or 25.3%, to $401,000 at December 31, 2008 from $537,000 at December 31, 2007. 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 2008, $41.0 million in real estate mortgages were originated for sale and $40.8 million in mortgages were sold, compared to $37.5 million and $38.9 million in 2007.

Total loans, excluding real estate mortgages held for sale, increased by $309.6 million, or 20.3%, to $1.833 billion at December 31, 2008 from $1.524 billion at December 31, 2007. The mix of loan types within the Company's portfolio continued a trend toward a higher percentage of the total loan portfolio being in commercial loans. This general increase in commercial loans is a result of the Company's long standing strategic focus toward emphasizing origination of commercial loans. The portfolio breakdown at year end 2008 reflected 84% commercial and industrial and agri-business, 13% residential real estate and home equity and 3% consumer loans compared to 82% commercial and industrial and agri-business, 15% residential real estate and home equity and 3% consumer loans at December 31, 2007.

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At December 31, 2008, the allowance for loan losses was $18.9 million, or 1.03% of total loans outstanding, versus $15.8 million, or 1.04% of total loans outstanding at December 31, 2007. The process of identifying probable credit losses is a subjective process. Therefore, the Company maintains a general allowance to cover probable incurred credit losses within the entire portfolio. The methodology management uses to determine the adequacy of the loan loss reserve includes the following considerations.

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. Commercial loans represent higher dollar 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 mortgage loans, which represent increased interest rate risk, are sold in the secondary market, as well as some variable rate mortgage loans. The remainder of the variable rate mortgage loans and a small number of fixed rate 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 stabilize or 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, 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, but do possess credit deficiencies or potential weaknesses deserving management's close attention. Assets classified as substandard or doubtful require the institution to establish specific allowances for loan losses. If an asset or portion thereof is classified as loss, the insured institution must 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 December 31, 2008, on the basis of management's review of the loan portfolio, the Company had loans totaling $98.8 million on the classified loan list versus $79.3 million on December 31, 2007. As of December 31, 2008, the Company had $47.2 million of assets classified special mention, $46.2 million classified as substandard, $5.4 million classified as doubtful and $0 classified as loss as compared to $39.4 million, $39.7 million, $244,000 and $0 at December 31, 2007.

Allowance estimates are developed by management taking into account actual loss experience, adjusted for current economic conditions. The Company discusses this methodology with regulatory authorities to ensure compliance. 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 FASB Statements 5 and 114, the allowance is provided for losses that have been incurred as of the balance sheet date and is based on past events and current economic conditions, and does not include the effects of expected losses on specific loans or groups of loans that are related to future events or expected changes in economic conditions. For a more thorough discussion of the allowance for loan losses methodology see the Critical Accounting Policies section of this Item.

The allowance for loan losses increased $3.1 million from $15.8 million December 31, 2007 to $18.9 million at December 31, 2008. Pooled loan allocations increased $2.1 million from $4.9 million at December 31, 2007 to $7.0 million at December 31, 2008, which was a result of an increase in pooled loan balances of $290.0 million year over year and an increase in commercial loan allocations due to the current economic environment. Specific loan allocations decreased $182,000 from $10.6 million at December 31, 2007 to $10.4 million at December 31, 2008. This decrease was primarily due to the payoffs received on previously classified commercial credits, charge-offs taken during 2008 as well as the well-collateralized nature of newly classified loans. The unallocated component of the allowance for loan losses increased $1.1 million from $322,000 at December 31, 2007 to $1.4 million at December 31, 2008 primarily due to the uncertainty in the current economic conditions.

The Company has experienced growth in total loans over the last three years of $634.6 million, or 52.9%. The concentration of this loan growth was in the commercial loan portfolio. Commercial loans comprised 84%, 82% and 80% of the total loan portfolio at December 31, 2008, 2007 and 2006. Traditionally, this type of lending may have more credit risk than other types of lending because of the size and diversity of the credits. The Company

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manages this risk by adjusting its pricing to the perceived risk of each individual credit and by diversifying the portfolio by customer, product, industry and geography. Management has historically considered growth and portfolio composition when determining loan loss allocations. Management believes that it is prudent to continue to provide for loan losses in a manner consistent with its historical approach due to the loan growth described above and current economic conditions.

As a result of the methodology in determining the adequacy of the allowance for loan losses, the provision for loan losses was $10.2 million in 2008 versus $4.3 million in 2007. At December 31, 2008, total nonperforming loans increased by $13.8 million to $21.3 million from $7.4 million at December 31, 2007. Loans delinquent 90 days or more that were included in the accompanying financial statements as accruing totaled $478,000 versus $409,000 at December 31, 2007. Total impaired loans increased by $13.6 million to $20.3 million at December 31, 2008 from $6.7 million at December 31, 2007. The increase in impaired and nonperforming loans resulted from the addition of four commercial relationships totaling $14.4 million. The $20.3 million in impaired loans are all in nonaccrual status. The Company allocated $3.2 million and $2.3 million of the allowance for loan losses to the impaired loans in 2008 and 2007. A loan is impaired when full payment under the original loan terms is not expected. Impairment is evaluated in total for smaller-balance loans of similar nature such as residential mortgage, consumer, and credit card 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.

Management believes that the regional economic conditions continue to worsen in the Company’s markets and does not foresee a rapid recovery from this distressed economic environment. In addition, slow downs in certain industries, including residential and commercial real estate development, recreational vehicle and mobile home manufacturing and other regional industries are occurring. The Company believes that the impact of these industry-specific issues will be mitigated by its overall expansion strategy, which promotes 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. The allowance for loan loss to total loans percentage was 1.03% in 2008 and 1.04% in 2007. The Company’s total nonperforming loans were 1.16% of total loans at year end 2008 versus 0.49% of total loans at the end of 2007. However, the Company’s overall asset quality position can be influenced by a small number of credits due to the focus on commercial lending activity.

Total deposits increased by $406.4 million, or 27.5%, to $1.885 billion at December 31, 2008 from $1.479 billion at December 31, 2007. The increase resulted from increases of $165.1 million in brokered deposits, $151.6 million in interest bearing transaction accounts, $82.8 million in other certificates of deposit and $58.3 million in certificates of deposit of $100,000 and over. The increase in interest bearing transaction accounts was driven primarily by the addition of a new product, which pays a higher interest rate on balances up to a maximum balance amount when certain conditions are met during each interest cycle. These increases were offset by decreases of $24.6 million in demand deposits, $15.1 million in money market deposit accounts, $7.6 million in public fund certificates of deposit and $4.2 million in savings accounts.

Total short-term borrowings decreased by $113.6 million, or 35.9%, to $202.6 million at December 31, 2008 from $316.2 million at December 31, 2007. The decrease resulted from decreases of $51.0 million in federal funds purchased, $45.0 million in other short-term borrowings, primarily short-term advances from the Federal Home Loan Bank of Indianapolis, $17.1 million in securities sold under agreements to repurchase and $402,000 in U.S. Treasury demand notes. In addition, long-term borrowings increased by $90.0 million as a result of long-term advances from the Federal Home Loan Bank of Indianapolis.

The Company believes that a strong, appropriately managed capital position is critical to long-term earnings and expansion. Bank regulatory agencies exclude the market value adjustment created by SFAS No. 115 (AFS adjustment) from capital adequacy calculations. Excluding this adjustment from the calculation, the Company had a total risk-based capital ratio of 10.2% and a Tier I risk-based capital ratio of 9.3% as of December 31, 2008. These ratios met or exceeded the Federal Reserve’s “well-capitalized” minimums of 10.0% and 6.0%, respectively. To further strengthen the Company’s capital position, on February 27, 2009, the Company participated in Treasury’s TARP Capital Purchase Program. Pursuant to the program, the Company issued to Treasury 56,044 shares of the Series A Preferred Stock and a warrant to purchase 396,538 shares of the Company’s common stock. The $56.0 million received by the Company in connection with this investment qualifies as Tier 1 regulatory capital for the Company.

The ability to maintain these ratios is a function of the balance between net income and a prudent dividend policy. Total stockholders’ equity increased by 2.5% to $149.9 million as of December 31, 2008 from $146.3 million as of December 31, 2007. The increase in 2008 resulted from net income of $19.7 million, as well as the following factors:

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- cash dividends of $7.4 million,
- an unfavorable change in the AFS adjustment for the market valuation on securities held for sale of $10.4 million, net of tax,
- negative pension liability adjustment of $629,000, net of tax,
- $211,000 for the acquisition of treasury stock and
- $2.1 million related to stock option exercises.

Total stockholders' equity increased by 12.4% to $146.3 million as of December 31, 2007 from $130.2 million as of December 31, 2006. The increase in 2007 resulted from net income of $19.2 million, as well as the following factors:

- cash dividends of $6.6 million,
- a favorable change in the AFS adjustment for the market valuation on securities held for sale of $1.9 million, net of tax,
- positive minimum pension liability adjustment of $232,000, net of tax,
- $243,000 for the acquisition of treasury stock and
- $1.2 million related to stock option exercises.

The 2008 AFS adjustment was primarily related to a 574 basis point decrease in the two to five year U.S. Treasury rates during 2008. Management has factored this into the determination of the size of the AFS portfolio to assure that stockholders' equity is adequate under various scenarios.

Critical Accounting Policies

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

Allowance for Loan Losses

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

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

The determination of the appropriate allowance is inherently subjective, as it requires significant estimates. The Company has an established process to determine the adequacy of the allowance for loan losses that generally includes consideration of the following factors: changes in the nature and volume of the loan portfolio, overall portfolio quality and current economic conditions that may affect the borrowers' ability to repay. Consideration is not limited to these factors, although they represent the most commonly cited factors. With respect to specific allocation levels for individual credits, management generally considers the amounts and timing of expected future cash flows and the valuation

of collateral as the primary measures. Management also considers trends in adversely classified loans based upon an ongoing review of those credits. With respect to pools of similar loans, we generally use percentage allocations based upon historical analysis. We may also adjust these allocations for other factors cited above. An appropriate level of general allowance for pooled loans is determined after considering the following: application of historical loss percentages, emerging market risk, commercial loan focus and large credit

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concentration, new industry lending activity and general economic conditions. It is also possible that the following could affect the overall process: social, political, economic and terrorist events or activities. All of these factors are susceptible to significant change. As a result of this detailed process, the allowance results in two forms of allocations, specific and general. These two components represent the total allowance for loan losses deemed adequate to cover probable losses inherent in the loan portfolio.

Commercial loans are subject to a dual standardized grading process administered by the credit administration and internal loan review functions. A credit grade is assigned to each commercial loan by both the commercial loan officer and the loan review department. These grade assignments are performed independent of each other and a loan may or may not be graded the same. The grade given by the loan review department is the assigned in the Company's loan system for individual credits. The need for specific allocation of the loan loss reserve is considered for individual credits when graded special mention, substandard, doubtful or loss. Other considerations with respect to specific allocations for individual credits include, but are not limited to, the following: (a) does the customer's cash flow or net worth appear insufficient to repay the loan; (b) is there adequate collateral to repay the loan; (c) has the loan been criticized in a regulatory examination; (d) is the loan on non-accrual; (e) are there other reasons where the ultimate collectibility of the loan is in question; or (f) are there unique loan characteristics require special monitoring. Specific allowances are established in cases where management has identified significant conditions or circumstances related to an individual credit that we believe indicates the loan is impaired.

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

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

Mortgage Servicing Rights Valuation

The Company adopted SFAS No. 156 on January 1, 2007, and for sales of mortgage loans beginning in 2007, mortgage servicing rights (MSRs) are initially recognized as assets for the full fair value of retained servicing rights on loans sold. Subsequent measurement uses the amortization method where all servicing rights are expensed in proportion to, and over the period of, estimated net servicing revenues. Impairment is evaluated based on the fair value of the rights, using groupings of the underlying loans as to type and interest rate. Fair value is determined based upon discounted cash flows using market-based assumptions.

To determine the fair value of MSRs, the Company uses a valuation model that calculates the present value of estimated future net servicing income. In using this valuation method, the Company incorporates assumptions that market participants would use in estimating future net servicing income, which 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 Company compares the valuation model inputs and results to published industry data in order to validate the model results and assumptions.

The most significant assumption used to value MSRs is prepayment rate. In general, during periods of declining interest rates, the value of MSRs decline due to increasing prepayment speeds attributable to increased mortgage refinancing activity. Prepayment rates are estimated based on published industry consensus prepayment rates. Prepayments will increase or decrease in correlation with market interest rates and actual prepayments generally differ from initial estimates. If actual prepayment rates are different than originally estimated, the Company may receive less mortgage servicing income, which could reduce the value of the MSRs. Other assumptions used in estimating the fair value of MSRs do not generally fluctuate to the same degree as prepayment rates, and therefore the fair value of MSRs is less sensitive to changes in these other assumptions.

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The servicing assets had a fair value of $2.1 million and $2.5 million at December 31, 2008 and 2007, respectively. At December 31, 2008, key economic assumptions and the sensitivity of the current fair value of mortgage servicing rights to an immediate 10% and 20% adverse changes in those assumptions are as follows:

Fair value of mortgage servicing assets	$	2,148
Constant prepayment speed (PSA)		287
Impact on fair value of 10% adverse change	$	(110)
Impact on fair value of 20% adverse change		(206)
Discount rate		9.4%
Impact on fair value of 10% adverse change	$	(54)
Impact on fair value of 20% adverse change		(107)

These sensitivities are hypothetical and should not be relied upon. As the figures indicate, changes in value based on a 10% and 20% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in value may not be linear. Also, in this table, the effect of a variation in a particular assumption on the value of the servicing asset is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another (for example, increases in market interest rates may result in lower prepayments), which might magnify or counteract the sensitivities.

On a monthly basis, the Company evaluates the possible impairment of MSRs based on the difference between the carrying amount and the current fair value of MSRs. For purposes of evaluating and measuring impairment, the Company stratifies its portfolios on the basis of certain risk characteristics, including loan type and interest rate. If impairment exists, a valuation allowance is established for any excess of amortized cost over the current fair value, by risk stratification, through a charge to income. If the Company later determines that all or a portion of the impairment no longer exists for a particular strata, a reduction of the valuation allowance may be recorded as an increase to income.

Valuation of Investment Securities

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

At the end of each reporting period securities held in the investment portfolio are evaluated on an individual security level for other-than-temporary impairment in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. An impairment is other-than-temporary if the decline in the fair value of the security is below its amortized cost and it is probable that all amounts due according to the contractual terms of a debt security will not be received. Significant judgments are required in determining impairment, which include making assumptions regarding the estimated prepayments, loss assumptions and the change in interest rates.

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

- The length of time and the extent to which the market value has been less than amortized cost;
- The financial condition and near-term prospects of the issuer;
- The underlying fundamentals of the relevant market and the outlook for such market for the near future; and
- Our intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in market value.

For the private label mortgage-backed securities, additional analysis is performed to determine if an other-than-temporary impairment needs to be recorded for these securities. This analysis includes outside, third party assistance and includes projecting the cash flows of the individual securities using several different scenarios regarding collateral defaults, prepayment speeds, expected losses and the severity of potential losses.

If, in management's judgment, an other-than-temporary impairment exists, the cost basis of the security will be written down to the then-current fair value, and the unrealized loss will be transferred from accumulated other comprehensive loss as an immediate reduction of

current earnings (as if the loss had been realized in the

period of other than temporary impairment). In addition, discount accretion will be discontinued on any bond that meets one or both of the following: (1) the rating by S&P, Moody's or Fitch decreases to below "A" and/or (2) the cash flow analysis on a security indicates under any scenario modeled there is a potential to not receive the full amount invested in the security.

Newly Issued But Not Yet Effective Accounting Standards

FASB Statement of Financial Accounting Standards No. 141 (revised 2007), *Business Combinations* is effective for fiscal years beginning after December 15, 2008. SFAS No. 141(R) establishes principles and requirements for how the acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The Company does not anticipate the adoption of this standard will have any material effect on the Company's operating results or financial condition.

FASB Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51* is effective for fiscal years beginning after December 15, 2008. SFAS No. 160 improves the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing certain accounting and reporting standards requirements. The Company does not anticipate the adoption of this standard will have any material effect on the Company's operating results or financial condition.

In March 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 161 (SFAS No. 161), "Disclosures about Derivative Instruments and Hedging Activities." SFAS No. 161 establishes, among other things, the disclosure requirements for derivative instruments and for hedging activities. This Statement amends and expands the disclosure requirements of Statement 133 with the intent to provide users of financial statements with an enhanced understanding of: how and why an entity uses derivative instruments; how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations; how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This Statement requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company will adopt SFAS No. 161 on January 1, 2009, and does not expect the adoption to have a material impact on the financial statements.

No other new accounting standards have been issued that are not yet effective that are expected to have a significant impact on the Company's financial condition or results of operations.

Liquidity

Management maintains a liquidity position that it believes will adequately provide funding for loan demand and deposit run-off that may occur in the normal course of business. The Company relies on a number of different sources in order to meet these potential liquidity demands. The primary sources are increases in deposit accounts and cash flows from loan payments and the securities portfolio. Given current prepayment assumptions, the cash flow from the securities portfolio is expected to provide approximately $85.3 million of funding in 2009.

In addition to these primary sources of funds, management has several secondary sources available to meet potential funding requirements. As of December 31, 2008, the Company had $180.0 million in Federal Funds lines with correspondent banks and may borrow up to $300.0 million at the Federal Home Loan Bank of Indianapolis. The Company had all of its securities in the available for sale (AFS) portfolio at December 31, 2008. Therefore, the Company may sell securities to meet funding demands. Management believes that the securities in the AFS portfolio are of high quality and would therefore be marketable. Approximately 64% of this portfolio is comprised of Federal agency securities or mortgage-backed securities directly or indirectly backed by the Federal government. In addition, the Company has historically sold the majority of its originated mortgage loans on the secondary market to reduce interest rate risk and to create an additional source of funding.

As a result of the unprecedented activity in the financial markets during the third and fourth quarters of 2008, the Company has reviewed its liquidity plan and has taken several actions designed to provide for an appropriate funding strategy in this unsettled environment. These actions include: actively communicating with correspondent banks who provide federal fund lines to ensure availability of these funds; expanded use of brokered

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certificate of deposits, which have been readily available to the Company at competitive rates; allocation of collateral at the Federal Reserve Bank for potential borrowings under their programs; increased usage of FHLB advances at advantageous rates and an increased focus on attractive core deposit programs offered by the Company. The Company will have capacity at the Federal Reserve Bank of more than $500 million given current collateral structure and the terms of these facilities.

During 2008, cash and cash equivalents decreased $3.7 million from $67.7 million as of December 31, 2007 to $64.0 million as of December 31, 2008. The primary driver of this decrease was an increase in loan balances of $317.5 million, which is net of approximately $41.0 million of loans originated and sold in 2008. Other uses of funds included the purchase of securities of $143.2 million and a $113.6 million paydown of short-term borrowings. Sources of funds were proceeds from deposit increases of $406.4 million, proceeds from long-term borrowings of $90.0 million, proceeds from maturities, calls and principal paydowns of securities of $66.5 million and proceeds from loan sales of $41.5 million.

During 2007, cash and cash equivalents decreased $52.0 million from $119.7 million as of December 31, 2006 to $67.7 million as of December 31, 2007. The primary driver of this decrease was an increase in loan balances of $178.5 million, which is net of approximately $37.5 million of loans originated and sold in 2007. Another use of funds was purchases of securities of $104.0 million. Sources of funds were proceeds from short-term borrowings of $128.7 million, proceeds from maturities, calls and principal paydowns of securities of $43.6 million, proceeds from loan sales of $39.5 million and proceeds from the sale of securities of $31.6 million.

During 2006, cash and cash equivalents increased $37.0 million from $82.7 million as of December 31, 2005 to $119.7 million as of December 31, 2006. The primary driver of this increase was an increase in deposit balances of $209.5 million. Other sources of funds were proceeds from maturities, calls and principal paydowns of securities of $46.8 million and proceeds from loan sales of $37.7 million. The primary use of funds was a $156.1 million increase in net loans, which is net of approximately $38.6 million in loans originated and sold during 2006. Other uses of funds were purchases of securities of $74.2 million and payments on short-term borrowings of $24.1 million.

The following tables disclose information on the maturity of the Company’s contractual long-term obligations and commitments. Certificates of deposit listed are those with original maturities of 1 year or more.

	Payments Due by Period				
	Total	One year or less	1-3 years	4-5 years	After 5 years
	(in thousands)				
Certificates of deposit	$ 426,895	$ 355,103	$ 67,948	$ 3,734	$ 110
Long-term debt	90,043	50,000	25,000	15,000	43
Operating leases	43	34	9	0	0
Subordinated debentures	30,928	0	0	0	30,928
Total contractual long-term cash obligations	$ 547,909	$ 405,137	$ 92,957	$ 18,734	$ 31,081

	Amount of Commitment Expiration Per Period		
	Total Amount Committed	One year or less	Over one year
	(in thousands)		
Unused loan commitments	$ 770,746	$ 538,989	$ 231,757
Commercial letters of credit	1,165	1,165	0
Standby letters of credit	25,825	18,052	7,773

Total commitments and letters of credit	$ 797,736	$ 558,206	$ 239,530

Off-Balance Sheet Transactions

During the normal course of business, the Company becomes a party to financial instruments with off-balance sheet risk in order to meet the financing needs of its customers. These financial instruments include commitments to make loans and open-ended revolving lines of credit. The Company follows the same credit policy (including requiring collateral, if deemed appropriate) to make such commitments as is followed for those loans that are recorded in its financial statements.

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The Company's exposure to credit losses in the event of nonperformance is represented by the contractual amount of the commitments. Management does not expect any significant losses as a result of these commitments. Off-Balance Sheet transactions are more fully discussed in Note 19.

Inflation

The effects of price changes and inflation can vary substantially for most financial institutions. While management believes that inflation affects the growth of total assets, it believes that it is difficult to assess the overall impact. Management believes this to be the case due to the fact that generally neither the timing nor the magnitude of the inflationary changes in the consumer price index ("CPI") coincides with changes in interest rates. The price of one or more of the components of the CPI may fluctuate considerably and thereby influence the overall CPI without having a corresponding affect on interest rates or upon the cost of those goods and services normally purchased by the Company. In years of high inflation and high interest rates, intermediate and long-term interest rates tend to increase, thereby adversely impacting the market values of investment securities, mortgage loans and other long-term fixed rate loans. In addition, higher short-term interest rates caused by inflation tend to increase the cost of funds. In other years, the reverse situation may occur.

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ITEM 7a. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Asset/Liability Management (ALCO) and Securities

Interest rate risk represents the Company's primary market risk exposure. The Company does not have material exposure to foreign currency exchange risk, does not own any significant derivative financial instruments and does not maintain a trading portfolio. The Board of Directors annually reviews and approves the ALCO policy used to manage interest rate risk. This 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. Given the Company's mix of interest bearing liabilities and interest bearing assets on December 31, 2008, the net interest margin could be expected to decline in a falling interest rate environment and conversely, to increase in a rising rate environment. During 2008 in response to the deteriorating economic environment the FOMC lowered the target federal funds rate on ten separate occasions. The target federal funds rate was 4.25% at the beginning of 2008 and was a range of 0% to .25% as of December 31, 2008. The result of these actions was a reduction in the Company's yield on earning assets of 1.05%. The decrease in the yield on earning assets was offset by a decrease in the rates paid on deposit accounts. The rate paid on deposit accounts and purchased funds decreased from 3.77% for 2007 to 2.76% for 2008. The combined result of the decreases in the yield on earning assets and in the rates paid on deposits and purchased funds was a decrease in the net margin from 3.22% for 2007 to 3.14% for 2008. Future changes in the net interest margin will be dependent upon multiple factors including further actions by the FOMC during 2009 in response to economic conditions, competitive pressures in the various markets served, and changes in the structure of the balance sheet as a result of changes in customer demands for products and services.

The Company utilizes a computer program to stress test the balance sheet under a wide variety of interest rate scenarios. The model quantifies the income impact of changes in customer preference for products, basis risk between the assets and the liabilities that support them and the risk inherent in different yield curves, as well as other factors. The ALCO committee reviews these possible outcomes and makes loan, investment and deposit decisions that maintain reasonable balance sheet structure in light of potential interest rate movements. Although management does not consider GAP ratios in this planning, the information can be used in a general fashion to look at asset and liability mismatches. The Company's cumulative repricing GAP ratio as of December 31, 2008 for the next 12 months using a rates unchanged scenario was a negative 17.00% of earning assets.

The Company's investment portfolio consists of U.S. Treasury securities, agencies, mortgage-backed securities and municipal bonds. During 2008, purchases in the securities portfolio consisted primarily of agency securities, private label mortgage-backed securities and municipal bonds. As of December 31, 2008, the Company's investment in mortgage-backed securities represented approximately 81% of total securities, with 78% of the securities consisting of CMOs and mortgage pools issued by Ginnie Mae, Fannie Mae and Freddie Mac. Ginnie Mae, Fannie Mae and Freddie Mac securities are each guaranteed by their respective agencies as to principal and interest. The private label mortgage-backed securities (CMOs not issued by the government or government sponsored agencies) comprised approximately 22% of the total securities portfolio. These private label mortgage-backed securities are all super senior securities, were rated AAA or better at the time of purchase and met specific criteria established by the Asset Liability Management Committee of the Company. All mortgage securities purchased by the Company are within risk tolerances for price, prepayment, extension and original life risk characteristics contained in the Company's investment policy. The Company uses Bloomberg analytics to evaluate and monitor all purchases. As of December 31, 2008, the securities in the AFS portfolio had approximately a five and one-half year average life with approximately 15% price depreciation in the event of a 300 basis points upward movement. The portfolio had approximately 5% price appreciation in the event of a 300 basis point downward movement in rates. As of December 31, 2008, all mortgage-backed securities were performing in a manner consistent with management's original ALCO modeled expectations.

The following table provides information regarding the Company's financial instruments used for purposes other than trading that are sensitive to changes in interest rates. For loans, securities and liabilities with contractual maturities, the tables present principal cash flows and related weighted-average interest rates by contractual maturities, as well as the Company's historical experience of the impact of interest-rate fluctuations on the prepayment of residential and home equity loans and mortgage-backed securities. Core deposits such as deposits, interest-bearing checking, savings and money market deposits that have no contractual maturity, are shown under Year 1, however historical experience indicates that some portion of the balances are retained over time. Weighted-average variable rates are based upon rates existing at the reporting date.

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2008
Principal/Notional Amount Maturing in:
(in thousands)

	Year 1	Year 2	Year 3	Year 4	Year 5	Thereafter	Total	Fair Value 12/31/2008
Rate sensitive assets:								
Fixed interest rate loans	$ 233,791	$ 154,216	$ 127,716	$ 121,875	$ 165,540	$ 62,159	$ 865,297	$ 882,148
Average interest rate	6.19%	6.55%	6.63%	6.52%	5.92%	6.32%	6.32%	
Variable interest rate loans	$ 655,893	$ 69,715	$ 46,169	$ 26,468	$ 31,962	$ 137,830	$ 968,037	$ 964,679
Average interest rate	3.37%	3.26%	3.49%	3.26%	3.26%	3.26%	3.34%	
Fixed interest rate securities	$ 205,454	$ 78,307	$ 29,830	$ 16,545	$ 10,998	$ 62,914	$ 404,048	$ 386,859
Average interest rate	5.46%	6.30%	7.04%	5.36%	5.62%	5.25%	5.75%	
Variable interest rate securities	$ 169	$ 0	$ 0	$ 0	$ 0	$ 0	$ 169	$ 171
Average interest rate	5.98%	0.00%	0.00%	0.00%	0.00%	0.00%	5.98%	
Other interest-bearing assets	$ 6,858	$ 0	$ 0	$ 0	$ 0	$ 0	$ 6,858	$ 6,858
Average interest rate	0.58%	0.00%	0.00%	0.00%	0.00%	0.00%	0.58%	
Rate sensitive liabilities:								
Non-interest bearing checking	$ 230,716	$ 0	$ 0	$ 0	$ 0	$ 0	$ 230,716	$ 230,716
Average interest rate								
Savings & interest bearing checking	$ 656,239	$ 0	$ 0	$ 0	$ 0	$ 0	$ 656,239	$ 656,239
Average interest rate	1.08%	0.00%	0.00%	0.00%	0.00%	0.00%	1.08%	
Time deposits	$ 849,234	$ 88,286	$ 46,850	$ 7,229	$ 6,209	$ 536	$ 998,344	$ 1,013,798
Average interest rate	3.38%	4.03%	4.53%	4.47%	4.25%	4.25%	3.51%	
Fixed interest rate borrowings	$ 70,288	$ 0	$ 25,000	$ 0	$ 15,000	$ 43	$ 110,331	$ 114,291
Average interest rate	2.80%	0.00%	4.61%	0.00%	4.49%	6.15%	3.44%	
Variable interest rate borrowings	$ 182,321	$ 0	$ 0	$ 0	$ 0	$ 30,928	$ 213,249	$ 213,283
Average interest rate	3.53%	0.00%	0.00%	0.00%	0.00%	1.41%	1.15%	

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

CONSOLIDATED BALANCE SHEETS (in thousands except share data)

December 31	**2008**	2007
ASSETS		
Cash and due from banks	**$ 57,149**	$ 56,278
Short-term investments	**6,858**	11,413
Total cash and cash equivalents	**64,007**	67,691
Securities available for sale (carried at fair value)	**387,030**	327,757
Real estate mortgage loans held for sale	**401**	537
Loans, net of allowance for loan losses of $18,860 and $15,801	**1,814,474**	1,507,919
Land, premises and equipment, net	**30,519**	27,525
Bank owned life insurance	**33,966**	21,543
Accrued income receivable	**8,599**	9,126
Goodwill	**4,970**	4,970
Other intangible assets	**413**	619
Other assets	**33,066**	21,446
Total assets	**$ 2,377,445**	$ 1,989,133
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Noninterest bearing deposits	**$ 230,716**	$ 255,348
Interest bearing deposits	**1,654,583**	1,223,570
Total deposits	**1,885,299**	1,478,918
Short-term borrowings		
Federal funds purchased	**19,000**	70,010
Securities sold under agreements to repurchase	**137,769**	154,913
U.S. Treasury demand notes	**840**	1,242
Other short-term borrowings	**45,000**	90,000
Total short-term borrowings	**202,609**	316,165
Accrued expenses payable	**17,163**	15,497
Other liabilities	**1,523**	1,311
Long-term borrowings	**90,043**	44
Subordinated debentures	**30,928**	30,928

Total liabilities	**2,227,565**	1,842,863
Commitments, off-balance sheet risks and contingencies (Notes 1 and 19)		
STOCKHOLDERS' EQUITY		
Common stock: 90,000,000 shares authorized, no par value 12,373,080 shares issued and 12,266,849 outstanding as of December 31, 2008 12,207,723 shares issued and 12,111,703 outstanding as of December 31, 2007	**1,453**	1,453
Additional paid-in capital	**20,632**	18,078
Retained earnings	**141,371**	129,090
Accumulated other comprehensive loss	**(12,024)**	(1,010)
Treasury stock, at cost (2008 - 106,231 shares, 2007 - 96,020 shares)	**(1,552)**	(1,341)
Total stockholders' equity	**149,880**	146,270
Total liabilities and stockholders' equity	**$ 2,377,445**	$ 1,989,133

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

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

Years Ended December 31	2008	2007	2006
NET INTEREST INCOME			
Interest and fees on loans			
Taxable	**$ 99,538**	$ 102,840	$ 91,946
Tax exempt	**113**	137	279
Interest and dividends on securities			
Taxable	**16,202**	11,591	10,123
Tax exempt	**2,411**	2,474	2,405
Interest on short-term investments	**220**	931	798
Total interest income	**118,484**	117,973	105,551
Interest on deposits	**44,580**	53,614	45,101
Interest on borrowings			
Short-term	**5,620**	7,239	5,594
Long-term	**5,016**	2,564	2,529
Total interest expense	**55,216**	63,417	53,224
NET INTEREST INCOME	**63,268**	54,556	52,327
Provision for loan losses	**10,207**	4,298	2,644
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	**53,061**	50,258	49,683
NONINTEREST INCOME			
Wealth advisory fees	**3,278**	3,142	2,550
Investment brokerage fees	**1,872**	1,491	1,290
Service charges on deposit accounts	**8,603**	7,238	7,260
Loan, insurance and service fees	**2,811**	2,483	2,292
Merchant card fee income	**3,471**	3,286	2,943
Other income	**1,826**	1,837	1,946
Net gains on sales of real estate mortgage loans held for sale	**786**	676	581
Net securities gains/(losses)	**39**	89	(68)
Gain on redemption of Visa shares	**642**	0	0
Total noninterest income	**23,328**	20,242	18,794
NONINTEREST EXPENSE			
Salaries and employee benefits	**25,482**	23,817	22,378
Net occupancy expense	**3,082**	2,734	2,510
Equipment costs	**1,941**	1,906	1,799
Data processing fees and supplies	**3,645**	3,096	2,626
Credit card interchange	**2,321**	2,204	1,988
Other expense	**11,010**	9,166	8,941

Total noninterest expense	**47,481**	42,923	40,242
INCOME BEFORE INCOME TAX EXPENSE	**28,908**	27,577	28,235
Income tax expense	**9,207**	8,366	9,514
NET INCOME	**$ 19,701**	$ 19,211	$ 18,721
BASIC WEIGHTED AVERAGE COMMON SHARES	**12,271,927**	12,188,594	12,069,300
BASIC EARNINGS PER COMMON SHARE	**$ 1.61**	$ 1.58	$ 1.55
DILUTED WEIGHTED AVERAGE COMMON SHARES	**12,459,802**	12,424,137	12,375,467
DILUTED EARNINGS PER COMMON SHARE	**$ 1.58**	$ 1.55	$ 1.51

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

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

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
Balance at January 1, 2006	$ 1,453	$ 14,287	$ 102,327	$ (3,814)	$ (919)	$ 113,334
Comprehensive income:						
Net income			18,721			18,721
Other comprehensive income, net of tax				1,084		1,084
Comprehensive income						19,805
Adjustment to initially apply SFAS No. 158, net of tax of $305				(448)		(448)
Cash dividends declared, $.375 per share			(4,532)			(4,532)
Treasury shares purchased under deferred directors' plan (9,361 shares)		210			(210)	0
Stock issued for stock option exercises (145,700 shares)		1,148				1,148
Tax benefit of stock option exercises		692				692
Stock option expense		188				188
Balance at December 31, 2006	1,453	16,525	116,516	(3,178)	(1,129)	130,187
Comprehensive income:						
Net income			19,211			19,211
Other comprehensive income, net of tax				2,168		2,168
Comprehensive income						21,379
Cash dividends declared, $.545 per share			(6,637)			(6,637)
Treasury shares purchased under deferred directors' plan (10,557 shares)		243			(243)	0
Treasury stock sold and distributed under deferred directors' plan (1,322 shares)		(31)			31	0
Stock issued for stock option exercises (98,117 shares, net of 8,202 shares redeemed)		771				771
Tax benefit of stock option exercises		396				396
Stock option expense		174				174
Balance at December 31, 2007	1,453	18,078	129,090	(1,010)	(1,341)	146,270
Comprehensive income:						
Net income			**19,701**			**19,701**
Other comprehensive income (loss), net of tax				**(11,029)**		**(11,029)**
Comprehensive income						**8,672**
Cash dividends declared, $.605 per share			**(7,417)**			