

LAKELAND FINANCIAL CORP  
Form 10-Q  
August 07, 2017  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10 Q

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

For the quarterly period ended June 30, 2017

OR

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

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

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

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

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

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

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

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

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

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

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

Smaller reporting company  Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Number of shares of common stock outstanding at July 31, 2017: 25,194,903

---

## TABLE OF CONTENTS

Page

## PART I. FINANCIAL INFORMATION

Item 1.	<u>Financial Statements</u>	
	<u>Consolidated Balance Sheets — June 30, 2017 and December 31, 2016</u>	1
	<u>Consolidated Statements of Income — three months and six months ended June 30, 2017 and 2016</u>	2
	<u>Consolidated Statements of Comprehensive Income — three months and six months ended June 30, 2017 and 2016</u>	3
	<u>Consolidated Statements of Shareholders' Equity — six months ended June 30, 2017 and 2016</u>	4
	<u>Consolidated Statements of Cash Flows — six months ended June 30, 2017 and 2016</u>	5
	<u>Notes to the Consolidated Financial Statements</u>	6
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	36
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	49
Item 4.	<u>Controls and Procedures</u>	50

## PART II. OTHER INFORMATION

Item 1.	<u>Legal Proceedings</u>	51
Item 1A.	<u>Risk Factors</u>	51
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	51
Item 3.	<u>Defaults Upon Senior Securities</u>	51
Item 4.	<u>Mine Safety Disclosures</u>	51
Item 5.	<u>Other Information</u>	51
Item 6.	<u>Exhibits</u>	52
	<u>SIGNATURES</u>	53

## ITEM 1. FINANCIAL STATEMENTS

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

	June 30, 2017 (Unaudited)	December 31, 2016
<b>ASSETS</b>		
Cash and due from banks	\$111,406	\$142,408
Short-term investments	25,930	24,872
Total cash and cash equivalents	137,336	167,280
Securities available for sale (carried at fair value)	530,312	504,191
Real estate mortgage loans held for sale	4,221	5,915
Loans, net of allowance for loan losses of \$44,563 and \$43,718	3,532,441	3,427,209
Land, premises and equipment, net	56,492	52,092
Bank owned life insurance	74,929	74,006
Federal Reserve and Federal Home Loan Bank stock	11,522	11,522
Accrued interest receivable	12,028	11,687
Goodwill	4,970	4,970
Other assets	28,748	31,153
Total assets	\$4,392,999	\$4,290,025
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Noninterest bearing deposits	\$762,965	\$819,803
Interest bearing deposits	2,852,974	2,758,109
Total deposits	3,615,939	3,577,912
Short-term borrowings		
Securities sold under agreements to repurchase	60,188	50,045
Other short-term borrowings	215,000	180,000
Total short-term borrowings	275,188	230,045
Long-term borrowings	30	32
Subordinated debentures	30,928	30,928
Accrued interest payable	4,809	5,676
Other liabilities	15,645	18,365
Total liabilities	3,942,539	3,862,958
<b>STOCKHOLDERS' EQUITY</b>		
Common stock: 90,000,000 shares authorized, no par value		
25,185,619 shares issued and 25,021,759 outstanding as of June 30, 2017		
25,096,087 shares issued and 24,937,865 outstanding as of December 31, 2016	105,744	104,405
Retained earnings	347,427	327,873
Accumulated other comprehensive income/(loss)	369	(2,387)
Treasury stock, at cost (2017 - 163,860 shares, 2016 - 158,222 shares)	(3,169)	(2,913)
Total stockholders' equity	450,371	426,978

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

Noncontrolling interest	89	89
Total equity	450,460	427,067
Total liabilities and equity	\$4,392,999	\$4,290,025

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

1

---

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
<b>NET INTEREST INCOME</b>				
Interest and fees on loans				
Taxable	\$36,967	\$30,918	\$71,414	\$60,548
Tax exempt	162	111	312	222
Interest and dividends on securities				
Taxable	2,364	2,297	4,684	4,843
Tax exempt	1,274	947	2,436	1,842
Interest on short-term investments	54	82	102	110
Total interest income	40,821	34,355	78,948	67,565
Interest on deposits	6,243	4,694	11,685	8,889
Interest on borrowings				
Short-term	431	99	741	246
Long-term	328	289	642	575
Total interest expense	7,002	5,082	13,068	9,710
<b>NET INTEREST INCOME</b>	<b>33,819</b>	<b>29,273</b>	<b>65,880</b>	<b>57,855</b>
Provision for loan losses	500	0	700	0
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>33,319</b>	<b>29,273</b>	<b>65,180</b>	<b>57,855</b>
<b>NONINTEREST INCOME</b>				
Wealth advisory fees	1,284	1,133	2,534	2,293
Investment brokerage fees	299	212	620	500
Service charges on deposit accounts	3,253	2,843	6,396	5,623
Loan, insurance and service fees	1,897	1,892	3,790	3,730
Merchant card fee income	570	527	1,108	1,024
Bank owned life insurance income	402	489	873	662
Other income	659	587	1,168	515
Mortgage banking income	378	384	509	711
Net securities gains	49	0	52	52
Total noninterest income	8,791	8,067	17,050	15,110
<b>NONINTEREST EXPENSE</b>				
Salaries and employee benefits	11,065	10,592	22,486	20,197
Net occupancy expense	1,154	1,041	2,274	2,137
Equipment costs	1,156	909	2,231	1,810
Data processing fees and supplies	1,974	2,120	3,990	4,152
Corporate and business development	1,196	763	2,698	1,620
FDIC insurance and other regulatory fees	419	557	853	1,080
Professional fees	801	859	1,755	1,686
Other expense	1,587	1,605	3,113	3,148
Total noninterest expense	19,352	18,446	39,400	35,830

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

INCOME BEFORE INCOME TAX EXPENSE	22,758	18,894	42,830	37,135
Income tax expense	7,394	6,091	12,952	12,053
NET INCOME	\$15,364	\$12,803	\$29,878	\$25,082
BASIC WEIGHTED AVERAGE COMMON SHARES	25,183,186	25,045,251	25,167,799	25,032,502
BASIC EARNINGS PER COMMON SHARE	\$0.61	\$0.51	\$1.19	\$1.00
DILUTED WEIGHTED AVERAGE COMMON SHARES	25,619,977	25,395,770	25,618,552	25,370,607
DILUTED EARNINGS PER COMMON SHARE	\$0.60	\$0.50	\$1.17	\$0.99

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

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited - in thousands)

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Net income	\$15,364	\$12,803	\$29,878	\$25,082
Other comprehensive income (loss)				
Change in securities available for sale:				
Unrealized holding gain on securities available for sale arising during the period	3,358	4,155	4,070	11,702
Reclassification adjustment for gains included in net income	(49)	0	(52)	(52)
Net securities gain activity during the period	3,309	4,155	4,018	11,650
Tax effect	(1,079)	(1,385)	(1,343)	(3,691)
Net of tax amount	2,230	2,770	2,675	7,959
Defined benefit pension plans:				
Amortization of net actuarial loss	67	54	133	108
Tax effect	(26)	(21)	(52)	(43)
Net of tax amount	41	33	81	65
 Total other comprehensive income, net of tax	 2,271	 2,803	 2,756	 8,024
 Comprehensive income	 \$17,635	 \$15,606	 \$32,634	 \$33,106

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



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

	Common Stock Shares	Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
Balance at January 1, 2016	24,819,066	\$99,123	\$294,002	\$2,142	\$(2,455)	\$392,812
Comprehensive income:						
Net income			25,082			25,082
Other comprehensive income (loss), net of tax				8,024		8,024
Cash dividends declared, \$0.35 per share			(8,767)			(8,767)
Treasury shares purchased under deferred						
directors' plan	(7,613)	226			(226)	0
Stock activity under equity compensation plans	82,775	(143)				(143)
Stock based compensation expense		1,796				1,796
Balance at June 30, 2016	24,894,228	\$101,002	\$310,317	\$10,166	\$(2,681)	\$418,804
Balance at January 1, 2017	24,937,865	\$104,405	\$327,873	\$(2,387)	\$(2,913)	\$426,978
Comprehensive income:						
Net income			29,878			29,878
Other comprehensive income (loss), net of tax				2,756		2,756
Cash dividends declared, \$0.41 per share			(10,324)			(10,324)
Treasury shares purchased under deferred						
directors' plan	(5,638)	256			(256)	0
Stock activity under equity compensation plans	89,532	(1,736)				(1,736)
Stock based compensation expense		2,819				2,819
Balance at June 30, 2017	25,021,759	\$105,744	\$347,427	\$369	\$(3,169)	\$450,371

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

4

---

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited - in thousands)		
Six Months Ended June 30	2017	2016
Cash flows from operating activities:		
Net income	\$29,878	\$25,082
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation	2,412	2,009
Provision for loan losses	700	0
Net (gain) loss on sale and write down of other real estate owned	(5)	2
Amortization of loan servicing rights	307	296
Loans originated for sale	(40,622)	(27,572)
Net gain on sales of loans	(859)	(814)
Proceeds from sale of loans	42,773	27,391
Net (gain) loss on sales of premises and equipment	(5)	10
Net gain on sales and calls of securities available for sale	(52)	(52)
Net securities amortization	1,407	1,420
Stock based compensation expense	2,819	1,796
Earnings on life insurance	(873)	(662)
Tax benefit of stock option exercises	(932)	(482)
Net change:		
Interest receivable and other assets	1,784	(2,259)
Interest payable and other liabilities	(2,804)	8,613
Total adjustments	6,050	9,696
Net cash from operating activities	35,928	34,778
Cash flows from investing activities:		
Proceeds from sale of securities available for sale	35,845	6,929
Proceeds from maturities, calls and principal paydowns of securities available for sale	30,837	35,591
Purchases of securities available for sale	(90,140)	(53,766)
Purchase of life insurance	(490)	(338)
Net increase in total loans	(106,011)	(117,495)
Proceeds from sales of land, premises and equipment	7	6
Purchases of land, premises and equipment	(6,814)	(4,485)
Purchases of Federal Home Loan Bank Stock	0	(704)
Proceeds from sales of other real estate	42	31
Net cash from investing activities	(136,724)	(134,231)

Cash flows from financing activities:		
Net increase in total deposits	38,027	220,034
Net increase (decrease) in short-term borrowings	45,143	(83,254)
Payments on long-term borrowings	(2)	(2)
Common dividends paid	(10,311)	(8,754)
Preferred dividends paid	(13)	(13)
Payments related to equity incentive plans	(1,736)	(143)
Purchase of treasury stock	(256)	(226)
Net cash from financing activities	70,852	127,642
Net change in cash and cash equivalents	(29,944)	28,189
Cash and cash equivalents at beginning of the period	167,280	80,674
Cash and cash equivalents at end of the period	\$137,336	\$108,863
Cash paid during the period for:		
Interest	\$13,936	\$9,080
Income taxes	11,513	8,750
Supplemental non-cash disclosures:		
Loans transferred to other real estate owned	79	64
Securities purchases payable	0	3,885

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

## NOTE 1. BASIS OF PRESENTATION

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

The unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and with the instructions for Form 10-Q. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements and are unaudited. In the opinion of management, all adjustments (all of which are normal and recurring in nature) considered necessary for a fair presentation have been included. Operating results for the three-month and six-month periods ended June 30, 2017 are not necessarily indicative of the results that may be expected for any subsequent reporting periods, including the year ending December 31, 2017. The Company's 2016 Annual Report on Form 10-K should be read in conjunction with these statements.

## NOTE 2. SECURITIES

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

(dollars in thousands)	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Losses	Fair Value
June 30, 2017				
U.S. Treasury securities	\$990	\$18	\$0	\$1,008
U.S. government sponsored agencies	5,895	13	(62)	5,846
Agency residential mortgage-backed securities	355,055	3,779	(1,930)	356,904
State and municipal securities	165,489	2,869	(1,804)	166,554
Total	\$527,429	\$6,679	\$(3,796)	\$530,312
December 31, 2016				
U.S. Treasury securities	\$990	\$13	\$0	\$1,003
U.S. government sponsored agencies	6,312	10	(81)	6,241
Agency residential mortgage-backed securities	351,108	3,604	(3,144)	351,568
State and municipal securities	146,917	1,784	(3,322)	145,379
Total	\$505,327	\$5,411	\$(6,547)	\$504,191

Information regarding the fair value and amortized cost of available for sale debt securities by maturity as of June 30, 2017 is presented below. Maturity information is based on contractual maturity for all securities other than mortgage-backed securities. Actual maturities of securities may differ from contractual maturities because borrowers may have the right to prepay the obligation without a prepayment penalty.

(dollars in thousands)	Amortized Fair	
	Cost	Value
Due in one year or less	\$2,293	\$2,320
Due after one year through five years	23,660	24,214
Due after five years through ten years	43,811	45,005
Due after ten years	102,610	101,869
	172,374	173,408
Mortgage-backed securities	355,055	356,904
Total debt securities .....	\$527,429	\$530,312
.....		

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

(dollars in thousands)	Three months		Six months	
	ended June 30,		ended June 30,	
	2017	2016	2017	2016
Sales of securities available for sale				
Proceeds	\$19,034	\$0	\$35,845	\$6,929
Gross gains	59	0	256	65
Gross losses	(10)	0	(204)	(13)

The Company sold eight securities with a total book value of \$19.0 million and a total fair value of \$19.0 million during the second quarter of 2017. The Company sold 35 securities with a total book value of \$35.8 million and a total fair value of \$35.8 million during the first six months of 2017. The Company sold four securities with a total book value of \$6.9 million and a total fair value of \$7.0 million during the first six months of 2016.

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

Securities with carrying values of \$156.7 million and \$168.3 million were pledged as of June 30, 2017 and December 31, 2016, respectively, as collateral for securities sold under agreements to repurchase, borrowings from the Federal Home Loan Bank and for other purposes as permitted or required by law.

Information regarding securities with unrealized losses as of June 30, 2017 and December 31, 2016 is presented below. The tables divide the securities between those with unrealized losses for less than twelve months and those with unrealized losses for twelve months or more.

(dollars in thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2017						
U.S. government sponsored agencies	\$3,054	\$62	\$0	\$0	\$3,054	\$62
Agency residential mortgage-backed securities	131,542	1,576	10,254	354	141,796	1,930
State and municipal securities	57,041	1,582	4,456	222	61,497	1,804
Total temporarily impaired	\$191,637	\$3,220	\$14,710	\$576	\$206,347	\$3,796

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

December 31, 2016

U.S. government sponsored agencies	\$3,290	\$81	\$0	\$0	\$3,290	\$81
Agency residential mortgage-backed securities	181,699	2,882	7,080	262	188,779	3,144
State and municipal securities	77,434	3,180	2,361	142	79,795	3,322
Total temporarily impaired	\$262,423	\$6,143	\$9,441	\$404	\$271,864	\$6,547

7

---

The total number of securities with unrealized losses as of June 30, 2017 and December 31, 2016 is presented below.

	Less than 12 months	12 months or more	Total
June 30, 2017			
U.S. government sponsored agencies	1	0	1
Agency residential mortgage-backed securities	38	3	41
State and municipal securities	74	6	80
Total temporarily impaired	113	9	122
December 31, 2016			
U.S. government sponsored agencies	1	0	1
Agency residential mortgage-backed securities	59	2	61
State and municipal securities	121	4	125
Total temporarily impaired	181	6	187

The following factors are considered in determining whether or not the impairment of these securities is other-than-temporary. In making this determination, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer, as well as the underlying fundamentals of the relevant market and the outlook for such market in the near future. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. Credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings. As of June 30, 2017 and December 31, 2016, ninety-nine percent of the securities in the Company's portfolio were backed by the U.S. government, government agencies, government sponsored agencies or were A-rated or better, except for certain non-local or local municipal securities, which are not rated. For the government, government-sponsored agency and municipal securities, management did not believe that there would be credit losses or that full principal would not be received. Management considered the unrealized losses on these securities to be primarily interest rate driven and does not expect material losses given current market conditions unless the securities are sold. However, at this time management does not have the intent to sell, and it is more likely than not that the Company will not be required to sell these securities before the recovery of their amortized cost basis.





## NOTE 3. LOANS

(dollars in thousands)	June 30, 2017		December 31, 2016	
Commercial and industrial loans:				
Working capital lines of credit loans	\$717,875	20.0 %	\$624,404	18.0 %
Non-working capital loans	646,517	18.1	644,086	18.5
Total commercial and industrial loans	1,364,392	38.1	1,268,490	36.5
Commercial real estate and multi-family residential loans:				
Construction and land development loans	209,772	5.8	245,182	7.1
Owner occupied loans	511,425	14.3	469,705	13.5
Nonowner occupied loans	450,907	12.6	458,404	13.2
Multifamily loans	170,902	4.8	127,632	3.7
Total commercial real estate and multi-family residential loans	1,343,006	37.5	1,300,923	37.5
Agri-business and agricultural loans:				
Loans secured by farmland	156,053	4.4	172,633	5.0
Loans for agricultural production	175,334	4.9	222,210	6.4
Total agri-business and agricultural loans	331,387	9.3	394,843	11.4
Other commercial loans	116,651	3.3	98,270	2.8
Total commercial loans	3,155,436	88.2	3,062,526	88.2
Consumer 1-4 family mortgage loans:				
Closed end first mortgage loans	171,495	4.8	163,155	4.7
Open end and junior lien loans	172,530	4.8	169,664	4.9
Residential construction and land development loans	10,118	0.3	15,015	0.4
Total consumer 1-4 family mortgage loans	354,143	9.9	347,834	10.0
Other consumer loans	68,646	1.9	61,308	1.8
Total consumer loans	422,789	11.8	409,142	11.8
Subtotal	3,578,225	100.0 %	3,471,668	100.0 %
Less: Allowance for loan losses	(44,563)		(43,718)	
Net deferred loan fees	(1,221)		(741)	
Loans, net	\$3,532,441		\$3,427,209	

The recorded investment in loans does not include accrued interest.

The Company had \$184,000 in residential real estate loans in the process of foreclosure as of June 30, 2017, compared to \$241,000 as of December 31, 2016.

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

The following tables present the activity in the allowance for loan losses by portfolio segment for the three-month periods ended June 30, 2017 and 2016:

	Commercial and Industrial	Commercial and Multifamily Residential	Real Estate and Agri-business Agricultural	Other Commercial	Consumer 1-4 Family Mortgage	Other Consumer	Unallocated	Total
(dollars in thousands) Three Months Ended June 30, 2017								
Beginning balance, April 1	\$19,781	\$13,718	\$3,459	\$545	\$2,790	\$379	\$3,102	\$43,774
Provision for loan losses	160	61	405	23	(123)	23	(49)	500
Loans charged-off	(11)	(211)	0	0	(6)	(33)	0	(261)
Recoveries	289	207	6	0	28	20	0	550
Net (charge-offs)/recoveries	278	(4)	6	0	22	(13)	0	289
Ending balance	\$20,219	\$13,775	\$3,870	\$568	\$2,689	\$389	\$3,053	\$44,563

	Commercial and Industrial	Real Estate and Multifamily Residential	Real Estate and Agri-business Agricultural	Other Commercial	Consumer 1-4 Family Mortgage	Other Consumer	Unallocated	Total
(dollars in thousands) Three Months Ended June 30, 2016								
Beginning balance, April 1	\$20,465	\$12,752	\$2,454	\$559	\$3,586	\$344	\$3,124	\$43,284
Provision for loan losses	605	(315)	589	(194)	(563)	6	(128)	0
Loans charged-off	(160)	0	0	0	(92)	(45)	0	(297)
Recoveries	25	200	4	0	3	28	0	260
Net (charge-offs)/recoveries	(135)	200	4	0	(89)	(17)	0	(37)
Ending balance	\$20,935	\$12,637	\$3,047	\$365	\$2,934	\$333	\$2,996	\$43,247

The following tables present the activity in the allowance for loan losses by portfolio segment for the six-month periods ended June 30, 2017 and 2016:

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

	Commercial and Industrial	Commercial Real Estate and Multifamily Residential	Agri-business and Agricultural	Other Commercial	Consumer 1-4 Family Mortgage	Other Consumer	Unallocated	Total
(dollars in thousands) Six Months Ended June 30, 2017								
Beginning balance, January 1	\$20,272	\$13,452	\$3,532	\$461	\$2,827	\$387	\$2,787	\$43,718
Provision for loan losses	(179)	318	328	107	(200)	60	266	700
Loans charged-off	(386)	(259)	0	0	(13)	(106)	0	(764)
Recoveries	512	264	10	0	75	48	0	909
Net (charge-offs)/recoveries	126	5	10	0	62	(58)	0	145
Ending balance	\$20,219	\$13,775	\$3,870	\$568	\$2,689	\$389	\$3,053	\$44,563

	Commercial and Industrial	Commercial Real Estate and Multifamily Residential	Agri-business and Agricultural	Other Commercial	Consumer 1-4 Family Mortgage	Other Consumer	Unallocated	Total
(dollars in thousands) Six Months Ended June 30, 2016								
Beginning balance, January 1	\$21,564	\$12,473	\$2,445	\$574	\$3,395	\$319	\$2,840	\$43,610
Provision for loan losses	(342)	121	593	(209)	(367)	48	156	0
Loans charged-off	(374)	(168)	0	0	(130)	(90)	0	(762)
Recoveries	87	211	9	0	36	56	0	399
Net (charge-offs)/recoveries	(287)	43	9	0	(94)	(34)	0	(363)
Ending balance	\$20,935	\$12,637	\$3,047	\$365	\$2,934	\$333	\$2,996	\$43,247

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of June 30, 2017 and December 31, 2016:

	Commercial and Industrial	Commercial Real Estate and Multifamily Residential	Agri-business and Agricultural	Other Commercial	Consumer 1-4 Family Mortgage	Other Consumer	Unallocated	Total
(dollars in thousands)								
June 30, 2017								
Allowance for loan losses:								
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	\$3,734	\$561	\$0	\$0	\$286	\$44	\$0	\$4,625
Collectively evaluated for impairment	16,485	13,214	3,870	568	2,403	345	3,053	39,938
Total ending allowance balance	\$20,219	\$13,775	\$3,870	\$568	\$2,689	\$389	\$3,053	\$44,563
Loans:								
Loans individually evaluated for impairment	\$11,192	\$6,661	\$283	\$0	\$1,391	\$53	\$0	\$19,580
Loans collectively evaluated for impairment	1,353,075	1,334,473	331,173	116,493	353,809	68,401	0	3,557,424
Total ending loans balance	\$1,364,267	\$1,341,134	\$331,456	\$116,493	\$355,200	\$68,454	\$0	\$3,577,004

	Commercial and Industrial	Commercial Real Estate and Multi-family Residential	Agri-business and Agricultural	Other Commercial	Consumer 1-4 Family Mortgage	Other Consumer	Unallocated	Total
--	---------------------------------	---	--------------------------------------	---------------------	---------------------------------------	-------------------	-------------	-------

(dollars in  
thousands)December 31,  
2016Allowance for  
loan losses:Ending allowance balance  
attributable to loans:Individually  
evaluated for  
impairmentCollectively  
evaluated for  
impairmentTotal ending  
allowance  
balance

Loans:

Loans  
individually  
evaluated for  
impairmentLoans  
collectively  
evaluated for  
impairmentTotal ending  
loans balance

\$3,191	\$576	\$0	\$0	\$296	\$51	\$0	\$4,114
17,081	12,876	3,532	461	2,531	336	2,787	39,604
\$20,272	\$13,452	\$3,532	\$461	\$2,827	\$387	\$2,787	\$43,718
\$9,776	\$9,151	\$283	\$0	\$1,427	\$55	\$0	\$20,692
1,258,682	1,290,131	394,621	98,265	347,408	61,128	0	3,450,235
\$1,268,458	\$1,299,282	\$394,904	\$98,265	\$348,835	\$61,183	\$0	\$3,470,927

The following table presents loans individually evaluated for impairment by class of loans as of June 30, 2017:

(dollars in thousands)	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
With no related allowance recorded:			
Commercial and industrial loans:			
Working capital lines of credit loans	\$515	\$515	\$0
Non-working capital loans	3,052	1,303	0
Commercial real estate and multi-family residential loans:			
Construction and land development loans	126	126	0
Owner occupied loans	2,515	2,267	0
Nonowner occupied loans	2,797	2,797	0
Agri-business and agricultural loans:			
Loans secured by farmland	603	283	0
Consumer 1-4 family loans:			
Closed end first mortgage loans	341	260	0
Open end and junior lien loans	366	154	0
With an allowance recorded:			
Commercial and industrial loans:			
Working capital lines of credit loans	2,839	2,536	1,212
Non-working capital loans	6,839	6,838	2,522
Commercial real estate and multi-family residential loans:			
Owner occupied loans	1,472	1,471	561
Consumer 1-4 family mortgage loans:			
Closed end first mortgage loans	976	977	286
Other consumer loans	53	53	44
<b>Total</b>	<b>\$22,494</b>	<b>\$19,580</b>	<b>\$4,625</b>





The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2016:

(dollars in thousands)	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
With no related allowance recorded:			
Commercial and industrial loans:			
Working capital lines of credit loans	\$951	\$494	\$0
Non-working capital loans	3,007	1,358	0
Commercial real estate and multi-family residential loans:			
Construction and land development loans	126	126	0
Owner occupied loans	2,868	2,620	0
Nonowner occupied loans	4,632	4,633	0
Agri-business and agricultural loans:			
Loans secured by farmland	603	283	0
Consumer 1-4 family loans:			
Closed end first mortgage loans	161	147	0
Open end and junior lien loans	408	195	0
With an allowance recorded:			
Commercial and industrial loans:			
Working capital lines of credit loans	1,100	1,099	465
Non-working capital loans	6,827	6,825	2,726
Commercial real estate and multi-family residential loans:			
Owner occupied loans	1,773	1,772	576
Consumer 1-4 family mortgage loans:			
Closed end first mortgage loans	1,152	1,085	296
Other consumer loans	55	55	51
<b>Total</b>	<b>\$23,663</b>	<b>\$20,692</b>	<b>\$4,114</b>



The following table presents loans individually evaluated for impairment by class of loans as of and for the three-month period ended June 30, 2017:

(dollars in thousands)	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Income Recognized
With no related allowance recorded:			
Commercial and industrial loans:			
Working capital lines of credit loans	\$ 562	\$ 8	\$ 8
Non-working capital loans	1,310	9	6
Commercial real estate and multi-family residential loans:			
Construction and land development loans	126	1	1
Owner occupied loans	2,390	2	1
Nonowner occupied loans	2,803	70	59
Agri-business and agricultural loans:			
Loans secured by farmland	283	0	0
Consumer 1-4 family loans:			
Closed end first mortgage loans	213	2	2
Open end and junior lien loans	155	0	0
With an allowance recorded:			
Commercial and industrial loans:			
Working capital lines of credit loans	2,376	11	4
Non-working capital loans	6,855	42	30
Commercial real estate and multi-family residential loans:			
Owner occupied loans	1,544	3	2
Consumer 1-4 family mortgage loans:			
Closed end first mortgage loans	1,028	5	2
Other consumer loans	53	1	0
Total	\$ 19,698	\$ 154	\$ 115



The following table presents loans individually evaluated for impairment by class of loans as of and for the three-month period ended June 30, 2016:

(dollars in thousands)	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Income Recognized
With no related allowance recorded:			
Commercial and industrial loans:			
Working capital lines of credit loans	\$493	\$0	\$0
Non-working capital loans	557	0	0
Commercial real estate and multi-family residential loans:			
Owner occupied loans	2,536	0	0
Nonowner occupied loans	4,783	88	89
Agri-business and agricultural loans:			
Loans secured by farmland	471	0	0
Loans for ag production	2,032	5	4
Consumer 1-4 family loans:			
Closed end first mortgage loans	149	0	0
With an allowance recorded:			
Commercial and industrial loans:			
Working capital lines of credit loans	841	5	5
Non-working capital loans	4,077	33	34
Commercial real estate and multi-family residential loans:			
Construction and land development loans	297	4	2
Owner occupied loans	975	0	0
Multifamily loans	383	5	5
Agri-business and agricultural loans:			
Other commercial loans	12	2	0
Consumer 1-4 family mortgage loans:			
Closed end first mortgage loans	1,363	10	14
Open end and junior lien loans	165	0	0
Other consumer loans	58	1	1
<b>Total</b>	<b>\$19,192</b>	<b>\$153</b>	<b>\$154</b>



The following table presents loans individually evaluated for impairment by class of loans as of and for the six-month period ended June 30, 2017:

(dollars in thousands)	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Income Recognized
With no related allowance recorded:			
Commercial and industrial loans:			
Working capital lines of credit loans	\$ 570	\$ 15	\$ 15
Non-working capital loans	1,345	17	14
Commercial real estate and multi-family residential loans:			
Construction and land development loans	126	2	2
Owner occupied loans	2,481	3	2
Nonowner occupied loans	3,703	154	143
Agri-business and agricultural loans:			
Loans secured by farmland	283	0	0
Consumer 1-4 family loans:			
Closed end first mortgage loans	202	3	3
Open end and junior lien loans	156	0	0
With an allowance recorded:			
Commercial and industrial loans:			
Working capital lines of credit loans	1,870	22	17
Non-working capital loans	6,777	91	81
Commercial real estate and multi-family residential loans:			
Owner occupied loans	1,605	8	7
Consumer 1-4 family mortgage loans:			
Closed end first mortgage loans	1,050	12	9
Other consumer loans	54	2	1
Total	\$ 20,222	\$ 329	\$ 294





The following table presents loans individually evaluated for impairment by class of loans as of and for the six-month period ended June 30, 2016:

(dollars in thousands)	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Income Recognized
With no related allowance recorded:			
Commercial and industrial loans:			
Working capital lines of credit loans	\$256	\$0	\$0
Non-working capital loans	615	0	0
Commercial real estate and multi-family residential loans:			
Owner occupied loans	2,630	0	0
Nonowner occupied loans	4,796	117	112
Agri-business and agricultural loans:			
Loans secured by farmland	471	0	0
Loans for ag production	1,016	5	4
Consumer 1-4 family loans:			
Closed end first mortgage loans	98	0	0
With an allowance recorded:			
Commercial and industrial loans:			
Working capital lines of credit loans	1,097	10	10
Non-working capital loans	4,356	67	68
Commercial real estate and multi-family residential loans:			
Construction and land development loans	318	7	5
Owner occupied loans	959	0	0
Nonowner occupied loans	38	0	0
Multifamily loans	384	10	10
Agri-business and agricultural loans:			
Other commercial loans	12	2	0
Consumer 1-4 family mortgage loans:			
Closed end first mortgage loans	1,495	25	25
Open end and junior lien loans	208	0	0
Other consumer loans	58	2	2
Total	\$18,807	\$245	\$236



The following table presents the ageing of the recorded investment in past due loans as of June 30, 2017 by class of loans:

(dollars in thousands)	Loans Not Past Due	30-89 Days Past Due	Greater than 90 Days Past Due	Nonaccrual	Total Past Due	Total
Commercial and industrial loans:						
Working capital lines of credit loans	\$716,236	\$0	\$0	\$1,614	\$1,614	\$717,850
Non-working capital loans	642,356	1	0	4,060	4,061	646,417
Commercial real estate and multi-family residential loans:						
Construction and land development loans	208,881	0	0	0	0	208,881
Owner occupied loans	507,600	48	0	3,471	3,519	511,119
Nonowner occupied loans	450,427	0	0	106	106	450,533
Multifamily loans	170,601	0	0	0	0	170,601
Agri-business and agricultural loans:						
Loans secured by farmland	155,745	30	0	283	313	156,058
Loans for agricultural production	175,398	0	0	0	0	175,398
Other commercial loans	116,493	0	0	0	0	116,493
Consumer 1-4 family mortgage loans:						
Closed end first mortgage loans	169,758	1,198	0	196	1,394	171,152
Open end and junior lien loans	173,646	156	0	154	310	173,956
Residential construction loans	10,092	0	0	0	0	10,092
Other consumer loans	68,325	129	0	0	129	68,454
Total	\$3,565,558	\$1,562	\$0	\$9,884	\$11,446	\$3,577,004

The following table presents the ageing of the recorded investment in past due loans as of December 31, 2016 by class of loans:

(dollars in thousands)	Loans Not Past Due	30-89 Days Past Due	Greater than 90 Days Past Due	Nonaccrual	Total Past Due	Total
Commercial and industrial loans:						
Working capital lines of credit loans	\$624,213	\$9	\$0	\$140	\$149	\$624,362
Non-working capital loans	642,014	0	0	2,082	2,082	644,096
Commercial real estate and multi-family residential loans:						
Construction and land development loans	244,411	0	0	0	0	244,411
Owner occupied loans	465,789	0	0	3,598	3,598	469,387

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

Nonowner occupied loans	457,880	0	0	122	122	458,002
Multi-family loans	127,482	0	0	0	0	127,482
Agri-business and agricultural loans:						
Loans secured by farmland	172,349	0	0	283	283	172,632
Loans for agricultural production	222,272	0	0	0	0	222,272
Other commercial loans	98,265	0	0	0	0	98,265
Consumer 1-4 family mortgage loans:						
Closed end first mortgage loans	161,499	1,072	53	213	1,338	162,837
Open end and junior lien loans	170,372	448	0	195	643	171,015
Residential construction loans	14,983	0	0	0	0	14,983
Other consumer loans	61,119	64	0	0	64	61,183
Total	\$3,462,648	\$1,593	\$53	\$6,633	\$8,279	\$3,470,927

Troubled Debt Restructurings:

Troubled debt restructured loans are included in the totals for impaired loans. The Company has allocated \$2.9 million and \$2.7 million of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of June 30, 2017 and December 31, 2016. The Company is not committed to lend additional funds to debtors whose loans have been modified in a troubled debt restructuring.

	June 30	December 31
(dollars in thousands)	2017	2016
Accruing troubled debt restructured loans	\$8,425	\$10,351
Nonaccrual troubled debt restructured loans	6,852	5,633
Total troubled debt restructured loans	\$15,277	\$15,984

During the three months ended June 30, 2017, no loans were modified as troubled debt restructurings.

During the three months ended March 31, 2017, certain loans were modified as troubled debt restructurings. The modified terms of these loans include one or a combination of the following: inadequate compensation for the terms of the restructure or renewal; a modification of the repayment terms which delays principal repayment for some period; or renewal terms offered to borrowers in financial distress where no additional credit enhancements were obtained at the time of renewal.

Additional concessions were granted to borrowers with previously identified troubled debt restructured loans during the three months ended March 31, 2017. The loans to two of the borrowers are for commercial real estate buildings where the collateral value and cash flows from the companies occupying the buildings do not support the loans with recorded investments of \$500,000. The loans to two other borrowers are for commercial and industrial non-working capital loans with recorded investments of \$690,000. These concessions are not included in table below.

The following table presents loans by class modified as new troubled debt restructurings that occurred during the six months ended June 30, 2017:

		Pre-Modification	Post-Modification	Modified Repayment	
	Number of	Outstanding	Outstanding	Number of	Extension
(dollars in thousands)	Loans	Recorded	Recorded	Loans	Period or
		Investment	Investment		Range
					(in months)
Troubled Debt Restructurings					
Commercial and industrial loans:					
Non-working capital loans	2	\$1,712	\$1,712	2	6
Commercial real estate and multi-family residential loans:					
Owner occupied loans	1	486	486	1	6
Consumer 1-4 family loans:					
Closed end first mortgage loans	1	44	46	1	350
Total	4	\$2,242	\$2,244	4	6-350

For the three-month period ended June 30, 2017, the commercial and industrial troubled debt restructurings described above increased the allowance for loan losses by \$8,000 and the commercial real estate and multi-family residential loan troubled debt restructuring described above decreased the allowance for loan losses by \$5,000. For the six-month period ended June 30, 2017, the commercial and industrial troubled debt restructurings described above increased the allowance for loan losses by \$42,000 and the commercial real estate and multi-family residential loan troubled debt restructuring described above increased the allowance for loan losses by \$44,000.

No charge-offs resulted from any troubled debt restructurings described above during the three- or six-month periods ended June 30, 2017.

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

During the three months ended June 30, 2016, certain loans were modified as troubled debt restructurings. The modified terms of these loans include one or a combination of the following: inadequate compensation for the terms of the restructure or renewal; a modification of the repayment terms which delays principal repayment for some period; or renewal terms offered to borrowers in financial distress where no additional credit enhancements were obtained at the time of renewal.

During the three months ended June 30, 2016, there were renewal terms, which are considered additional concessions, offered to three borrowers under financial duress with previously identified troubled debt restructured loans which did not require additional compensation or consideration, and the terms offered would not have been readily available in the marketplace for loans bearing a similar risk profile. In these instances, it was determined that a concession had been granted. The loan to one of the borrowers was for a commercial real estate building where the collateral value and cash flows from the company occupying the building does not support the loan with a recorded investment of \$374,000. The loans to the other two borrowers are for commercial and industrial non-working capital loans with recorded investments of \$574,000. These concessions are not included in the table below.

Additional concessions were granted to borrowers with previously identified troubled debt restructured loans during the three-months ended March 31, 2016. The loans to two of the borrowers are for commercial real estate buildings where the collateral value and cash flows from the companies occupying the buildings do not support the loans with recorded investments of \$542,000. The other loans were to a borrower engaged in land development, where the aggregate recorded investment totaled \$484,000. These concessions are not included in table below.

The following table presents loans by class modified as new troubled debt restructurings that occurred during the three months ended June 30, 2016:

(dollars in thousands)	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Modified Repayment Terms	
				Number of Loans	Extension Period or Range (in months)
Troubled Debt Restructurings					
Commercial and industrial loans:					
Non-working capital loans	3	\$775	\$775	3	9-15
Commercial real estate and multi-family residential loans:					
Owner occupied loans	1	305	305	1	13
Total	4	\$1,080	\$1,080	4	9-15

The following table presents loans by class modified as new troubled debt restructurings that occurred during the six months ended June 30, 2016:

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



Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

Non-working capital loans	3	\$775	\$775	3	9-15
Commercial real estate and multi-family residential loans:					
Owner occupied loans	2	640	640	2	13-15
Total	5	\$1,415	\$1,415	5	9-15

For the three months ended June 30, 2016, the commercial and industrial troubled debt restructurings described above increased the allowance for loan losses by \$182,000 and the commercial real estate and multi-family residential loan troubled debt restructuring described above decreased the allowance for loan losses by \$145,000. For the six months ended June 30, 2016, the commercial and industrial troubled debt restructurings described above increased the allowance for loan losses by \$684,000 and the commercial real estate and multi-family residential loan troubled debt restructuring described above increased the allowance for loan losses by \$15,000.

No charge-offs resulted from any troubled debt restructurings described above during the three- or six-month periods ended June 30, 2016.

There were no troubled debt restructurings that had payment defaults within the twelve months following modification during the three- or six-month periods ended June 30, 2017 and 2016.

Credit Quality Indicators:

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

The Company uses the following definitions for risk ratings:

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

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

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

Loans not meeting the criteria above that are analyzed individually as part of the above-described process are considered to be Pass rated loans with the exception of consumer troubled debt restructurings which are evaluated and listed with Substandard commercial grade loans and consumer nonaccrual loans which are evaluated individually and listed with Not Rated loans. Loans listed as Not Rated are consumer loans or commercial loans with consumer characteristics included in groups of homogenous loans which are analyzed for credit quality indicators utilizing delinquency status. As of June 30, 2017, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

(dollars in thousands)	Pass	Special Mention	Substandard	Doubtful	Not Rated	Total
Commercial and industrial loans:						
Working capital lines of credit loans	\$660,503	\$30,547	\$26,602	\$0	\$198	\$717,850
Non-working capital loans	596,679	23,539	22,546	0	3,653	646,417
Commercial real estate and multi-family residential loans:						
Construction and land development loans	207,566	1,315	0	0	0	208,881
Owner occupied loans	483,925	14,384	12,810	0	0	511,119
Nonowner occupied loans	445,235	4,475	823	0	0	450,533
Multifamily loans	170,349	252	0	0	0	170,601
Agri-business and agricultural loans:						
Loans secured by farmland	146,607	7,051	2,400	0	0	156,058

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

Loans for agricultural production	170,484	4,209	705	0	0	175,398
Other commercial loans	116,489	0	0	0	4	116,493
Consumer 1-4 family mortgage loans:						
Closed end first mortgage loans	45,974	0	1,237	0	123,941	171,152
Open end and junior lien loans	7,275	0	0	0	166,681	173,956
Residential construction loans	0	0	0	0	10,092	10,092
Other consumer loans	19,612	0	53	0	48,789	68,454
Total	\$3,070,698	\$85,772	\$67,176	\$0	\$353,358	\$3,577,004

21

---

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

As of December 31, 2016, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

(dollars in thousands)	Pass	Special Mention	Substandard	Doubtful	Not Rated	Total
Commercial and industrial loans:						
Working capital lines of credit loans	\$577,208	\$17,636	\$29,396	\$0	\$122	\$624,362
Non-working capital loans	583,135	32,587	24,405	0	3,969	644,096
Commercial real estate and multi-family residential loans:						
Construction and land development loans	242,964	1,447	0	0	0	244,411
Owner occupied loans	444,143	10,285	14,959	0	0	469,387
Nonowner occupied loans	451,390	4,550	2,062	0	0	458,002
Multi-family loans	127,219	263	0	0	0	127,482
Agri-business and agricultural loans:						
Loans secured by farmland	168,660	3,689	283	0	0	172,632
Loans for agricultural production	218,581	3,691	0	0	0	222,272
Other commercial loans	98,261	0	0	0	4	98,265
Consumer 1-4 family mortgage loans:						
Closed end first mortgage loans	44,687	126	1,232	0	116,792	162,837
Open end and junior lien loans	7,028	0	0	0	163,987	171,015
Residential construction loans	0	0	0	0	14,983	14,983
Other consumer loans	17,717	0	55	0	43,411	61,183
Total	\$2,980,993	\$74,274	\$72,392	\$0	\$343,268	\$3,470,927

## NOTE 5. FAIR VALUE DISCLOSURES

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

- Level 1 Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
- Level 2 Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3 Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

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

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

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

Securities pricing is obtained from a third party pricing service and all security prices are tested annually against prices from another third party provider and reviewed with a market value price tolerance variance that varies by sector: municipal securities +/- 5%, government mbs/cmo +/- 3% and U.S. treasuries +/-1%. If any securities fall outside the tolerance threshold, a determination of materiality is made for the amount over the threshold. Any security that would have a material threshold difference would be further investigated to determine why the variance exists and if any action is needed concerning the security pricing for that individual security. Changes in market value are reviewed monthly in aggregate by security type and any material differences are reviewed to determine why they exist. At least annually, the pricing methodology of the pricing service is received and reviewed to support the fair value levels used by the Company. A detailed pricing evaluation is requested and reviewed on any security determined to be fair valued using unobservable inputs by the pricing service.

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

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

**Impaired loans:** Impaired loans with specific allocations of the allowance for loan losses are generally based on the fair value of the underlying collateral if repayment is expected solely from the collateral. Fair value is determined using several methods. Generally, the fair value of real estate is based on appraisals by qualified third party appraisers. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and result in a Level 3 classification of the inputs for determining fair value. In addition, the Company's management routinely applies internal discount factors to the value of appraisals used in the fair value evaluation of impaired loans. The deductions to the appraisals take into account changing business factors and market conditions, as well as value impairment in cases where the appraisal date predates a likely change in market conditions. Commercial real estate is generally discounted from its appraised value by 0-50% with the higher discounts applied to real estate that is determined to have a thin trading market or to be specialized collateral. In addition to real estate, the Company's management evaluates other types of collateral as follows: (a) raw and finished inventory is discounted from its cost or book value by 35-65%, depending on the marketability of the goods (b) finished goods are generally discounted by 30-60%, depending on the ease of marketability, cost of transportation or scope of use of the finished good (c) work in process inventory is typically discounted by 50-100%, depending on the length of manufacturing time, types of components used in the completion process, and the breadth of the user base (d) equipment is valued at a percentage of depreciated book value or recent appraised value, if available, and is typically discounted at 30-70% after various considerations including age and condition of the equipment, marketability, breadth of use, and whether the equipment includes unique components or add-ons; and (e) marketable securities are discounted by 10-30%, depending on the type of investment, age of valuation report and general market conditions. This methodology is based on a market approach and typically results in a Level 3 classification of the inputs for determining fair value.

**Mortgage servicing rights:** As of June 30, 2017, the fair value of the Company's Level 3 servicing assets for residential mortgage loans was \$3.9 million, none of which are currently impaired and therefore are carried at amortized cost. These residential mortgage loans have a weighted average interest rate of 3.82%, a weighted average maturity of 19 years and are secured by homes generally within the Company's market area, which is primarily Northern Indiana. A valuation model is used to estimate fair value by stratifying the portfolios on the basis of certain risk characteristics, including loan type and interest rate. Impairment is estimated based on an income approach. The inputs used include estimates of prepayment speeds, discount rate, cost to service, escrow account earnings, contractual servicing fee income, ancillary income, late fees, and float income. The most significant assumption used to value mortgage servicing rights is prepayment rate. Prepayment rates are estimated based on published industry consensus prepayment rates. The most significant unobservable assumption is the discount rate. At June 30, 2017, the constant prepayment speed (PSA) used was 148 and the discount rate used was 9.4%. At December 31, 2016, the PSA used was 162 and the discount rate used was 9.3%.

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

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





Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

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

(dollars in thousands)	June 30, 2017			Assets at Fair Value
	Level 1	Level 2	Level 3	
<b>Assets</b>				
U.S. Treasury securities	\$ 1,008	\$ 0	\$ 0	\$ 1,008
U.S. government sponsored agency securities	0	5,846	0	5,846
Mortgage-backed securities	0	356,904	0	356,904
State and municipal securities	0	165,935	619	166,554
Total Securities	1,008	528,685	619	530,312
Mortgage banking derivative	0	264	0	264
Interest rate swap derivative	0	2,693	0	2,693
Total assets	\$ 1,008	\$ 531,642	\$ 619	\$ 533,269
<b>Liabilities</b>				
Mortgage banking derivative	0	7	0	7
Interest rate swap derivative	0	2,840	0	2,840
Total liabilities	\$ 0	\$ 2,847	\$ 0	\$ 2,847

(dollars in thousands)	December 31, 2016			Assets at Fair Value
	Level 1	Level 2	Level 3	
<b>Assets</b>				
U.S. Treasury securities	\$ 1,003	\$ 0	\$ 0	\$ 1,003
U.S. government sponsored agency securities	0	6,241	0	6,241
Mortgage-backed securities	0	351,568	0	351,568
State and municipal securities	0	144,709	670	145,379
Total Securities	1,003	502,518	670	504,191
Mortgage banking derivative	0	314	0	314
Interest rate swap derivative	0	2,645	0	2,645
Total assets	\$ 1,003	\$ 505,477	\$ 670	\$ 507,150
<b>Liabilities</b>				
Mortgage banking derivative	0	14	0	14
Interest rate swap derivative	0	2,735	0	2,735
Total liabilities	\$ 0	\$ 2,749	\$ 0	\$ 2,749

There were no transfers between Level 1 and Level 2 during the six months ended June 30, 2017 and there were no transfers between Level 1 and Level 2 during 2016.



The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the six months ended June 30, 2017 and 2016:

(dollars in thousands)	State and Municipal Securities	
	2017	2016
Balance of recurring Level 3 assets at January 1	\$ 670	\$ 551
Transfers into Level 3	0	339
Changes in fair value of securities included in other comprehensive income	(6)	6
Principal payments	(45)	(40)
Balance of recurring Level 3 assets at June 30	\$ 619	\$ 856

The fair values of two municipal securities with a fair value of \$339,000 as of March 31, 2016 were transferred from Level 2 and into Level 3 because of a lack of observable market data for these investments. The Company's policy is to recognize transfers as of the end of the reporting period. As a result the fair value for these municipal securities was transferred on March 31, 2016. The municipal securities measured at fair value included below are non-rated Indiana and Ohio municipal revenue bonds and are not actively traded.

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

(dollars in thousands)	Fair Value at June 30, 2017	Valuation Technique	Unobservable Input	Range of Inputs (Average)
State and municipal securities \$	619	Price to type, par, call	Discount to benchmark index	0-5% (2.01%)

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

(dollars in thousands)	Fair Value at December 31, 2016	Valuation Technique	Unobservable Input	Range of Inputs (Average)
State and municipal securities \$	670	Price to type, par, call	Discount to benchmark index	0-5% (2.98%)

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



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

(dollars in thousands)	June 30, 2017			Assets at Fair Value
	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	
Assets				
Impaired loans:				
Commercial and industrial loans:				
Working capital lines of credit loans	\$ 0	\$ 0	\$ 1,341	\$ 1,341
Non-working capital loans	0	0	4,013	4,013
Commercial real estate and multi-family residential loans:				
Owner occupied loans	0	0	910	910
Total impaired loans	\$ 0	\$ 0	\$ 6,264	\$ 6,264
Other real estate owned	0	0	75	75
Total assets	\$ 0	\$ 0	\$ 6,339	\$ 6,339

(dollars in thousands)	December 31, 2016			Assets at Fair Value
	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	
Assets				
Impaired loans:				
Commercial and industrial loans:				
Working capital lines of credit loans	\$ 0	\$ 0	\$ 621	\$ 621
Non-working capital loans	0	0	3,889	3,889
Commercial real estate and multi-family residential loans:				
Owner occupied loans	0	0	1,195	1,195
Consumer 1-4 family mortgage loans:				
Closed end first mortgage loans	0	0	62	62
Total impaired loans	\$ 0	\$ 0	\$ 5,767	\$ 5,767
Other real estate owned	0	0	75	75
Total assets	\$ 0	\$ 0	\$ 5,842	\$ 5,842



The following table presents the valuation methodology and unobservable inputs for Level 3 assets measured at fair value on a non-recurring basis at June 30, 2017:

(dollars in thousands)	Fair Value	Valuation Methodology	Unobservable Inputs	Average	Range of Inputs
Impaired loans: Commercial and industrial	\$ 5,354	Collateral based measurements	Discount to reflect current market conditions and ultimate collectability	37%	(23% - 100%)
Impaired loans: Commercial real estate and multi-family residential loans	910	Collateral based measurements	Discount to reflect current market conditions and ultimate collectability	38%	(3% - 60%)
Other real estate owned	75	Appraisals	Discount to reflect current market conditions	49%	

The following table presents the valuation methodology and unobservable inputs for Level 3 assets measured at fair value on a non-recurring basis at December 31, 2016:

(dollars in thousands)	Fair Value	Valuation Methodology	Unobservable Inputs	Average	Range of Inputs
Impaired loans: Commercial and industrial	\$ 4,510	Collateral based measurements	Discount to reflect current market conditions and ultimate collectability	44%	(22% - 100%)
Impaired loans: Commercial real estate	1,195	Collateral based measurements	Discount to reflect current market conditions and ultimate collectability	30%	(6% - 59%)
Impaired loans: Consumer 1-4 family mortgage	62	Collateral based measurements	Discount to reflect	15%	

current market  
conditions  
and ultimate  
collectability

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

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a gross carrying amount of \$10.0 million, with a valuation allowance of \$3.7 million at June 30, 2017, resulting in a net reduction in the provision for loan losses of \$200,000 in the three months ended June 30, 2017 and a net increase in the provision for loan losses of \$600,000 in the six months ended June 30, 2017. At June 30, 2016, impaired loans had a gross carrying amount of \$6.4 million, with a valuation allowance of \$2.5 million, resulting in a net increase in the provision for loan losses of \$0 and \$100,000 for the three and six months ended June 30, 2016.

Other real estate owned measured at fair value less costs to sell, at both June 30, 2017 and June 30, 2016, had a net carrying amount of \$75,000, which is made up of the outstanding balance of \$147,000, net of a valuation allowance of \$72,000, all of which was written down during 2012.



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

(dollars in thousands)	June 30, 2017				
	Carrying Value	Estimated Fair Value			Total
		Level 1	Level 2	Level 3	
<b>Financial Assets:</b>					
Cash and cash equivalents	\$ 137,336	\$ 135,131	\$ 2,207	\$ 0	\$ 137,338
Securities available for sale	530,312	1,008	528,685	619	530,312
Real estate mortgages held for sale	4,221	0	4,294	0	4,294
Loans, net	3,532,441	0	0	3,502,029	3,502,029
Federal Home Loan Bank stock	8,102	N/A	N/A	N/A	N/A
Federal Reserve Bank stock	3,420	N/A	N/A	N/A	N/A
Accrued interest receivable	12,028	3	2,924	9,101	12,028
<b>Financial Liabilities:</b>					
Certificates of deposit	(1,254,976)	0	(1,261,314)	0	(1,261,314)
All other deposits	(2,360,963)	(2,360,963)	0	0	(2,360,963)
Securities sold under agreements to repurchase	(60,188)	0	(60,188)	0	(60,188)
Other short-term borrowings	(215,000)	0	(214,985)	0	(214,985)
Long-term borrowings	(30)	0	(31)	0	(31)
Subordinated debentures	(30,928)	0	0	(31,206)	(31,206)
Standby letters of credit	(427)	0	0	(427)	(427)
Accrued interest payable	(4,809)	(103)	(4,702)	(4)	(4,809)
<b>December 31, 2016</b>					
(dollars in thousands)	December 31, 2016				
	Carrying Value	Estimated Fair Value			Total
		Level 1	Level 2	Level 3	
<b>Financial Assets:</b>					
Cash and cash equivalents	\$ 167,280	\$ 165,385	\$ 1,899	\$ 0	\$ 167,284
Securities available for sale	504,191	1,003	502,518	670	504,191
Real estate mortgages held for sale	5,915	0	5,994	0	5,994
Loans, net	3,427,209	0	0	3,411,121	3,411,121
Federal Home Loan Bank stock	8,102	N/A	N/A	N/A	N/A
Federal Reserve Bank stock	3,420	N/A	N/A	N/A	N/A
Accrued interest receivable	11,687	3	2,688	8,996	11,687
<b>Financial Liabilities:</b>					
Certificates of deposit	(1,163,818)	0	(1,169,905)	0	(1,169,905)
All other deposits	(2,414,094)	(2,414,094)	0	0	(2,414,094)
Securities sold under agreements to repurchase	(50,045)	0	(50,045)	0	(50,045)
Other short-term borrowings	(180,000)	0	(180,005)	0	(180,005)
Long-term borrowings	(32)	0	(34)	0	(34)
Subordinated debentures	(30,928)	0	0	(31,194)	(31,194)
Standby letters of credit	(323)	0	0	(323)	(323)
Accrued interest payable	(5,676)	(93)	(5,580)	(3)	(5,676)



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

Cash and cash equivalents - The carrying amount of cash and cash equivalents approximate fair value and are classified as Level 1, with the exception of certificates of deposits, which are estimated using discounted cash flow analysis using current market rates applied to the estimated life resulting in a Level 2 classification.

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

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

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

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

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

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

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

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

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

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

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

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

Securities sold under agreements to repurchase of \$60.2 million and \$50.0 million, which mature on demand, are secured by mortgage-backed securities with a carrying amount of \$89.8 million and \$98.0 million at June 30, 2017 and December 31, 2016, respectively. Additional information concerning recognition of these liabilities is disclosed in Note 8.

## NOTE 7. EMPLOYEE BENEFIT PLANS

Components of net periodic benefit cost:

	Six Months Ended June 30,				Three Months Ended June 30,			
	Pension Benefits		SERP Benefits		Pension Benefits		SERP Benefits	
(dollars in thousands)	2017	2016	2017	2016	2017	2016	2017	2016
Interest cost	\$52	\$52	\$20	\$24	\$26	\$26	\$10	\$12
Expected return on plan assets	(72)	(70)	(31)	(36)	(37)	(35)	(15)	(18)
Recognized net actuarial (gain) loss	93	68	40	40	47	34	20	20
Net pension expense (benefit)	\$73	\$50	\$29	\$28	\$36	\$25	\$15	\$14

The Company previously disclosed in its financial statements for the year ended December 31, 2016 that it expected to contribute \$355,000 to its pension plan and \$41,000 to its Supplemental Executive Retirement Plan ("SERP") in 2017. The Company has contributed \$197,000 to its pension plan and \$41,000 to its SERP as of June 30, 2017. The Company does not expect to make any additional contributions to its pension plan or SERP during the remainder of 2017.

## NOTE 8. OFFSETTING ASSETS AND LIABILITIES

The following tables summarize gross and net information about financial instruments and derivative instruments that are offset in the statement of financial position or that are subject to an enforceable master netting arrangement at June 30, 2017 and December 31, 2016.

	June 30, 2017					
	Gross Amounts of Recognized Assets/ Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets presented in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position	Cash Collateral Received	Net Amount
<b>Assets</b>						
Interest Rate Swap Derivatives	\$2,693	\$0	\$2,693	\$0	\$0	\$2,693
Total Assets	\$2,693	\$0	\$2,693	\$0	\$0	\$2,693
<b>Liabilities</b>						
Interest Rate Swap Derivatives	\$2,840	\$0	\$2,840	\$0	\$(2,680)	\$160
Repurchase Agreements	60,188	0	60,188	(60,188)	0	0
Total Liabilities	\$63,028	\$0	\$63,028	\$(60,188)	\$(2,680)	\$160

	December 31, 2016					
	Gross Amounts of Recognized Assets/ Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets presented in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position	Cash Collateral Received	Net Amount

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

(dollars in thousands)	Liabilities	Position	Position	Instruments	Received	Net Amount
Assets						
Interest Rate Swap Derivatives	\$2,645	\$0	\$2,645	\$0	\$0	\$2,645
Total Assets	\$2,645	\$0	\$2,645	\$0	\$0	\$2,645
Liabilities						
Interest Rate Swap Derivatives	\$2,735	\$0	\$2,735	\$0	\$(1,330)	\$1,405
Repurchase Agreements	50,045	0	50,045	(50,045)	0	0
Total Liabilities	\$52,780	\$0	\$52,780	\$(50,045)	\$(1,330)	\$1,405

31

---

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

## NOTE 9. EARNINGS PER SHARE

Basic earnings per common share is net income available to common shareholders divided by the weighted average number of common shares outstanding during the period, including shares held in treasury on behalf of participants in the Company's Directors Fee Deferral Plan. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable under stock options, stock awards and warrants, none of which were antidilutive.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Weighted average shares outstanding for basic earnings per common share	25,183,186	25,045,251	25,167,799	25,032,502
Dilutive effect of stock options, awards and warrants	436,791	350,519	450,753	338,105
Weighted average shares outstanding for diluted earnings per common share	25,619,977	25,395,770	25,618,552	25,370,607
Basic earnings per common share	\$0.61	\$0.51	\$1.19	\$1.00
Diluted earnings per common share	\$0.60	\$0.50	\$1.17	\$0.99

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

The following tables summarize the changes within each classification of accumulated other comprehensive income (loss) for the six months ended June 30, 2017 and the year ended December 31, 2016:

(dollars in thousands)	Unrealized Gains and Losses on Available- for-Sales Securities	Defined Benefit Pension Items	Total
Balance at December 31, 2016	\$(722)	\$(1,665)	\$(2,387)
Other comprehensive income before reclassification	2,706	0	2,706
Amounts reclassified from accumulated other comprehensive income (loss)	(31)	81	50
Net current period other comprehensive income	2,675	81	2,756
Balance at June 30, 2017	\$1,953	\$(1,584)	\$369

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

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

Balance at December 31, 2015	\$3,836	\$(1,694)	\$2,142
Other comprehensive income before reclassification	(4,518)	(101)	(4,619)
Amounts reclassified from accumulated other comprehensive income (loss)	(40)	130	90
Net current period other comprehensive income	(4,558)	29	(4,529)
Balance at December 31, 2016	\$(722)	\$(1,665)	\$(2,387)

32

---



Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

Reclassifications out of accumulated comprehensive income for the three months ended June 30, 2017 are as follows:

Details about Accumulated Other Comprehensive Income Components	Amount Reclassified From Accumulated Other Comprehensive Income	Affected Line Item in the Statement Where Net Income is Presented
(dollars in thousands)		
Unrealized gains and losses on available-for-sale securities	\$49	Net securities gains (losses)
Tax effect	(21)	Income tax expense
	28	Net of tax
Amortization of defined benefit pension items	(67)	Salaries and employee benefits
Tax effect	26	Income tax expense
	(41)	Net of tax
Total reclassifications for the period	\$(13)	Net income

Reclassifications out of accumulated comprehensive income for the three months ended June 30, 2016 are as follows:

Details about Accumulated Other Comprehensive Income Components	Amount Reclassified From Accumulated Other Comprehensive Income	Affected Line Item in the Statement Where Net Income is Presented
(dollars in thousands)		
Unrealized gains and losses on available-for-sale securities	\$0	Net securities gains (losses)
Tax effect	0	Income tax expense
	0	Net of tax
Amortization of defined benefit pension items	(54)	Salaries and employee benefits
Tax effect	21	Income tax expense
	(33)	Net of tax
Total reclassifications for the period	\$(33)	Net income

Reclassifications out of accumulated comprehensive income for the six months ended June 30, 2017 are as follows:

Details about Accumulated Other Comprehensive Income Components	Amount Reclassified From Accumulated Other Comprehensive Income	Affected Line Item in the Statement Where Net Income is Presented
(dollars in thousands)		
Unrealized gains and losses on available-for-sale securities	\$52	Net securities gains (losses)
Tax effect	(21)	Income tax expense
	31	Net of tax
Amortization of defined benefit pension items	(133)	Salaries and employee benefits
Tax effect	52	Income tax expense
	(81)	Net of tax
Total reclassifications for the period	\$(50)	Net income



Reclassifications out of accumulated comprehensive income for the six months ended June 30, 2016 are as follows:

Details about Accumulated Other Comprehensive Income Components	Amount Reclassified From Accumulated Other Comprehensive Income	Affected Line Item in the Statement Where Net Income is Presented
(dollars in thousands)		
Unrealized gains and losses on available-for-sale securities	\$52	Net securities gains (losses)
Tax effect	(21)	Income tax expense
	31	Net of tax
Amortization of defined benefit pension items	(108)	Salaries and employee benefits
Tax effect	43	Income tax expense
	(65)	Net of tax
Total reclassifications for the period	\$(34)	Net income

#### NOTE 11. NEW ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB issued new accounting guidance related to revenue recognition. This new standard will replace all current U.S. GAAP guidance on this topic and eliminate all industry-specific guidance. The new revenue recognition standard provides a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration for which the entity expects to be entitled in exchange for those goods or services. This guidance will be effective for the Company beginning January 1, 2018 and can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. Management does not expect the adoption of this new accounting standard to have a material impact on our financial statements because the majority of the Company's financial instruments are not within the scope of the new guidance, however the new guidance will result in new disclosure requirements

In January 2016, the FASB amended existing accounting guidance related to the recognition and measurement of financial assets and financial liabilities. These amendments make targeted improvements to U.S. GAAP as follows: (1) Require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. (2) Simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value. (3) Eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities. (4) Eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet. (5) Require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. (6) Require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. (7) Require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivable) on the balance sheet or the accompanying notes to the financial statements. (8) Clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in

combination with the entity's other deferred tax assets. This guidance will be effective for the Company beginning January 1, 2018 and should be applied as a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values (including disclosure requirements) should be applied prospectively to equity investments that exist as of the date of adoption. Adopting this standard is not expected to have a significant impact on the Company's financial condition or results of operations.

In February 2016, the FASB issued new accounting guidance related to leases. This update, effective for the Company beginning January 1, 2019, will replace existing lease guidance in GAAP and will require lessees to recognize lease assets and lease liabilities on the balance sheet for all leases and disclose key information about leasing arrangements. When implemented, lessees and lessors will be required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The Company currently has approximately \$4.7 million of lease obligations that would come on balance sheet as both assets and liabilities upon adoption of this accounting standard.

In March 2016, the FASB issued new guidance related to employee share-based payment accounting. This standard requires all income tax effects of awards to be recognized in the income statement when the awards vest or are settled. It also allows an employer to repurchase more of an employee's shares than it can today for tax withholding purposes without triggering liability accounting and to make a policy election for forfeitures as they occur. The guidance is effective for public business entities for fiscal years beginning after December 15, 2016, and interim periods within those years. Early adoption is permitted. The Company adopted this new standard effective January 1, 2017. The adoption of this new standard could result in increased volatility to reported income tax expense related to excess tax benefits and tax deficiencies for employee share-based transactions, however, the actual amounts recognized in income tax expense will be dependent on the amount of employee share-based transactions and the stock price at the time of vesting or exercise. For the six months ended June 30, 2017, adopting this new standard resulted in \$932,000 in income tax benefit offsetting income tax expense and current tax liability due to the vesting of restricted stock and performance stock units.

In June 2016, the FASB issued guidance related to credit losses on financial instruments. This update will change the accounting for credit losses on loans and debt securities. For loans, the proposal will require an expected credit loss model rather than the current incurred loss model to determine the allowance for credit losses. The expected credit loss model would estimate losses for the estimated life of the financial asset. In addition, the guidance will modify the other-than-temporary impairment model for available-for-sale debt securities to require an allowance for credit impairment instead of a direct write-down, which will allow for reversal of credit impairments in future periods. This guidance is effective for public business entities that meet the definition of an SEC filer for fiscal years beginning after December 15, 2019, including interim periods in those fiscal years. A committee has been formed to assess the requirements of this accounting standard as it relates to the Company and develop a plan for implementing them. Management expects to recognize credit losses earlier upon adoption of this accounting standard and the expected credit loss model than it has historically done under the current incurred credit loss model and is evaluating the impact of adopting this new accounting standard on our financial statements.

In August 2016, the FASB issued guidance related to the classification of certain cash receipts and cash payments in the statement of cash flow. This standard provides cash flow statement classification guidance for certain transactions including how the predominance principle should be applied when cash receipts and cash payments have aspects of more than one class of cash flows. The guidance is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years and should be applied retrospectively. Early adoption is permitted, including adoption in an interim period. Management does not expect the adoption of this new accounting standard to have a material impact on our financial statements.

In January 2017, the FASB issued ASU No. 2017-04 "Intangibles - Goodwill and Other - Simplifying the Test for Goodwill Impairment." These amendments eliminate Step 2 from the goodwill impairment test. The amendments also eliminate the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The guidance is effective for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. ASU 2017-04 should be adopted on a prospective basis. Management does not expect the adoption of this new accounting standard to have a material impact on our financial statements.

In March 2017, the FASB issued ASU No. 2017-07, "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost." Under the new guidance, employers will present the service cost component of the net periodic benefit cost in the same income statement line item as other employee compensation costs arising from services rendered during the period. In addition, only the service cost component will be eligible for capitalization in assets. Employers will present the other components separately from the line item that includes the service cost. ASU No. 2017-07 is effective for interim and annual reporting periods beginning after December 15, 2017. Early adoption is permitted. Employers will apply the guidance on the presentation of the components of net

periodic benefit cost in the income statement retrospectively. The guidance limiting the capitalization of net periodic benefit cost in assets to the service cost component will be applied prospectively. Management does not expect the adoption of this new accounting standard to have a material impact on our financial statements.

NOTE 12. RECLASSIFICATIONS

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

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

### OVERVIEW

Net income in the first six months of 2017 was \$29.9 million, up 19.1% from \$25.1 million for the comparable period of 2016. Diluted income per common share was \$1.17 in the first six months of 2017, up 18.2% from \$0.99 in the comparable period of 2016. Return on average total equity was 13.74% in the first six months of 2017 versus 12.43% in the comparable period of 2016. Return on average total assets was 1.38% in the first six months of 2017 versus 1.29% in the comparable period of 2016. The average equity to average assets ratio was 10.08% in the first six months of 2017 versus 10.39% in the comparable period of 2016.

Net income in the second quarter of 2017 was \$15.4 million, up 20.0% from \$12.8 million for the comparable period of 2016. Diluted income per common share was \$0.60 in the second quarter of 2017, up 20.0% from \$0.50 in the comparable period of 2016. Return on average total equity was 13.84% in the second quarter of 2017 versus 12.50% in the comparable period of 2016. Return on average total assets was 1.40% in the second quarter of 2017 versus 1.29% in the comparable period of 2016. The average equity to average assets ratio was 10.13% in the second quarter of 2017 versus 10.29% in the comparable period of 2016.

Total assets were \$4.393 billion as of June 30, 2017 versus \$4.290 billion as of December 31, 2016, an increase of \$103.0 million, or 2.4%. This increase was primarily due to a \$105.2 million increase in net loans as well as a \$26.1 million increase in securities available for sale. The increases were somewhat offset by a \$29.9 million decrease in cash and cash equivalents. The increase in assets was funded through growth in deposits of \$38.0 million, increased short-term borrowings of \$45.1 million and increases in equity of \$23.4 million.

### CRITICAL ACCOUNTING POLICIES

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

#### Allowance for Loan Losses

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

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

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



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

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

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

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

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

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

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

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

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

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

37

---

The assessment of whether a decline exists that is other-than-temporary, involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time. If, in management's judgment, other-than-temporary impairment exists, the cost basis of the security will be written down to the computed net present value, and the unrealized loss will be transferred from accumulated other comprehensive loss as an immediate reduction of current earnings (as if the loss had been realized in the period of other-than-temporary impairment).

## RESULTS OF OPERATIONS

### Overview

Selected income statement information for the three months and six months ended June 30, 2017 and 2016 is presented in the following table:

(dollars in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Income Statement Summary:				
Net interest income	\$33,819	\$29,273	\$65,880	\$57,855
Provision for loan losses	500	0	700	0
Noninterest income	8,791	8,067	17,050	15,110
Noninterest expense	19,352	18,446	39,400	35,830
Other Data:				
Efficiency ratio (1)	45.42%	49.40%	47.51%	49.11%
Dilutive EPS	\$0.60	\$0.50	\$1.17	\$0.99
Tangible capital ratio (2)	10.19%	10.57%	10.19%	10.57%
Net charge-offs/(recoveries) to average loans	-0.03%	0.00%	-0.01%	0.02%
Net interest margin	3.34%	3.19%	3.31%	3.22%
Noninterest income to total revenue	20.63%	21.60%	20.56%	20.71%

(1) Noninterest expense/Net interest income plus Noninterest income

(2) Non-GAAP financial measure. See reconciliation below.

(dollars in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Total Equity	\$450,460	\$418,893	\$450,460	\$418,893
Less: Goodwill	(4,970)	(4,970)	(4,970)	(4,970)
Plus: Deferred tax assets related to goodwill	1,844	1,833	1,844	1,833
Tangible Common Equity	447,334	415,756	447,334	415,756
Total Assets	\$4,392,999	\$3,937,304	\$4,392,999	\$3,937,304
Less: Goodwill	(4,970)	(4,970)	(4,970)	(4,970)
Plus: Deferred tax assets related to goodwill	1,844	1,833	1,844	1,833
Tangible Assets	4,389,873	3,934,167	4,389,873	3,934,167
Tangible Common Equity/Tangible Assets	10.19%	10.57%	10.19%	10.57%

### Net Income

Net income was \$29.9 million in the first six months of 2017, an increase of \$4.8 million, or 19.1%, versus net income of \$25.1 million in the first six months of 2016. Net interest income increased \$8.0 million, or 13.9%, to \$65.9 million versus \$57.9 million in the first six months of 2016. Net interest income increased primarily due to an 11.5% increase in average earning assets. An increase of \$382.9 million, or 13.6%, in average commercial loans from the first six months of 2016 was the primary reason for the increase in average earning assets over the past twelve months, which reflects our continuing strategic focus on commercial lending. The net interest margin increased nine basis points to 3.31% in the first six months of 2017 compared to 3.22% for the first six months of 2016.

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

Net income was \$15.4 million in the second quarter of 2017, an increase of \$2.6 million, or 20.0%, versus net income of \$12.8 million in the second quarter of 2016. Net interest income increased \$4.5 million, or 15.5%, to \$33.8 million versus \$29.3 million in the second quarter of 2016. Net interest income increased primarily due to a 10.3% increase in average earning assets, driven by an increase of 12.9% in the commercial loan portfolio. In addition, net interest income increased as a result of the increases in the federal funds rate by 0.25% in both March and June of 2017. The net interest margin was 3.34% in the second quarter of 2017 versus 3.19% in 2016. The higher margin reflected an increase in loan and securities yields, which more than offset the increase in the cost of funds.

Net Interest Income

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

(fully tax equivalent basis, dollars in thousands)	Six Months Ended June 30, 2017			2016			Yield (1)/Rate	
	Average Balance	Interest Income	Yield (1)/Rate	Average Balance	Interest Income	Yield (1)/Rate		
<b>Earning Assets</b>								
Loans:								
Taxable (2)(3)	\$3,528,970	\$71,414	4.08	% \$3,129,112	\$60,548	3.89	%	
Tax exempt (1)	19,025	459	4.87	11,835	330	5.61		
Investments: (1)								
Available for sale	523,317	8,374	3.23	483,649	7,642	3.18		
Short-term investments	5,625	13	0.47	6,008	7	0.23		
Interest bearing deposits	28,372	89	0.63	51,143	103	0.41		
Total earning assets	\$4,105,309	\$80,349	3.95	% \$3,681,747	\$68,630	3.75	%	
Less: Allowance for loan losses	(44,035)			(43,311)				
<b>Nonearning Assets</b>								
Cash and due from banks	105,044			98,593				
Premises and equipment	53,539			48,078				
Other nonearning assets	133,199			122,867				
Total assets	\$4,353,056			\$3,907,974				
<b>Interest Bearing Liabilities</b>								
Savings deposits	\$272,876	\$203	0.15	% \$258,322	\$237	0.18	%	
Interest bearing checking accounts	1,393,730	4,339	0.63	1,274,835	2,779	0.44		
Time deposits:								
In denominations under \$100,000	230,131	1,370	1.20	252,028	1,456	1.16		
In denominations over \$100,000	992,803	5,773	1.17	879,515	4,417	1.01		
Miscellaneous short-term borrowings	199,816	741	0.75	111,818	246	0.44		
Long-term borrowings and subordinated debentures	30,959	642	4.18	30,960	575	3.73		
Total interest bearing liabilities	\$3,120,315	\$13,068	0.84	% \$2,807,478	\$9,710	0.70	%	
<b>Noninterest Bearing Liabilities</b>								
Demand deposits	762,345			669,695				
Other liabilities	23,769			24,847				
Stockholders' Equity	438,627			405,954				
Total liabilities and stockholders' equity	\$4,345,056			\$3,907,974				

Interest Margin Recap

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

Interest income/average earning assets	80,349	3.95		68,630	3.75	
Interest expense/average earning assets	13,068	0.64		9,710	0.53	
Net interest income and margin	\$67,281	3.31	%	\$58,920	3.22	%

Tax exempt income was converted to a fully taxable equivalent basis at a 35 percent tax rate for 2017 and 2016.

The tax equivalent rate for tax exempt loans and tax exempt securities acquired after January 1, 1983 included the

(1) Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") adjustment applicable to nondeductible interest expenses. Taxable equivalent basis adjustments were \$1.4 million and \$1.1 million in the six-month periods ended June 30, 2017 and 2016, respectively.

(2) Loan fees, which are immaterial in relation to total taxable loan interest income for the six months ended June 30, 2017 and 2016, are included as taxable loan interest income.

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

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

(fully tax equivalent basis, dollars in thousands)	Three Months Ended June 30, 2017			2016			Yield (1)/	%
	Average Balance	Interest Income	Yield (1)/ Rate	Average Balance	Interest Income	Yield (1)/ Rate		
<b>Earning Assets</b>								
Loans:								
Taxable (2)(3)	\$3,566,504	\$36,967	4.16	% \$3,180,783	\$30,918	3.91		%
Tax exempt (1)	19,903	240	4.82	11,763	164	5.62		
Investments: (1)								
Available for sale	531,262	4,291	3.24	488,762	3,736	3.07		
Short-term investments	6,124	8	0.52	5,805	3	0.21		
Interest bearing deposits	26,441	46	0.70	75,909	79	0.42		
Total earning assets	\$4,150,234	\$41,552	4.02	% \$3,763,022	\$34,900	3.73		%
Less: Allowance for loan losses	(44,090)			(43,228)				
<b>Nonearning Assets</b>								
Cash and due from banks	101,446			109,743				
Premises and equipment	54,341			48,921				
Other nonearning assets	133,564			125,175				
Total assets	\$4,395,495			\$4,003,633				
<b>Interest Bearing Liabilities</b>								
Savings deposits	\$274,645	\$105	0.15	% \$263,331	\$115	0.18		%
Interest bearing checking accounts	1,403,560	2,387	0.68	1,309,443	1,455	0.45		
Time deposits:								
In denominations under \$100,000	237,917	700	1.18	249,452	719	1.16		
In denominations over \$100,000	1,009,964	3,051	1.21	937,470	2,405	1.03		
Miscellaneous short-term borrowings	214,520	431	0.81	96,878	99	0.41		
Long-term borrowings and subordinated debentures	30,959	328	4.25	30,960	289	3.75		
Total interest bearing liabilities	\$3,171,565	\$7,002	0.89	% \$2,887,534	\$5,082	0.71		%
<b>Noninterest Bearing Liabilities</b>								
Demand deposits	756,262			677,797				
Other liabilities	22,381			26,316				
Stockholders' Equity	445,287			411,986				
Total liabilities and stockholders' equity	\$4,395,495			\$4,003,633				
<b>Interest Margin Recap</b>								
Interest income/average earning assets		41,552	4.02		34,900	3.73		
Interest expense/average earning assets		7,002	0.68		5,082	0.54		
Net interest income and margin		\$34,550	3.34	%	\$29,818	3.19		%

Tax exempt income was converted to a fully taxable equivalent basis at a 35 percent tax rate for 2017 and 2016.

The tax equivalent rate for tax exempt loans and tax exempt securities acquired after January 1, 1983 included the (1) Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") adjustment applicable to nondeductible interest expenses. Taxable equivalent basis adjustments were \$731,000 and \$545,000 in the three-month periods ended June 30, 2017 and 2016, respectively.

(2)

Loan fees, which are immaterial in relation to total taxable loan interest income for the three months ended June 30, 2017 and 2016, are included as taxable loan interest income.

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

Net interest income increased \$8.0 million, or 13.9%, for the six months ended June 30, 2017 compared with the first six months of 2016. The increased level of net interest income during the first six months of 2017 was largely driven by an increase in average earning assets of \$423.6 million, which resulted primarily from loan growth. Average loans outstanding increased \$407.0 million during the six months ended June 30, 2017 compared with the same period of 2016, with most of the growth being in commercial loans. The earning asset growth was funded through deposit growth and an increase in short-term borrowings. Average interest bearing transaction accounts increased by \$118.9 million, average public fund time deposits in denominations over \$100,000 increased by \$113.2 million, average noninterest bearing demand deposits which increased by \$92.7 million and short-term borrowings increased by \$88.0 million.

The tax equivalent net interest margin was 3.31% for the first six months of 2017 compared to 3.22% during the first six months of 2016. The yield on earning assets totaled 3.95% during the six months ended June 30, 2017 compared to 3.75% in the same period of 2016. Cost of funds (expressed as a percentage of average earning assets) totaled 0.64% during the first six months of 2017 compared to 0.53% in the same period of 2016.



Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

Average earning assets increased by \$387.2 million for the three months ended June 30, 2017 compared with the same period of 2016. Average loans outstanding increased \$393.9 million during the three months ended June 30, 2017 compared with the same period of 2016, with most of the growth being in commercial loans. The earning asset growth was funded through a mix of deposit growth and short-term borrowings. Average interest bearing deposits increased by \$166.4 million, average short-term borrowings increased by \$117.6 million and noninterest bearing demand deposits increased by \$78.5 million.

The tax equivalent net interest margin was 3.34% for the second quarter of 2017 compared to 3.19% during the second quarter of 2016. The yield on earning assets totaled 4.02% during the second quarter of 2017 compared to 3.73% in the same period of 2016, while the cost of funds (expressed as a percentage of average earning assets) totaled 0.68% during the second quarter of 2017 compared to 0.54% in the same period of 2016. Approximately \$2.2 billion of total loans are variable rate loans as of June 30, 2017, primarily tied to Prime Rate Indexes, and have repriced to higher interest rates as a result of the increases in the Federal Funds Rate in mid-March 2017 and mid-June 2017. The benefit to loan yields as a result of the Federal Reserve Bank increases to the Federal Funds Rate has more than offset the increases to the cost of funds for the periods discussed.

#### Provision for Loan Losses

The Company recorded a provision for loan loss expense of \$500,000 and \$700,000, respectively, in the three-month and six-month periods ended June 30, 2017 due to the increase in the loan portfolio, compared to no provision during the comparable periods of 2016. The allowance for loan losses at June 30, 2017 represented 1.25% of the loan portfolio, versus 1.24% at March 31, 2017 and 1.35% at June 30, 2016. The primary factor impacting the decision to record a provision in the first six months of 2017 was the increasing size of the loan portfolio. Slightly offsetting the loan portfolio growth was the consideration management gave to the continued stability in key loan quality metrics including appropriate reserve coverage of nonperforming loans, a decrease in historical loss percentages and stable economic conditions in the Company's markets, and changes in the allocation for specific watch list credits. Management's overall view on current credit quality was also a factor in the determination of the provision for loan losses. The Company's management continues to monitor the adequacy of the provision based on loan levels, asset quality, economic conditions and other factors that may influence the assessment of the collectability of loans.

#### Noninterest Income

Noninterest income categories for the six-month and three-month periods ended June 30, 2017 and 2016 are shown in the following tables:

(dollars in thousands)	Six Months Ended June 30,		Percent
	2017	2016	Change
Wealth advisory fees	\$2,534	\$2,293	10.5 %
Investment brokerage fees	620	500	24.0
Service charges on deposit accounts	6,396	5,623	13.7
Loan, insurance and service fees	3,790	3,730	1.6
Merchant card fee income	1,108	1,024	8.2
Bank owned life insurance	873	662	31.9
Other income	1,168	515	126.8
Mortgage banking income	509	711	(28.4)
Net securities gains (losses)	52	52	N/A
Total noninterest income	\$17,050	\$15,110	12.8 %
Noninterest income to total revenue	20.56%	20.71%	



(dollars in thousands)	Three Months Ended June 30,			Percent Change
	2017	2016		
Wealth advisory fees	\$1,284	\$1,133	13.3	%
Investment brokerage fees	299	212	41.0	
Service charges on deposit accounts	3,253	2,843	14.4	
Loan, insurance and service fees	1,897	1,892	0.3	
Merchant card fee income	570	527	8.2	
Bank owned life insurance	402	489	(17.8)	
Other income	659	587	12.3	
Mortgage banking income	378	384	(1.6)	
Net securities gains (losses)	49	0	N/A	
Total noninterest income	\$8,791	\$8,067	9.0	%
Noninterest income to total revenue	20.63%	21.60%		

The Company's noninterest income increased 13% to \$17.1 million for the six months ended June 30, 2017 compared to \$15.1 million in the prior year period. Noninterest income was positively impacted by a \$773,000 increase in service charges on deposit accounts. In addition, wealth advisory fees increased by \$241,000 and investment brokerage fees increased by \$120,000. Bank owned life insurance income increased \$211,000 from the first six months of 2016 to the first six months of 2017 primarily due to increased revenue from variable life insurance contracts owned by the Company. In addition, other income increased \$653,000 compared to the first six months of 2016. During the first quarter of 2016, other income was negatively impacted by credit valuation adjustment losses related to the Company's swap arrangements, which account for \$295,000 of the increase in other income from the first six months of 2016 to the first six months of 2017. In addition, a write down in the first quarter of 2016 of \$226,000 to a property formerly used as a Lake City Bank branch negatively impacted other income in 2016. Noninterest income was negatively impacted by a decrease of \$202,000 in mortgage banking income resulting from lower mortgage loan originations during the first six months of 2017 as compared to the prior year period.

The Company's noninterest income increased \$724,000 or 9% to \$8.8 million for the second quarter of 2017 versus \$8.1 million for the second quarter of 2016. Noninterest income was positively impacted by a \$410,000 increase in service charges on deposit accounts primarily due to growth in fees from business accounts. In addition, wealth advisory fees increased \$151,000 or 13%, due to the growth in assets under management.

#### Noninterest Expense

Noninterest expense categories for the six-month and three-month periods ended June 30, 2017 and 2016 are shown in the following tables:

(dollars in thousands)	Six Months Ended June 30,			Percent Change
	2017	2016		
Salaries and employee benefits	\$22,486	\$20,197	11.3	%
Net occupancy expense	2,274	2,137	6.4	
Equipment costs	2,231	1,810	23.3	
Data processing fees and supplies	3,990	4,152	(3.9)	
Corporate and business development	2,698	1,620	66.5	

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

FDIC insurance and other regulatory fees	853	1,080	(21.0)
Professional fees	1,755	1,686	4.1
Other expense	3,113	3,148	(1.1)
Total noninterest expense	\$39,400	\$35,830	10.0 %

42

---

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

(dollars in thousands)	Three Months Ended		
	June 30,		
	2017	2016	Percent Change
Salaries and employee benefits	\$11,065	\$10,592	4.5 %
Net occupancy expense	1,154	1,041	10.9
Equipment costs	1,156	909	27.2
Data processing fees and supplies	1,974	2,120	(6.9)
Corporate and business development	1,196	763	56.7
FDIC insurance and other regulatory fees	419	557	(24.8)
Professional fees	801	859	(6.8)
Other expense	1,587	1,605	(1.1)
Total noninterest expense	\$19,352	\$18,446	4.9 %

The Company's noninterest expense increased by \$3.6 million or 10% to \$39.4 million in the first six months of 2017 compared to \$35.8 million in the prior year period. The increase was driven by salaries and employee benefits, which increased by 11% or \$2.3 million, primarily due to incentive-based compensation costs, increased health insurance cost, normal merit increases and staff additions related to the Company's branch expansion. In addition, corporate and business development increased by 67%, or \$1.1 million, primarily due to community support and donation expense of \$750,000 and \$283,000 of increased advertising expense. For the first six months of 2017 and 2016, the Company's efficiency ratio was 47.5% and 49.1%, respectively.

The Company's noninterest expense increased by 5% to \$19.4 million in the second quarter of 2017 compared to \$18.4 million in the second quarter of 2016. Salaries and employee benefits increased by 4% or \$473,000 primarily due to incentive-based compensation costs, increased health insurance cost, normal merit increases and staff additions related to the Company's branch expansion. Corporate and business development expense increased by \$433,000, primarily due to second quarter 2017 community support and donation expense of \$400,000. Equipment costs and net occupancy expense increased by \$247,000 and \$113,000, respectively, driven by the Company's branch expansion as well as remodeling of existing branches. Noninterest expense was positively impacted by decreases of \$146,000 in data processing fees and supplies and \$138,000 in FDIC insurance and other regulatory fees. The Company's efficiency ratio was 45.4% for the second quarter of 2017, compared to 49.4% for the second quarter of 2016 and 49.7% for the linked first quarter of 2017.

#### Income Taxes

The Company's income tax expense increased \$899,000 and \$1.3 million, respectively, in the six-month and three-month periods ended June 30, 2017, compared to the same periods in 2016. The effective tax rate was 30.2% and 32.5%, respectively, in the six-month and three-month periods ended June 30, 2017, compared to 32.5% and 32.2% for the comparable periods of 2016. The decrease in the effective tax rate in the six-month period ended June 30, 2017 was due to the Company adopting new FASB guidance related to employee share-based payment accounting effective January 1, 2017. This standard requires all income tax effects of awards to be recognized in the income statement when the awards vest or are settled. Adopting this standard resulted in the recognition of a \$932,000 income tax benefit during the first six months of 2017 related to vested employee share-based payments. The Company's long-term incentive plans vest in January of each year on the third anniversary of the grant date and are subject to performance conditions.

#### FINANCIAL CONDITION

##### Overview

Total assets of the Company were \$4.393 billion as of June 30, 2017, an increase of \$103.0 million, or 2.4%, when compared to \$4.290 billion as of December 31, 2016. Overall asset growth was primarily driven by a \$106.1 million, or 3.1%, increase in total loans to \$3.577 billion at June 30, 2017 from \$3.471 billion at December 31, 2016 and an increase of \$26.1 million, or 5.2%, in securities available for sale to \$530.3 million at June 30, 2017 from \$504.2 million at December 31, 2016 due to securities purchases and an increase in unrealized gains. Funding for the balance sheet growth came from a \$45.1 million increase in short-term borrowings as well as a \$38.0 million increase in deposits. A decrease of \$29.9 million, or 17.9%, in cash and cash equivalents partially offset the overall growth of total assets.

## Uses of Funds

## Total Cash and Cash Equivalents

Total cash and cash equivalents decreased by \$29.9 million, or 17.9%, to \$137.3 million at June 30, 2017, from \$167.3 million at December 31, 2016. Cash and cash equivalents decreased in order to fund growth in loans and securities.

## Investment Portfolio

The amortized cost and the fair value of securities as of June 30, 2017 and December 31, 2016 were as follows:

(dollars in thousands)	June 30, 2017		December 31, 2016	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
U.S. Treasury securities	\$990	\$1,008	\$990	\$1,003
U.S. government sponsored agencies	5,895	5,846	6,312	6,241
Agency residential mortgage-backed securities	355,055	356,904	351,108	351,568
State and municipal securities	165,489	166,554	146,917	145,379
Total	\$527,429	\$530,312	\$505,327	\$504,191

At June 30, 2017 and December 31, 2016, there were no holdings of securities of any one issuer, other than the U.S. government, government agencies and government sponsored agencies, in an amount greater than 10% of stockholders' equity.

Purchases of securities available for sale totaled \$90.1 million in the first six months of 2017. The purchases consisted primarily of agency residential mortgage-backed securities. Paydowns from prepayments and scheduled payments of \$26.8 million were received in the first six months of 2017, and the amortization of premiums, net of the accretion of discounts, was \$1.4 million. Sales of securities totaled \$35.8 million in the first six months of 2017. Maturities and calls of securities totaled \$4.0 million in the first six months of 2017. No other-than-temporary impairment was recognized in the first six months of 2017. Purchases of securities available for sale totaled \$53.8 million in the first six months of 2016. The purchases consisted primarily of federally tax-exempt municipal securities. Paydowns from prepayments and scheduled payments of \$24.8 million were received in the first six months of 2016, and the amortization of premiums, net of the accretion of discounts, was \$1.4 million. Sales of securities totaled \$6.9 million in the first six months of 2016. Maturities and calls of securities totaled \$10.8 million in the first six months of 2016. No other-than-temporary impairment was recognized in the first six months of 2016. The investment portfolio is managed by a third party firm to provide for an appropriate balance between liquidity, credit risk and investment return and to limit the Company's exposure to risk to an acceptable level. The Company does not trade or invest in or sponsor certain unregistered investment companies defined as hedge funds and private equity funds under what is commonly referred to as the "Volcker Rule" of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

## Real Estate Mortgage Loans HFS

Real estate mortgage loans held-for-sale decreased by \$1.7 million, or 28.6%, to \$4.2 million at June 30, 2017, from \$5.9 million at December 31, 2016. The balance of this asset category is subject to a high degree of variability depending on, among other things, recent mortgage loan rates and the timing of loan sales into the secondary market. The Company generally sells all of the mortgage loans it originates on the secondary market. Proceeds from sales totaled \$42.8 million in the first six months of 2017 compared to \$27.4 million in the first six months of 2016.

Loan Portfolio

The loan portfolio by portfolio segment as of June 30, 2017 and December 31, 2016 is summarized as follows:

44

---



Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

(dollars in thousands)	June 30, 2017	December 31, 2016	Current Period Change
Commercial and industrial loans	\$1,364,392 38.1 %	\$1,268,490 36.5 %	\$95,902
Commercial real estate and multi-family residential loans	1,343,006 37.5	1,300,923 37.5	42,083
Agri-business and agricultural loans	331,387 9.3	394,843 11.4	(63,456)
Other commercial loans	116,651 3.3	98,270 2.8	18,381
Consumer 1-4 family mortgage loans	354,143 9.9	347,834 10.0	6,309
Other consumer loans	68,646 1.9	61,308 1.8	7,338
Subtotal	3,578,225 100.0 %	3,471,668 100.0 %	106,557
Less: Allowance for loan losses	(44,563)	(43,718)	(845)
Net deferred loan fees	(1,221)	(741)	(480)
Loans, net	\$3,532,441	\$3,427,209	\$105,232

Total loans, excluding real estate mortgage loans held for sale, increased by \$106.6 million to \$3.578 billion at June 30, 2017 from \$3.472 billion at December 31, 2016. The increase was concentrated in the commercial and commercial real estate categories and reflected the Company's long standing strategic plan that is focused on expanding and growing the commercial lending business throughout our market areas. In addition, the Company's consumer loans grew by \$13.6 million. The increase was partially offset by seasonal declines in agri-business loans.

The following table summarizes the Company's non-performing assets as of June 30, 2017 and December 31, 2016:

(dollars in thousands)	June 30, 2017	December 31, 2016
Nonaccrual loans including nonaccrual troubled debt restructured loans	\$ 9,884	\$ 6,633
Loans past due over 90 days and still accruing	0	53
Total nonperforming loans	\$ 9,884	\$ 6,686
Other real estate owned	194	153
Repossessions	0	11
Total nonperforming assets	\$ 10,078	\$ 6,850
Impaired loans including troubled debt restructurings	\$ 19,580	\$ 20,692
Nonperforming loans to total loans	0.28%	0.19%
Nonperforming assets to total assets	0.23%	0.16%
Performing troubled debt restructured loans	\$ 8,425	\$ 10,351
Nonperforming troubled debt restructured loans (included in nonaccrual loans)	6,852	5,633
Total troubled debt restructured loans	\$ 15,277	\$ 15,984

Total nonperforming assets increased by \$3.2 million, or 47.2%, to \$10.1 million during the six-month period ended June 30, 2017. The increase in nonperforming assets was primarily due to two commercial relationships being placed in nonaccrual status. One of the nonaccrual relationships is with a financial services firm and the second is with a manufacturer.

Net recoveries totaled \$289,000 in the second quarter of 2017, versus net charge-offs of \$36,000 during the second quarter of 2016 and net charge-offs of \$144,000 during the first quarter of 2017.

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

Total impaired loans decreased by \$1.1 million, or 5.4%, to \$19.6 million at June 30, 2017 from \$20.7 million at December 31, 2016. The decrease in the impaired loans category was primarily due to payments received on impaired commercial credits.

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

At June 30, 2017, the allowance for loan losses was 1.25% of total loans outstanding, versus 1.26% of total loans outstanding at December 31, 2016. At June 30, 2017, management believed the allowance for loan losses was at a level commensurate with the overall risk exposure of the loan portfolio. However, if economic conditions do not remain stabilized, certain borrowers may experience difficulty and the level of nonperforming loans, charge-offs and delinquencies could rise and require increases in the allowance for loan losses. The process of identifying probable credit losses is a subjective process. Therefore, the Company maintains a general allowance to cover probable credit losses within the entire portfolio. The methodology management uses to determine the adequacy of the loan loss reserve includes the considerations below.

The Company has a relatively high percentage of commercial and commercial real estate loans, most of which are extended to small or medium-sized businesses from a wide variety of industries. Generally, this type of lending has more credit risk than other types of lending because of the size and diversity of the credits. The Company manages this risk by adjusting its pricing to the perceived risk of each individual credit and by diversifying the portfolio by customer, product, industry and market area.

As of June 30, 2017, on the basis of management's review of the loan portfolio, the Company had 81 credits totaling \$152.9 million on the classified loan list versus 84 credits totaling \$147.3 million on December 31, 2016. As of June 30, 2017, the Company had \$85.8 million of assets classified as Special Mention, \$67.2 million classified as Substandard, \$0 classified as Doubtful and \$0 classified as Loss as compared to \$74.3 million, \$72.4 million, \$0 and \$0, respectively, at December 31, 2016.

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

for loan losses methodology see the Critical Accounting Policies section of this Item 2.

The allowance for loan losses increased 1.9%, or \$845,000, from \$43.7 million at December 31, 2016 to \$44.6 million at June 30, 2017. Pooled loan allocations increased from \$39.6 million at December 31, 2016 to \$39.9 million at June 30, 2017, which was primarily due to management's view of current credit quality and the current economic environment. Impaired loan allocations increased \$511,000 from \$4.1 million at December 31, 2016 to \$4.6 million at June 30, 2017 due primarily to slightly higher allocations on specific classified loans. The unallocated component of the allowance for loan losses increased \$266,000 from \$2.8 million at December 31, 2016 to \$3.1 million at June 30, 2017. While general trends in the overall economy and credit quality were stable or favorable, the Company believes that the unallocated component is appropriate given the uncertainty that exists regarding near term economic conditions.

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

Economic conditions in the Company's markets have generally improved and stabilized, and management is cautiously optimistic that the growth is positively impacting its borrowers. While the growth is not robust, commercial real estate activity and manufacturing growth is occurring. The Company's continued growth strategy promotes diversification among industries as well as continued focus on enforcement of a strong credit environment and an aggressive position in loan work-out situations. The Company believes that historical industry-specific issues in the Company's markets have improved and continue to be somewhat mitigated by its overall expansion strategy, the economic environment impacting its entire geographic footprint will continue to present challenges.

#### Sources of Funds

The following table summarizes deposits and borrowings as of June 30, 2017 and December 31, 2016:

(dollars in thousands)	June 30, 2017	December 31, 2016	Current Period Change
Non-interest bearing demand deposits	\$762,965	\$819,803	\$(56,838)
Savings and transaction accounts:			
Savings deposits	275,151	268,970	6,181
Interest bearing demand deposits	1,322,847	1,325,320	(2,473)
Time deposits:			
Deposits of \$100,000 or more	1,015,741	924,825	90,916
Other time deposits	239,235	238,994	241
Total deposits	\$3,615,939	\$3,577,912	\$38,027
FHLB advances and other borrowings	306,146	261,005	45,141
Total funding sources	\$3,922,085	\$3,838,917	\$83,168

#### Deposits and Borrowings

Total deposits increased by \$38.0 million, or 1.1%, from December 31, 2016. The growth in deposits consisted of \$19.8 million of growth in core deposits, which excludes brokered deposits, and an increase of \$18.2 million in brokered deposits. Total brokered deposits were \$116.4 million at June 30, 2017 compared to \$98.2 million at December 31, 2016. Core deposit growth was comprised of increases in retail deposits of \$36.7 million and in public fund deposits of \$31.3 million, which were offset by a decrease in commercial deposits of \$48.2 million. Total public funds deposits, including public funds transaction accounts, were \$1.238 billion at June 30, 2017 compared to \$1.207 billion at December 31, 2016.

Total borrowings increased by \$45.1 million, or 17.3%, from December 31, 2016. Most of the increase was from an increase in short-term advances from the Federal Home Loan Bank of Indianapolis. The Company used wholesale funding, including brokered deposits and Federal Home Loan Bank advances, to fund part of its loan growth and to help maintain its desired interest rate risk position.

#### Capital

As of June 30, 2017, total stockholders' equity was \$450.4 million, an increase of \$23.4 million, or 5.5%, from \$427.0 million at December 31, 2016. In addition to net income of \$29.9 million, other increases in equity during the first six months of 2017 included \$2.8 million in stock based compensation expense and \$2.8 million in accumulated other comprehensive income component of equity, which was driven by a net increase in the fair value of available-for-sale securities. Offsetting the increases to stockholders' equity were dividends paid in the amount of \$10.3 million and \$1.7 million in stock activity under equity compensation plans. The impact on equity by other comprehensive income is not included in regulatory capital. The banking regulators have established guidelines for leverage capital requirements, expressed in terms of Tier 1, or core capital, as a percentage of average assets, to measure the soundness of a financial institution. In addition, banking regulators have established risk-based capital guidelines for U.S. banking organizations. The final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks became effective for the Company on January 1, 2015, with full compliance with all of the final rule's requirements phased in over a multi-year schedule, to be fully phased-in by January 1, 2019. The final rules include a capital conservation buffer, comprised of common equity Tier 1 capital, which was phased in beginning January 1, 2016 at 0.625% of risk-weighted assets and will increase each subsequent year by an additional 0.625% until reaching its final level of 2.5% on January 1, 2019. The capital conservation buffer was 0.625% as of December 31, 2016 and 1.25% as of June 30, 2017. As of June 30, 2017, the Company's capital levels remained characterized as "well-capitalized" under the new rules. The actual capital amounts and ratios of the Company and the Bank as of June 30, 2017 and December 31, 2016, are presented in the table below:

Edgar Filing: LAKELAND FINANCIAL CORP - Form 10-Q

(dollars in thousands)	Actual		Minimum Required For Capital Adequacy Purposes		For Capital Adequacy Purposes Plus Conservation Buffer		Minimum Required to Be Well Capitalized Under Prompt Corrective Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of June 30, 2017:								
Total Capital (to Risk Weighted Assets)								
Consolidated	\$519,675	13.30%	\$312,647	8.00%	\$361,498	9.25%	\$390,809	10.00%
Bank	\$504,152	12.93%	\$311,959	8.00%	\$360,703	9.25%	\$389,949	10.00%
Tier I Capital (to Risk Weighted Assets)								
Consolidated	\$475,023	12.15%	\$234,485	6.00%	\$283,336	7.25%	\$312,647	8.00%
Bank	\$459,500	11.78%	\$233,969	6.00%	\$282,713	7.25%	\$311,959	8.00%
Common Equity Tier 1 (CET1)								
Consolidated	\$445,023	11.39%	\$175,864	4.50%	\$224,715	5.75%	\$254,026	6.50%
Bank	\$459,500	11.78%	\$175,477	4.50%	\$224,221	5.75%	\$253,467	6.50%
Tier I Capital (to Average Assets)								
Consolidated	\$475,023	10.82%	\$175,621	4.00%	\$175,621	4.00%	\$219,526	5.00%
Bank	\$459,500	10.50%	\$175,008	4.00%	\$175,008	4.00%	\$218,760	5.00%
As of December 31, 2016:								
Total Capital (to Risk Weighted Assets)								
Consolidated	\$498,189	13.23%	\$301,243	8.00%	\$324,777	8.625%	\$376,554	10.00%
Bank	\$482,600	12.84%	\$300,784	8.00%	\$324,283	8.625%	\$375,980	10.00%
Tier I Capital (to Risk Weighted Assets)								
Consolidated	\$454,382	12.07%	\$225,932	6.00%	\$249,467	6.625%	\$301,243	8.00%
Bank	\$438,793	11.67%	\$225,588	6.00%	\$249,087	6.625%	\$300,784	8.00%
Common Equity Tier 1 (CET1)								
Consolidated	\$424,382	11.27%	\$169,449	4.50%	\$192,984	5.125%	\$244,760	6.50%
Bank	\$438,793	11.67%	\$169,191	4.50%	\$192,690	5.125%	\$244,387	6.50%
Tier I Capital (to Average Assets)								
Consolidated	\$454,382	10.86%	\$167,310	4.00%	\$167,310	4.00%	\$209,138	5.00%
Bank	\$438,793	10.54%	\$166,522	4.00%	\$166,522	4.00%	\$208,153	5.00%

FORWARD-LOOKING STATEMENTS

This document (including information incorporated by reference) contains, and future oral and written statements of the Company and its management may contain, forward-looking statements, within the meaning of such term in the Private Securities Litigation Reform Act of 1995, with respect to the financial condition, results of operations, plans, objectives, future performance and business of the Company. Forward-looking statements, which may be based upon beliefs, expectations and assumptions of the Company's management and on information currently available to management, are generally identifiable by the use of words such as "believe," "expect," "anticipate," "plan," "intend," "estimate," "may," "will," "would," "could," "should" or other similar expressions. Additionally, all statements in this

document, including forward-looking statements, speak only as of the date they are made, and the Company undertakes no obligation to update any statement in light of new information or future events.

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 the Company's Annual Report on Form 10-K. In addition to the risk factors described in that section, there are other factors that may impact any public company, including ours, which could have a material adverse effect on the operations and future prospects of the Company and its subsidiaries. These additional factors include, but are not limited to, the following:

- the effects of future economic, business and market conditions and changes, both domestic and foreign;
- governmental monetary and fiscal policies;



legislative and regulatory changes, including changes in banking, securities and tax laws and regulations and their application by our regulators;

· national and international political conditions and events;

· the risks of changes in interest rates on the levels, composition and costs of deposits, loan demand, and the values and liquidity of loan collateral, securities and other interest sensitive assets and liabilities;

· changes in borrowers' credit risks and payment behaviors;

· changes in the availability and cost of credit and capital in the financial markets;

· the effects of disruption and volatility in capital markets on the value of our investment portfolio;

· cyber-security risks and/or cyber-security damage that could result from attacks on the Company's or third party service providers, networks or data of the Company;

· changes in the prices, values and sales volumes of residential and commercial real estate;

· the effects of competition from a wide variety of local, regional, national and other providers of financial, investment and insurance services;

· changes in technology or products that may be more difficult or costly, or less effective than anticipated;

· the effects of war or other conflicts, acts of terrorism or other catastrophic events, including storms, droughts, tornados and flooding, that may affect general economic conditions, including agricultural production and demand and prices for agricultural goods and land used for agricultural purposes, generally and in our markets;

· the failure of assumptions and estimates used in our reviews of our loan portfolio, underlying the establishment of reserves for possible loan losses, our analysis of our capital position and other estimates;

· changes in the scope and cost of FDIC insurance, the state of Indiana's Public Deposit Insurance Fund and other coverages;

· changes in accounting policies, rules and practices; and

· the risks of mergers, acquisitions and divestitures, including, without limitation, the related time and costs of implementing such transactions, integrating operations as part of these transactions and possible failures to achieve expected gains, revenue growth and/or expense savings from such transactions.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Additional information concerning the Company and its business, including factors that could materially affect the Company's financial results, is included in the Company's filings with the Securities and Exchange Commission, including the Company's Annual Report on Form 10-K.

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

Interest rate risk represents the Company's primary market risk exposure. The Company does not have a material exposure to foreign currency exchange risk, does not have any material amount of derivative financial instruments and does not maintain a trading portfolio. The Corporate Risk Committee of the Board of Directors annually reviews and approves the policy used to manage interest rate risk. The policy was last reviewed and approved in July 2017. The

policy sets guidelines for balance sheet structure, which are designed to protect the Company from the impact that interest rate changes could have on net income but does not necessarily indicate the effect on future net interest income. The Company, through its Asset and Liability Committee, manages interest rate risk by monitoring the computer simulated earnings impact of various rate scenarios and general market conditions. The Company then modifies its long-term risk parameters by attempting to generate the types of loans, investments, and deposits that currently fit the Company's needs, as determined by its Asset and Liability Committee. This computer simulation analysis measures the net interest income impact of various interest rate scenario changes during the next twelve months. The Company continually evaluates the assumptions used in the model. The current balance sheet structure is considered to be within acceptable risk levels.

Interest rate scenarios for the base, falling 100 basis points, rising 25 basis points, rising 50 basis points, rising 100 basis points, rising 200 basis points and rising 300 basis points are listed below based upon the Company's rate sensitive assets and liabilities at June 30, 2017. The net interest income shown represents cumulative net interest income over a twelve-month time horizon. Balance sheet assumptions used for the base scenario are the same for the rising and falling simulations.

The base scenario is highly dependent on numerous assumptions embedded in the model. While the base sensitivity analysis incorporates management's best estimate of interest rate and balance sheet dynamics under various market rate movements, the actual behavior and resulting earnings impact will likely differ from that projected. For certain assets, the base simulation model captures the expected prepayment behavior under changing interest rate environments. Assumptions and methodologies regarding the interest rate or balance behavior of indeterminate maturity core deposit products, such as savings, money market, NOW and demand deposits reflect management's best estimate of expected future behavior.

(dollars in thousands)	Base	Falling (100 Basis Points)	Rising 25 Basis Points	Rising 50 Basis Points	Rising 100 Basis Points	Rising 200 Basis Points	Rising 300 Basis Points	
Net interest income	\$138,573	\$124,997	\$141,083	\$143,576	\$148,511	\$158,116	\$167,447	
Variance from Base		(\$13,576)	\$2,510	\$5,003	\$9,938	\$19,543	\$28,874	
Percent of change from Base		-9.80	% 1.81	% 3.61	% 7.17	% 14.10	% 20.84	%

#### ITEM 4 – CONTROLS AND PROCEDURES

As required by Rules 13a-15(b) and 15d-15(b) under the Securities Exchange Act of 1934, management has evaluated, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures (as defined in Securities Exchange Act Rules 13a-15(e) and 15d-15(e)) were effective as of June 30, 2017. Disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. These disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure.

During the quarter ended June 30, 2017, there were no changes to the Company's internal control over financial reporting that have materially affected or are reasonably likely to materially affect its internal control over financial reporting.

## PART II – OTHER INFORMATION

Item 1. Legal proceedings

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

Item 1A. Risk Factors

There have been no material changes to the risk factors disclosed in Item 1A. of Part I of the Company's 2016 Form 10-K. Please refer to that section of the Company's Form 10-K for disclosures regarding the risks and uncertainties related to the Company's business.

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

The following table provides information as of June 30, 2017 with respect to shares of common stock repurchased by the Company during the quarter then ended:

## ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Appropriate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
April 1-30	0	\$0	0	\$0
May 1-31	792	45.31	0	0
June 1-30	0	0	0	0
Total	792	\$45.31	0	\$0

(a) The shares purchased during the periods were credited to the deferred share accounts of

non-employee directors under the Company's directors' deferred compensation plan. These shares were purchased in the ordinary course of business and consistent with past practice.

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

N/A

Item 5. Other Information

Frequency of Future Advisory Votes on Named Executive Officer Compensation

As previously reported in a Current Report on Form 8-K filed on April 13, 2017, a non-binding, advisory vote was taken at our 2017 Annual Meeting of Shareholders on the frequency of our future advisory votes regarding named executive officer compensation. A majority of the votes cast at the Annual Meeting were in favor of holding such advisory vote on an annual basis, in accordance with the recommendation of the Company's Board of Directors. Accordingly, the Company has determined that it will hold a non-binding, advisory vote on the compensation of its named executive officers every year, until changed as a result of a subsequent vote on the frequency of the advisory vote.

Item 6. Exhibits

- 10.1 Lakeland Financial Corporation 2017 Equity Incentive Plan (incorporated by reference to Exhibit 4.5 to the Company's Form S-8 filed on April 13, 2017)
- 10.2 Form of Restricted Stock Unit Award Agreement (incorporated by reference to Exhibit 4.6 to the Company's Form S-8 filed on April 13, 2017)
- 10.3 Form of Restricted Stock Award Agreement (incorporated by reference to Exhibit 4.7 to the Company's Form S-8 filed on April 13, 2017)
- 10.4 Form of Incentive Stock Option Award Agreement (incorporated by reference to Exhibit 4.8 to the Company's Form S-8 filed on April 13, 2017)
- 10.5 Form of Nonqualified Stock Option Award Agreement (incorporated by reference to Exhibit 4.9 to the Company's Form S-8 filed on April 13, 2017)
- 31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a)
- 31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a)
- 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101 Interactive Data File

Interactive data files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheets as of June 30, 2017 and December 31, 2016; (ii) Consolidated Statements of Income for the three months and six months ended June 30, 2017 and June 30, 2016; (iii) Consolidated Statements of Comprehensive Income for the three months and six months ended June 30, 2017 and June 30, 2016; (iv) Consolidated Statements of Changes in Stockholders' Equity for the six months ended June 30, 2017 and June 30, 2016; (v) Consolidated Statements of Cash Flows for the six months ended June 30, 2017 and June 30, 2016; and (vi) Notes to Unaudited Consolidated Financial Statements.

SIGNATURES

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

LAKELAND FINANCIAL CORPORATION  
(Registrant)

Date: August 7, 2017 /s/ David M. Findlay  
David M. Findlay – President and  
Chief Executive Officer

Date: August 7, 2017 /s/ Lisa M. O'Neill  
Lisa M. O'Neill – Executive Vice President and  
Chief Financial Officer

Date: August 7, 2017 /s/ Sarah J. Earls  
Sarah J. Earls – Senior Vice President and Controller





Exhibit Index

Exhibit Number

- 10.1 Lakeland Financial Corporation 2017 Equity Incentive Plan (incorporated by reference to Exhibit 4.5 to the Company's Form S-8 filed on April 13, 2017)
- 10.2 Form of Restricted Stock Unit Award Agreement (incorporated by reference to Exhibit 4.6 to the Company's Form S-8 filed on April 13, 2017)
- 10.3 Form of Restricted Stock Award Agreement (incorporated by reference to Exhibit 4.7 to the Company's Form S-8 filed on April 13, 2017)
- 10.4 Form of Incentive Stock Option Award Agreement (incorporated by reference to Exhibit 4.8 to the Company's Form S-8 filed on April 13, 2017)
- 10.5 Form of Nonqualified Stock Option Award Agreement (incorporated by reference to Exhibit 4.9 to the Company's Form S-8 filed on April 13, 2017)
- 31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a)
- 31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a)
- 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101 Interactive Data File

Interactive data files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheets as of June 30, 2017 and December 31, 2016; (ii) Consolidated Statements of Income for the three months and six months ended June 30, 2017 and June 30, 2016; (iii) Consolidated Statements of Comprehensive Income for the three months and six months ended June 30, 2017 and June 30, 2016; (iv) Consolidated Statements of Changes in Stockholders' Equity for the six months ended June 30, 2017 and June 30, 2016; (v) Consolidated Statements of Cash Flows for the six

months ended June 30, 2017 and June 30, 2016; and (vi) Notes to Unaudited Consolidated Financial Statements.