

LANDMARK BANCORP INC  
Form 10-Q  
August 03, 2006

**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, 2006**

**OR**

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

**For transition period from        to**

**Commission File Number 0-33203**

**LANDMARK BANCORP, INC.**

(Exact name of Registrant as specified in its charter)

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**Delaware**

(State or other jurisdiction of incorporation or organization)

**43-1930755**

(I.R.S. Employer Identification Number)

**701 Poyntz Avenue, Manhattan, Kansas**

(Address of principal executive offices)

**66502**

(Zip Code)

**(785) 565-2000**

(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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Indicate the number of shares outstanding of each of the Registrant's classes of common stock as of the latest practicable date: As of July 31, 2006, the Registrant had outstanding 2,229,258 shares of its common stock, \$.01 par value per share.

**LANDMARK BANCORP, INC.**  
**Form 10-Q Quarterly Report**

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**LANDMARK BANCORP, INC. AND SUBSIDIARY**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

|   | <b>June 30,<br/>2006</b> | <b>December 31,<br/>2005</b> |
|---|--------------------------|------------------------------|
| <b>ASSETS</b>   |                          |                              |
|   | <b>(Unaudited)</b>       |                              |
| Cash and cash equivalents   | \$ 13,832,885            | \$ 21,490,512                |
| Investment securities available for sale, at fair value   | 134,557,744              | 140,130,512                  |
| Loans, net  | 392,953,154              | 274,565,855                  |
| Loans held for sale   | 4,137,150                | 1,163,211                    |
| Premises and equipment, net   | 12,992,315               | 8,412,235                    |
| Goodwill  | 13,009,167               | 7,535,584                    |
| Other intangible assets, net  | 4,512,120                | 2,418,213                    |
| Accrued interest and other assets   | 17,582,041               | 9,393,839                    |
| <b>Total assets</b>   | <b>\$ 593,576,576</b>    | <b>\$ 465,109,961</b>        |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                          |                              |
| <b>Liabilities:</b>   |                          |                              |
| Deposits  | \$ 429,796,665           | \$ 331,272,731               |
| Federal Home Loan Bank borrowings   | 80,317,370               | 63,212,318                   |
| Other borrowings  | 30,552,178               | 22,046,000                   |
| Accrued expenses, taxes and other liabilities   | 7,223,297                | 4,506,305                    |
| <b>Total liabilities</b>  | <b>547,889,510</b>       | <b>421,037,354</b>           |
| <b>Stockholders' equity:</b>  |                          |                              |
| Common stock, \$0.01 par, 5,000,000 shares authorized,<br>2,244,994 and 2,244,327 shares issued, respectively | 22,450                   | 22,443                       |
| Additional paid-in capital  | 19,943,097               | 19,868,567                   |
| Retained earnings   | 27,581,301               | 25,322,019                   |
| Accumulated other comprehensive loss  | (1,445,268)              | (725,908)                    |
| Treasury stock, at cost; 15,736 shares  | (414,514)                | (414,514)                    |
| <b>Total stockholders' equity</b>   | <b>45,687,066</b>        | <b>44,072,607</b>            |
| <b>Total liabilities and stockholders' equity</b>   | <b>\$ 593,576,576</b>    | <b>\$ 465,109,961</b>        |

*See accompanying notes to condensed consolidated financial statements.*

**LANDMARK BANCORP, INC. AND SUBSIDIARY**  
**CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS**  
(Unaudited)

|  | <b>Three Months Ended June 30,</b> |                   |
|--|------------------------------------|-------------------|
|  | <b>2006</b>                        | <b>2005</b>       |
| <b>Interest income:</b>                                    |                                    |                   |
| Loans  | \$ 6,860,807                       | \$ 4,288,778      |
| Investment securities                                      | 1,455,327                          | 1,121,711         |
| Other  | 30,108                             | 40,175            |
| <b>Total interest income</b>                               | <b>8,346,242</b>                   | <b>5,450,664</b>  |
| <b>Interest expense:</b>                                   |                                    |                   |
| Deposits   | 2,616,379                          | 1,355,432         |
| Borrowed funds   | 1,182,976                          | 874,884           |
| <b>Total interest expense</b>                              | <b>3,799,355</b>                   | <b>2,230,316</b>  |
| <b>Net interest income</b>                                 | <b>4,546,887</b>                   | <b>3,220,348</b>  |
| Provision for loan losses                                  | 15,000                             | 105,000           |
| <b>Net interest income after provision for loan losses</b> | <b>4,531,887</b>                   | <b>3,115,348</b>  |
| <b>Non-interest income:</b>                                |                                    |                   |
| Fees and service charges                                   | 1,128,463                          | 892,928           |
| Gains on sale of loans                                     | 322,983                            | 205,818           |
| Gains (losses) on sale of investments, net                 | (443,797 )                         | 40,540            |
| Gains on sale of other assets                              | 681,630                            |                   |
| Bank owned life insurance                                  | 112,300                            | 20,287            |
| Other  | 139,746                            | 117,447           |
| <b>Total non-interest income</b>                           | <b>1,941,325</b>                   | <b>1,277,020</b>  |
| <b>Non-interest expense:</b>                               |                                    |                   |
| Compensation and benefits                                  | 2,112,612                          | 1,505,144         |
| Occupancy and equipment                                    | 687,102                            | 484,108           |
| Data processing  | 187,543                            | 141,237           |
| Amortization of intangibles                                | 259,679                            | 86,932            |
| Professional fees  | 126,349                            | 98,913            |
| Advertising  | 111,219                            | 97,007            |
| Other  | 732,650                            | 597,588           |
| <b>Total non-interest expense</b>                          | <b>4,217,154</b>                   | <b>3,010,929</b>  |
| <b>Earnings before income taxes</b>                        | <b>2,256,058</b>                   | <b>1,381,439</b>  |
| Income tax expense   | 659,968                            | 431,775           |
| <b>Net earnings</b>  | <b>\$ 1,596,090</b>                | <b>\$ 949,664</b> |
| <b>Earnings per share:</b>                                 |                                    |                   |
| Basic  | \$ 0.72                            | \$ 0.43           |
| Diluted  | \$ 0.71                            | \$ 0.43           |
| Dividends per share  | \$ 0.1700                          | \$ 0.1619         |

*See accompanying notes to condensed consolidated financial statements.*



**LANDMARK BANCORP, INC. AND SUBSIDIARY**  
**CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS**  
**(Unaudited)**

|   | Six Months Ended June 30,<br>2006 | 2005         |
|---|-----------------------------------|--------------|
| <b>Interest income:</b>                             |                                   |              |
| Loans   | \$ 13,511,515                     | \$ 8,390,492 |
| Investment securities                               | 2,870,664                         | 2,158,512    |
| Other   | 101,394                           | 53,245       |
| Total interest income                               | 16,483,573                        | 10,602,249   |
| <b>Interest expense:</b>                            |                                   |              |
| Deposits  | 5,043,714                         | 2,515,497    |
| Borrowed funds                                      | 2,247,585                         | 1,755,610    |
| Total interest expense                              | 7,291,299                         | 4,271,107    |
| Net interest income                                 | 9,192,274                         | 6,331,142    |
| Provision for loan losses                           | 75,000                            | 225,000      |
| Net interest income after provision for loan losses | 9,117,274                         | 6,106,142    |
| <b>Non-interest income:</b>                         |                                   |              |
| Fees and service charges                            | 2,135,335                         | 1,668,954    |
| Gains on sale of loans                              | 586,364                           | 371,394      |
| Gains (losses) on sale of investments, net          | (300,256 )                        | 40,540       |
| Gains on sale of other assets                       | 728,453                           | 17,211       |
| Bank owned life insurance                           | 157,654                           | 41,920       |
| Other   | 325,316                           | 197,416      |
| Total non-interest income                           | 3,632,866                         | 2,337,435    |
| <b>Non-interest expense:</b>                        |                                   |              |
| Compensation and benefits                           | 4,248,576                         | 2,962,862    |
| Occupancy and equipment                             | 1,396,022                         | 974,342      |
| Data processing                                     | 348,990                           | 270,233      |
| Amortization of intangibles                         | 524,172                           | 182,962      |
| Professional fees                                   | 210,726                           | 185,056      |
| Advertising   | 218,737                           | 181,847      |
| Other   | 1,506,785                         | 1,151,869    |
| Total non-interest expense                          | 8,454,008                         | 5,909,171    |
| Earnings before income taxes                        | 4,296,132                         | 2,534,406    |
| Income tax expense                                  | 1,279,128                         | 781,366      |
| Net earnings  | \$ 3,017,004                      | \$ 1,753,040 |
| <b>Earnings per share:</b>                          |                                   |              |
| Basic   | \$ 1.35                           | \$ 0.79      |
| Diluted   | \$ 1.35                           | \$ 0.79      |
| Dividends per share                                 | \$ 0.3400                         | \$ 0.3238    |

*See accompanying notes to condensed consolidated financial statements.*





**LANDMARK BANCORP, INC. AND SUBSIDIARY**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)

|   | Six Months Ended June 30, |               |
|---|---------------------------|---------------|
|   | 2006                      | 2005          |
| Net cash provided by (used in) operating activities                 | \$ (4,193,736 )           | \$ 3,846,525  |
| Cash flows from investing activities:                               |                           |               |
| Net increase in loans   | (10,573,691 )             | (429,630 )    |
| Maturities and prepayments of investments                           | 22,388,576                | 21,712,032    |
| Purchase of investment securities                                   | (27,281,977 )             | (27,804,212 ) |
| Proceeds from sale of investment securities                         | 19,804,823                | 140,540       |
| Net cash paid in FMB acquisition                                    | (8,023,721 )              |               |
| Proceeds from sales of premises and equipment and foreclosed assets | 564,923                   | 247,943       |
| Purchases of premises and equipment, net                            | (1,979,916 )              | (258,374 )    |
| Net cash used in investing activities                               | (5,100,983 )              | (6,391,701 )  |
| Cash flows from financing activities:                               |                           |               |
| Net increase (decrease) in deposits                                 | (8,401,243 )              | 59,891        |
| Federal Home Loan Bank advance borrowings                           |                           | 3,500,000     |
| Federal Home Loan Bank advance repayments                           | (1,018,384 )              | (5,018,384 )  |
| Federal Home Loan Bank line of credit borrowings, net               | 10,000,000                | 2,400,000     |
| Proceeds from other borrowings                                      | 6,675,686                 | 2,375,000     |
| Repayments on other borrowings                                      | (4,873,240 )              | (725,000 )    |
| Purchase of treasury stock  |                           | (531 )        |
| Proceeds from issuance of common stock under stock option plans     | 9,491                     | 147,566       |
| Tax benefit related to stock option plans                           | 2,503                     | 32,541        |
| Payment of dividends  | (757,721 )                | (717,597 )    |
| Net cash provided by financing activities                           | 1,637,092                 | 2,053,486     |
| Net decrease in cash and cash equivalents                           | (7,657,627 )              | (491,690 )    |
| Cash and cash equivalents at beginning of period                    | 21,490,512                | 7,845,438     |
| Cash and cash equivalents at end of period                          | \$ 13,832,885             | \$ 7,353,748  |
| Supplemental disclosure of cash flow information:                   |                           |               |
| Cash paid during period for interest                                | \$ 6,329,000              | \$ 3,829,000  |
| Cash paid during period for taxes                                   | \$ 560,000                | \$            |
| Supplemental schedule of non-cash investing activities:             |                           |               |
| Transfer of loans to real estate owned                              | \$ 25,000                 | \$ 486,000    |
| FMB Acquisition:  |                           |               |
| Fair value of liabilities assumed                                   | 131,988,000               |               |
| Fair value of assets acquired, including goodwill                   | 123,964,000               |               |

*See accompanying notes to condensed consolidated financial statements.*

**LANDMARK BANCORP, INC. AND SUBSIDIARY**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**1. Interim Financial Statements**

The condensed consolidated financial statements of Landmark Bancorp, Inc. (the Company) and subsidiary have been prepared in accordance with the instructions to Form 10-Q. To the extent that information and footnotes required by U.S. generally accepted accounting principles for complete financial statements are contained in or consistent with the consolidated audited financial statements incorporated by reference in the Company's Form 10-K for the year ended December 31, 2005, such information and footnotes have not been duplicated herein. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation of financial statements have been reflected herein. The December 31, 2005, condensed consolidated balance sheet has been derived from the audited consolidated balance sheet as of that date. The results of the interim periods ended June 30, 2006 are not necessarily indicative of the results expected for the year ending December 31, 2006 and include the results of operations of First Manhattan Bancorporation, Inc. (FMB) beginning on January 1, 2006.

**2. Acquisition of First Manhattan Bancorporation, Inc.**

The Company completed the acquisition of FMB effective January 1, 2006. FMB's subsidiary thrift was merged into the Company's wholly-owned subsidiary, Landmark National Bank, immediately following the acquisition. This acquisition expanded our market share in Manhattan and further expanded the Company's presence in higher-growth market areas. At December 31, 2005, FMB had total assets of \$129 million, including loans and deposits of \$109 million and \$107 million, respectively. The Company paid cash in the amount of \$12.9 million for all of the outstanding stock of FMB. In connection with the acquisition, the Company recorded a core deposit intangible asset of \$2.6 million, which is being amortized on an accelerated basis over 10 years. The acquisition cost in excess of the tangible and identifiable net assets acquired has been recorded as goodwill of \$5.5 million, none of which is deductible for tax purposes. Pro forma information, for the three and six months ended June 30, 2005, as if the acquisition was consummated January 1, 2005, is as follows (in thousands, except per share data):

|                            | <b>Three months ended<br/>June 30, 2005</b> | <b>Six months ended<br/>June 30, 2005</b> |
|----------------------------|---|---|
| Interest income            | \$ 7,238                                    | \$ 14,086                                 |
| Net earnings               | 1,082                                       | 1,910                                     |
| Basic earnings per share   | 0.49  | 0.86                                      |
| Diluted earnings per share | 0.49  | 0.86                                      |

### 3. Stock Based Compensation

In December 2004, The Financial Accounting Standards Board issued SFAS No. 123 (revised), Shared-Based Payment (123R). The revision disallows the expense recognition alternatives permitted in the original statement and requires entities to recognize stock-based compensation cost in their statements of earnings. The revision contains additional guidance in several areas including award modifications and forfeitures, measuring fair value, classifying an award as equity or as a liability, and attributing compensation cost to reporting periods. It also contains additional disclosure requirements. Prior to the adoption of SFAS No. 123R on January 1, 2006, the Company recorded the fair value of options issued under the plan as expense in accordance with SFAS No. 123, *Accounting for Stock Based Compensation*. The Company's adoption of the revised Statement on January 1, 2006, did not have a material effect on its consolidated financial statements.

The Company has a stock option plan, the purpose of which is to provide additional incentive to certain officers, directors, and key employees by facilitating their purchase of a stock interest in the Company. The plan is administered by the board of directors who selects employees to whom options are granted and the number of shares granted. The option price may not be less than 100% of the fair market value of the shares on the date of the grant, and no option shall be exercisable after the expiration of ten years from the grant date. In the case of any employee who owns more than 10% of the outstanding common stock at the time the option is granted, the option price may not be less than 110% of the fair market value of the shares on the date of the grant, and the option shall not be exercisable after the expiration of ten years from the grant date. The Company intends to utilize authorized, but un-issued shares to satisfy option exercises. The stock-based compensation cost that has been recognized was \$63,000 in the first six months of 2006 and \$55,000 in the first six months of 2005.

In determining compensation cost, the Black-Scholes option-pricing model is used to estimate the fair value of options on date of grant. The Black-Scholes model is a closed-end model that uses the assumptions outlined below. Expected volatility is based on historical volatility of the Company's stock and a consideration of other factors. The Company uses historical exercise behavior and other factors to estimate the expected term of the options, which represents the period of time that the options granted are expected to be outstanding. The risk-free rate for the expected term is based on U.S. Treasury rates in effect at the time of grant. The fair value of each option grant is estimated on the date of grant. The fair value of options granted in 2005 were estimated utilizing the following assumptions: dividend rate of 4.8%, volatility of 18.0%, risk-free interest rate of 4.3%, and expected lives of five years, resulting in a fair value of \$3.40 per option at grant date. The fair value of options granted in 2006 were estimated utilizing the following assumptions: dividend rate of 5.0%, volatility of 19.1%, risk-free interest rate of 4.9%, and expected lives of five years, resulting in a fair value of \$3.55 per option at grant date.

A summary of option activity during the first six months of 2006 is presented below.

| (Dollars in thousands, except per share data) | Shares  | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term | Aggregate<br>Intrinsic<br>Value |
|---|---------|--|---|---------------------------------|
| Outstanding at January 1, 2006                | 127,340 | \$ 23.73                                 | 7.38 years  | n/a                             |
| Granted                                       | 109,025 | 27.15                                    |   | n/a                             |
| Cancelled                                     |         |  |   | n/a                             |
| Exercised                                     | (667 )  | 14.23                                    |   | n/a                             |
| Outstanding at June 30, 2006                  | 235,698 | \$ 25.34                                 | 8.25 years  | \$ 569,000                      |
| Exercisable at June 30, 2006                  | 76,334  | \$ 22.04                                 | 6.35 years  | \$ 436,000                      |
| Vested and expected to vest at June 30, 2006  | 226,146 | \$ 25.27                                 | 8.22 years  | \$ 561,000                      |

Additional information about stock options exercised is presented below.

| (Dollars in thousands)                      | Six Months<br>Ended June 30, |            |
|---|------------------------------|------------|
|   | 2006                         | 2005       |
| Intrinsic value of options exercised        | \$ 16,852                    | \$ 243,275 |
| Cash received from options exercised        | \$ 9,491                     | \$ 147,469 |
| Tax benefit realized from options exercised | \$ 2,503                     | \$ 32,541  |

As of June 30, 2006, there was \$404,000 of total unrecognized compensation cost related to the options. That cost is expected to be recognized over a weighted-average period of 4 years. The total fair value (at vest date) of shares vested during the six month periods ended June 30, 2006 and 2005 was \$103,000 and \$93,000 respectively.

#### 4. Earnings per Share

Basic earnings per share have been computed based upon the weighted average number of common shares outstanding during each period. Diluted earnings per share include the effect of all potential common shares outstanding during each period. Earnings and dividends per share for all periods presented have been adjusted to give effect to the 5% stock dividend paid by the Company in December 2005.

The shares used in the calculation of basic and diluted income per share are shown below:

|  | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|--|--------------------------------|-----------|------------------------------|-----------|
|  | 2006                           | 2005      | 2006                         | 2005      |
| Weighted average common shares outstanding (basic) | 2,228,928                      | 2,217,921 | 2,228,761                    | 2,217,025 |
| Dilutive stock options                             | 12,362                         | 11,704    | 9,776                        | 12,394    |
| Weighted average common shares (diluted)           | 2,241,290                      | 2,229,625 | 2,238,537                    | 2,229,419 |

## 5. Comprehensive Income

The Company's other comprehensive income consists of the unrealized holding gains and losses on available-for-sale securities and an unrealized gain on an interest rate swap as shown below.

|  | Three Months Ended<br>June 30,<br>2006 |              | Six Months Ended<br>June 30,<br>2006 |              |
|--|--|--------------|--------------------------------------|--------------|
|  | 2005                                   | 2005         | 2005                                 | 2005         |
| Net earnings   | \$ 1,596,090                           | \$ 949,664   | \$ 3,017,004                         | \$ 1,753,040 |
| Change in unrealized holding(gains)/losses                                 | (1,409,756 )                           | 715,178      | (1,506,517 )                         | (105,530 )   |
| Less reclassification adjustment for gains/(losses) included in net income | (443,797 )                             | 40,540       | (300,256 )                           | 40,540       |
| Net change in unrealized (gains)/losses on securities                      | (965,959 )                             | 674,638      | (1,206,261 )                         | (146,070 )   |
| Unrealized gain/(loss) on interest rate swap                               | 17,000                                 | (49,000 )    | 46,000                               | 9,000        |
| Income tax expense/(benefit)   | (360,604 )                             | 237,742      | (440,899 )                           | (52,087 )    |
| Total comprehensive income   | \$ 1,007,735                           | \$ 1,337,560 | \$ 2,297,642                         | \$ 1,668,057 |

## 6. Other Intangible Assets

The following table presents information about the Company's other intangible assets:

|                              | June 30, 2006         |                          | December 31, 2005     |                          |
|------------------------------|-----------------------|--------------------------|-----------------------|--------------------------|
|                              | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Amortized intangible assets: |                       |                          |                       |                          |
| Core deposit premium         | \$ 5,396,065          | \$ (1,228,525 )          | \$ 2,818,602          | \$ (774,588 )            |
| Mortgage servicing rights    | 791,691               | (447,111 )               | 775,666               | (401,467 )               |
| Total                        | \$ 6,187,756          | \$ (1,675,636 )          | \$ 3,594,268          | \$ (1,176,055 )          |

Aggregate amortization expense for the three months ended June 30, 2006 and 2005, was \$260,000 and \$87,000, respectively. Aggregate amortization expense for the six months ended June 30, 2006 and 2005, was \$524,000 and \$183,000, respectively. The following depicts estimated amortization expense for the remainder of 2006 and in successive years ending December 31:

| Year | Amount     |
|------|------------|
| 2006 | \$ 549,000 |
| 2007 | 972,000    |
| 2008 | 697,000    |
| 2009 | 599,000    |
| 2010 | 500,000    |

The mortgage servicing rights correspond to loans serviced by the Company for others with outstanding principal balances of \$105.9 million and \$107.2 million at June 30, 2006 and December 31, 2005, respectively. Gross service fee income related to such loans was \$67,000 and \$69,000 for the three months ended June 30, 2006 and June 30, 2005, respectively, and was \$135,000 and \$139,000 for the six months ended June 30, 2006 and June 30, 2005, respectively. The income is included in fees and service charges in the condensed consolidated statements of earnings.

The following is an analysis of the changes in mortgage servicing rights:

|                                | Three Months<br>Ended June 30, |            | Six Months<br>Ended June 30, |            |
|--------------------------------|--------------------------------|------------|------------------------------|------------|
|                                | 2006                           | 2005       | 2006                         | 2005       |
| Balance at beginning of period | \$ 356,973                     | \$ 442,786 | \$ 374,199                   | \$ 446,332 |
| Additions                      | 21,692                         | 10,954     | 40,616                       | 51,120     |
| Amortization                   | (34,085 )                      | (37,363 )  | (70,235 )                    | (81,075 )  |
| Balance at end of period       | \$ 344,580                     | \$ 416,377 | \$ 344,580                   | \$ 416,377 |

## 7. Impact of Recent Accounting Pronouncements

In February 2006, the FASB issued Statement of Financial Accounting Standards No. 155, Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140 . The Statement permits fair value remeasurement for certain hybrid financial instruments containing embedded derivatives, and clarifies the derivative accounting requirements for interest and principal-only strip securities and interests in securitized financial assets. It also clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives and eliminates a previous prohibition on qualifying special-purpose entities from holding certain derivative financial instruments. For calendar year companies, this statement is effective for all financial instruments acquired or issued after January 1, 2007. The Company does not expect that adoption of the Statement will have a material effect on its consolidated financial statements.

In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156, Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140 . The Statement specifies under what situations servicing assets and servicing liabilities must be recognized. It requires these assets and liabilities to be initially measured at fair value and specifies acceptable measurement methods subsequent to their recognition. Separate presentation in the financial statements and additional disclosures are also required. For calendar year companies, this statement is effective beginning January 1, 2007. The Company does not expect that adoption of the Statement will have a material effect on its consolidated financial statements.

Also in March 2006, the FASB issued Staff Position 85-4-1, which provides initial and subsequent measurement guidance and financial statement presentation and disclosure guidance for investments by third-party investors in life settlement contracts. The investments must be accounted for by either (a) recognizing the initial investment at transaction price plus direct external costs and capitalizing continuing costs, with no gain recognized in earnings until the insured dies, or (b) recognizing the initial investment at transaction price and remeasuring the investment at fair value at each reporting period, with fair value changes recognized in earnings as they occur. For calendar year companies, the guidance in this staff position must be applied beginning January 1, 2007. The Company does not expect that adoption of the Staff Position will have a material effect on its consolidated financial statements.

In June 2006, the FASB issued Interpretation No. 48 (FIN 48), *Accounting For Uncertainty in Income Taxes*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company is evaluating any impact that the adoption of this Interpretation may have on the Company's consolidated financial statements.

## **8. Other Events**

The Company has entered into an agreement to construct a new branch location in Topeka, Kansas, which is anticipated to be completed in August 2006.

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

*Overview.* Landmark Bancorp, Inc. is a bank holding company incorporated under the laws of the State of Delaware and is engaged in the banking business through its wholly-owned subsidiary, Landmark National Bank. Landmark Bancorp is listed on the NASDAQ Global Market under the symbol LARK. Landmark National Bank is dedicated to providing quality financial and banking services to its local communities. Landmark National Bank originates commercial, commercial real estate, one-to-four family residential mortgage loans, consumer loans, multi-family residential mortgage loans, and home equity loans.

Effective January 1, 2006 we completed our acquisition of FMB, which was a thrift holding company. Immediately following the acquisition, the Company merged the thrift into Landmark National Bank. This acquisition expanded our market share in Manhattan and further expanded the Company's presence in higher-growth market areas including Lawrence and Junction City, Kansas. At December 31, 2005, FMB had total assets of \$129 million, including loans and deposits of \$109 million and \$107 million, respectively. We paid cash in the amount of \$12.9 million for all of the outstanding stock of FMB. In connection with the acquisition, the Company recorded a core deposit intangible asset of \$2.6 million, which is being amortized on an accelerated basis over 10 years, and goodwill of \$5.5 million, none of which is deductible for tax purposes.

Our results of operations depend primarily on net interest income, which is the difference between interest income from interest-earning assets and interest expense on interest-bearing liabilities. Net interest income is affected by regulatory, economic and competitive factors that influence interest rates, loan demand and deposit flows. In addition, we are subject to interest rate risk to the degree that our interest-earning assets mature or reprice at different times, or at different speeds, than our interest-bearing liabilities. Our results of operations are also affected by non-interest income, such as service charges, loan fees and gains and losses from the sale of newly originated loans and investments. Our principal operating expenses, aside from interest expense, consist of compensation and employee benefits, occupancy costs, federal deposit insurance costs, data processing expenses and provision for loan losses.

We are significantly impacted by prevailing economic conditions including federal monetary and fiscal policies and federal regulations of financial institutions. Deposit balances are influenced by numerous factors such as competing personal investments, the level of personal income and the personal rate of savings within our market areas. Factors influencing lending activities include the demand for housing and the interest rate pricing competition from other lending institutions.

*Critical Accounting Policies.* Critical accounting policies are those which are both most important to the portrayal of our financial condition and results of operations, and require our management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Our critical accounting policies relate to the allowance for loan losses, the valuation of investment securities, accounting for income taxes and the accounting related to business acquisitions, all of which involve significant judgment by our management.



We perform periodic and systematic detailed reviews of our lending portfolio to assess overall collectability. The level of the allowance for loan losses reflects our estimate of the collectability of the loan portfolio. While these estimates are based on substantive methods for determining allowance requirements, nevertheless, actual outcomes may differ significantly from estimated results. Additional explanation of the methodologies used in establishing this reserve is provided in the Asset Quality and Distribution section.

We report our investment securities at estimated fair values based on published market ascertainable values, which are obtained from independent sources. We perform periodic reviews of the fair value of investment securities to determine if any declines in value might be considered other than temporary. Our most recent review showed that the decrease in fair value of the securities, resulting in an unrealized loss position, was related to changes in interest rates. None of the unrealized losses are related to credit deterioration. The Company has the ability to hold these securities until market values recover, including up to the maturity date. Although we believe that our estimates of the fair values of investment securities to be reasonable, economic and market factors may affect the amounts that will ultimately be realized from these investments.

The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in our financial statements or tax returns. Fluctuations in the actual outcome of these future tax consequences, including the effects of IRS examinations and examinations by other state agencies, could materially impact our financial position and results of operations.

We have completed several business and asset acquisitions which have generated significant amounts of goodwill and intangible assets and related amortization. The values assigned to goodwill and intangibles, as well as their related useful lives, are subject to judgment and estimation by the Company. Goodwill and intangibles related to acquisitions are determined and based on purchase price allocations. Valuation of intangible assets is generally based on the estimated cash flows related to those assets, while the initial value assigned to goodwill is the residual of the purchase price over the fair value of all identifiable assets acquired and liabilities assumed. If the carrying value of the goodwill exceeded the implied fair value of the goodwill, an impairment loss would be recorded in an amount equal to that excess. Performing such a discounted cash flow analysis involves the use of estimates and assumptions. Useful lives are determined based on the expected future period of the benefit of the asset, the assessment of which considers various characteristics of the asset, including the historical cash flows. Due to the number of estimates involved related to the allocation of purchase price and determining the appropriate useful lives of intangible assets, we have identified purchase accounting as a critical accounting policy.

*Summary of Results.* Net earnings for the three months ended June 30, 2006, increased \$646,000, or 68.1%, to \$1.6 million as compared to the three months ended June 30, 2005. Our improved earnings were attributed primarily to our acquisition of FMB along with continued improvement in our net interest margin. The acquisition allowed for continued growth in non-interest income areas such as fees and service charges and gains on sale of loans. At the same time, we were able to realize some cost savings associated with the acquisition during the second quarter of 2006. In addition, we realized gains on sale of other assets of approximately \$682,000, which was partially offset by losses of \$444,000 on the sale of investments.

Net earnings for the six months ended June 30, 2006, increased \$1.3 million, or 72.1%, to \$3.0 million as compared to the six months ended June 30, 2005. Our improved earnings were attributed primarily to our acquisition of FMB along with continued improvement in our net interest margin. The acquisition allowed for continued growth in non-interest income areas such as fees and service charges and gains on sale of loans. At the same time, we were able to begin realizing some cost savings associated with the acquisition during the first six months of 2006. In addition, we realized gains on sale of other assets of approximately \$728,000, which was partially offset by losses of \$300,000 on the sale of investments.

The three months ended June 30, 2006 resulted in diluted earnings per share of \$0.71 compared to \$0.43 for the same period in 2005. Return on average assets was 1.07% for the period compared to 0.85% for the same period in 2005. Return on average stockholders' equity was 14.05% for the period compared to 8.99% for the same period in 2005.

The six months ended June 30, 2006 resulted in diluted earnings per share of \$1.35 compared to \$0.79 for the same period in 2005. Return on average assets was 1.02% for the period compared to 0.80% for the same period in 2005. Return on average stockholders' equity was 13.54% for the period compared to 8.35% for the same period in 2005.

The following table summarizes net earnings per share and key performance measures for the periods presented.

|                              | Three Months Ended |         | Six Months Ended |         |   |
|------------------------------|--------------------|---------|------------------|---------|---|
|                              | June 30, 2006      | 2005    | June 30, 2006    | 2005    |   |
| Net earnings:                |                    |         |                  |         |   |
| Basic earnings per share     | \$ 0.72            | \$ 0.43 | \$ 1.35          | \$ 0.79 |   |
| Diluted earnings per share   | \$ 0.71            | \$ 0.43 | \$ 1.35          | \$ 0.79 |   |
| Earnings ratios:             |                    |         |                  |         |   |
| Return on average assets (1) | 1.07               | % 0.85  | % 1.02           | % 0.80  | % |
| Return on average equity (1) | 14.05              | % 8.99  | % 13.54          | % 8.35  | % |
| Dividend payout ratio        | 23.94              | % 37.78 | % 25.19          | % 40.96 | % |
| Net interest margin (1)      | 3.39               | % 3.10  | % 3.42           | % 3.09  | % |

(1) The ratio has been annualized and is not necessarily indicative of the results for the entire year.

*Interest Income.* Interest income for the three months ended June 30, 2006, increased \$2.9 million, or 53.1%, to \$8.3 million from \$5.4 million in the same period of 2005, resulting from increased interest income on both investment securities and loans. Average loans for the quarter ended June 30, 2006 increased to \$393.9 million from \$279.0 million for the quarter ended June 30, 2005. The increase in average loans was primarily due to the \$109.4 million in loans acquired in the FMB acquisition. Additionally, the rise in interest rates experienced during the past year contributed to the increased interest income. As a result, interest income on loans increased \$2.6 million, or 60.0%, to \$6.9 million for the quarter ended June 30, 2006. Average investment securities increased from \$134.7 million for the quarter ended June 30, 2005, to \$143.8 million for the quarter ended June 30, 2006. Corresponding with the increase in average investments for the comparable periods, interest income on investment securities increased \$334,000, or 29.7%, to \$1.5 million for the second quarter of 2006, as compared to the same period of 2005. Also contributing to the increased investment income was the increase in interest rates, which resulted in yields on our investments purchased during the past year being higher than the yields on our maturing investments.

Interest income for the six months ended June 30, 2006, increased \$5.9 million, or 55.5%, to \$16.5 million from \$10.6 million in the same period of 2005, resulting largely from increased interest income on investment securities and loans. Average loans for the first six months of 2006 increased to \$392.3 million from \$279.3 million for the same period in 2005. The increase in average loans was primarily due to the \$109.4 million in loans acquired in the FMB acquisition. Additionally, the rise in interest rates experienced during the past year contributed to the increased interest income. As a result, interest income on loans increased \$5.1 million, or 61.0%, to \$13.5 million for the first six months of 2006. Average investment securities increased from \$132.8 million for the six months ended June 30, 2005, to \$145.9 million for the six months ended June 30, 2006. Corresponding with the increase in average investments for the comparable periods, interest income on investment securities increased \$712,000, or 33.0%, to \$2.9 million for the first six months of 2006, as compared to the same period of 2005. Also contributing to the increased investment income was the increase in interest rates, which resulted in yields on our investments purchased during the past year being higher than the yields on our maturing investments.

*Interest Expense.* Interest expense during the three months ended June 30, 2006, increased \$1.6 million, or 70.4%, as compared to the same period of 2005. For the three months ended June 30, 2006, interest expense on deposits increased \$1.3 million, or 93.0%. The increase in interest expense on deposits resulted from the addition of approximately \$106.8 million in deposits that we acquired through the FMB acquisition on January 1, 2006 and from the rise in interest rates and the associated repricing of deposits as they matured. Average borrowings for the quarter ended June 30, 2006 increased to \$107.3 million from \$91.5 million for the quarter ended June 30, 2005. Corresponding with the increase in average borrowings for the comparable periods, interest expense on borrowings increased \$308,000, or 35.2%. Also contributing to the increased interest expense was the increase in interest rates.

Interest expense during the six months ended June 30, 2006, increased \$3.0 million, or 70.7%, as compared to the same period of 2005. For the six months ended June 30, 2006, interest expense on deposits increased \$2.5 million, or 100.5%. The increase in interest expense on deposits resulted from the addition of approximately \$106.8 million in deposits that we acquired through the FMB acquisition on January 1, 2006 and from the rise in interest rates and the associated repricing of deposits as they matured. Average borrowings for the six months ended June 30, 2006 increased to \$103.6 million from \$92.9 million for the six months ended June 30, 2005. Corresponding with the increase in average borrowings for the comparable periods, interest expense on borrowings increased \$492,000, or 28.0%. Also contributing to the increased interest expense was the increase in interest rates.

*Net Interest Income.* Net interest income for the three months ended June 30, 2006, totaled \$4.5 million, increasing \$1.3 million, or 41.2%, as compared to the three months ended June 30, 2005. This increase resulted primarily from the increased level of average interest earning assets associated with the January 1, 2006 FMB acquisition. Average earning assets increased during the second quarter of 2006, increasing to \$538.5 million from \$416.6 million for the second quarter of 2005. Also contributing to the improvement in net interest income was an increase in our net interest margin. The net interest margin was 3.39% for the second quarter of 2006, up from 3.10% during the second quarter of 2005.

Net interest income for the six months ended June 30, 2006, totaled \$9.2 million, increasing \$2.9 million, or 45.2%, as compared to the six months ended June 30, 2005. This increase resulted primarily from the increased level of average interest earning assets associated with the January 1, 2006 FMB acquisition. Average earning assets increased during the first six months of 2006, increasing to \$541.4 million from \$413.3 million for the first six months of 2005. Also contributing to the improvement in net interest income was an increase in our net interest margin. The net interest margin was 3.42% for the first six months of 2006, up from 3.09% during the first six months of 2005.

*Provision for Loan Losses.* We maintain, and our Board of Directors monitors, an allowance for losses on loans. The allowance is established based upon management's periodic evaluation of known and inherent risks in the loan portfolio, review of significant individual loans and collateral, review of delinquent loans, past loss experience, adverse situations that may affect the borrowers' ability to repay, current and expected market conditions, and other factors management deems important. Determining the appropriate level of reserves involves a high degree of management judgment and is based upon historical and projected losses in the loan portfolio and the collateral value of specifically identified problem loans. Additionally, allowance strategies and policies are subject to periodic review and revision in response to a number of factors, including current market conditions, actual loss experience and management's expectations.

The provision for loan losses for the three months ended June 30, 2006, was \$15,000, compared to a provision of \$105,000 during the three months ended June 30, 2005. Our continuous review of the loan portfolio prompted a decrease in our provision primarily as a result of improvement in the asset quality of the commercial loan portfolio. Our review also included the analysis of the FMB loans acquired along with the FMB allowance for loan losses acquired in the amount of \$891,000. One measure of the adequacy of the allowance for estimated losses on loans is the ratio of the allowance to the total loan portfolio. At June 30, 2006, and December 31, 2005, the allowance for loan losses was \$4.0 million and \$3.2 million, or 1.0% and 1.1%, respectively, of gross loans outstanding. The provision for loan losses for the six months ended June 30, 2006, was \$75,000 compared to a provision of \$225,000 for the same period in 2005. For further discussion of the provision for loan losses, refer to the "Asset Quality and Distribution" section.

*Non-interest Income.* Non-interest income increased \$664,000, or 52.0%, for the three months ended June 30, 2006, to \$1.9 million compared to the three months ended June 30, 2005. This improvement was primarily the result of a \$117,000, or 56.9%, increase of gains on sale of loans, and an increase in fees and service charges of \$236,000, or 26.4%, both of which are attributable to volume increases associated with the FMB acquisition. Additionally, total non-interest income included \$682,000 in gains recognized with the sale of other assets, primarily our previous headquarters located at 800 Poyntz, during the second quarter of 2006. Also contributing to the increased non-interest income during the second quarter was the increase in bank owned life insurance income, which resulted from the purchase of additional policies totaling \$7.5 million in March 2006. Partially offsetting these increases were losses of \$444,000 on the sale of investments as we repositioned our investment portfolio by selling some relatively short term, lower yielding investments and purchasing longer term, higher yielding investments.

Non-interest income increased \$1.3 million or 55.4%, for the six months ended June 30, 2006, to \$3.6 million compared to the six months ended June 30, 2005. This improvement was primarily the result of a \$215,000, or 57.9%, increase of gains on sale of loans, and an increase in fees and service charges of \$466,000, or 27.9%, both of which are attributable to volume increases associated with the FMB acquisition. Additionally, total non-interest income included \$728,000 in gains recognized with the sale of other assets, primarily our previous headquarters located at 800 Poyntz. Also contributing to the increased non-interest income during the first six months of 2006 was the increase in bank owned life insurance income, which resulted from the purchase of additional policies totaling \$7.5 million in March 2006. Partially offsetting these increases were losses of \$300,000 on the sale of investments as we repositioned our investment portfolio by selling some relatively short term, lower yielding investments and purchasing longer term, higher yielding investments.

|  | Three Months Ended<br>June 30, |              | Six Months Ended<br>June 30, |              |
|--|--------------------------------|--------------|------------------------------|--------------|
|  | 2006                           | 2005         | 2006                         | 2005         |
| Non-interest income:                       |                                |              |                              |              |
| Fees and service charges                   | \$ 1,128,463                   | \$ 892,928   | \$ 2,135,335                 | \$ 1,668,954 |
| Gains on sales of loans                    | 322,983                        | 205,818      | 586,364                      | 371,394      |
| Gains (losses) on sale of investments, net | (443,797 )                     | 40,540       | (300,256 )                   | 40,540       |
| Gains on sale of other assets              | 681,630                        |              | 728,453                      | 17,211       |
| Bank owned life insurance                  | 112,300                        | 20,287       | 157,654                      | 41,920       |
| Other                                      | 139,746                        | 117,447      | 325,316                      | 197,416      |
| Total non-interest income                  | \$ 1,941,325                   | \$ 1,277,020 | \$ 3,632,866                 | \$ 2,337,435 |

*Non-interest Expense.* Non-interest expense increased \$1.2 million, or 40.1%, to \$4.2 million for the three months ended June 30, 2006, as compared to the three months ended June 30, 2005, resulting primarily from the impact of the acquisition of FMB on January 1, 2006 and the late August 2005 acquisition of two branches in Great Bend, Kansas. While we have made significant progress achieving cost savings by consolidating our personnel, operations and facilities, the impact of the acquisition includes a net increase in personnel, equipment and facilities and the number of accounts being processed. Accordingly the impact of the acquisition includes increases in compensation and benefits of \$607,000, occupancy and equipment of \$203,000, amortization of acquired intangibles of \$173,000 and data processing costs of \$46,000.

Non-interest expense increased \$2.5 million, or 43.1%, to \$8.5 million for the six months ended June 30, 2006, as compared to the six months ended June 30, 2005, resulting primarily from the impact of the acquisition of FMB on January 1, 2006 and the late August 2005 acquisition of two branches in Great Bend, Kansas. While we have made significant progress achieving cost savings by consolidating our personnel, operations and facilities, the impact of the acquisition includes a net increase in personnel, equipment and facilities and the number of accounts being processed. Accordingly the impact of the acquisition includes increases in compensation and benefits of \$1.3 million, occupancy and equipment of \$422,000, amortization of acquired intangibles of \$341,000 and data processing costs of \$79,000.

|                                   | Three Months Ended June 30, |                     | Six Months Ended June 30, |                     |
|-----------------------------------|-----------------------------|---------------------|---------------------------|---------------------|
|                                   | 2006                        | 2005                | 2006                      | 2005                |
| <b>Non-interest expense:</b>      |                             |                     |                           |                     |
| Compensation and benefits         | \$ 2,112,612                | \$ 1,505,144        | \$ 4,248,576              | \$ 2,962,862        |
| Occupancy and equipment           | 687,102                     | 484,108             | 1,396,022                 | 974,342             |
| Amortization of intangible assets | 259,679                     | 86,932              | 524,172                   | 182,962             |
| Professional fees                 | 126,349                     | 98,913              | 210,726                   | 185,056             |
| Data processing                   | 187,543                     | 141,237             | 348,990                   | 270,233             |
| Advertising                       | 111,219                     | 97,007              | 218,737                   | 181,847             |
| Other                             | 732,650                     | 597,588             | 1,506,785                 | 1,151,869           |
| <b>Total non-interest expense</b> | <b>\$ 4,217,154</b>         | <b>\$ 3,010,929</b> | <b>\$ 8,454,008</b>       | <b>\$ 5,909,171</b> |

*Income Tax Expense.* Income tax expense increased \$228,000, or 52.9%, from \$432,000 for the three months ended June 30, 2005, to \$660,000 for the three months ended June 30, 2006. The increase in income tax expense for the three months ended June 30, 2006, resulted from the increase in taxable income for the second quarter of 2006 as compared to the second quarter of 2005. The effective tax rate for the second quarter of 2006 decreased to 29.3% from 31.3% in the second quarter of 2005 as a result of an increase in the utilization of tax exempt investments.

Income tax expense increased \$498,000, or 63.7%, from \$781,000 for the six months ended June 30, 2005, to \$1.3 million for the six months ended June 30, 2006. The increase in income tax expense for the six months ended June 30, 2006, resulted from the increase in taxable income for the first six months of 2006 as compared to the first six months of 2005. The effective tax rate for the first six months of 2006 decreased to 29.8% from 30.8% during the first six months of 2005 as a result of an increase in the utilization of tax exempt investments.

*Asset Quality and Distribution.* Total assets increased to \$593.6 million at June 30, 2006, compared to \$465.1 million at December 31, 2005, resulting from the FMB acquisition. Our primary ongoing sources of funds are deposits, proceeds from principal and interest payments on loans and investment securities and proceeds from the sale of mortgage loans and investment securities. While maturities and scheduled amortization of loans are a predictable source of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions, competition, and the restructuring of the financial services industry.

Net loans, excluding loans held for sale, increased by \$118.4 million to \$393.0 million during the six months ended June 30, 2006. This increase was primarily the result of the addition of \$109.4 million in loans in the FMB acquisition. We have concentrated on generating commercial loans over the past years and are pleased that this segment of our loan portfolio has grown. While the FMB acquisition increased our one-to-four family residential loan totals, as the majority of the acquired loans were residential, we plan to continue our efforts to grow our commercial lending activities.

Our primary investing activities are the origination of commercial, mortgage, consumer loans and the purchase of investment and mortgage-backed securities. Generally, we originate fixed-rate, residential mortgage loans with maturities in excess of ten years for sale in the secondary market. We do not originate and warehouse these fixed-rate residential loans for resale in order to speculate on interest rates.

The allowance for losses on loans is established through a provision for losses on loans based on our evaluation of the risk inherent in the loan portfolio and changes in the nature and volume of its loan activity. Such evaluation, which includes a review of all loans with respect to which full collectibility may not be reasonably assured, considers the fair value of the underlying collateral, economic conditions, historical loan loss experience, level of classified loans and other factors that warrant recognition in providing for an adequate allowance for losses on loans. We believe that we use the best information available to determine the allowance for losses on loans, unforeseen market conditions could result in adjustment to the allowance for losses on loans. In addition, net earnings could be significantly affected if circumstances differ substantially from the assumptions used in establishing the allowance for losses on loans.

A summary of the activity in the allowance for loan losses is as follows:

|                              |              |
|------------------------------|--------------|
| Balance at December 31, 2005 | \$ 3,151,373 |
| Allowance of acquired bank   | 891,374      |
| Provision for loan losses    | 75,000       |
| Charge-offs                  | (121,733 )   |
| Recoveries                   | 52,610       |
| Balance at June 30, 2006     | \$ 4,048,624 |

We believe that the quality of the loan portfolio continues to be strong as evidenced by our low levels of past due and non-accrual loans. The loans acquired from FMB on January 1, 2006 did not have a material impact on our non-accrual loan totals or our classified asset ratios as the fair market value of impaired loans acquired were recorded in accordance with Statement of Position (SOP) 03-03, *Accounting for Certain Loans and Debt Securities Acquired in a Transfer*. As of June 30, 2006, loans with a balance of \$4.9 million were on non-accrual status, or 1.2% of total loans, compared to loan balances totaling \$3.3 million on non-accrual status, or 1.2% of total loans, as of December 31, 2005. This increase was primarily related to a \$1.2 million commercial loan, which became past due for payments in excess of 90 days at June 30, 2006. Management does not anticipate any significant loss exposure on this loan. In addition, the ratio of non-performing assets as a percentage of total assets remained constant at 0.9% as of December 31, 2005 and June 30, 2006. Residential home loans comprised 40.5% of the \$4.9 million non-accrual balance at June 30, 2006. These loans have been underwritten according to our residential lending policies and are well secured by real estate collateral, and in many instances, private mortgage insurance or government guarantees. We have historically incurred minimal losses on mortgage loans based upon collateral values and underlying insurance or guarantees. We are aggressively pursuing collection activity of these loans which should enable the collection of principal.

*Liability Distribution.* Total deposits increased \$98.5 million to \$429.8 million at June 30, 2006, from \$331.3 million at December 31, 2005. The amount of deposits acquired in the January 1, 2006 FMB acquisition approximated \$106.8 million. Borrowings increased \$25.6 million to \$110.9 million at June 30, 2006, from \$85.3 million at December 31, 2005, resulting from borrowings utilized to fund the FMB acquisition, \$5 million of FHLB advances acquired in the FMB acquisition, and additional FHLB line of credit borrowings.

Non-interest bearing demand accounts at June 30, 2006, were \$49.2 million, or 11.4% of deposits, compared to \$38.4 million, or 11.6% of deposits, at December 31, 2005. Certificates of deposit increased to \$216.2 million at June 30, 2006, from \$163.1 million at December 31, 2005. Money market and NOW demand accounts increased to \$133.8 million at June 30, 2006, from \$103.7 million at December 31, 2005, and were 31.1% of total deposits. Savings accounts increased to \$30.6 million at June 30, 2006, from \$26.1 million at December 31, 2005.

Certificates of deposit at June 30, 2006, which were scheduled to mature in one year or less, totaled \$150.0 million. Historically, maturing deposits have generally remained with our bank and we believe that a significant portion of the deposits maturing in one year or less will remain with us upon maturity.

*Contractual Obligations and Commercial Commitments.* The following table presents our contractual obligations, defined as operating lease obligations and principal payments due on non-deposit obligations with maturities in excess of one year as of June 30, 2006, for the periods indicated.

| <b>Contractual Cash Obligations</b> | <b>Total</b>   | <b>One Year or Less</b> | <b>One to Three Years</b> | <b>Four to Five Years</b> | <b>More than Five Years</b> |
|-------------------------------------|----------------|-------------------------|---------------------------|---------------------------|-----------------------------|
| Operating leases                    | \$ 362,272     | \$ 102,132              | \$ 200,664                | \$ 59,476                 | \$                          |
| Service contracts                   | 5,880,000      | 1,260,000               | 2,520,000                 | 2,100,000                 |                             |
| FHLB borrowings                     | 80,317,370     | 17,900,000              | 34,000,000                | 22,767,500                | 5,649,870                   |
| Other borrowings                    | 30,552,178     | 5,916,178               | 8,140,000                 |                           | 16,496,000                  |
| Total contractual obligations       | \$ 117,111,820 | \$ 25,178,310           | \$ 44,860,664             | \$ 24,926,976             | \$ 22,145,870               |



*Liquidity.* Our most liquid assets are cash and cash equivalents and investment securities available for sale. The levels of these assets are dependent on the operating, financing, lending and investing activities during any given period. These liquid assets totaled \$148.4 million at June 30, 2006, and \$161.6 million at December 31, 2005. During periods in which we are not able to originate a sufficient amount of loans and/or periods of high principal prepayments, we increase our liquid assets by investing in short-term U. S. Government and agency securities or high-grade municipal securities.

Liquidity management is both a daily and long-term function of our strategy. Excess funds are generally invested in short-term investments. In the event we require funds beyond our ability to generate them internally, additional funds are generally available through the use of Federal Home Loan Bank advances, a line of credit with the Federal Home Loan Bank or through sales of securities. At June 30, 2006, we had outstanding Federal Home Loan Bank advances of \$66.9 million and \$13.4 million borrowed against our line of credit with the Federal Home Loan Bank. At June 30, 2006, our total borrowing capacity with the Federal Home Loan Bank was \$125.8 million. We also had other borrowings of \$30.6 million at June 30, 2006, which included \$16.5 million of subordinated debentures, \$8.2 million of long-term debt and \$5.9 million in repurchase agreements.

As a provider of financial services, we routinely issue financial guarantees in the form of financial and performance standby letters of credit. Standby letters of credit are contingent commitments issued by us generally to guarantee the payment or performance obligation of a customer to a third party. While these standby letters of credit represent a potential outlay by us, a significant amount of the commitments may expire without being drawn upon. We have recourse against the customer for any amount the customer is required to pay to a third party under a standby letter of credit. The letters of credit are subject to the same credit policies, underwriting standards and approval process as loans made by us. Most of the standby letters of credit are secured, and in the event of nonperformance by the customers, we have the right to the underlying collateral, which could include commercial real estate, physical plant and property, inventory, receivables, cash and marketable securities. The contract amount of these standby letters of credit, which represents the maximum potential future payments guaranteed by us, was \$2.8 million at June 30, 2006.

At June 30, 2006, we had outstanding loan commitments, excluding standby letters of credit, of \$62.4 million. We anticipate that sufficient funds will be available to meet current loan commitments. These commitments consist of unfunded lines of credit and commitments to finance real estate loans.

*Capital.* The Federal Reserve Board has established capital requirements for bank holding companies which generally parallel the capital requirements for national banks under the Office of the Comptroller of the Currency regulations. The regulations provide that such standards will generally be applied on a consolidated (rather than a bank-only) basis in the case of a bank holding company with more than \$150 million in total consolidated assets.

At June 30, 2006, we continued to maintain a sound leverage ratio of 7.83% and a total risk based capital ratio of 12.76%. As shown by the following table, our capital exceeded the minimum capital requirements at June 30, 2006 (dollars in thousands):

| <b>Company</b>           | <b>Actual<br/>Amount</b> | <b>Actual<br/>Percent</b> | <b>Required<br/>Percent</b> | <b>Required<br/>Amount</b> |
|--------------------------|--------------------------|---------------------------|-----------------------------|----------------------------|
| Leverage                 | \$ 45,633                | 7.83                      | %4.0                        | % \$ 23,301                |
| Tier 1 Capital           | \$ 45,633                | 11.54                     | %4.0                        | % \$ 15,816                |
| Total Risk Based Capital | \$ 50,467                | 12.76                     | %8.0                        | % \$ 31,632                |

At June 30, 2006, Landmark National Bank continued to maintain a sound leverage ratio of 9.07% and a total risk based capital ratio of 14.37%. As shown by the following table, the bank's capital exceeded the minimum capital requirements at June 30, 2006 (dollars in thousands):

| <b>Landmark National Bank</b> | <b>Actual Amount</b> | <b>Actual Percent</b> | <b>Required<br/>Percent</b> | <b>Required<br/>Amount</b> |
|-------------------------------|----------------------|-----------------------|-----------------------------|----------------------------|
| Leverage                      | \$ 52,646            | 9.07                  | %4.0                        | % \$ 23,220                |
| Tier 1 Capital                | \$ 52,646            | 13.35                 | %4.0                        | % \$ 15,778                |
| Total Risk Based Capital      | \$ 56,695            | 14.37                 | %8.0                        | % \$ 31,557                |

Banks and bank holding companies are generally expected to operate at or above the minimum capital requirements. The above ratios are well in excess of regulatory minimums and should allow us to operate without capital adequacy concerns. The Federal Deposit Insurance Corporation Improvement Act of 1991 establishes a bank rating system based on the capital levels of banks. As of June 30, 2006, we were rated well capitalized, which is the highest rating available under this capital-based rating system.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

*Quantitative and Qualitative Disclosures about Market Risk.* Our assets and liabilities are principally financial in nature and the resulting net interest income thereon is subject to changes in market interest rates and the mix of various assets and liabilities. Interest rates in the financial markets affect our decision on pricing our assets and liabilities, which impacts net interest income, a significant cash flow source for us. As a result, a substantial portion of our risk management activities relates to managing interest rate risk.

Our Asset/Liability Management Committee monitors the interest rate sensitivity of our balance sheet using earnings simulation models and interest sensitivity gap analysis. We have set policy limits of interest rate risk to be assumed in the normal course of business and monitor such limits through our simulation process.

We have been successful in meeting the interest rate sensitivity objectives set forth in our policy. Simulation models are prepared to determine the impact on net interest income for the coming twelve months, including one using rates at June 30, 2006, and forecasting volumes for the twelve-month projection. This position is then subjected to a shift in interest rates of 100 and 200 basis points rising and falling with an impact to our net interest income on a one year horizon as follows:

| Scenario | \$ Change in Net Interest Income |
|----------|----------------------------------|
|----------|----------------------------------|