LANDMARK BANCORP INC
Form 10-Q
November 09, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2012

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the transition period from ________ to ________

Commission File Number 0-33203

LANDMARK BANCORP, INC.

(Exact name of Registrant as specified in its charter)

Delaware	43-1930755
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

701 Poyntz Avenue, Manhattan, Kansas 66502
(Address of principal executive offices) (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 x 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 x No ¨

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

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

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

Indicate the number of shares outstanding of each of the Issuer's classes of common stock as of the latest practicable date: as of November 9, 2012, the Issuer had outstanding 2,783,380 shares of its common stock, $.01 par value per share.

LANDMARK BANCORP, INC.

Form 10-Q Quarterly Report

Table of Contents

ITEM 1. FINANCIAL STATEMENTS

LANDMARK BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)	September 30, 2012 (Unaudited)	December 31, 2011 (Audited)
Assets		
Cash and cash equivalents	$ 23,117	$ 17,501
Investment securities:		
Available-for-sale, at fair value	239,018	198,214
Other securities	5,727	6,671
Loans, net	307,292	310,081
Loans held for sale	9,767	9,754
Premises and equipment, net	15,106	14,692
Real estate owned	2,584	2,264
Bank owned life insurance	16,548	16,163
Goodwill	13,075	12,894
Other intangible assets, net	2,266	1,923
Accrued interest and other assets	9,718	8,083
Total assets	$ 644,218	$ 598,240
Liabilities and Stockholders’ Equity		
Liabilities:		
Deposits:		
Non-interest-bearing demand	$ 72,647	$ 66,122
Money market and NOW	217,963	171,529
Savings	45,410	36,650
Time, $100,000 and greater	64,280	63,374
Time, other	114,520	116,459
Total deposits	514,820	454,134
Federal Home Loan Bank borrowings	35,735	49,163
Other borrowings	23,296	27,434
Accrued interest, taxes, and other liabilities	7,446	8,389
Total liabilities	581,297	539,120
Commitments and contingencies		
Stockholders’ equity:		
Preferred stock, $0.01 par, 200,000 shares authorized; none issued	-	-

Common stock, $0.01 par, 7,500,000 shares authorized; 2,783,380 and 2,782,826 shares issued and outstanding at September 30, 2012 and December 31, 2011, respectively	28	28
Additional paid-in capital	29,386	29,313
Retained earnings	29,363	26,200
Accumulated other comprehensive income	4,144	3,579
Total stockholders' equity	62,921	59,120
Total liabilities and stockholders' equity	$ 644,218	$ 598,240

See accompanying notes to consolidated financial statements.

2

LANDMARK BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

(Dollars in thousands, except per share amounts)	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Interest income:				
Loans:				
Taxable	$ 4,033	$ 4,296	$ 12,380	$ 12,871
Tax-exempt	96	78	287	250
Investment securities:				
Taxable	756	712	2,280	2,038
Tax-exempt	604	605	1,802	1,800
Total interest income	5,489	5,691	16,749	16,959
Interest expense:				
Deposits	525	669	1,692	2,132
Borrowings	439	471	1,326	1,427
Total interest expense	964	1,140	3,018	3,559
Net interest income	4,525	4,551	13,731	13,400
Provision for loan losses	1,000	500	1,600	1,600
Net interest income after provision for loan losses	3,525	4,051	12,131	11,800
Non-interest income:				
Fees and service charges	1,360	1,271	3,851	3,625
Gains on sales of loans, net	1,626	841	4,255	1,923
Bank owned life insurance	103	149	393	443
Other	126	120	416	535
Total non-interest income	3,215	2,381	8,915	6,526
Investment securities:				
Net impairment losses	-	(19)	(63)	(19)
Gains on sales of investment securities	-	186	359	186
Investment securities gains, net	-	167	296	167
Non-interest expense:				
Compensation and benefits	2,457	2,338	7,265	7,009
Occupancy and equipment	771	755	2,254	2,183
Professional fees	281	159	848	1,190
Amortization of intangibles	481	190	907	551
Data processing	213	187	631	564
Advertising	121	128	363	425
Federal deposit insurance premiums	80	75	262	367
Foreclosure and real estate owned expense	60	20	89	84
Other	804	821	2,508	2,358
Total non-interest expense	5,268	4,673	15,127	14,731
Earnings before income taxes	1,472	1,926	6,215	3,762

Income tax expense	267	437	1,465	573
Net earnings	$ 1,205	$ 1,489	$ 4,750	$ 3,189
Earnings per share:				
Basic (1)	$ 0.43	$ 0.54	$ 1.71	$ 1.15
Diluted (1)	$ 0.43	$ 0.54	$ 1.70	$ 1.15
Dividends per share (1)	$ 0.19	$ 0.18	$ 0.57	$ 0.54

(1) Per share amounts for the periods ended September 30, 2011 have been adjusted to give effect to the 5% stock dividend paid during December 2011.

See accompanying notes to consolidated financial statements.

LANDMARK BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(Dollars in thousands)	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Net earnings	$ 1,205	$ 1,489	$ 4,750	$ 3,189
Unrealized holding gains (losses) on available-for-sale securities for which a portion of an other-than-temporary impairment has been recorded in earnings	84	(37)	178	205
Net unrealized holding gains on all other available-for-sale securities	1,139	1,326	1,011	3,794
Less reclassification adjustment for net gains included in earnings	-	(167)	(296)	(167)
Net unrealized gains	1,223	1,122	893	3,832
Income tax expense	452	418	328	1,420
Total comprehensive income	$ 1,976	$ 2,193	$ 5,315	$ 5,601

See accompanying notes to consolidated financial statements.

4

LANDMARK BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Dollars in thousands)	Nine months ended September 30, 2012	2011
Cash flows from operating activities:		
Net earnings	$4,750	$3,189
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Provision for loan losses	1,600	1,600
Provision for valuation allowance on real estate owned	39	27
Amortization of investment security premiums, net	1,010	627
Amortization of intangibles	907	551
Depreciation	716	669
Bank owned life insurance	(393)	(443)
Stock-based compensation	67	76
Deferred income taxes	(420)	(347)
Gains on investment securities, net	(296)	(167)
Gain on sales of real estate owned, net	(39)	(166)
Gains on sales of loans, net	(4,255)	(1,923)
Proceeds from sales of loans	159,771	90,209
Origination of loans held for sale	(155,529)	(84,300)
Changes in assets and liabilities:		
Accrued interest and other assets	(2,349)	448
Accrued expenses, taxes, and other liabilities	(1,026)	1,708
Net cash provided by operating activities	4,553	11,758
Cash flows from investing activities:		
Net decrease (increase) in loans	16,172	(3,051)
Maturities and prepayments of investment securities	38,795	40,913
Purchases of investment securities	(73,970)	(59,643)
Proceeds from sales of investment securities	9,841	4,740
Net cash received in bank acquisition	3,965	-
Purchase of bank owned life insurance	-	(2,500)
Proceeds from sales of premises and equipment and real estate owned	412	2,317
Purchases of premises and equipment, net	(721)	(252)
Net cash used in investing activities	(5,506)	(17,476)
Cash flows from financing activities:		
Net increase in deposits	25,716	19,915
Federal Home Loan Bank advance repayments	(28)	(28)
Change in Federal Home Loan Bank line of credit, net	(13,400)	(8,500)
Proceeds from other borrowings	-	1,237
Repayments on other borrowings	(4,138)	-
Proceeds from issuance of common stock under stock option plans	5	28

Excess tax benefit related to stock option plans	1	5
Payment of dividends	(1,587)	(1,507)
Net cash provided by financing activities	6,569	11,150
Net increase in cash and cash equivalents	5,616	5,432
Cash and cash equivalents at beginning of period	17,501	9,735
Cash and cash equivalents at end of period	$23,117	$15,167

LANDMARK BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS, CONTINUED

(Unaudited)

(Dollars in thousands)	Nine months ended September 30, 2012	2011
Supplemental disclosure of cash flow information:		
Cash payments (refunds) for income taxes	$ 1,880	$ (445)
Cash paid for interest	3,068	3,666
Supplemental schedule of noncash investing and financing activities:		
Transfer of loans to real estate owned	125	1,221
Bank acquisition:		
Fair value of liabilities assumed	35,061	-
Fair value of assets acquired	31,096	-

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Unaudited)

(Dollars in thousands, except per share amounts)	Common stock	Additional paid-in capital	Retained earnings	Accumulated other Comprehensive income	Total
Balance at December 31, 2011	$ 28	$ 29,313	$ 26,200	$ 3,579	$ 59,120
Net earnings	-	-	4,750	-	4,750
Change in fair value of investment securities available-for-sale, net of tax	-	-	-	565	565
Dividends paid ($0.57 per share)	-	-	(1,587)	-	(1,587)
Stock-based compensation	-	67	-	-	67
Exercise of stock options, 554 shares, including excess tax benefit of $1	-	6	-	-	6
Balance at September 30, 2012	$ 28	$ 29,386	$ 29,363	$ 4,144	$ 62,921
Balance at December 31, 2010	$ 26	$ 27,102	$ 25,767	$ 922	$ 53,817
Net earnings	-	-	3,189	-	3,189
Change in fair value of investment securities available-for-sale, net of tax	-	-	-	2,412	2,412
Dividends paid ($0.54 per share)	-	-	(1,507)	-	(1,507)
Stock-based compensation	-	76	-	-	76
Exercise of stock options, 2,559 shares, including excess tax benefit of $5	-	33	-	-	33
Balance at September 30, 2011	$ 26	$ 27,211	$ 27,449	$ 3,334	$ 58,020

LANDMARK BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Interim Financial Statements

The 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 (“GAAP”) 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, 2011, 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 results of the interim period ended September 30, 2012 are not necessarily indicative of the results expected for the year ending December 31, 2012. The Company evaluates subsequent events and transactions that occur after the balance sheet date up to the date that financial statements are filed for potential recognition or disclosure.

2. Goodwill and Other Intangible Assets

The Company tests goodwill for impairment annually or more frequently if circumstances warrant. The Company’s annual impairment test as of December 31, 2011 concluded that its goodwill was not impaired; however, the Company can make no assurances that future impairment tests will not result in goodwill impairments. The Company concluded there were no triggering events during the first nine months of 2012 that required an interim goodwill impairment test.

On April 1, 2012, the Company’s subsidiary, Landmark National Bank, assumed approximately $35.0 million in deposits with the acquisition of the Wellsville Bank. The Company identified $24.7 million of core deposits and recorded a core deposit intangible asset of $308,000 as a result of the acquisition. The core deposit intangible asset will be amortized over its estimated useful life of ten years on an accelerated basis. A summary of this and the other intangible assets that continue to be subject to amortization is as follows:

(Dollars in thousands)	As of September 30, 2012			
	Gross carrying amount	Accumulated amortization	Valuation allowance	Net carrying amount
Core deposit intangible assets	$4,973	$ (4,171)	$ -	$ 802
Mortgage servicing rights	2,785	(1,109)	(212)	1,464
Total other intangible assets	$7,758	$ (5,280)	$ (212)	$ 2,266

(Dollars in thousands)	As of December 31, 2011			
	Gross carrying amount	Accumulated amortization	Valuation allowance	Net carrying amount
Core deposit intangible assets	$4,665	$ (3,902)	$ -	$ 763
Mortgage servicing rights	2,149	(989)	-	1,160
Total other intangible assets	$6,814	$ (4,891)	$ -	$ 1,923

Aggregate core deposit and mortgage servicing rights amortization expense was $481,000 and $190,000 for the third quarter of 2012 and 2011, respectively. Aggregate core deposit and mortgage servicing rights amortization expense was $907,000 and $551,000 for the first nine months of 2012 and 2011, respectively. The following sets forth estimated amortization expense for other intangible assets for the remainder of 2012 and in successive years ending December 31:

(Dollars in thousands)	Amortization expense
Remainder of 2012	$ 229
2013	846
2014	756
2015	301
2016	38
Thereafter	96
Total	$ 2,266

3. Investments

A summary of investment securities available-for-sale is as follows:

	As of September 30, 2012			
(Dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
U. S. federal agency obligations	$7,135	$ 54	$ -	$7,189
Municipal obligations, tax exempt	73,117	3,989	(32)	77,074
Municipal obligations, taxable	37,444	912	(8)	38,348
Mortgage-backed securities	107,319	1,918	(60)	109,177
Common stocks	621	250	-	871
Pooled trust preferred securities	1,023	-	(458)	565
Certificates of deposit	5,794	-	-	5,794
Total	$232,453	$ 7,123	$ (558)	$239,018

	As of December 31, 2011			
(Dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
U. S. federal agency obligations	$9,120	$ 44	$ -	$9,164
Municipal obligations, tax exempt	65,404	4,226	(1)	69,629
Municipal obligations, taxable	18,961	243	(69)	19,135
Mortgage-backed securities	92,742	1,823	(93)	94,472
Common stocks	621	198	-	819
Pooled trust preferred securities	1,104	-	(699)	405
Certificates of deposit	4,590	-	-	4,590
Total	$192,542	$ 6,534	$ (862)	$198,214

Certain of the Company's investment securities have unrealized losses, or are temporarily impaired. This temporary impairment represents the estimated amount of loss that would be realized if the securities were sold on the valuation date. Securities which are temporarily impaired are shown below, along with the length of the impairment period.

		As of September 30, 2012					
(Dollars in thousands)		Less than 12 months		12 months or longer		Total	
	No. of securities	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Municipal obligations, tax exempt	15	$4,512	$ (32)	$ -	$ -	$4,512	$ (32)
Municipal obligations, taxable	7	2,599	(6)	211	(2)	2,810	(8)
Mortgage-backed securities	5	7,079	(60)	-	-	7,079	(60)
Pooled trust preferred securities	2	-	-	565	(458)	565	(458)
Total	29	$14,190	$ (98)	$ 776	$ (460)	$14,966	$ (558)

		As of December 31, 2011					
(Dollars in thousands)		Less than 12 months		12 months or longer		Total	
	No. of securities	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Municipal obligations, tax exempt	1	$247	$ (1)	$ -	$ -	$247	$ (1)
Municipal obligations, taxable	15	6,579	(69)	-	-	6,579	(69)
Mortgage-backed securities	10	14,260	(93)	-	-	14,260	(93)
Pooled trust preferred securities	2	-	-	405	(699)	405	(699)
Total	28	$21,086	$ (163)	$ 405	$ (699)	$21,491	$ (862)

The Company performs quarterly reviews of the investment portfolio to determine if investment securities have any declines in fair value which might be considered other-than-temporary. The initial review begins with all securities in an unrealized loss position. The Company's assessment of other-than-temporary impairment is based on the specific facts and circumstances impacting each individual security. The Company reviews and considers all available information, including expected cash flows, the structure of the security, the credit quality of the underlying assets and the current and anticipated market conditions. Any credit-related impairment on debt securities is realized through a charge to earnings. If an equity security is determined to be other-than-temporarily impaired, the entire impairment is realized through a charge to earnings.

The Company's portfolio of municipal obligations consists of both tax-exempt and taxable general obligations securities issued by various municipalities. The Company does not intend to sell and it is more likely than not that the Company will not be required to sell its municipal obligations in an unrealized loss position until the recovery of its cost. Due to the issuers' continued satisfaction of the securities' obligations in accordance with their contractual terms and the expectation that they will continue to do so, the evaluation of the fundamentals of the issuers' financial condition and other objective evidence, the Company believes that the municipal obligations identified in the tables above are temporarily impaired.

The Company’s mortgage-backed securities portfolio consists of securities underwritten to the standards of and guaranteed by the government-sponsored agencies of the Federal Home Loan Mortgage Corporation (“FHLMC”), Federal National Mortgage Association (“FNMA”) and Government National Mortgage Association (“GNMA”). The receipt of principal, at par, and interest on mortgage-backed securities is guaranteed by the respective government-sponsored agency guarantor, such that the Company believes that its mortgage-backed securities do not expose the Company to credit-related losses. Based on these factors, along with the Company’s intent to not sell the securities and the Company’s belief that it is more likely than not that the Company will not be required to sell the securities before recovery of their cost basis, the Company believes that the mortgage-backed securities identified in the tables above are temporarily impaired.

As of September 30, 2012, the Company owned two pooled trust preferred securities, which represent investments in pools of collateralized debt obligations issued by financial institutions and insurance companies. The market for these securities is considered to be inactive. The Company's investments, Preferred Term Security ("PreTSL") VIII and PreTSL IX, have remaining aggregate cost bases of $318,000 and $705,000 and non-credit-related, unrealized losses of $98,000 and $360,000, respectively. The Company uses discounted cash flow models on these two securities to assess if the present value of the cash flows expected to be collected is less than the amortized cost, which would result in an other-than-temporary impairment associated with the credit of the underlying collateral. The assumptions used in preparing the discounted cash flow models include the following: estimated discount rates, estimated deferral and default rates on collateral, assumed recoveries and estimated cash flows including all information available through the date of issuance of these financial statements. The discounted cash flow analysis includes a review of all issuers within the collateral pool and incorporates higher deferral and default rates, as compared to historical rates, in the cash flow projections through maturity. The Company also reviews stress tests of these securities to determine the additional estimated deferrals or defaults in the collateral pool in excess of what the Company believes is likely, before the payments on the individual securities are negatively impacted.

As of September 30, 2012, the analysis of the Company's PreTSL VIII and IX investments indicated that the unrealized losses of $98,000 and $360,000, respectively, were not credit-related.

The following table provides additional information related to the Company's investments in pooled trust preferred securities as of September 30, 2012:

(Dollars in thousands) Investment	Class	Moody's rating	Original par	Principal payments	Cumulative credit losses	Cost basis	Unrealized loss	Fair value
PreTSL VIII	B	C	$ 1,000	$ -	$ (682)	$ 318	$ (98)	$ 220
PreTSL IX	B	Ca	1,000	(60)	(235)	705	(360)	345
Total			$ 2,000	$ (60)	$ (917)	$ 1,023	$ (458)	$ 565

It is reasonably possible that the fair values of the Company's investment securities could decline in the future if the overall economy and/or the financial condition of some of the issuers of these securities deteriorate and/or if the liquidity in markets for these securities declines. As a result, there is a risk that additional other-than-temporary impairments may occur in the future and any such amounts could be material to the Company's consolidated financial statements. An increase in market interest rates may also cause the fair value of the Company's investment securities to decline, as the market prices of these investments move inversely to their market yields.

Maturities of investment securities at September 30, 2012 are as follows:

(Dollars in thousands)	Amortized cost	Estimated fair value
Due in less than one year	$ 15,379	$ 15,509
Due after one year but within five years	148,248	151,264
Due after five years but within ten years	52,817	55,634
Due after ten years	15,388	15,740
Common stocks	621	871
Total	$ 232,453	$ 239,018

The preceding table includes scheduled principal payments and estimated prepayments for mortgage-backed securities, where actual maturities may differ from contractual maturities because borrowers have the right to prepay obligations with or without prepayment penalties.

11

Gross realized gains and losses on sales of available-for-sale investment securities are as follows:

(Dollars in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Realized gains	$ -	$ 186	$ 359	$ 186
Realized losses	-	-	-	-
Total	$ -	$ 186	$ 359	$ 186

Other investment securities primarily consist of restricted investments in Federal Home Loan Bank ("FHLB") and Federal Reserve Bank ("FRB") stock. The carrying value of the FHLB stock was $3.9 million and $4.9 million at September 30, 2012 and December 31, 2011, respectively. The carrying value of the FRB stock was $1.8 million at September 30, 2012 and December 31, 2011. These securities are not readily marketable and are required for regulatory purposes and borrowing availability. Since there is no available market value, these securities are carried at cost. Redemption of these investments at par value is at the option of the FHLB or FRB. Also included in other investment securities are other miscellaneous investments in the common stock of various correspondent banks which are held for borrowing purposes and totaled $112,000 and $60,000 at September 30, 2012 and December 31, 2011, respectively. The Company assessed the ultimate recoverability of these investments and believes that no impairment has occurred.

4. Loans and Allowance for Loan Losses

Loans consisted of the following as of:

(Dollars in thousands)	September 30, 2012	December 31, 2011
One-to-four family residential real estate	$ 82,457	$ 79,108
Construction and land	24,619	21,672
Commercial real estate	90,163	93,786
Commercial loans	59,360	57,006
Agriculture loans	32,927	39,052
Municipal loans	10,065	10,366
Consumer loans	13,563	13,584
Total gross loans	313,154	314,574
Net deferred loan costs and loans in process	305	214
Allowance for loan losses	(6,167)	(4,707)
Loans, net	$ 307,292	$ 310,081

12

The following tables provide information on the Company's allowance for loan losses by loan class and allowance methodology:

(Dollars in thousands)	Three and nine months ended September 30, 2012 One-to-four family residential real estate	Construction and land	Commercial real estate	Commercial loans	Agriculture loans	Municipal loans	Consumer loans	Total
Allowance for loan losses:								
Balance at June 30, 2012	$708	$ 1,786	$ 1,485	$ 652	$ 402	$ 112	$ 127	$5,272
Charge-offs	-	(15)	-	(60)	-	-	(43)	(118)
Recoveries	1	1	-	5	1	-	5	13
Net charge-offs	1	(14)	-	(55)	1	-	(38)	(105)
Provision for loan losses	76	523	265	18	47	20	51	1,000
Balance at September 30, 2012	785	2,295	1,750	615	450	132	140	6,167
Balance at December 31, 2011	$560	$ 928	$ 1,791	$ 745	$ 433	$ 130	$ 120	$4,707
Charge-offs	(15)	(15)	-	(70)	-	-	(120)	(220)
Recoveries	6	4	-	10	39	-	21	80
Net charge-offs	(9)	(11)	-	(60)	39	-	(99)	(140)
Provision for loan losses	234	1,378	(41)	(70)	(22)	2	119	1,600
Balance at September 30, 2012	785	2,295	1,750	615	450	132	140	6,167
Allowance for loan losses:								
Individually evaluated for loss	184	1,414	-	-	-	65	16	1,679
Collectively evaluated for loss	601	881	1,750	615	450	67	124	4,488
Total	785	2,295	1,750	615	450	132	140	6,167
Loan balances:								
Individually evaluated for loss	848	3,326	-	204	5	772	72	5,227
Collectively evaluated for loss	81,609	21,293	90,163	59,156	32,922	9,293	13,491	307,927
Total	$82,457	$ 24,619	$ 90,163	$ 59,360	$ 32,927	$ 10,065	$ 13,563	$313,154

(Dollars in thousands)	Three and nine months ended September 30, 2011	Total

	One-to-four family residential real estate	Construction and land	Commercial real estate	Commercial loans	Agriculture loans	Municipal loans	Consumer loans	
Allowance for loan losses:								
Balance at June 30, 2011	$ 339	$ 1,022	$ 1,482	$ 612	$ 376	$ 102	$ 72	$ 4,005
Charge-offs	-	(208)	-	-	-	-	(41)	(249)
Recoveries	2	3	37	3	34	-	(12)	67
Net charge-offs	2	(205)	37	3	34	-	(53)	(182)
Provision for loan losses	(12)	117	149	106	36	(3)	107	500
Balance at September 30, 2011	329	934	1,668	721	446	99	126	4,323
Balance at December 31, 2010	395	1,186	1,576	1,173	399	99	139	4,967
Charge-offs	(104)	(1,173)	(434)	(590)	(1)	-	(93)	(2,395)
Recoveries	26	3	37	11	35	-	39	151
Net charge-offs	(78)	(1,170)	(397)	(579)	34	-	(54)	(2,244)
Provision for loan losses	12	918	489	127	13	-	41	1,600
Balance at September 30, 2011	329	934	1,668	721	446	99	126	4,323
Allowance for loan losses:								
Individually evaluated for loss	19	11	-	-	-	66	23	119
Collectively evaluated for loss	310	923	1,668	721	446	33	103	4,204
Total	329	934	1,668	721	446	99	126	4,323
Loan balances:								
Individually evaluated for loss	803	225	18	-	71	775	39	1,931
Collectively evaluated for loss	77,901	21,882	94,114	53,209	42,206	6,499	13,407	309,218
Total	$ 78,704	$ 22,107	$ 94,132	$ 53,209	$ 42,277	$ 7,274	$ 13,446	$ 311,149

The Company's key credit quality indicator is a loan's performance status, defined as accruing or non-accruing. Performing loans are considered to have a lower risk of loss. Non-accrual loans are those which the Company believes have a higher risk of loss. The accrual of interest on non-performing loans is discontinued at the time the loan is ninety days delinquent, unless the credit is well secured and in process of collection. Loans are placed on non-accrual or are charged off at an earlier date if collection of principal or interest is considered doubtful. There were no loans 90 days delinquent and accruing interest at September 30, 2012 or December 31, 2011. The following tables present information on the Company's past due and non-accrual loans by loan class:

(Dollars in thousands)	As of September 30, 2012 30-59 days delinquent and accruing	60-89 days delinquent and accruing	90 days or more delinquent and accruing	Total past due loans accruing	Non-accrual loans	Total
One-to-four family residential real estate	$ 500	$ 1,752	$ -	$ 2,252	$ 839	$ 3,091
Construction and land	19	-	-	19	3,326	3,345
Commercial real estate	148	-	-	148	-	148
Commercial loans	20	150	-	170	204	374
Agriculture loans	22	39	-	61	5	66
Municipal loans	-	-	-	-	131	131
Consumer loans	239	45	-	284	72	356
Total	$ 948	$ 1,986	$ -	$ 2,934	$ 4,577	$ 7,511
Percent of gross loans	0.30 %	0.63 %	0.00 %	0.94 %	1.46 %	2.40 %

(Dollars in thousands)	As of December 31, 2011 30-59 days delinquent and accruing	60-89 days delinquent and accruing	90 days or more delinquent and accruing	Total past due loans accruing	Non-accrual loans	Total
One-to-four family residential real estate	$ 368	$ 1,174	$ -	$ 1,542	$ 752	$ 2,294
Construction and land	21	-	-	21	225	246
Commercial real estate	64	211	-	275	17	292
Commercial loans	1	201	-	202	78	280
Agriculture loans	1	-	-	1	63	64
Municipal loans	-	-	-	-	241	241
Consumer loans	160	18	-	178	43	221
Total	$ 615	$ 1,604	$ -	$ 2,219	$ 1,419	$ 3,638
Percent of gross loans	0.20 %	0.51 %	0.00 %	0.71 %	0.45 %	1.16 %

14

The Company's impaired loans increased from $2.5 million at December 31, 2011 to $5.2 million at September 30, 2012. The difference between the unpaid contractual principal and the impaired loan balance is a result of charge-offs recorded against impaired loans. The difference in the Company's non-accrual loan balances and impaired loan balances at September 30, 2012 and December 31, 2011, was related to troubled debt restructurings ("TDR") that are current and accruing interest, but still classified as impaired. The following tables present information on impaired loans:

(Dollars in thousands)	As of September 30, 2012						
	Unpaid contractual principal	Impaired loan balance	Impaired loans without an allowance	Impaired loans with an allowance	Related allowance recorded	Year-to-date average loan balance	Year-to-date interest income recognized
One-to-four family residential real estate	$1,138	$ 848	$ 648	$ 200	$ 184	$ 873	$ -
Construction and land	3,326	3,326	60	3,266	1,414	3,334	-
Commercial	204	204	203	1	-	335	-
Agriculture loans	5	5	5	-	-	10	-
Municipal loans	772	772	641	131	65	782	15
Consumer loans	72	72	56	16	16	73	-
Total impaired loans	$5,517	$ 5,227	$ 1,613	$ 3,614	$ 1,679	$ 5,407	$ 15

(Dollars in thousands)	As of December 31, 2011						
	Unpaid contractual principal	Impaired loan balance	Impaired loans without an allowance	Impaired loans with an allowance	Related allowance recorded	Year-to-date average loan balance	Year-to-date interest income recognized
One-to-four family residential real estate	$1,570	$ 1,280	$ 1,072	$ 208	$ 65	$ 1,311	$ 32
Construction and land	574	225	200	25	8	419	-
Commercial real estate	17	17	17	-	-	20	-
Commercial loans	78	78	-	78	35	83	-
Agriculture loans	63	63	63	-	-	65	-
Municipal loans	784	784	653	131	65	772	35
Consumer loans	43	43	10	33	32	49	-
Total impaired loans	$3,129	$ 2,490	$ 2,015	$ 475	$ 205	$ 2,719	$ 67

During the first nine months of 2012, the Company classified a commercial loan relationship consisting of two commercial loans as a troubled debt restructuring after agreeing to extend the maturity of the loans while the borrower liquidated the business assets securing the loans. The Company did not charge-off any of the loan balances as the anticipated proceeds were expected to exceed the loan balances. As of September 30, 2012, the outstanding balances of these loans totaled $196,000 and were classified as non-accrual and impaired. During the third quarter of 2011, the Company restructured a construction and land loan relationship totaling $599,000 which was secured by raw land which had experienced a severe decline in value. As part of the agreement the Company agreed to reduce the outstanding loan balance to $250,000 in exchange for a $50,000 principal payment in the third quarter of 2011 and the remaining $200,000 to be received during the first quarter of 2012. The Company charged off $141,000 of the loan during the third quarter of 2010 and $208,000 during the third quarter of 2011, and the remaining $200,000 loan balance was classified as non-accrual and impaired as of September 30, 2011. The collateral deficiency of the raw land had previously been included in the allowance on impaired loans. During the first quarter of 2012, a construction and land loan totaling $200,000, after a modification during the third quarter of 2011, was paid off per the terms of the loan modification agreement. As of September 30, 2012, the Company had six loan modifications classified as TDRs. The Company evaluates each TDR individually and returns the loan to accrual status when a payment history is established after the restructuring and future payments are reasonably assured. There were no loans as of September 30, 2012 that had been modified as TDRs and then subsequently defaulted. At September 30, 2012, there are no commitments to lend additional funds to any borrower whose loan terms have been modified as a TDR. As of September 30, 2012, the Company had $148,000 of allowance recorded against loans classified as TDRs compared to $5,000 recorded at December 31, 2011. The following table presents information on loans that are classified as TDRs:

(Dollars in thousands)

	As of September 30, 2012		As of December 31, 2011	
	Number of loans	Loan balance	Number of loans	Loan balance
One-to-four family residential real estate	2	$ 503	2	$ 528
Construction and land	-	-	1	200
Commerical loans	2	196	-	-
Municipal loans	2	641	2	653
Total troubled debt restructurings	6	$ 1,340	5	$ 1,381

The Company services one-to-four family residential real estate loans for others with outstanding principal balances of $240.2 million and $183.3 million at September 30, 2012 and December 31, 2011, respectively. Gross service fee income related to such loans was $145,000 and $106,000 for the quarters ended September 30, 2012 and 2011, respectively, and is included in fees and service charges in the consolidated statements of earnings. Gross service fee income for the nine months ended September 30, 2012 and 2011 was $394,000 and $319,000, respectively.

The Company had a mortgage repurchase reserve of $418,000 and $500,000 at September 30, 2012 and December 31, 2011, respectively, which represents the Company's best estimate of probable losses that the Company will incur related to the repurchase of one-to-four family residential real estate loans previously sold or to reimburse investors for credit losses incurred on loans previously sold where a breach of the contractual representations and warranties occurred. Because the level of mortgage repurchase losses depends upon economic factors, investor demand strategies and other external conditions that may change over the life of the underlying loans, mortgage repurchase losses are difficult to estimate and require considerable judgment. The Company did not make any provisions against the reserve during the first nine months of 2012. Actual losses during the first nine months of 2012, which were charged against the reserve, were $82,000. As of September 30, 2012, the Company did not have any outstanding mortgage repurchase requests.

5. Earnings per Share

Basic earnings per share has been computed based upon the weighted average number of common shares outstanding during each period. Diluted earnings per share includes the effect of all potential common shares outstanding during each period. The shares used in the calculation of basic and diluted earnings per share are shown below:

(Dollars in thousands, except per share amounts)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Net earnings	$1,205	$1,489	$4,750	$3,189

Weighted average common shares outstanding - basic (1)	2,783,271	2,780,453	2,783,054	2,776,578
Assumed exercise of stock options (1)	24,053	600	18,663	647
Weighted average common shares outstanding - diluted (1)	2,807,324	2,781,053	2,801,717	2,777,225
Net earnings per share (1):				
Basic	$0.43	$0.54	$1.71	$1.15
Diluted	$0.43	$0.54	$1.70	$1.15

(1) Share and per share values for the periods ended September 30, 2011 have been adjusted to give effect to the 5% stock dividend paid during December 2011.

The diluted earnings per share computations for the three months ended September 30, 2012 and 2011 exclude unexercised stock options of 62,775 and 465,744, respectively, because their inclusion would have been anti-dilutive to earnings per share. The diluted earnings per share computations for the nine months ended September 30, 2012 and 2011 exclude unexercised stock options of 144,948 and 441,918, respectively, for the same reason.

6. Fair Value of Financial Instruments and Fair Value Measurements

The Company follows the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 820 "Fair Value Measurements and Disclosures," which defines fair value, establishes a framework for measuring fair value and expands the disclosures about fair value measurements. ASC Topic 820-10-55 requires the use of a hierarchy of fair value techniques based upon whether the inputs to those fair values reflect assumptions other market participants would use based upon market data obtained from independent sources or reflect the Company's own assumptions of market participant valuation. The Company applies FASB ASC 820 to certain nonfinancial assets and liabilities, which include foreclosed real estate, long-lived assets, goodwill, and core deposit premium, which are recorded at fair value only upon impairment. The fair value hierarchy is as follows:

• Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
• Level 2: Quoted prices for similar assets in active markets or quoted prices that contain observable inputs such as yield curves, volatilities, prepayment speeds and other inputs derived from market data.
• Level 3: Quoted prices in markets that are not active or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable.

Fair value estimates of the Company's financial instruments as of September 30, 2012 and December 31, 2011, including methods and assumptions utilized, are set forth below:

(Dollars in thousands)	September 30, 2012		December 31, 2011	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Financial assets:				
Cash and cash equivalents	$23,117	$23,117	$17,501	$17,501
Investment securities:				
Available-for-sale	239,018	239,018	198,214	198,214
Other securities	5,727	5,727	6,671	6,671
Loans, net	307,292	307,754	310,081	309,927
Loans held for sale	9,767	9,989	9,754	9,846
Mortgage servicing rights	1,464	1,562	1,160	1,319
Derivative financial instruments	534	534	255	255
Accrued interest receivable	2,964	2,964	2,468	2,468
Financial liabilities:				
Non-maturity deposits	$336,020	$336,020	$274,301	$274,301
Time deposits	178,800	180,058	179,833	181,280
FHLB borrowings	35,735	40,427	49,163	53,376
Other borrowings	23,296	21,052	27,434	25,200
Accrued interest payable	482	482	532	532

Methods and Assumptions Utilized

The carrying amount of cash and cash equivalents is considered to approximate fair value.

The Company’s investment securities classified as available-for-sale include U.S. federal agency securities, municipal obligations, mortgage-backed securities, pooled trust preferred securities, certificates of deposits and common stocks. Quoted exchange prices are available for the Company’s common stock investments, which are classified as Level 1. U.S. federal agency securities and mortgage-backed obligations are priced utilizing industry-standard models that consider various assumptions, including time value, yield curves, volatility factors, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace, can be derived from observable data, or are supported by observable levels at which transactions are executed in the marketplace and are classified as Level 2. Municipal securities are valued using a type of matrix, or grid, pricing in which securities are benchmarked against the treasury rate based on credit rating. These model and matrix measurements are classified as Level 2 in the fair value hierarchy. The Company’s investments in FDIC-insured, fixed-rate certificates of deposits are valued using a net present value model that discounts the future cash flows at the current market rates and are classified as Level 2.

The Company classifies the fair value of its pooled trust preferred securities as Level 3. The portfolio consists of two investments in pooled trust preferred securities issued by various financial companies. These securities are valued based on a matrix pricing in which the securities are benchmarked against single issuer trust preferred securities based on credit rating. The pooled trust preferred market is inactive; therefore single issuer trading is used as the benchmark, with additional adjustments made for credit and liquidity risk.

The Company's other investment securities primarily include investments in FHLB and FRB stock, which are held for regulatory purposes. These investments generally have restrictions on the sale and/or liquidation of stock and the carrying value is approximately equal to fair value. Fair value measurements for these securities are classified as Level 3 based on the restrictions on sale and/or liquidation and related credit risk.

The estimated fair value of the Company's loan portfolio is based on the segregation of loans by collateral type, interest terms, and maturities. The fair value is estimated based on discounting scheduled and estimated cash flows through maturity using an appropriate risk-adjusted yield curve to approximate current interest rates for each category. No adjustment was made to the interest rates for changes in credit risk of performing loans where there were no known credit concerns. Management segregates loans in appropriate risk categories. Management believes that the risk factor embedded in the interest rates along with the allowance for loan losses applicable to the performing loan portfolio results in a fair valuation of such loans. The fair values of impaired loans are generally based on market prices for similar assets determined through independent appraisals or discounted values of independent appraisals and brokers' opinions of value. This method of estimating fair value is classified as Level 3 and does not incorporate the exit-price concept of fair value prescribed by ASC Topic 820.

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value, determined on an aggregate basis. The mortgage loan valuations are based on quoted secondary market prices for similar loans and are classified as Level 2.

The Company measures its mortgage servicing rights at the lower of amortized cost or fair value. Periodic impairment assessments are performed based on fair value estimates at the reporting date. The fair value of mortgage servicing rights is estimated based on a valuation model which calculates the present value of estimated future cash flows associated with servicing the underlying loans. The model incorporates assumptions that market participants use in estimating future net servicing income, including estimated prepayment speeds, market discount rates, cost to service, and other servicing income, including late fees. The fair value measurements are classified as Level 3.

The carrying amount of accrued interest receivable and payable is considered to approximate fair value and is classified as Level 3.

The estimated fair value of deposits with no stated maturity, such as non-interest-bearing demand deposits, savings, money market accounts, and NOW accounts, is equal to the amount payable on demand. The fair value of interest-bearing time deposits is based on the discounted value of contractual cash flows of such deposits. The discount rate is tied to the FHLB yield curve plus an appropriate servicing spread. Fair value measurements based on discounted cash flows are classified as Level 3. These fair values do not incorporate the value of core deposit intangibles which may be associated with the deposit base.

The fair value of advances from the FHLB and other borrowings is estimated using current yield curves for similar borrowings adjusted for the Company's current credit spread, if applicable, and classified as Level 2.

The Company's derivative financial instruments consist of interest rate lock commitments and corresponding forward sales contracts on mortgage loans held for sale. The fair values of these derivatives are based on quoted prices for similar loans in the secondary market. The market prices are adjusted by a factor, based on the Company's historical data and its judgment about future economic trends, which considers the likelihood that a commitment will ultimately result in a closed loan. These instruments are classified as Level 2. The amounts are included in other assets or other liabilities on the consolidated balance sheets and gains on sales of loans in the consolidated statements of earnings.

Off-Balance Sheet Financial Instruments

The fair value of letters of credit and commitments to extend credit is based on the fees currently charged to enter into similar agreements. The aggregate of these fees is not material.

Transfers

The Company did not transfer any assets or liabilities among levels during the nine months ended September 30, 2012 or during the year ended December 31, 2011.

Limitations

Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instruments. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment, and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates. Fair value estimates are based on existing balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments.

Valuation methods for instruments measured at fair value on a recurring basis

The following table represents the Company's financial instruments that are measured at fair value on a recurring basis at September 30, 2012 and December 31, 2011, allocated to the appropriate fair value hierarchy:

(Dollars in thousands)		As of September 30, 2012		
		Fair value hierarchy		
	Total	Level 1	Level 2	Level 3
Assets:				
Available-for-sale securities:				

U. S. federal agency obligations	$7,189	$ -	$7,189	$ -
Municipal obligations, tax exempt	77,074	-	77,074	-
Municipal obligations, taxable	38,348	-	38,348	-
Mortgage-backed securities	109,177	-	109,177	-
Common stocks	871	871	-	-
Pooled trust preferred securities	565	-	-	565
Certificates of deposit	5,794	-	5,794	-
Derivative financial instruments	$534	$ -	$534	$ -

		As of December 31, 2011		
		Fair value hierarchy		
	Total	Level 1	Level 2	Level 3
Assets:				
Available-for-sale securities:				
U. S. federal agency obligations	$9,164	$ -	$9,164	$ -
Municipal obligations, tax exempt	69,629	-	69,629	-
Municipal obligations, taxable	19,135	-	19,135	-
Mortgage-backed securities	94,472	-	94,472	-
Common stocks	819	819	-	-
Pooled trust preferred securities	405	-	-	405
Certificates of deposit	4,590	-	4,590	-
Derivative financial instruments	$255	$ -	$255	$ -

The following table reconciles the changes in the Company's Level 3 financial instruments during the first nine months of 2012:

(Dollars in thousands)

	Available-for sale securities
Level 3 asset fair value at December 31, 2011	$ 405
Payments applied to reduce carrying value	(18)
Total (losses) gains:	
Included in earnings	(63)
Included in other comprehensive income	241
Level 3 asset fair value at September 30, 2012	$ 565

Changes in the fair value of available-for-sale securities are included in other comprehensive income to the extent the changes are not considered other-than-temporary impairments. Other-than-temporary impairment tests are performed on a quarterly basis and any decline in the fair value of an individual security below its cost that is deemed to be other-than-temporary results in a write-down of that security's cost basis.

Valuation methods for instruments measured at fair value on a nonrecurring basis

The Company does not value its loan portfolio at fair value, however adjustments are recorded on certain loans to reflect the impaired value on the underlying collateral. Collateral values are reviewed on a loan-by-loan basis through independent appraisals. Appraised values may be discounted based on management's historical knowledge, changes in market conditions and/or management's expertise and knowledge of the client and the client's business. Because many of these inputs are unobservable, the valuations are classified as Level 3. The carrying value of the Company's impaired loans was $5.2 million at September 30, 2012 and $2.5 million at December 31, 2011, with allocated allowances of $1.7 million and $205,000, respectively.

The Company measures the fair value of its goodwill based on the Company's market capitalization with appropriate control premiums and valuation multiples, as compared to recent similar financial industry acquisition multiples, to estimate the fair value of the Company's single reporting unit. The fair value measurements are classified as Level 3. Core deposit intangibles are recognized at the time core deposits are acquired, using valuation techniques which calculate the present value of the estimated net cost savings relative to the Company's alternative costs of funds over the expected remaining economic life of the deposits. Subsequent evaluations are made when facts or circumstances indicate potential impairment may have occurred. The models incorporate market discount rates, estimated average core deposit lives and alternative funding rates. The fair value measurements are classified as Level 3.

Real estate owned includes assets acquired through, or in lieu of, foreclosure and land previously acquired for expansion. Real estate owned is initially recorded at the fair value of the collateral less estimated selling costs. Subsequent valuations are updated periodically and are based upon independent appraisals, third party price opinions or internal pricing models and are classified as Level 3.

The following table represents the Company's financial instruments that are measured at fair value on a non-recurring basis as of September 30, 2012 and December 31, 2011 allocated to the appropriate fair value hierarchy:

(Dollars in thousands)		As of September 30, 2012			
		Fair value hierarchy			Total
	Total	Level 1	Level 2	Level 3	losses
Assets:					
Impaired loans	$3,548	$ -	$ -	$ 3,548	$(1,535)
Loans held for sale	9,989	-	9,989	-	-
Mortgage servicing rights	1,562	-	-	1,562	(212)
Real estate owned	$2,584	$ -	$ -	$ 2,584	$-

(Dollars in thousands)		As of December 31 ,2011			
		Fair value hierarchy			Total
	Total	Level 1	Level 2	Level 3	losses
Assets:					
Impaired loans	$2,285	$ -	$ -	$ 2,285	$(112)
Loans held for sale	9,846	-	9,846	-	-
Mortgage servicing rights	1,319	-	-	1,319	-
Real estate owned	$2,264	$ -	$ -	$ 2,264	$(517)

8. Impact of Recent Accounting Pronouncements

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards ("IFRS"). The amendments in ASU No. 2011-04 result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRS. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The amendments in ASU No. 2011-04 became effective for interim and annual periods beginning after December 15, 2011. Adoption of ASU 2011-04 did not have a significant impact on the Company's consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. ASU 2011-05 requires that all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. The new guidance became effective for interim and annual periods beginning after December 15, 2011 with early adoption permitted. Adoption of ASU 2011-05 did not have a significant impact on the Company’s consolidated financial statements.

In September 2011, the FASB issued ASU No. 2011-08, Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment. ASU 2011-08 allows the use of qualitative factors to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying amounts as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The new guidance became effective for annual and interim goodwill impairment tests beginning after December 15, 2011 with early adoption permitted. Adoption of ASU 2011-08 did not have a significant impact on the Company’s consolidated financial statements.

9. Acquisition

The Company completed the acquisition, by its wholly-owned subsidiary, Landmark National Bank, of The Wellsville Bank from Wellsville Bancshares, Inc., effective April 1, 2012. The purchase price consisted of cash of $3.7 million for 100% of The Wellsville Bank. The acquisition was effected through the merger of The Wellsville Bank with and into Landmark National Bank. The acquisition added one additional branch, located in Wellsville, Kansas, to the Company's existing branch network, giving the Company a total of 22 offices in 17 communities across Kansas.

The assets acquired and liabilities assumed were recorded by Landmark National Bank at their estimated fair value as of April 1, 2012 based on management's best estimate using information available at the time. The acquisition included the assumption of investments of $14.2 million, loans of $15.0 million and deposits of $35.0 million. The unpaid contractual amount of the loans totaled $15.1 million. During the nine months ended September 30, 2012, the Company incurred $147,000 of acquisition related expenses which are included in professional fees. Based on estimates of the fair values of the net assets acquired, the Company recorded $181,000 of goodwill. The acquisition created $51,000 of tax deductible goodwill.

10. Subsequent Events

On November 5, 2012, the Company entered into an amendment to extend the maturity of its $7.5 million line of credit from November 5, 2012 to November 5, 2013.

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

Overview. Landmark Bancorp, Inc. is a one-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. Our overall strategy includes continuing a tradition of quality assets while growing our commercial and commercial real estate loan portfolios. We are committed to developing relationships with our borrowers and providing a total banking service.

Landmark National Bank is principally engaged in the business of attracting deposits from the general public and using such deposits, together with borrowings and other funds, to originate one-to-four family residential real estate, construction and land, commercial real estate, commercial, agriculture, municipal and consumer loans. Although not our primary business function, we also invest in certain investment and mortgage-related securities using deposits and other borrowings as funding sources.

Our results of operations depend generally 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 from the sale of newly originated loans and gains or losses on investments. Our principal operating expenses, aside from interest expense, consist of compensation and employee benefits, occupancy costs, professional fees, advertising, 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 investments, the level of income and the personal rate of savings within our market areas. Factors influencing lending activities include the demand for housing and interest rate pricing competition from other lending institutions.

Our business consists of ownership of Landmark National Bank, with its main office in Manhattan, Kansas and twenty one branch offices in eastern, central and southwestern Kansas as of September 30, 2012. In January 2012, we entered into an agreement to purchase a bank in Wellsville, Kansas with approximately $35.0 million in deposits, $14.2 million in investments and $15.0 million in loans, which was merged into Landmark National Bank upon the April 1, 2012 closing of the acquisition.

Recent Regulatory Developments. In June 2012, the federal bank regulatory agencies issued joint proposed rules that would implement an international capital accord called “Basel III,” developed by the Basel Committee on Banking Supervision, a committee of central banks and bank supervisors. The proposed rules would apply to all depository organizations in the United States and most of their parent companies and would increase minimum capital ratios, add a new minimum common equity ratio, add a new capital conservation buffer, and would change the risk-weightings of certain assets for the purposes of calculating certain capital ratios. The proposed changes, if implemented, would be phased in from 2013 through 2019. On October 22, 2012, the comment period for the proposed rules expired. Various banking associations and industry groups provided comments on the proposed rules to the regulators and it is unclear when the final rules will be adopted and what changes, if any, may be made to the proposed rules. Management is currently assessing the effect of the proposed rules on the Company and Landmark National Bank's capital position and will continue to monitor developments concerning the proposed rules.

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, valuation of real estate owned, valuation of investment securities, accounting for income taxes and accounting for goodwill and other intangible assets, all of which involve significant judgment by our management. Information about our critical accounting policies is included under Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our Annual Report on Form 10-K for the year ended December 31, 2011.

Summary of Results**.** During the third quarter of 2012, we recorded net earnings of $1.2 million as compared to net earnings of $1.5 million in the same period of 2011. The decrease in net earnings was primarily due to increases of $500,000 in provision for loans losses and $595,000 in other non-interest expense compared to the prior year period. Partially offsetting the higher expenses was a $785,000 increase in our gains on sales of loans.

During the first nine months of 2012, we recorded net earnings of $4.8 million as compared to $3.2 million in the same period of 2011. The increase in net earnings was primarily due to a $2.3 million increase in our gains on sales of loans compared to the prior year period.

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

(Dollars in thousands, expcept per share amounts)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Net earnings:				
Net earnings	$ 1,205	$ 1,489	$ 4,750	$ 3,189
Basic earnings per share (1)	$ 0.43	$ 0.54	$ 1.71	$ 1.15
Diluted earnings per share (1)	$ 0.43	$ 0.54	$ 1.70	$ 1.15
Earnings ratios:				