LANDMARK BANCORP INC
Form 10-K
March 14, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

THE SECURITIES EXCHANGE ACT OF 1934

For fiscal year ended December 31, 2016

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)

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)

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

Title of each class:	**Name of exchange on which registered:**
Common Stock, par value $0.01 per share	Nasdaq Global Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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 ¨ (do not check if a smaller reporting company) Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes ¨ No x

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, based on the last sales price quoted on the Nasdaq Global Market on the last business day of the registrant’s most recently completed second fiscal quarter, was approximately $72.4 million. On March 10, 2017, the total number of shares of common stock outstanding was 3,869,922.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Annual Meeting of Stockholders to be held May 17, 2017, are incorporated by reference in Part III hereof, to the extent indicated herein.

LANDMARK BANCORP, INC.

2016 Form 10-K Annual Report

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PART I.

ITEM 1. BUSINESS

The Company

Landmark Bancorp, Inc. (the "Company") is a bank holding company which was incorporated under the laws of the State of Delaware in 2001. Currently, the Company's business consists solely of the ownership of Landmark National Bank (the "Bank"), which is a wholly-owned subsidiary of the Company. As of December 31, 2016, the Company had $911.4 million in consolidated total assets.

The Company is headquartered in Manhattan, Kansas and has expanded its geographic presence through past acquisitions. Effective November 1, 2013, the Company completed the acquisition of Citizens Bank, National Association ("Citizens Bank"). Effective April 1, 2012, the Company completed the acquisition of The Wellsville Bank. The Company completed several other mergers and acquisitions since 2002.

The Bank has continued to focus on increasing its originations of commercial, commercial real estate and agricultural loans, which management believes will be more profitable and provide more growth for the Bank than traditional one-to-four family residential real estate lending. While the Bank has grown these portfolios, generally weak loan demand over the past few years as the economy has recovered has made it difficult to have meaningful growth while maintaining high credit standards. Additionally, greater emphasis has been placed on diversification of the deposit mix through expansion of core deposit accounts such as checking, savings, and money market accounts. The Bank has also diversified its geographical markets as a result of its acquisitions. The Company's main office is in Manhattan, Kansas. The Company has 29 branch offices in 23 communities across the state of Kansas. The Company continues to explore opportunities to expand its banking markets through mergers and acquisitions, as well as branching opportunities.

The results of operations of the Bank and the Company are dependent primarily upon net interest income and, to a lesser extent, upon other income derived from sales of one-to-four family residential mortgage loans, loan servicing fees and customer deposit services. Additional expenses of the Bank include general and administrative expenses such as salaries, employee benefits, federal deposit insurance premiums, data processing, occupancy and related expenses.

Deposits of the Bank are insured by the Deposit Insurance Fund (the "DIF") of the Federal Deposit Insurance Corporation (the "FDIC") up to the maximum amount allowable under applicable federal law and regulation. The Bank is regulated by the Office of the Comptroller of the Currency (the "OCC"), as the chartering authority for national banks, and the FDIC, as the administrator of the DIF. The Bank is also subject to regulation by the Board of Governors of the Federal Reserve System (the "Federal Reserve") with respect to reserves required to be maintained against deposits and certain other matters. The Bank is a member of the Federal Reserve Bank of Kansas City and the Federal Home Loan Bank (the "FHLB") of Topeka.

The Company's executive office and the Bank's main office are located at 701 Poyntz Avenue, Manhattan, Kansas 66502. The telephone number is (785) 565-2000.

Market Areas

The Bank’s primary deposit gathering and lending markets are geographically diversified throughout central, eastern, southeast, and southwest Kansas. The primary industries within these respective markets are also diverse and dependent upon a wide array of industry and governmental activity for their economic base. The Bank’s markets have been impacted by slow economic growth. To varying degrees, the Bank’s markets generally have experienced flat commercial and residential real estate values and slow growth in consumer spending. The Bank’s markets have also been impacted by an economic downturn in the agriculture sector in recent years. A brief description of the four geographic areas and the communities which the Bank serves is set forth below.

The central region of the Bank’s market area consists of the Bank’s locations in Auburn, Junction City, Manhattan, Osage City, Topeka and Wamego, Kansas and includes the counties of Riley, Geary, Osage, Pottawatomie and Shawnee. The economies are significantly impacted by employment at Fort Riley Military Base in Junction City and Kansas State University, the second largest university in Kansas, which is located in Manhattan. Topeka is the capital of Kansas and strongly influenced by the government of the State of Kansas. Topeka and Manhattan are regional destinations for retail shopping as well as home to regional hospitals. Manhattan was also selected as the site of the new National Bio and Agro-Defense Facility, which is expected to have a significant impact on the regional economy as the facility is constructed and begins operations. Construction of the facility began in 2013 and is expected to be completed in August 2023. Additionally, manufacturing and service industries also play a key role within the central Kansas market.

The Bank’s eastern Kansas branches are located in the communities of Lawrence, Lenexa, Louisburg, Osawatomie, Overland Park, Paola and Wellsville. The Bank’s Lawrence locations are located in Douglas County and are significantly impacted by the University of Kansas, the largest university in Kansas. The eastern region is strongly influenced by the Kansas City metropolitan market, which is the highest growth area in the State of Kansas. The region is influenced by public and private industries and businesses of all sizes. In addition, housing growth and commercial real estate are major drivers of the region’s economy. The Citizens Bank acquisition in 2013 expanded the Bank’s presence in the eastern Kansas market with branches in the Kansas City metropolitan suburbs of Lenexa and Overland Park.

The southeast region of the Bank’s market area consists of the Bank’s locations in Fort Scott, Iola, Kincaid, Mound City and Pittsburg, Kansas. Agriculture, oil, and gas are the predominant industries in the southeast Kansas region. Both Fort Scott and Pittsburg are recognized as regional commercial centers within the southeast region of the state, which attracts small retail businesses to the region. Additionally, Pittsburg State University and Fort Scott Community College attract a number of individuals from the surrounding area to live within the communities to participate in educational programs and pursue a degree. Fort Scott is also home to a regional hospital. Additionally, manufacturing and service industries play a key role within the southeast Kansas market. This market area primarily consists of branches acquired in the Citizens Bank acquisition.

The Bank’s southwest Kansas branches are located in the communities of Dodge City, Garden City, Great Bend, Hoisington and LaCrosse. Agriculture, oil, and gas are the predominant industries in the southwest Kansas region. Predominant activities involve crop production, feed lot operations, and food processing. Dodge City is known as the “Cowboy Capital of the World” and maintains a significant tourism industry. Both Dodge City and Garden City are recognized as regional commercial centers within the state with small businesses, manufacturing, retail, and service industries having a significant influence upon the local economies. Additionally, the Dodge City, Garden City and Great Bend communities each have a community college which attracts individuals from the surrounding areas.

Competition

The Company faces strong competition both in attracting deposits and making real estate, commercial and other loans. Its most direct competition for deposits comes from commercial banks and other savings institutions located in its principal market areas, including many larger financial institutions which have greater financial and marketing resources available to them. The ability of the Company to attract and retain deposits generally depends on its ability to provide a rate of return, service levels, liquidity and risk comparable to or better than those offered by competing investment opportunities. The Company competes for loans principally through the interest rates and loan fees it charges and the efficiency and quality of services it provides borrowers.

Employees

At December 31, 2016, the Bank had a total of 292 employees (275 full time equivalent employees). The Company has no employees, although the Company is a party to several employment agreements with executives of the Bank. Employees are provided with a comprehensive benefits program, including basic and major medical insurance, life and disability insurance, sick leave, and a 401(k) profit sharing plan. Employees are not represented by any union or collective bargaining group, and the Bank considers its employee relations to be good.

Lending Activities

General. The Bank strives to provide a full range of financial products and services to small- and medium-sized businesses and to consumers in each market area it serves. The Bank targets owner-operated businesses and utilizes Small Business Administration lending as a part of its product mix. The Bank has a loan committee for each of its markets, which has authority to approve credits within established guidelines. Concentrations in excess of those guidelines must be approved by either a corporate loan committee comprised of the Bank's Chief Executive Officer, the Credit Risk Manager, and other senior commercial lenders or the Bank's board of directors. When lending to an entity, the Bank generally obtains a guaranty from the principals of the entity. The loan mix is subject to the discretion of the Bank's board of directors and the demands of the local marketplace.

The following is a brief description of each major category of the Bank's lending activity.

One-to-Four Family Residential Real Estate Lending. The Bank originates one-to-four family residential real estate loans with both fixed and variable rates. One-to-four family residential real estate loans are priced and originated following underwriting standards that are consistent with guidelines established by the major buyers in the secondary market. Generally, residential real estate loans retained in the Bank's loan portfolio have fixed or variable rates with adjustment periods of five years or less and amortization periods of typically either 15 or 30 years. A significant portion of these loans prepay prior to maturity. The Bank has no potential negative amortization loans. While the origination of fixed-rate, one-to-four family residential loans continues to be a key component of our business, the majority of these loans are sold in the secondary market. One-to-four family residential real estate loans that exceed 80% of the appraised value of the real estate generally are required, by policy, to be supported by private mortgage insurance, although on occasion the Bank will retain non-conforming residential loans to known customers at premium pricing. While the Bank does not intend to increase its one-to-four family residential real estate loan portfolio, the Bank slowed the runoff of the portfolio by retaining some of the new loan originations to offset weak commercial loan demand in the past several years. However, most of the new loan originations continue to be sold.

Construction and Land Lending. Loans in this category include loans to facilitate the development of both residential and commercial real estate. Construction and land loans generally have terms of less than 18 months, and the Bank will retain a security interest in the borrower's real estate. Construction loans are generally limited, by policy, to 80% of the appraised value of the property. Land loans are generally limited, by policy, to 65% of the appraised value of the property. The Bank has generally been reducing its exposure to construction and land loans over the past few years as a strategy to reduce risk.

Commercial Real Estate Lending. Commercial real estate loans, including multi-family loans, generally have amortization periods of 15 or 20 years. Commercial real estate and multi-family loans are generally limited, by policy, to 80% of the appraised value of the property. Commercial real estate loans are also supported by an analysis demonstrating the borrower's ability to repay. The Bank continues to focus on generating additional commercial real estate loan relationships.

Commercial Lending. Commercial loans include loans to service, retail, wholesale and light manufacturing businesses. Commercial loans are made based on the financial strength and repayment ability of the borrower, as well as the collateral securing the loans. The Bank targets owner-operated businesses as its customers and makes lending decisions based upon a cash flow analysis of the borrower as well as a collateral analysis. Accounts receivable loans and loans for inventory purchases are generally on a one-year renewable term and loans for equipment generally have a term of seven years or less. The Bank generally takes a blanket security interest in all assets of the borrower. Equipment loans are generally limited to 75% of the cost or appraised value of the equipment. Inventory loans are generally limited to 50% of the value of the inventory, and accounts receivable loans are generally limited to 75% of a predetermined eligible base. The Bank continues to focus its organic growth on generating additional commercial loan relationships.

Municipal Lending. Loans to municipalities are generally related to equipment leasing or general fund loans. Terms are generally limited to 5 years. Equipment leases are generally made for the purchase of municipal assets and are secured by the leased asset. The Bank is generally not active in the origination of municipal loans and leases; however, the Bank may originate loans or leases for municipalities in its market area.

Agriculture Lending. Agricultural real estate loans generally have amortization periods of 20 years or less, during which time the Bank generally retains a security interest in the borrower’s real estate. The Bank also provides short-term credit for operating loans and intermediate-term loans for farm product, livestock and machinery purchases and other agricultural improvements. Farm product loans generally have a one-year term, and machinery, equipment and breeding livestock loans generally have five to seven year terms. Extension of credit is based upon the borrower’s ability to repay, as well as the existence of federal guarantees and crop insurance coverage. These loans are generally secured by a blanket lien on livestock, equipment, feed, hay, grain and growing crops. Equipment and breeding livestock loans are generally limited to 75% of appraised value. The Bank continues to focus on generating additional agriculture loan relationships in each of its market areas.

Consumer and Other Lending. Loans classified as consumer and other loans include automobile, boat, home improvement and home equity loans. With the exception of home improvement loans and home equity loans, the Bank generally takes a purchase money security interest in collateral for which it provides the original financing. Home improvement loans and home equity loans are principally secured through second mortgages. The terms of the loans typically range from one to five years, depending upon the use of the proceeds, and generally range from 75% to 90% of the value of the collateral. The majority of these loans are installment loans with fixed interest rates. Home improvement and home equity loans are generally secured by a second mortgage on the borrower’s personal residence and, when combined with the first mortgage, limited to 80% of the value of the property unless further protected by private mortgage insurance. Home improvement loans are generally made for terms of five to seven years with fixed interest rates. Home equity loans are generally made for terms of ten years on a revolving basis with adjustable monthly interest rates tied to the national prime interest rate. While the Bank primarily provides consumer loans to its existing customers, consumer lending is not a category the Bank targets for organic growth.

Loan Origination and Processing

Loan originations are derived from a number of sources. Residential loan originations result from real estate broker referrals, direct solicitation by the Bank's loan officers, present depositors and borrowers, referrals from builders and attorneys, walk-in customers and, in some instances, other lenders. Consumer and commercial real estate loan originations generally emanate from many of the same sources.

Residential loan applications are underwritten and closed based upon standards which generally meet secondary market guidelines. The loan underwriting procedures followed by the Bank conform to regulatory specifications and are designed to assess both the borrower's ability to make principal and interest payments and the value of any assets or property serving as collateral for the loan. Generally, as part of the process, a loan officer meets with each applicant to obtain the appropriate employment and financial information as well as any other required loan information. The Bank then obtains reports with respect to the borrower's credit record, and on real estate loans, orders and reviews an appraisal of any collateral for the loan (prepared for the Bank by an independent appraiser).

Loan applicants are notified promptly of the decision of the Bank. Prior to closing any long-term loan, the borrower must provide proof of fire and casualty insurance on the property serving as collateral, and such insurance must be maintained during the full term of the loan. Title insurance is required on loans collateralized by real property.

The Bank is focusing on the generation of commercial, commercial real estate and agriculture loans to grow and diversify the loan portfolio. However, the slow economic growth has impacted loan origination as a result of decreased demand for loans that meet the Bank's credit standards. In addition, low commodity prices have negatively impacted collateral values and cash flows for agriculture loans, which have caused the Bank to increase underwriting requirements.

Supervision and Regulation

General

FDIC-insured institutions, their holding companies and their affiliates, are extensively regulated under federal and state law. As a result, the Company's growth and earnings performance may be affected not only by management decisions and general economic conditions, but also by the requirements of federal and state statutes and by the regulations and policies of various bank regulatory agencies, including the OCC, the Federal Reserve, the FDIC and the Consumer Financial Protection Bureau (the "CFPB"). Furthermore, taxation laws administered by the Internal Revenue Service and state taxing authorities, accounting rules developed by the Financial Accounting Standards Board, securities laws administered by the Securities and Exchange Commission (the "SEC") and state securities authorities, and anti-money laundering laws enforced by the U.S. Department of the Treasury ("Treasury") have an impact on the Company's business. The effect of these statutes, regulations, regulatory policies and accounting rules are significant to the Company's operations and results.

Federal and state banking laws impose a comprehensive system of supervision, regulation and enforcement on the operations of FDIC-insured institutions, their holding companies and affiliates that is intended primarily for the protection of the FDIC-insured deposits and depositors of banks, rather than shareholders. These laws, and the regulations of the bank regulatory agencies issued under them, affect, among other things, the scope of the Company's business, the kinds and amounts of investments the Company and the Bank may make, reserve requirements, required capital levels relative to assets, the nature and amount of collateral for loans, the establishment of branches, the Company's ability to merge, consolidate and acquire, dealings with the Company's and the Bank's insiders and affiliates and the Company's payment of dividends. In the last several years, the Company has experienced heightened regulatory requirements and scrutiny following the global financial crisis and as a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Although the reforms primarily targeted systemically important financial service providers, their influence filtered down in varying degrees to community banks over time, and the reforms have caused the Company's compliance and risk management processes, and the costs thereof, to increase. While it is anticipated that the Trump administration will not increase the regulatory burden on community banks and may reduce some of the burdens associated with implementation of the Dodd-Frank Act, the true impact of the new administration is impossible to predict with any certainty.

This supervisory and regulatory framework subjects banks and bank holding companies to regular examination by their respective regulatory agencies, which results in examination reports and ratings that are not publicly available and that can impact the conduct and growth of their business. These examinations consider not only compliance with applicable laws and regulations, but also capital levels, asset quality and risk, management ability and performance, earnings, liquidity, and various other factors. The regulatory agencies generally have broad discretion to impose restrictions and limitations on the operations of a regulated entity where the agencies determine, among other things, that such operations are unsafe or unsound, fail to comply with applicable law or are otherwise inconsistent with laws and regulations or with the supervisory policies of these agencies.

The following is a summary of the material elements of the supervisory and regulatory framework applicable to the Company and the Bank, beginning with a discussion of the continuing regulatory emphasis on the Company’s capital levels. It does not describe all of the statutes, regulations and regulatory policies that apply, nor does it restate all of the requirements of those that are described. The descriptions are qualified in their entirety by reference to the particular statutory and regulatory provision.

Regulatory Emphasis on Capital

Regulatory capital represents the net assets of a banking organization available to absorb losses. Because of the risks attendant to their business, FDIC-insured institutions are generally required to hold more capital than other businesses, which directly affects the Company's earnings capabilities. While capital has historically been one of the key measures of the financial health of both bank holding companies and banks, its role became fundamentally more important in the wake of the global financial crisis, as the banking regulators recognized that the amount and quality of capital held by banks prior to the crisis was insufficient to absorb losses during periods of severe stress. Certain provisions of the Dodd-Frank Act and Basel III, discussed below, establish strengthened capital standards for banks and bank holding companies that are meaningfully more stringent than those in place previously.

Minimum Required Capital Levels. Banks have been required to hold minimum levels of capital based on guidelines established by the bank regulatory agencies since 1983. The minimums have been expressed in terms of ratios of capital divided by total assets. As discussed below, bank capital measures have become more sophisticated over the years and have focused more on the quality of capital and the risk of assets. Bank holding companies have historically had to comply with less stringent capital standards than their bank subsidiaries and have been able to raise capital with hybrid instruments such as trust preferred securities. The Dodd-Frank Act mandated the Federal Reserve to establish minimum capital levels for holding companies on a consolidated basis as stringent as those required for FDIC-insured institutions. A result of this change is that the proceeds of hybrid instruments, such as trust preferred securities, are being excluded from capital over a phase-out period. However, if such securities were issued prior to May 19, 2010 by bank holding companies with less than $15 billion of assets, they may be retained, subject to certain restrictions. Because the Company has assets of less than $15 billion, the Company is able to maintain its trust preferred proceeds as capital but the Company has to comply with new capital mandates in other respects and will not be able to raise capital in the future through the issuance of trust preferred securities.

The Basel International Capital Accords. The risk-based capital guidelines for U.S. banks since 1989 were based upon the 1988 capital accord known as "Basel I" adopted by the international Basel Committee on Banking Supervision, a committee of central banks and bank supervisors that acts as the primary global standard-setter for prudential regulation, as implemented by the U.S. bank regulatory agencies on an interagency basis. The accord recognized that bank assets for the purpose of the capital ratio calculations needed to be risk weighted (the theory being that riskier assets should require more capital) and that off-balance sheet exposures needed to be factored in the calculations. Basel I had a very simple formula for assigning risk weights to bank assets from 0% to 100% based on four categories. In 2008, the banking agencies collaboratively began to phase-in capital standards based on a second capital accord, referred to as "Basel II," for large or "core" international banks (generally defined for U.S. purposes as having total assets of $250 billion or more, or consolidated foreign exposures of $10 billion or more) known as "advanced approaches" banks. The primary focus of Basel II was on the calculation of risk weights based on complex models developed by each advanced approaches bank. Because most banks were not subject to Basel II, the U.S. bank regulators worked to improve the risk sensitivity of Basel I standards without imposing the complexities of Basel II. This "standardized approach" increased the number of risk-weight categories and recognized risks well above the original 100% risk weighting. The standardized approach is institutionalized by the Dodd-Frank Act for all banking organizations as a floor.

On September 12, 2010, the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee on Banking Supervision, announced agreement on a strengthened set of capital requirements for banking organizations around the world, known as Basel III, to address deficiencies recognized in connection with the global financial crisis.

The Basel III Rule. In July of 2013, the U.S. federal banking agencies approved the implementation of the Basel III regulatory capital reforms in pertinent part, and, at the same time, promulgated rules effecting certain changes required by the Dodd-Frank Act (the “Basel III Rule”). In contrast to capital requirements historically, which were in the form of guidelines, Basel III was released in the form of enforceable regulations by each of the regulatory agencies. The Basel III Rule is applicable to all banking organizations that are subject to minimum capital requirements, including federal and state banks and savings and loan associations, as well as to bank and savings and loan holding companies, other than “small bank holding companies” (generally holding companies with consolidated assets of less than $1 billion that do not have securities registered with the SEC).

The Basel III Rule required higher capital levels, increased the required quality of capital, and required more detailed categories of risk weighting of riskier, more opaque assets. For nearly every class of assets, the Basel III Rule requires a more complex, detailed and calibrated assessment of credit risk and calculation of risk weightings.

Not only did the Basel III Rule increase most of the required minimum capital ratios in effect prior to January 1, 2015, but it introduced the concept of Common Equity Tier 1 Capital, which consists primarily of common stock, related surplus (net of Treasury stock), retained earnings, and Common Equity Tier 1 minority interests subject to certain regulatory adjustments. The Basel III Rule also changed the definition of capital by establishing more stringent criteria that instruments must meet to be considered Additional Tier 1 Capital (primarily non-cumulative perpetual preferred stock that meets certain requirements) and Tier 2 Capital (primarily other types of preferred stock and subordinated debt, subject to limitations). A number of instruments that qualified as Tier 1 Capital under Basel I do not qualify, or their qualifications changed. For example, noncumulative perpetual preferred stock, which qualified as simple Tier 1 Capital under Basel I, does not qualify as Common Equity Tier 1 Capital, but qualifies as Additional Tier 1 Capital. The Basel III Rule also constrained the inclusion of minority interests, mortgage-servicing assets, and deferred tax assets in capital and requires deductions from Common Equity Tier 1 Capital in the event that such assets exceed a certain percentage of a banking institution’s Common Equity Tier 1 Capital.

The Basel III Rule required **minimum** capital ratios as of January 1, 2015, as follows:

- A ratio of minimum Common Equity Tier 1 Capital equal to 4.5% of risk-weighted assets;
- An increase in the minimum required amount of Tier 1 Capital from 4% to 6% of risk-weighted assets;
- A continuation of the minimum required amount of Total Capital (Tier 1 plus Tier 2) at 8% of risk-weighted assets; and
- A minimum leverage ratio of Tier 1 Capital to total quarterly average assets equal to 4% in all circumstances.

In addition, institutions that seek the freedom to make capital distributions (including for dividends and repurchases of stock) and pay discretionary bonuses to executive officers without restriction must also maintain 2.5% in Common Equity Tier 1 Capital attributable to a capital conservation buffer being phased in over three years beginning in 2016 (which, as of January 1, 2017, was phased in half-way to 1.25%). The purpose of the conservation buffer is to ensure that banking institutions maintain a buffer of capital that can be used to absorb losses during periods of financial and economic stress. Factoring in the fully phased-in conservation buffer increases the minimum ratios depicted above to 7% for Common Equity Tier 1 Capital, 8.5% for Tier 1 Capital and 10.5% for Total Capital.

Banking organizations (except for large, internationally active banking organizations) became subject to the new rules on January 1, 2015. However, there are separate phase-in/phase-out periods for: (i) the capital conservation buffer; (ii) regulatory capital adjustments and deductions; (iii) nonqualifying capital instruments; and (iv) changes to the prompt corrective action rules discussed below. The phase-in periods commenced on January 1, 2016 and extend until 2019.

Well-Capitalized Requirements. The ratios described above are minimum standards in order for banking organizations to be considered "adequately capitalized." Bank regulatory agencies uniformly encourage banks to hold more capital and be "well-capitalized" and, to that end, federal law and regulations provide various incentives for banking organizations to maintain regulatory capital at levels in excess of minimum regulatory requirements. For example, a banking organization that is well-capitalized may: (i) qualify for exemptions from prior notice or application requirements otherwise applicable to certain types of activities; (ii) qualify for expedited processing of other required notices or applications; and (iii) accept, roll-over or renew brokered deposits. Higher capital levels could also be required if warranted by the particular circumstances or risk profiles of individual banking organizations. For example, the Federal Reserve's capital guidelines contemplate that additional capital may be required to take adequate account of, among other things, interest rate risk, or the risks posed by concentrations of credit, nontraditional activities or securities trading activities. Further, any banking organization experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions (*i.e.*, Tier 1 Capital less all intangible assets), well above the minimum levels.

Under the capital regulations of the OCC, in order to be well-capitalized, a banking organization must maintain:

- A Common Equity Tier 1 Capital ratio to risk-weighted assets of 6.5% or more;
- A ratio of Tier 1 Capital to total risk-weighted assets of 8% or more (6% under Basel I);

- A ratio of Total Capital to total risk-weighted assets of 10% or more (the same as Basel I); and

- A leverage ratio of Tier 1 Capital to total adjusted average quarterly assets of 5% or greater.

It is possible under the Basel III Rule to be well-capitalized while remaining out of compliance with the capital conservation buffer discussed above.

As of December 31, 2016: (i) the Bank was not subject to a directive from the OCC to increase its capital and (ii) the Bank was well-capitalized, as defined by OCC regulations. As of December 31, 2016, the Company had regulatory capital in excess of the Federal Reserve's requirements and met the Basel III Rule requirements to be well-capitalized.

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

Regulation and Supervision of the Company

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

Acquisitions, Activities and Change in Control. The primary purpose of a bank holding company is to control and manage banks. The BHCA generally requires the prior approval of the Federal Reserve for any merger involving a bank holding company or any acquisition by a bank holding company of another bank or bank holding company. Subject to certain conditions (including deposit concentration limits established by the BHCA), the Federal Reserve may allow a bank holding company to acquire banks located in any state of the United States. In approving interstate acquisitions, the Federal Reserve is required to give effect to applicable state law limitations on the aggregate amount of deposits that may be held by the acquiring bank holding company and its FDIC-insured institution affiliates in the state in which the target bank is located (provided that those limits do not discriminate against out-of-state institutions or their holding companies) and state laws that require that the target bank have been in existence for a minimum period of time (not to exceed five years) before being acquired by an out-of-state bank holding company. Furthermore, in accordance with the Dodd-Frank Act, bank holding companies must be well-capitalized and examiners must rate them well-managed in order to effect interstate mergers or acquisitions. For a discussion of the capital requirements, see "—Regulatory Emphasis on Capital" above.

The BHCA generally prohibits the Company from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company that is not a bank and from engaging in any business other than that of banking, managing and controlling banks or furnishing services to banks and their subsidiaries. This general prohibition is subject to a number of exceptions. The principal exception allows bank holding companies to engage in, and to own shares of companies engaged in, certain businesses found by the Federal Reserve prior to November 11, 1999 to be "so closely related to banking ... as to be a proper incident thereto." This authority would permit the Company to engage in a variety of banking-related businesses, including the ownership and operation of a savings association, or any entity engaged in consumer finance, equipment leasing, the operation of a computer service bureau (including software development) and mortgage banking and brokerage services. The BHCA does not place territorial restrictions on the domestic activities of nonbank subsidiaries of bank holding companies.

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

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

Capital Requirements. Bank holding companies are required to maintain capital in accordance with Federal Reserve capital adequacy requirements. For a discussion of capital requirements, see “—Regulatory Emphasis on Capital” above.

Dividend Payments. The Company’s ability to pay dividends to its shareholders may be affected by both general corporate law considerations and policies of the Federal Reserve applicable to bank holding companies. As a Delaware corporation, the Company is subject to the limitations of the Delaware General Corporation Law (the “DGCL”). The DGCL allows the Company to pay dividends only out of its surplus (as defined and computed in accordance with the provisions of the DGCL) or if the Company has no such surplus, out of its net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year.

As a general matter, the Federal Reserve has indicated that the board of directors of a bank holding company should eliminate, defer or significantly reduce dividends to shareholders if: (i) the company’s net income available to shareholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends; (ii) the prospective rate of earnings retention is inconsistent with the company’s capital needs and overall current and prospective financial condition; or (iii) the company will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. The Federal Reserve also possesses enforcement powers over bank holding companies and their non-bank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to proscribe the payment of dividends by banks and bank holding companies. In addition, under the Basel III Rule, institutions that seek the freedom to pay dividends will have to maintain 2.5% in Common Equity Tier 1 Capital attributable to the capital conservation buffer to be phased in over three years beginning in 2016. See “—Regulatory Emphasis on Capital” above.

Incentive Compensation. There have been a number of developments in recent years focused on incentive compensation plans sponsored by bank holding companies and banks, reflecting recognition by the bank regulatory agencies and Congress that flawed incentive compensation practices in the financial industry were one of many factors contributing to the global financial crisis. Layered on top of that are the abuses in the headlines dealing with product cross-selling incentive plans. The result is interagency guidance on sound incentive compensation practices and proposed rulemaking by the agencies required under Section 956 of the Dodd-Frank Act.

The interagency guidance recognized three core principles: effective incentive plans should: (i) provide employees incentives that appropriately balance risk and reward; (ii) be compatible with effective controls and risk-management; and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors. Much of the guidance addresses large banking organizations and, because of the size and complexity of their operations, the regulators expect those organizations to maintain systematic and formalized policies, procedures, and systems for ensuring that the incentive compensation arrangements for all executive and non-executive employees covered by this guidance are identified and reviewed, and appropriately balance risks and rewards. Smaller banking organizations like the Company that use incentive compensation arrangements are expected to be less extensive, formalized, and detailed than those of the larger banks.

Monetary Policy. The monetary policy of the Federal Reserve has a significant effect on the operating results of financial or bank holding companies and their subsidiaries. Among the tools available to the Federal Reserve to affect the money supply are open market transactions in U.S. government securities, changes in the discount rate on bank borrowings and changes in reserve requirements against bank deposits. These means are used in varying combinations to influence overall growth and distribution of bank loans, investments and deposits, and their use may affect interest rates charged on loans or paid on deposits.

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

Corporate Governance. The Dodd-Frank Act addressed many investor protection, corporate governance and executive compensation matters that will affect most U.S. publicly traded companies. It increased stockholder influence over boards of directors by requiring companies to give stockholders a non-binding vote on executive compensation and so-called "golden parachute" payments, and authorizing the SEC to promulgate rules that would allow stockholders to nominate and solicit voters for their own candidates using a company's proxy materials. The legislation also directed the Federal Reserve to promulgate rules prohibiting excessive compensation paid to executives of bank holding companies, regardless of whether such companies are publicly traded.

Regulation and Supervision of the Bank

General. The Bank is a national bank, chartered by the OCC under the National Bank Act. The deposit accounts of the Bank are insured by the DIF to the maximum extent provided under federal law and FDIC regulations, currently $250,000 per insured depositor category, and the Bank is a member of the Federal Reserve System. As a national bank, the Bank is subject to the examination, supervision, reporting and enforcement requirements of the OCC, the chartering authority for national banks. The FDIC, as administrator of the DIF, also has regulatory authority over the Bank.

Deposit Insurance. As an FDIC-insured institution, the Bank is required to pay deposit insurance premium assessments to the FDIC. The FDIC has adopted a risk-based assessment system whereby FDIC-insured institutions pay insurance premiums at rates based on their risk classification. The total base assessment rates currently range from three basis points to 30 basis points. At least semi-annually, the FDIC updates its loss and income projections for the DIF and, if needed, increases or decreases the assessment rates, following notice and comment on proposed rulemaking. The assessment base against which an FDIC-insured institution's deposit insurance premiums paid to the DIF are calculated is based on its average consolidated total assets less its average tangible equity. This method shifts the burden of deposit insurance premiums toward those large depository institutions that rely on funding sources other than U.S. deposits.

The reserve ratio is the DIF balance divided by estimated insured deposits. The Dodd-Frank Act altered the minimum reserve ratio of the DIF, increasing the minimum from 1.15% to 1.35% of the estimated amount of total insured deposits, and eliminating the requirement that the FDIC pay dividends to FDIC-insured institutions when the reserve ratio exceeds certain thresholds. The reserve ratio reached 1.15% on June 30, 2016, when revised factors were put in place for calculating the assessment. If the reserve ratio does not reach 1.35% by December 31, 2018 (provided it is at least 1.15%), the FDIC will impose a shortfall assessment on March 31, 2019 on insured depository institutions with total consolidated assets of $10 billion or more. The FDIC will provide assessment credits to insured depository institutions, like the Bank, with total consolidated assets of less than $10 billion for the portion of their regular assessments that contribute to growth in the reserve ratio between 1.15% and 1.35%. The FDIC will apply the credits each quarter that the reserve ratio is at least 1.38% to offset the regular deposit insurance assessments of institutions with credits.

FICO Assessments. In addition to paying basic deposit insurance assessments, FDIC-insured institutions must pay Financing Corporation ("FICO") assessments. FICO is a mixed-ownership governmental corporation chartered by the former Federal Home Loan Bank Board pursuant to the Competitive Equality Banking Act of 1987 to function as a financing vehicle for the recapitalization of the former Federal Savings and Loan Insurance Corporation. FICO issued 30-year noncallable bonds of approximately $8.1 billion that mature in 2017 through 2019. FICO's authority to issue bonds ended on December 12, 1991. Since 1996, federal legislation has required that all FDIC-insured institutions pay assessments to cover interest payments on FICO's outstanding obligations. The FICO assessment rate is adjusted quarterly and for the fourth quarter of 2016 was 0.560 basis points (56 cents per $100 dollars of assessable deposits).

Supervisory Assessments. National banks are required to pay supervisory assessments to the OCC to fund the operations of the OCC. The amount of the assessment is calculated using a formula that takes into account the bank's size and its supervisory condition. During the year ended December 31, 2016, the Bank paid supervisory assessments to the OCC totaling $222,000.

Capital Requirements. Banks are generally required to maintain capital levels in excess of other businesses. For a discussion of capital requirements, see "—Regulatory Emphasis on Capital" above.

Liquidity Requirements. Liquidity is a measure of the ability and ease with which bank assets may be converted to cash. Liquid assets are those that can be converted to cash quickly if needed to meet financial obligations. To remain viable, FDIC-insured institutions must have enough liquid assets to meet their near-term obligations, such as withdrawals by depositors. Because the global financial crisis was in part a liquidity crisis, Basel III also includes a liquidity framework that requires FDIC-insured institutions to measure their liquidity against specific liquidity tests. One test, referred to as the Liquidity Coverage Ratio ("LCR"), is designed to ensure that the banking entity has an adequate stock of unencumbered high-quality liquid assets that can be converted easily and immediately in private markets into cash to meet liquidity needs for a 30-calendar day liquidity stress scenario. The other test, known as the Net Stable Funding Ratio ("NSFR"), is designed to promote more medium- and long-term funding of the assets and activities of FDIC-insured institutions over a one-year horizon. These tests provide an incentive for banks and holding companies to increase their holdings in Treasury securities and other sovereign debt as a component of assets, increase the use of long-term debt as a funding source and rely on stable funding like core deposits (in lieu of brokered deposits).

In addition to liquidity guidelines already in place, the federal bank regulatory agencies implemented the Basel III LCR in 2014 and have proposed the NSFR. While the LCR only applies to the largest banking organizations in the country, as will the NSFR, certain elements are expected to filter down to all FDIC-insured institutions. The Company continues to review the Company's liquidity risk management policies in light of the LCR and NSFR.

Stress Testing. A stress test is an analysis or simulation designed to determine the ability of a given FDIC-insured institution to deal with an economic crisis. In October 2012, U.S. bank regulators unveiled new rules mandated by the Dodd-Frank Act that require the largest U.S. banks to undergo stress tests twice per year, once internally and once conducted by the regulators. Stress tests are not required for banks with less than $10 billion in assets; however, the FDIC now recommends stress testing as means to identify and quantify loan portfolio risk and the Bank is engaged in the process.

Dividend Payments. The primary source of funds for the Company is dividends from the Bank. Under the National Bank Act, a national bank may pay dividends out of its undivided profits in such amounts and at such times as the bank's board of directors deems prudent. Without prior OCC approval, however, a national bank may not pay dividends in any calendar year that, in the aggregate, exceed the bank's year-to-date net income plus the bank's retained net income for the two preceding years. The payment of dividends by any FDIC-insured institution is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and an FDIC-insured institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. As described above, the Bank exceeded its capital requirements under applicable guidelines as of December 31, 2016. Notwithstanding the availability of funds for dividends, however, the OCC may prohibit the payment of dividends by the Bank if it determines such payment would constitute an unsafe or unsound practice. In addition, under the Basel III Rule, institutions that seek the freedom to pay dividends will have to maintain 2.5% in Common Equity Tier 1 Capital attributable to the capital conservation buffer to be phased in over three years beginning in 2016. See "—Regulatory Emphasis on Capital" above.

Insider Transactions. The Bank is subject to certain restrictions imposed by federal law on "covered transactions" between the Bank and its "affiliates." The Company is an affiliate of the Bank for purposes of these restrictions, and covered transactions subject to the restrictions include extensions of credit to the Company, investments in the stock or other securities of the Company and the acceptance of the stock or other securities of the Company as collateral for loans made by the Bank. The Dodd-Frank Act enhanced the requirements for certain transactions with affiliates, including an expansion of the definition of "covered transactions" and an increase in the amount of time for which collateral requirements regarding covered transactions must be maintained.

Certain limitations and reporting requirements are also placed on extensions of credit by the Bank to its directors and officers, to directors and officers of the Company and its subsidiaries, to principal shareholders of the Company and to “related interests” of such directors, officers and principal shareholders. In addition, federal law and regulations may affect the terms upon which any person who is a director or officer of the Company or the Bank, or a principal shareholder of the Company, may obtain credit from banks with which the Bank maintains a correspondent relationship.

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

In general, the safety and soundness guidelines prescribe the goals to be achieved in each area, and each institution is responsible for establishing its own procedures to achieve those goals. If an institution fails to comply with any of the standards set forth in the guidelines, the FDIC-insured institution’s primary federal regulator may require the institution to submit a plan for achieving and maintaining compliance. If an FDIC-insured institution fails to submit an acceptable compliance plan, or fails in any material respect to implement a compliance plan that has been accepted by its primary federal regulator, the regulator is required to issue an order directing the institution to cure the deficiency. Until the deficiency cited in the regulator’s order is cured, the regulator may restrict the FDIC-insured institution’s rate of growth, require the FDIC-insured institution to increase its capital, restrict the rates the institution pays on deposits or require the institution to take any action the regulator deems appropriate under the circumstances. Noncompliance with the standards established by the safety and soundness guidelines may also constitute grounds for other enforcement action by the federal bank regulatory agencies, including cease and desist orders and civil money penalty assessments.

During the past decade, the bank regulatory agencies have increasingly emphasized the importance of sound risk management processes and strong internal controls when evaluating the activities of the FDIC-insured institutions they supervise. Properly managing risks has been identified as critical to the conduct of safe and sound banking activities and has become even more important as new technologies, product innovation, and the size and speed of financial transactions have changed the nature of banking markets. The agencies have identified a spectrum of risks facing a banking institution including, but not limited to, credit, market, liquidity, operational, legal, and reputational risk. In particular, recent regulatory pronouncements have focused on operational risk, which arises from the potential that inadequate information systems, operational problems, breaches in internal controls, fraud, or unforeseen catastrophes will result in unexpected losses. New products and services, third-party risk and cybersecurity are critical sources of operational risk that FDIC-insured institutions are expected to address in the current environment. The Bank is expected to have active board and senior management oversight; adequate policies, procedures, and limits; adequate risk measurement, monitoring, and management information systems; and comprehensive internal controls.

Branching Authority. National banks headquartered in Kansas, such as the Bank, have the same branching rights in Kansas as banks chartered under Kansas law, subject to OCC approval. Kansas law grants Kansas-chartered banks the authority to establish branches anywhere in the State of Kansas, subject to receipt of all required regulatory approvals.

Federal law permits state and national banks to merge with banks in other states subject to: (i) regulatory approval; (ii) federal and state deposit concentration limits; and (iii) state law limitations requiring the merging bank to have been in existence for a minimum period of time (not to exceed five years) prior to the merger. However, the Dodd-Frank Act permits well-capitalized and well-managed banks to establish new branches across state lines without these impediments.

Financial Subsidiaries. Under federal law and OCC regulations, national banks are authorized to engage, through "financial subsidiaries," in any activity that is permissible for a financial holding company and any activity that the Secretary of the Treasury, in consultation with the Federal Reserve, determines is financial in nature or incidental to any such financial activity, except (i) insurance underwriting, (ii) real estate development or real estate investment activities (unless otherwise permitted by law), (iii) insurance company portfolio investments and (iv) merchant banking. The authority of a national bank to invest in a financial subsidiary is subject to a number of conditions, including, among other things, requirements that the bank must be well-managed and well-capitalized (after deducting from capital the bank's outstanding investments in financial subsidiaries). The Bank has not applied for approval to establish any financial subsidiaries.

Federal Home Loan Bank System. The Bank is a member of the FHLB of Topeka, which serves as a central credit facility for its members. The FHLB is funded primarily from proceeds from the sale of obligations of the FHLB system. It makes loans to member banks in the form of FHLB advances. All advances from the FHLB are required to be fully collateralized as determined by the FHLB.

Transaction Account Reserves. Federal Reserve regulations require FDIC-insured institutions to maintain reserves against their transaction accounts (primarily NOW and regular checking accounts). For 2017: the first $15.5 million of otherwise reservable balances are exempt from reserves and have a zero percent reserve requirement; for transaction accounts aggregating more than $15.5 million to $115.1 million, the reserve requirement is 3% of total transaction accounts; and for net transaction accounts in excess of $115.1 million, the reserve requirement is 3% up to $115.1 million plus 10% of the aggregate amount of total transaction accounts in excess of $115.1 million. These reserve requirements are subject to annual adjustment by the Federal Reserve.

Community Reinvestment Act Requirements. The Community Reinvestment Act requires the Bank to have a continuing and affirmative obligation in a safe and sound manner to help meet the credit needs of its entire community, including low- and moderate-income neighborhoods. Federal regulators regularly assess the Bank's record of meeting the credit needs of its communities. Applications for additional acquisitions would be affected by the evaluation of the Bank's effectiveness in meeting its Community Reinvestment Act requirements.

Anti-Money Laundering. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "Patriot Act") is designed to deny terrorists and criminals the ability to obtain access to the U.S. financial system and has significant implications for FDIC-insured institutions, brokers, dealers and other businesses involved in the transfer of money. The Patriot Act mandates financial services companies to have policies and procedures with respect to measures designed to address any or all of the following matters: (i) customer identification programs; (ii) money laundering; (iii) terrorist financing; (iv) identifying and reporting suspicious activities and currency transactions; (v) currency crimes; and (vi) cooperation between FDIC-insured institutions and law enforcement authorities.

Concentrations in Commercial Real Estate. Concentration risk exists when FDIC-insured institutions deploy too many assets to any one industry or segment. A concentration in commercial real estate is one example of regulatory concern. The interagency Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices guidance ("CRE Guidance") provides supervisory criteria, including the following numerical indicators, to assist bank examiners in identifying banks with potentially significant commercial real estate loan concentrations that may warrant greater supervisory scrutiny: (i) commercial real estate loans exceeding 300% of capital and increasing 50% or more in the preceding three years; or (ii) construction and land development loans exceeding 100% of capital. The CRE Guidance does not limit banks' levels of commercial real estate lending activities, but rather guides institutions in developing risk management practices and levels of capital that are commensurate with the level and nature of their commercial real estate concentrations. On December 18, 2015, the federal banking agencies issued a statement to reinforce prudent risk-management practices related to CRE lending, having observed substantial growth in many

CRE asset and lending markets, increased competitive pressures, rising CRE concentrations in banks, and an easing of CRE underwriting standards. The federal bank agencies reminded FDIC-insured institutions to maintain underwriting discipline and exercise prudent risk-management practices to identify, measure, monitor, and manage the risks arising from CRE lending. In addition, FDIC-insured institutions must maintain capital commensurate with the level and nature of their CRE concentration risk.

Based on the Bank’s loan portfolio as of December 31, 2016, it did not exceed the 300% guideline for commercial real estate loans.

Consumer Financial Services. The historical structure of federal consumer protection regulation applicable to all providers of consumer financial products and services changed significantly on July 21, 2011, when the CFPB commenced operations to supervise and enforce consumer protection laws. The CFPB has broad rulemaking authority for a wide range of consumer protection laws that apply to all providers of consumer products and services, including the Bank, as well as the authority to prohibit “unfair, deceptive or abusive” acts and practices. The CFPB has examination and enforcement authority over providers with more than $10 billion in assets. FDIC-insured institutions with $10 billion or less in assets, like the Bank, continue to be examined by their applicable bank regulators.

Because abuses in connection with residential mortgages were a significant factor contributing to the global financial crisis, many new rules issued by the CFPB and required by the Dodd-Frank Act address mortgage and mortgage-related products, their underwriting, origination, servicing and sales. The Dodd-Frank Act significantly expanded underwriting requirements applicable to loans secured by 1-4 family residential real property and augmented federal law combating predatory lending practices. In addition to numerous disclosure requirements, the Dodd-Frank Act imposed new standards for mortgage loan originations on all lenders, including all FDIC-insured institutions, in an effort to strongly encourage lenders to verify a borrower's "ability to repay," while also establishing a presumption of compliance for certain "qualified mortgages." In addition, the Dodd-Frank Act generally required lenders or securitizers to retain an economic interest in the credit risk relating to loans that the lender sells, and other asset-backed securities that the securitizer issues, if the loans have not complied with the ability-to-repay standards. The Company does not currently expect the CFPB's rules to have a significant impact on the Bank's operations, except for higher compliance costs.

Company Web site

The Company maintains a corporate Web site at www.landmarkbancorpinc.com. In addition, the Company has an investor relations link at the Bank's corporate Web site at www.banklandmark.com. Many of the Company's policies, including its code of ethics, committee charters and other investor information, are available on its website. The Company makes available free of charge on or through its website its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after the Company electronically files such material with, or furnishes it to, the SEC. Copies of the Company's filings with the SEC are also available from the SEC's website (http://www.sec.gov) free of charge. The Company will also provide copies of its filings free of charge upon written request to our Corporate Secretary at Landmark Bancorp, Inc., 701 Poyntz Avenue, Manhattan, Kansas 66502.

Statistical Data

The Company has a fiscal year ending on December 31. Unless otherwise noted, the information presented in this Annual Report on Form 10-K presents information on behalf of the Company as of and for the year ended December 31, 2016.

The statistical data required by Guide 3 of the Securities Act of 1933 Industry Guides is set forth in the following pages. This data should be read in conjunction with the consolidated financial statements, related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in this Annual Report on Form 10-K.

I. Distribution of Assets, Liabilities, and Stockholders' Equity; Interest Rates and Interest Differential

The following table describes the extent to which changes in tax equivalent interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities affected the Company's interest income and expense during the periods indicated. The table distinguishes between (i) changes attributable to rate (changes in rate multiplied by prior volume), (ii) changes attributable to volume (changes in volume multiplied by prior rate), and (iii) net change (the sum of the previous columns). The net changes attributable to the combined effect of volume and rate, which cannot be segregated, have been allocated proportionately to the change due to volume and the change due to rate.

	Years ended December 31,					
	2016 vs 2015			2015 vs 2014		
	Increase/(decrease) attributable to			Increase/(decrease) attributable to		
	Volume	Rate	Net	Volume	Rate	Net
	(Dollars in thousands)					
Interest income:						
Interest-bearing deposits at banks	$1	$9	$10	$ (14)	$ -	$ (14)
Investment securities						
Taxable	(263)	221	(42)	113	366	479
Tax-exempt	832	(302)	530	919	(219)	700
Loans	264	(367)	(103)	304	(119)	185
Total	834	(439)	395	1,322	28	1,350
Interest expense:						
Deposits	6	57	63	14	(178)	(164)
Borrowings	39	8	47	150	(91)	59

Total	45	65	110	164	(269)	(105)
Net interest income	$789	$(504)	$285	$ 1,158	$ 297	$ 1,455

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The following table sets forth information relating to average balances of interest-earning assets and interest-bearing liabilities for the years ended December 31, 2016, 2015 and 2014. Average balances are derived from daily average balances. Non-accrual loans were included in the computation of average balances but have been reflected in the table as loans carrying a zero yield. The yields set forth in the table below include the effect of deferred fees, discounts and premiums that are amortized or accreted to interest income or interest expense. This table reflects the average yields on assets and average costs of liabilities for the periods indicated (derived by dividing income or expense by the monthly average balance of assets or liabilities, respectively) as well as the "net interest margin" (which reflects the effect of the net earnings balance) for the periods shown.

	Average balance	Income/ expense	Yield/ cost	Average balance	Income/ expense	Yield/ cost	Average balance	Income/ expense	Yield/ cost
(Dollars in thousands)									
Assets									
Interest-earning assets:									
Interest bearing deposits at banks	$3,075	$17	0.55%	$2,817	$7	0.25%	$8,266	$21	0.25%
Investment securities									
Taxable	219,091	4,535	2.07%	227,161	4,577	2.01%	221,215	4,098	1.85%
Tax-exempt (1)	152,737	5,132	3.36%	126,796	4,602	3.63%	100,965	3,902	3.86%
Loans receivable, net (2)	433,707	21,377	4.93%	428,780	21,480	5.01%	422,342	21,295	5.04%
Total interest-earning assets	808,610	31,061	3.84%	785,554	30,666	3.90%	752,788	29,316	3.89%
Non-interest-earning assets	85,759			84,831			84,468		
Total	$894,369			$870,385			$837,256		
Liabilities and Stockholders' Equity									
Interest-bearing liabilities:									
Money market and checking	$330,252	$458	0.14%	$321,184	$311	0.10%	$297,998	$282	0.09%
Savings accounts	86,538	26	0.03%	78,791	24	0.03%	73,743	23	0.03%
Time deposit	144,678	650	0.45%	158,172	736	0.47%	180,634	930	0.51%
Total deposits	561,468	1,134	0.20%	558,147	1,071	0.19%	552,375	1,235	0.22%
FHLB advances and other borrowings	79,090	2,057	2.60%	77,683	2,010	2.59%	71,253	1,951	2.74%
Total interest-bearing liabilities	640,558	3,191	0.50%	635,830	3,081	0.48%	623,628	3,186	0.51%
Non-interest-bearing liabilities	167,144			158,470			145,907		
Stockholders' equity	86,667			76,085			67,721		
Total	$894,369			$870,385			$837,256		

Interest rate spread (3)		3.34 %		3.42 %		3.38 %
Net interest margin (4)	$27,870	3.45 %	$27,585	3.51 %	$26,130	3.47 %
Tax equivalent interest - imputed (1) (2)	1,831		1,669		1,466	
Net interest income	$26,039		$25,916		$24,664	
Ratio of average interest-earning assets to average interest-bearing liabilities	126.2 %		123.5 %		120.7 %	

(1) Income on tax-exempt investment securities is presented on a fully taxable equivalent basis, using a 34% federal tax rate.
(2) Income on tax-exempt loans is presented on a fully taxable equivalent basis, using a 34% federal tax rate.
(3) Interest rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.
(4) Net interest margin represents net interest income divided by average interest-earning assets.

II. Investment Portfolio

Investment Securities. The following table sets forth the carrying value of the Company's investment securities at the dates indicated. None of the investment securities issued by an individual issuer held as of December 31, 2016 were in excess of 10% of the Company's stockholders' equity, excluding U.S. federal agency obligations. The Company's federal agency obligations consist of obligations of U.S. government-sponsored enterprises, primarily the FHLB. The Company's agency mortgage-backed securities portfolio consists of securities predominantly underwritten to the standards and guaranteed by the government-sponsored agencies of Federal Home Loan Mortgage Corporation, Federal National Mortgage Association and Government National Mortgage Association. The Company's investments in certificates of deposits consist of FDIC-insured certificates of deposits with other financial institutions.

	As of December 31,		
	2016	2015	2014
	(Dollars in thousands)		
Investment securities:			
U.S. treasury securities	$6,015	$6,517	$6,530
U.S. federal agency obligations	27,139	29,920	25,743
Municipal obligations, tax-exempt	161,662	137,941	110,509
Municipal obligations, taxable	71,563	81,890	63,922
Agency mortgage-backed securities	108,376	85,985	135,519
Certificates of deposits	9,700	9,699	5,425
Common stocks	1,108	1,486	1,283
Total investment securities available-for-sale, at fair value	$385,563	$353,438	$348,931
FHLB stock	3,276	2,483	1,996
Federal Reserve Bank stock	1,912	1,903	1,900
Correspondent bank common stock	111	111	111
Bank stocks, at cost	$5,299	$4,497	$4,007

The following table sets forth certain information regarding the carrying values, weighted average yields, and maturities of the Company's investment securities portfolio, excluding common stocks, as of December 31, 2016. Yields on tax-exempt obligations have been computed on a tax equivalent basis, using a 34% federal tax rate. Mortgage-backed investment securities include scheduled principal payments and estimated prepayments based on observable market inputs. Actual prepayments will differ from contractual maturities because borrowers have the right to prepay obligations with or without prepayment penalties.

	As of December 31, 2016									
	One year or less		One to five years		Five to ten years		More than ten years		Total	
	Carrying	Average	Carrying	Average	Carrying	Average	Carrying	Average	Carrying	Average

	value	yield	value	yield	value	yield	value	yield	value	yield
	(Dollars in thousands)									
Investment securities:										
U.S. treasury securities	$6,015	1.04 %	$-	0.00 %	$-	0.00 %	$-	0.00 %	$6,015	1.04 %
U.S. federal agency obligations	8,458	0.97 %	18,215	1.28 %	251	2.46 %	215	3.77 %	27,139	1.21 %
Municipal obligations, tax-exempt	7,451	2.56 %	37,658	2.74 %	55,253	3.30 %	61,300	3.92 %	161,662	3.37 %
Municipal obligations, taxable	10,935	1.87 %	26,315	1.97 %	24,155	2.82 %	10,158	3.57 %	71,563	2.47 %
Agency mortgage-backed securities	876	2.62 %	97,459	2.05 %	5,301	2.77 %	4,740	2.63 %	108,376	2.12 %
Certificates of deposits	972	0.88 %	8,728	1.56 %	-	0.00 %	-	0.00 %	9,700	1.49 %
Total	$34,707	1.65 %	$188,375	2.08 %	$84,960	3.13 %	$76,413	3.79 %	$384,455	2.61 %

III. Loan Portfolio

Loan Portfolio Composition. The following table sets forth the composition of the loan portfolio by type of loan at the dates indicated.

	As of December 31,				
	2016	2015	2014	2013	2012
	(Dollars in thousands)				
Balance					
One-to-four family residential real estate loans	$136,846	$131,930	$127,555	$125,087	$88,454
Construction and land loans	13,738	15,043	21,950	23,776	23,435
Commercial real estate loans	118,200	118,983	118,411	119,390	88,790
Commercial loans	54,506	61,300	59,971	61,383	64,570
Agriculture loans	78,324	71,030	64,316	62,287	31,935
Municipal loans	3,884	7,635	8,982	8,846	9,857
Consumer loans	20,271	19,895	20,044	18,600	13,417
Total gross loans	425,769	425,816	421,229	419,369	320,458
Net deferred loan costs and loans in process	36	29	281	187	37
Allowance for loan losses	(5,344)	(5,922)	(5,320)	(5,540)	(4,581)
Loans, net	$420,461	$419,923	$416,190	$414,016	$315,914
Percent of total					
One-to-four family residential real estate loans	32.1 %	31.0 %	30.3 %	29.8 %	27.6 %
Construction and land loans	3.2 %	3.5 %	5.2 %	5.7 %	7.3 %
Commercial real estate loans	27.8 %	27.9 %	28.1 %	28.5 %	27.7 %
Commercial loans	12.8 %	14.4 %	14.2 %	14.6 %	20.1 %
Agriculture loans	18.4 %	16.7 %	15.3 %	14.9 %	10.0 %
Municipal loans	0.9 %	1.8 %	2.1 %	2.1 %	3.1 %
Consumer loans	4.8 %	4.7 %	4.8 %	4.4 %	4.2 %
Total gross loans	100.0 %	100.0 %	100.0 %	100.0 %	100.0 %

The following table sets forth the contractual maturities of loans as of December 31, 2016. The table does not include unscheduled prepayments.

	As of December 31, 2016			
	< 1 year	1-5 years	> 5 years	Total
	(Dollars in thousands)			
One-to-four family residential real estate loans	$16,938	$59,023	$60,885	$136,846
Construction and land loans	9,815	1,645	2,278	13,738

Commercial real estate loans	17,711	45,381	55,108	118,200
Commercial loans	38,175	13,408	2,923	54,506
Agriculture loans	41,030	18,305	18,989	78,324
Municipal loans	464	996	2,424	3,884
Consumer loans	3,233	5,418	11,620	20,271
Total gross loans	$127,366	$144,176	$154,227	$425,769

The following table sets forth the dollar amount of all loans due after December 31, 2016 and whether such loans had fixed interest rates or adjustable interest rates:

	As of December 31, 2016		
	Fixed	Adjustable	Total
	(Dollars in thousands)		
One-to-four family residential real estate loans	$74,608	$45,300	$119,908
Construction and land loans	391	3,532	3,923
Commercial real estate loans	17,488	83,001	100,489
Commercial loans	9,259	7,072	16,331
Agriculture loans	19,137	18,157	37,294
Municipal loans	3,420	-	3,420
Consumer loans	2,136	14,902	17,038
Total gross loans	$126,439	$171,964	$298,403

Non-performing Assets. The following table sets forth information with respect to non-performing assets, including non-accrual loans and real estate acquired through foreclosure or by deed in lieu of foreclosure ("real estate owned"). Under the original terms of the Company's non-accrual loans as of December 31, 2016, interest earned on such loans for the years ended December 31, 2016, 2015 and 2014 would have increased interest income by $75,000, $99,000 and $525,000, respectively, if included in the Company's interest income for those years. No interest income related to non-accrual loans was included in interest income for the years ended December 31, 2016, 2015 and 2014.

	As of December 31,				
	2016	2015	2014	2013	2012
	(Dollars in thousands)				
Non-accrual loans	$2,746	$2,168	$6,046	$9,836	$9,108
Accruing loans over 90 days past due	-	-	-	-	-
Non-performing investments	-	-	-	-	-
Real estate owned, net	1,279	1,000	255	400	2,444
Non-performing assets	$4,025	$3,168	$6,301	$10,236	$11,552
Performing TDRs	$3,983	$4,669	$4,657	$6,920	$5,846
Non-performing loans to total gross loans	0.64 %	0.51 %	1.44 %	2.35 %	2.84 %
Non-performing assets to total assets	0.44 %	0.36 %	0.73 %	1.24 %	1.88 %
Allowance for loan losses to non-performing loans	194.61 %	273.15 %	87.99 %	56.32 %	50.30 %

The increase in non-accrual loans during 2016 compared to 2015 was primarily driven by higher levels on non-performing agriculture loans. The decrease in non-accrual loans during 2015 compared to 2014 was primarily the result of a $2.0 million commercial real estate loan that returned to accrual status, the payoff of a $1.6 million land loan relationship and from transfers to real estate owned. The decrease in non-accrual loans during 2014 compared to 2013 was principally associated with a $4.0 million commercial loan relationship which was placed on non-accrual status in 2013 as the performance of the business deteriorated and the borrower agreed to sell the business. The business was liquidated in 2014 and resulted in a charge-off of $755,000, and the Bank received $3.2 million as a payoff for the credit. The increase in non-accrual loans during 2013 compared to 2012 was primarily due to the $4.0 million commercial loan relationship that was placed on non-accrual status in 2013, as discussed above, which was partially offset by the return to accrual status of $1.5 million of a $2.2 million land loan that was subject to a troubled debt restructuring ("TDR") in 2012 after a payment history was established based on the terms of the TDR. Also partially offsetting the increase in our non-accrual loan balances in 2013 was the pay down of a $1.1 million commercial loan with proceeds from the liquidation of the borrower's assets in 2013. The remaining loan balance of $192,000 was charged off in 2013.

At December 31, 2016, the $1.3 million of real estate owned primarily consisted of residential real estate properties. The increase in real estate owned during 2016 and 2015 compared to 2014 was principally associated with obtaining the collateral securing a non-performing loan relationship. The decline in real estate owned during 2014 compared to 2013 was principally associated with the sale of residential real estate properties. The decline in real estate owned during 2013 compared to 2012 was principally associated with the sale of a residential subdivision development, a commercial real estate building and land previously acquired by the Bank for expansion.

As part of the Company's credit risk management, the Company continues to aggressively manage the loan portfolio to identify problem loans and has placed additional emphasis on its commercial real estate relationships. As discussed in more detail in the "Asset Quality and Distribution" section of Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," as of December 31, 2016, the Company concluded its allowance for loan losses was adequate based on the evaluation of the loan portfolio's probable incurred losses.

IV. Summary of Loan Loss Experience

The following table sets forth information with respect to the Company's allowance for loan losses at the dates and for the periods indicated:

	As of and for the year ended December 31,				
	2016	2015	2014	2013	2012
	(Dollars in thousands)				
Balances at beginning of year	$5,922	$5,320	$5,540	$4,581	$4,707
Provision for loan losses	500	(700)	600	800	1,900
Charge-offs:					
One-to-four family residential real estate loans	(14)	(57)	(29)	(93)	(70)
Construction and land loans	-	-	-	(53)	(1,749)
Commercial real estate loans	-	(13)	-	(11)	-
Commercial loans	(306)	(78)	(783)	(200)	(70)
Agriculture loans	(375)	-	-	-	-
Municipal loans	-	(88)	-	(65)	-
Consumer loans	(471)	(318)	(237)	(194)	(238)
Total charge-offs	(1,166)	(554)	(1,049)	(616)	(2,127)
Recoveries:					
One-to-four family residential real estate loans	9	10	12	202	20
Construction and land loans	-	1,722	166	523	4
Commercial real estate loans	-	2	4	-	-
Commercial loans	34	15	2	20	12
Agriculture loans	-	73	-	-	39

Municipal loans	6	-	-	-	-
Consumer loans	39	34	45	30	26
Total recoveries	88	1,856	229	775	101
Net recoveries (charge-offs)	(1,078)	1,302	(820)	159	(2,026)
Balances at end of year	$5,344	$5,922	$5,320	$5,540	$4,581
Allowance for loan losses to total gross loans	1.26 %	1.39 %	1.26 %	1.32 %	1.43 %
Net loans charged off (recovered) to average net loans	0.25 %	(0.31 %)	0.20 %	(0.05 %)	0.66 %

The Company recorded net loan charge-offs of $1.1 million during 2016, which were primarily related to an agriculture loan relationship which was subject to a TDR and the liquidation of the assets securing an impaired commercial loan relationship. We recorded net loan recoveries of $1.3 million during 2015, which were primarily associated with the recovery of $1.7 million on a $4.3 million construction loan which was fully charged-off during 2010 and 2011. As of December 31, 2016, we have recovered approximately $2.4 million of the loan, and the Company continues to pursue collection of the remaining amount. During 2014, we had net loan charge-offs of $820,000. The charge-offs were primarily associated with a previously identified and impaired $4.0 million commercial loan relationship. During 2013, we had net loan recoveries of $159,000, which were primarily associated with the $4.3 million construction loan noted above and recoveries on the payoff of a one-to-four family residential real estate loan which had been partially charged-off as part of a TDR in 2010. During 2012, we had net loan charge-offs of $2.0 million which were primarily associated with two land loans that were the subject of TDRs, resulting in charge-offs to reduce the loans down to the market value of the collateral.

The distribution of the Company's allowance for losses on loans at the dates indicated and the percent of loans in each category to total loans is summarized in the following table. This allocation reflects management's judgment as to risks inherent in the types of loans indicated, but in general the Company's total allowance for loan losses included in the table is not restricted and is available to absorb all loan losses. The amount allocated in the following table to any category should not be interpreted as an indication of expected actual charge-offs in that category.

	As of December 31,														
	2016			2015			2014			2013			2012		
	Amount	% Loan type to total loans		Amount	% Loan type to total loans		Amount	% Loan type to total loans		Amount	% Loan type to total loans		Amount	% Loan type to total loans	
	(Dollars in thousands)														
One-to-four family residential real estate loans	$504	32.1	%	$925	31.0	%	$755	30.3	%	$732	29.8	%	$714	27.6	%
Construction and land loans	53	3.2	%	77	3.5	%	762	5.2	%	1,343	5.7	%	1,214	7.3	%
Commercial real estate loans	1,777	27.8	%	1,740	27.9	%	1,832	28.1	%	1,970	28.5	%	1,313	27.7	%
Commercial loans	1,119	12.8	%	1,530	14.4	%	836	14.2	%	769	14.6	%	707	20.1	%
Agriculture loans	1,684	18.4	%	1,428	16.7	%	915	15.3	%	545	14.9	%	367	10.0	%
Municipal loans	12	0.9	%	23	1.8	%	51	2.1	%	47	2.1	%	107	3.1	%
Consumer loans	195	4.8	%	199	4.7	%	169	4.8	%	134	4.4	%	159	4.2	%
Total	$5,344	100.0	%	$5,922	100.0	%	$5,320	100.0	%	$5,540	100.0	%	$4,581	100.0	%

In 2015, the Company adjusted the historical loss analysis within the evaluation of the allowance for loan losses. The Company previously used a twelve quarter historical loss rate calculated by loan class. The updated historical loss analysis uses a migration analysis to track historical losses by loan class and risk categories over a longer period of time. In the opinion of management, the adjusted historical loss analysis more accurately allocates estimated losses. The adjustments resulted in reclassifications of the allocated allowance among various loan classes. The adjustments to the historical loss analysis did not have a significant impact on the total allowance for loan losses.

The decrease in the allocation of the allowance for loan losses on our one-to-four family residential real estate loans during 2016 compared to 2015 was primarily related to continued improvements in the housing market which contributed to lower qualitative adjustments in our analysis. The increase in the allocation for loan losses on our one-to-four family residential real estate loans during 2015 compared to 2014 and 2013 compared to 2012 was primarily related to an increase in outstanding loan balances while the increase during 2014 compared to 2013 was primarily related to the increase in specific allowances related to impaired loans. The allocation of the allowance for loan losses on construction and land decreased in 2016 and 2015 compared to prior years due to lower outstanding loan balances. The allocation of the allowance for loan losses on construction and land loans decreased in 2014 compared to 2013 primarily due to a decrease in the specific allowance related to an impaired land loan and a decrease in outstanding loan balances. The allocation of the allowance for loan losses on construction and land loans increased in 2013 compared to 2012 as a result of increases in loan balances and in the specific allowance related to an impaired land loan. The allocation of the allowance for loan losses on commercial real estate loans increased in 2016 compared to 2015 primarily as a result of the increase in specific allowances related to impaired loans. The allocation of the allowance for loan losses on commercial real estate loans decreased in 2015 compared to 2014 and 2014 compared to 2013 primarily as a result of the decrease in specific allowances related to impaired loans. The allocation of the allowance for loan losses on commercial real estate loans increased in 2013 compared to 2012 as a result of higher outstanding loan balances. The allocation of the allowance for loan losses on commercial loans decreased in 2016 compared to 2015 primarily due to a decrease in outstanding loan balances. The increase in the allocation of the allowance for loan losses on commercial loans during 2015, 2014, and 2013 compared to prior years was related primarily to increased historical charge-offs, specific allowances on impaired loans and management's judgment to increase the risk factors. The increase in the allocation of the allowance for loan losses on agriculture loans during 2016, 2015, 2014 and 2013 compared to prior years was primarily due to higher loan balances, specific allowances on impaired loans, and management's judgment to increase the risk factors. The allowance for loan losses is discussed in more detail in the "Asset Quality and Distribution" section of Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations." As of December 31, 2016, we believed the Company's allowance for loan losses continued to be adequate based on the Company's evaluation of the loan portfolio's probable incurred losses.

V. Deposits

The following table presents the average deposit balances and the average rate paid on those balances for the years indicated:

(Dollars in thousands)	Years ended December 31,								
	2016			2015			2014		
	Average Balance	Average Rate		Average Balance	Average Rate		Average Balance	Average Rate	
Non-interest bearing demand	$154,487	-		$145,715	-		$134,865	-	
Money market and checking	330,252	0.14	%	321,184	0.10	%	297,998	0.09	%
Savings accounts	86,538	0.03	%	78,791	0.03	%	73,743	0.03	%
Time	144,678	0.45	%	158,172	0.47	%	180,634	0.51	%
Total	$715,955			$703,862			$687,240		

The following table presents the maturities of jumbo time deposits (amounts of $100,000 or more).

(Dollars in thousands)	As of December 31,	
	2016	2015
Three months or less	$20,800	$11,284
Over three months through six months	11,149	8,128
Over six months through 12 months	10,191	11,325
Over 12 months	9,672	14,870
Total	$51,812	$45,607

VI. Return on Equity and Assets

The following table presents information on return on average equity, return on average assets, equity to total assets and our dividend payout ratio.

	As of or for the years ended December 31,					
	2016		2015		2014	
Return on average assets	1.00	%	1.21	%	0.96	%
Return on average equity	10.34	%	13.81	%	11.89	%
Equity to total assets	9.32	%	9.17	%	8.30	%

Dividend payout ratio	32.90	%	24.87	%	30.25	%

VII. Short-term Borrowings

Information on short-term borrowings is excluded as the average balances of each category of short-term borrowings was less than 30 percent of stockholders' equity at December 31, 2016, 2015 and 2014.

ITEM 1A. RISK FACTORS

An investment in our securities is subject to certain risks inherent in our business. Before making an investment decision, you should carefully consider the risks and uncertainties described below together with all of the other information included in this report. In addition to the risks and uncertainties described below, other risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition and results of operations. The value or market price of our securities could decline due to any of these identified or other risks, and you could lose all or part of your investment.

Monetary policies and regulations of the Federal Reserve could adversely affect our business, financial condition and results of operations.

In addition to being affected by general economic conditions, our earnings and growth are affected by the policies of the Federal Reserve. An important function of the Federal Reserve is to regulate the money supply and credit conditions. Among the instruments used by the Federal Reserve to implement these objectives are open market operations in U.S. government securities, adjustments of the discount rate and changes in reserve requirements against bank deposits. These instruments are used in varying combinations to influence overall economic growth and the distribution of credit, bank loans, investments and deposits. Their use also affects interest rates charged on loans or paid on deposits.

The monetary policies and regulations of the Federal Reserve have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. The effects of such policies upon our business, financial condition and results of operations cannot be predicted.

Legislative and regulatory reforms applicable to the financial services industry may have a significant impact on our business, financial condition and results of operations.

The laws, regulations, rules, policies and regulatory interpretations governing us are constantly evolving and may change significantly over time as Congress and various regulatory agencies react to adverse economic conditions or other matters. The global financial crisis of 2008–09 served as a catalyst for a number of significant changes in the financial services industry, including the Dodd-Frank Act, which reformed the regulation of financial institutions in a comprehensive manner, and the Basel III Rule, which increased both the amount and quality of capital that financial institutions must hold.

The implementation of these provisions, as well as any other aspects of current or proposed regulatory or legislative changes to laws applicable to the financial industry, may impact the profitability of our business activities and may change certain of our business practices, including the ability to offer new products, obtain financing, attract deposits, make loans, and achieve satisfactory interest spreads, and could expose us to additional costs, including increased compliance costs.

The financial services industry, as well as the broader economy, may be subject to new legislation, regulation, and government policy.

At this time, it is difficult to predict the legislative and regulatory changes that will result from the combination of a new President of the United States and the first year since 2010 in which both Houses of Congress and the White House have majority memberships from the same political party. Recently, however, both the new President and senior members of the House of Representatives have advocated for significant reduction of financial services regulation, to include amendments to the Dodd-Frank Act and structural changes to the CFPB. The new administration and Congress also may cause broader economic changes due to changes in governing ideology and governing style. New appointments to the Federal Reserve could affect monetary policy and interest rates, and changes in fiscal policy could affect broader patterns of trade and economic growth. Future legislation, regulation, and government policy could affect the banking industry as a whole, including our business and results of operations, in ways that are difficult to predict. In addition, our results of operations also could be adversely affected by changes in the way in which existing statutes and regulations are interpreted or applied by courts and government agencies.

Our business is subject to domestic and, to a lesser extent, international economic conditions and other factors, many of which are beyond our control and could materially and adversely affect us.

Our financial performance generally, and in particular the ability of customers to pay interest on and repay principal of outstanding loans and the value of collateral securing those loans, as well as demand for loans and other products and services we offer, is highly dependent upon the business environment not only in the markets where we operate, but also in the state of Kansas generally and in the United States as a whole. A favorable business environment is generally characterized by, among other factors: economic growth; efficient capital markets; low inflation; low unemployment; high business and investor confidence; and strong business earnings. Unfavorable or uncertain economic and market conditions can be caused by: declines in economic growth, business activity or investor or business confidence; limitations on the availability or increases in the cost of credit and capital; increases in inflation or interest rates; high unemployment; natural disasters; or a combination of these or other factors.

Economic conditions in the state of Kanas have recently been impacted by a decline in commodity prices. This decline has adversely impacted the Kansas economy, specifically the agriculture sector. A continuation of these conditions could materially and adversely affect us.

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

We established our allowance for loan losses and maintain it at a level considered appropriate by management to absorb probable incurred loan losses in the portfolio. Additionally, our Board of Directors regularly monitors the appropriateness of our allowance for loan losses. The allowance is also subject to regulatory examinations and a determination by the regulatory agencies as to the appropriate level of the allowance. The amount of future loan losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates and the value of the underlying collateral, which may be beyond our control, and such losses may exceed current estimates. At December 31, 2016 and 2015 our allowance for loan losses as a percentage of total loans was 1.26% and 1.39%, respectively, and as a percentage of total non-performing loans was 194.61% and 273.15%, respectively. Although management believes that the allowance for loan losses is appropriate to absorb probable incurred losses on any existing loans that may become uncollectible, we cannot predict loan losses with certainty nor can we assure you that our allowance for loan losses will prove sufficient to cover actual loan losses in the future. Loan losses in excess of our reserves will adversely affect our business, financial condition and results of operations.

Our concentration of one-to-four family residential mortgage loans may result in lower yields and profitability.

One-to-four family residential mortgage loans comprised $136.8 million and $131.9 million, or 32.1% and 31.0%, of our loan portfolio at December 31, 2016 and 2015, respectively. These loans are secured primarily by properties located in the state of Kansas. Our concentration of these loans results in lower yields relative to other loan categories within our loan portfolio. While these loans generally possess higher yields than investment securities, their repayment characteristics are not as well defined and they generally possess a higher degree of interest rate risk versus other loans and investment securities within our portfolio. This increased interest rate risk is due to the repayment and prepayment options inherent in residential mortgage loans which are exercised by borrowers based upon the overall level of interest rates. These residential mortgage loans are generally made on the basis of the borrower’s ability to make repayments from his or her employment and the value of the property securing the loan. Thus, as a result, repayment of these loans is also subject to general economic and employment conditions within the communities and surrounding areas where the property is located.

A decline in residential real estate market prices or home sales has the potential to adversely affect our one-to-four family residential mortgage portfolio in several ways, each of which could adversely affect our operating results and/or financial condition.

The Bank may be required to repurchase mortgage loans in some circumstances, which could harm our liquidity, results of operations and financial condition.

When the Bank sells mortgage loans, we are required to make certain representations and warranties to the purchaser about the loans and the manner in which they were originated. Our sales agreements require us to repurchase mortgage loans in the event of a breach of any of these representations or warranties. In addition, we may be required to repurchase mortgage loans as a result of borrower fraud or in the event of early payment default of the borrower on a mortgage loan. In 2016, we were obligated to repurchase two loans. If repurchase and indemnity demands increase, our liquidity, results of operations and financial condition will be adversely affected.

The repeal of federal prohibitions on the payment of interest on business demand deposits could increase our interest expense and have a material adverse effect on us.

All federal prohibitions on the ability of financial institutions to pay interest on business demand deposit accounts were repealed as part of the Dodd-Frank Act. As a result, some financial institutions have commenced offering interest on these demand deposits to compete for customers. Although this development has not meaningfully impacted our interest expense in the current low-rate, high-liquidity environment in which competition among financial institutions for deposits is generally low, if competitive pressures in the future could require us to pay interest on these demand deposits to attract and retain business customers, our interest expense would increase and our net interest margin would decrease. This could have a material adverse effect on us.

Commercial loans make up a significant portion of our loan portfolio.

Commercial loans comprised $54.5 million and $61.3 million, or 12.8% and 14.4%, of our loan portfolio at December 31, 2016 and 2015, respectively. Our commercial loans are made based primarily on the identified cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. Most often, this collateral is accounts receivable, inventory, or machinery. Credit support provided by the borrower for most of these loans and the probability of repayment is based on the liquidation of the pledged collateral and enforcement of a personal guarantee, if any exists. As a result, in the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers. The collateral securing other loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. Due to the larger average size of each commercial loan as compared with other loans such as residential loans, as well as collateral that is generally less readily marketable, losses incurred on a small number of commercial loans could have a material adverse impact on our financial condition and results of operations.

Our agriculture loans involve a greater degree of risk than other loans, and the ability of the borrower to repay may be affected by many factors outside of the borrower's control.

Agriculture operating loans comprised $45.4 million and $43.6 million, or 10.7% and 10.3%, of our loan portfolio at December 31, 2016 and 2015, respectively. The repayment of agriculture operating loans is dependent on the successful operation or management of the farm property. Likewise, agricultural operating loans involve a greater degree of risk than lending on residential properties, particularly in the case of loans that are unsecured or secured by rapidly depreciating assets such as farm equipment, livestock or crops. We generally secure agricultural operating loans with a blanket lien on livestock, equipment, food, hay, grain and crops. Nevertheless, any repossessed collateral for a defaulted loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation.

We also originate agriculture real estate loans. At December 31, 2016 and 2015, agricultural real estate loans totaled $32.9 million and $27.4 million, or 7.7% and 6.4% of our total loan portfolio, respectively. Agricultural real estate lending involves a greater degree of risk and typically involves larger loans to single borrowers than lending on single-family residences. As with agriculture operating loans, payments on agricultural real estate loans are dependent on the profitable operation or management of the farm property securing the loan. The success of the farm may be affected by many factors outside the control of the farm borrower, including adverse weather conditions that prevent the planting of a crop or limit crop yields (such as hail, drought and floods), loss of livestock due to disease or other factors, declines in market prices for agricultural products (both domestically and internationally) and the impact of government regulations (including changes in price supports, subsidies and environmental regulations). In addition, many farms are dependent on a limited number of key individuals whose injury or death may significantly affect the successful operation of the farm. If the cash flow from a farming operation is diminished, the borrower’s ability to repay the loan may be impaired. The primary crops in our market areas are wheat, corn and soybean. Accordingly, adverse circumstances affecting wheat, corn and soybean crops could have an adverse effect on our agricultural real estate loan portfolio.

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Our business is concentrated in and dependent upon the continued growth and welfare of the markets in which we operate, including eastern, central, southeast and southwest Kansas.

We operate primarily in eastern, central, southeast and southwest Kansas, and as a result, our financial condition, results of operations and cash flows are subject to changes in the economic conditions in those areas. Although each market we operate in is geographically and economically diverse, our success depends upon the business activity, population, income levels, deposits and real estate activity in each of these markets. Although our customers' business and financial interests may extend well beyond our market area, adverse economic conditions that affect our specific market area could reduce our growth rate, affect the ability of our customers to repay their loans to us and generally affect our financial condition and results of operations. Because of our geographic concentration, we are less able than other regional or national financial institutions to diversify our credit risks across multiple markets.

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

As part of our general strategy, we may acquire banks, branches and related businesses that we believe provide a strategic fit with our business. In the past, we have acquired a number of local banks and branches, and, to the extent that we grow through future acquisitions, we cannot assure you that we will be able to adequately and profitably manage this growth. Acquiring other banks and businesses will involve risks commonly associated with acquisitions, including:

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

In addition to acquisitions, we may expand into additional communities or attempt to strengthen our position in our current markets by undertaking additional branch openings. We believe that it generally takes several years for new banking facilities to first achieve operational profitability, due to the impact of organization and overhead expenses and the start-up phase of generating loans and deposits. To the extent that we undertake additional branch openings, we are likely to experience the effects of higher operating expenses relative to operating income from the new operations, which may have an adverse effect on our levels of reported net income, return on average equity and return on average assets.

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

The banking and financial services business in our market is highly competitive. Our competitors include large regional banks, local community banks, savings and loan associations, securities and brokerage companies, mortgage companies, insurance companies, finance companies, money market mutual funds, credit unions and other non-bank financial service providers, many of which have greater financial, marketing and technological resources than us. Many of these competitors are not subject to the same regulatory restrictions that we are and may be able to compete more effectively as a result. Increased competition in our market may result in a decrease in the amounts of our loans and deposits, reduced spreads between loan rates and deposit rates or loan terms that are more favorable to the borrower. Any of these results could have a material adverse effect on our ability to grow and remain profitable. If increased competition causes us to significantly discount the interest rates we offer on loans or increase the amount we pay on deposits, our net interest income could be adversely impacted. If increased competition causes us to relax our underwriting standards, we could be exposed to higher losses from lending activities. Additionally, many of our competitors are much larger in total assets and capitalization, have greater access to capital markets and offer a broader range of financial services than we can offer.

Consumers and businesses are increasingly using non-banks to complete their financial transactions, which could adversely affect our business and results of operations.

Technology and other changes are allowing consumers and businesses to complete financial transactions that historically have involved banks through alternative methods. For example, the wide acceptance of internet-based commerce has resulted in a number of alternative payment processing systems and lending platforms in which banks play only minor roles. Customers can now maintain funds in prepaid debit cards or digital currencies, and pay bills and transfer funds directly without the direct assistance of banks. The diminishing role of banks as financial intermediaries has resulted and could continue to result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the potential loss of lower cost deposits as a source of funds could have a material adverse effect on our business, financial condition and results of operations.

Interest rates and other conditions impact our results of operations.

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

Changes in interest rates also can affect the value of loans, securities and other assets. An increase in interest rates that adversely affects the ability of borrowers to pay the principal or interest on loans may lead to an increase in non-performing assets and a reduction of income recognized, which could have a material adverse effect on our results of operations and cash flows. Further, when we place a loan on nonaccrual status, we reverse any accrued but unpaid interest receivable, which decreases interest income. Subsequently, we continue to have a cost to fund the loan, which is reflected as interest expense, without any interest income to offset the associated funding expense. Thus, an increase in the amount of non-performing assets would have an adverse impact on net interest income.

Rising interest rates will result in a decline in value of our fixed-rate debt securities. The unrealized losses resulting from holding these securities would be recognized in other comprehensive income and reduce total stockholders' equity. Unrealized losses do not negatively impact our regulatory capital ratios; however, tangible common equity and the associated ratios would be reduced. If debt securities in an unrealized loss position are sold, such losses become realized and will reduce our regulatory capital ratios.

Declines in value may adversely impact the carrying amount of our investment portfolio and result in other-than-temporary impairment charges.

We may be required to record impairment charges on our investment securities if they suffer declines in value that are considered other-than-temporary. If the credit quality of the securities in our investment portfolio deteriorates, we may also experience a loss in interest income from the suspension of either interest or dividend payments. Numerous factors, including lack of liquidity for resales of certain investment securities, absence of reliable pricing information for investment securities, adverse changes in business climate or adverse actions by regulators could have a negative effect on our investment portfolio in future periods.

Downgrades in the credit rating of one or more insurers that provide credit enhancement for our state and municipal securities portfolio may have an adverse impact on the market for and valuation of these types of securities.

We invest in tax-exempt state and local municipal investment securities, some of which are insured by monoline insurers. As of December 31, 2016, we had $233.2 million of municipal securities, which represented 60.5% of our total securities portfolio. With the economic crisis that began to unfold in 2008, several of these insurers came under scrutiny by rating agencies. Even though management generally purchases municipal securities on the overall credit strength of the issuer, the reduction in the credit rating of an insurer may negatively impact the market for and valuation of our investment securities. Such downgrade could adversely affect our liquidity, financial condition and results of operations.

We must effectively manage our credit risk.

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

Most of our loans are commercial, real estate, or agriculture loans, each of which is subject to distinct types of risk. To reduce the lending risks we face, we generally take a security interest in borrowers' property for all three types of loans. In addition, we sell certain residential real estate loans to third parties. Nevertheless, the risk of non-payment is inherent in all three types of loans and if we are unable to collect amounts owed, it may materially affect our operations and financial performance. For a more complete discussion of our lending activities see Item 1 of this Annual Report on Form 10-K.

Non-performing assets take significant time to resolve and adversely affect our results of operations and financial condition, and could result in further losses in the future.

As of December 31, 2016, our non-performing loans (which consist of non-accrual loans and loans past due 90 days or more and still accruing interest) totaled $2.7 million, or 0.64% of our loan portfolio, and our non-performing assets (which include non-performing loans plus real estate owned) totaled $4.0 million, or 0.44% of total assets. In addition, we had $758,000 in accruing loans that were 30-89 days delinquent as of December 31, 2016.

Our non-performing assets adversely affect our net income in various ways. We do not record interest income on non-accrual loans or other real estate, thereby adversely affecting our net income and returns on assets and equity, increasing our loan administration costs and adversely affecting our efficiency ratio. When we take collateral in foreclosure and similar proceedings, we are required to mark the collateral to its then-fair market value, which may result in a loss. These non-performing loans and other real estate also increase our risk profile and the capital our regulators believe is appropriate in light of such risks. The resolution of non-performing assets requires significant time commitments from management and can be detrimental to the performance of their other responsibilities. If we experience increases in non-performing loans and non-performing assets, our net interest income may be negatively impacted and our loan administration costs could increase, each of which could have an adverse effect on our net income and related ratios, such as return on assets and equity.

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

Real estate lending (including commercial, construction, land and residential) is a large portion of our loan portfolio. These categories were $268.8 million, or approximately 63.1% of our total loan portfolio, as of December 31, 2016, as compared to $265.9 million, or approximately 62.4% of our total loan portfolio, as of December 31, 2015. The market value of real estate can fluctuate significantly in a short period of time as a result of market conditions in the geographic area in which the real estate is located. Although a significant portion of such loans are secured by a secondary form of collateral, adverse developments affecting real estate values in one or more of our markets could increase the credit risk associated with our loan portfolio. Additionally, real estate lending typically involves higher loan principal amounts and the repayment of the loans generally is dependent, in large part, on sufficient income from the properties securing the loans to cover operating expenses and debt service. Economic events or governmental regulations outside of the control of the borrower or lender could negatively impact the future cash flow and market values of the affected properties.

If the loans that are collateralized by real estate become troubled during a time when market conditions are declining or have declined, then we may not be able to realize the amount of security that we anticipated at the time of originating the loan, which could cause us to increase our provision for loan losses and adversely affect our operating results and financial condition. In light of the uncertainty that exists in the economy and credit markets nationally, there can be no guarantee that we will not experience additional deterioration in credit performance by our real estate loan customers.

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

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations, and those requirements became more onerous with the implementation of the Basel III Rule. We anticipate that our existing capital resources will satisfy our capital requirements for the foreseeable future. However, we may at some point need to raise additional capital to support continuing growth. Our ability to raise additional capital is particularly important to our strategy of continual growth through acquisitions. Our ability to raise additional capital depends on conditions in the capital markets, economic conditions and a number of other factors, including investor perceptions regarding the banking industry, market conditions and governmental activities, and on our financial condition and performance. Accordingly, we cannot assure you of our ability to raise additional capital if needed on terms acceptable to us. If we cannot raise additional capital when needed, our ability to further expand our operations through internal growth and acquisitions could be materially impaired.

Attractive acquisition opportunities may not be available to us in the future.

We expect that other banking and financial service companies, many of which have significantly greater resources than us, will compete with us in acquiring other financial institutions if we pursue such acquisitions. This competition could increase prices for potential acquisitions that we believe are attractive. Also, acquisitions are subject to various regulatory approvals. If we fail to receive the appropriate regulatory approvals, we will not be able to consummate an acquisition that we believe is in our best interests. Among other things, our regulators consider our capital, liquidity, profitability, regulatory compliance and levels of goodwill and intangibles when considering acquisition and expansion proposals. Any acquisition could be dilutive to our earnings and stockholders' equity per share of our common stock.

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

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

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

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

Our information systems may experience an interruption or breach in security and cyber-attacks, all of which could have a material adverse effect on our business.

We rely heavily on internal and outsourced technologies, communications, and information systems to conduct our business. Additionally, in the normal course of business, we collect, process and retain sensitive and confidential information regarding our customers. As our reliance on technology has increased, so have the potential risks of a technology-related operation interruption (such as disruptions in our customer relationship management, general ledger, deposit, loan, or other systems) or the occurrence of cyber-attacks (such as unauthorized access to our systems). These risks have increased for all financial institutions due to new technologies, the use of the Internet and telecommunications technologies (including mobile devices) to conduct financial and other business transactions and the increased sophistication and activities of organized crime, perpetrators of fraud, hackers, terrorists and others. In addition to cyber-attacks or other security breaches involving the theft of sensitive and confidential information, hackers have engaged in attacks against large financial institutions, particularly denial of service attacks, that are designed to disrupt key business services, such as customer-facing web sites. In addition, it is possible that we may not be able to detect security breaches on a timely basis, or at all, which could increase the costs and risks associated with any such breach. We are not able to anticipate or implement effective preventive measures against all security breaches of these types, especially because the techniques used change frequently and because attacks can originate from a wide variety of sources. However, applying guidance from the Federal Financial Institutions Examination Council, we have analyzed and will continue to analyze security related to device specific considerations, user access topics, transaction-processing and network integrity.

We also face risks related to cyber-attacks and other security breaches in connection with credit card and debit card transactions that typically involve the transmission of sensitive information regarding our customers through various third parties, including merchant acquiring banks, payment processors, payment card networks and our processors. Some of these parties have in the past been the target of security breaches and cyber-attacks. Because the transactions involve third parties and environments such as the point of sale that we do not control or secure, future security breaches or cyber-attacks affecting any of these third parties could impact us through no fault of our own, and in some cases we may have exposure and suffer losses for breaches or attacks relating to them. In addition, we offer our customers protection against fraud and certain losses for unauthorized use of debit cards in order to stay competitive with other financial institutions. Offering such protection exposes us to possible losses. Further cyber-attacks or other breaches in the future, whether affecting us or others, could intensify consumer concern and regulatory focus and result in reduced use of payment cards and increased costs, all of which could have a material adverse effect on our business. To the extent we are involved in any future cyber-attacks or other breaches, our reputation could be affected which could also have a material adverse effect on our business, financial condition or results of operations.

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

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

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

Failure to pay interest on our debt may adversely impact our ability to pay dividends.

Our $21.3 million of subordinated debentures are held by three business trusts that we control. Interest payments on the debentures must be paid before we pay dividends on our capital stock, including our common stock. We have the right to defer interest payments on the debentures for up to 20 consecutive quarters. However, if we elect to defer interest payments, all deferred interest must be paid before we may pay dividends on our capital stock. Deferral of interest payments could also cause a decline in the market price of our common stock.

We are subject to changes in accounting principles, policies or guidelines.

Our financial performance is impacted by accounting principles, policies and guidelines. Some of these policies require the use of estimates and assumptions that may affect the value of our assets or liabilities and financial results. Some of our accounting policies are critical because they require management to make difficult, subjective and complex judgments about matters that are inherently uncertain and because it is likely that materially different amounts would be reported under different conditions or using different assumptions. If such estimates or assumptions underlying our financial statements are incorrect, we may experience material losses.

From time to time, the FASB and the SEC change the financial accounting and reporting standards or the interpretation of those standards that govern the preparation of our financial statements. These changes are beyond our control, can be difficult to predict and could materially impact how we report our financial condition and results of operations. Changes in these standards are continuously occurring, and given recent economic conditions, more drastic changes may occur. The implementation of such changes could have a material adverse effect on our financial condition and results of operations.

A new accounting standard may require us to increase our allowance for loan losses and may have a material adverse effect on our financial condition and results of operations.

The FASB has adopted a new accounting standard that will be effective for the Company and the Bank for our first fiscal year after December 15, 2019. This standard, referred to as Current Expected Credit Loss, or CECL, will require financial institutions to determine periodic estimates of lifetime expected credit losses on loans, and recognize the expected credit losses as allowances for loan losses. This will change the current method of providing allowances for loan losses that are probable, which may require us to increase our allowance for loan losses, and to greatly increase the types of data we will need to collect and review to determine the appropriate level of the allowance for loan losses. Any increase in our allowance for loan losses or expenses incurred to determine the appropriate level of the allowance for loan losses may have a material adverse effect on our financial condition and results of operations.

Our framework for managing risks may not be effective in mitigating risk and loss to us.

Our risk management framework seeks to mitigate risk and loss to us. We have established processes and procedures intended to identify, measure, monitor, report and analyze the types of risk to which we are subject, including liquidity risk, credit risk, market risk, interest rate risk, operational risk, compensation risk, legal and compliance risk, and reputational risk, among others. However, as with any risk management framework, there are inherent limitations to our risk management strategies as there may exist, or develop in the future, risks that we have not appropriately anticipated or identified. Our ability to successfully identify and manage risks facing us is an important factor that can significantly impact our results. If our risk management framework proves ineffective, we could suffer unexpected losses and could be materially adversely affected.

We are subject to environmental liability risk associated with lending activities.

A significant portion of our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property's value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Environmental reviews of real property before initiating foreclosure actions may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our business, financial condition and results of operations.

Our business is affected from time to time by federal and state laws and regulations relating to hazardous substances.

Under the federal Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), owners and operators of properties containing hazardous substances may be liable for the costs of cleaning up the substances. CERCLA and similar state laws can affect us both as an owner of branches and other properties used in our business and as a lender holding a security interest in property which is found to contain hazardous substances. In particular, our leased branch office located in Iola is located on property that has been designated as a "Superfund" site under CERCLA. While CERCLA contains an exemption for holders of security interests, the exemption is not available if the holder participates in the management of a property, and some courts have broadly defined what constitutes participation in management of property. Moreover, CERCLA and similar state statutes can affect our decision whether or not to foreclose on a property. Before foreclosing on commercial real estate, our general policy is to obtain an environmental report, thereby increasing the costs of foreclosure. In addition, the existence of hazardous substances on a property securing a troubled loan may cause us to elect not to foreclose on the property, thereby reducing our flexibility in handling the loan.

Financial services companies depend on the accuracy and completeness of information about customers and counterparties.

In deciding whether to extend credit or enter into other transactions, we may rely on information furnished by or on behalf of customers and counterparties, including financial statements, credit reports and other financial information. We may also rely on representations of those customers, counterparties or other third parties, such as independent auditors, as to the accuracy and completeness of that information. Reliance on inaccurate or misleading financial statements, credit reports or other financial information could have a material adverse impact on our business, financial condition and results of operations.

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

Although our common shares are listed for trading on the Nasdaq Global Market under the symbol "LARK," the trading in our common shares has substantially less liquidity than many other publicly traded companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the market of willing buyers and sellers of our common shares at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. We cannot assure you that volume of trading in our common shares will increase in the future.

The stock market can be volatile, and fluctuations in our operating results and other factors could cause our stock price to decline.

The stock market has experienced, and may continue to experience, fluctuations that significantly impact the market prices of securities issued by many companies. Market fluctuations could adversely affect our stock price. These fluctuations have often been unrelated or disproportionate to the operating performance of particular companies. These broad market fluctuations, as well as general economic, systemic, political and market conditions, such as recessions, loss of investor confidence, interest rate changes, or international currency fluctuations, may negatively affect the market price of our common stock. Moreover, our operating results may fluctuate and vary from period to period due to the risk factors set forth herein. As a result, period-to-period comparisons should not be relied upon as an indication of future performance. Our stock price could fluctuate significantly in response to our quarterly or annual results, annual projections and the impact of these risk factors on our operating results or financial position.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. PROPERTIES

The Company has 29 offices in 23 communities across Kansas: Manhattan (2), Auburn, Dodge City (2), Fort Scott (2), Garden City, Great Bend (2), Hoisington, Iola, Junction City, Kincaid, LaCrosse, Lawrence (2), Lenexa, Louisburg, Mound City, Osage City, Osawatomie, Overland Park, Paola, Pittsburg, Topeka (2), Wamego and Wellsville, Kansas. The Company owns its main office in Manhattan, Kansas and 25 branch offices and leases three branch offices. The Company leases one branch office in each of Iola, Topeka, and Wamego, Kansas. The Company also leases a parking lot for one of the Dodge City branch offices it owns.

ITEM 3. LEGAL PROCEEDINGS

There are no material pending legal proceedings to which the Company or the Bank is a party or of which any of their property is subject, other than ordinary routine litigation incidental to the Bank's business. While the ultimate outcome of current legal proceedings cannot be predicted with certainty, it is the opinion of management that the resolution of these legal actions should not have a material effect on the Company's consolidated financial position or results of operations.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II.

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

Our common stock has traded on the Nasdaq Global Market under the symbol "LARK" since 2001. At December 31, 2016, the Company had approximately 321 common shareholders of record. Set forth below are the reported high and low sale prices of our common stock and dividends paid during the past two years. Information presented below has been adjusted to give effect to the 5% stock dividends declared in December 2016 and 2015.

Year ended December 31, 2016	High	Low	Cash dividends paid
First Quarter	$24.51	$22.67	$ 0.1905
Second Quarter	24.76	23.62	$ 0.1905
Third Quarter	25.29	23.86	$ 0.1905
Fourth Quarter	28.73	25.00	$ 0.1905

Year ended December 31, 2015	High	Low	Cash dividends paid
First Quarter	$26.01	$18.63	$ 0.1724
Second Quarter	25.26	21.04	$ 0.1724
Third Quarter	25.22	22.22	$ 0.1724
Fourth Quarter	26.19	23.10	$ 0.1724

The Company's ability to pay dividends is largely dependent upon the dividends it receives from the Bank. The Company and the Bank are subject to regulatory limitations on the amount of cash dividends they may pay. See "Item 1. Business – Supervision and Regulation – Regulation and Supervision of the Company – Dividend Payments" and "Business - Supervision and Regulation – Regulation and Supervision the Bank – Dividend Payments" for a more detailed description of these limitations.

In May 2008, our Board of Directors announced the approval of a stock repurchase program permitting us to repurchase up to 113,400 shares, or 5% of our then-outstanding common stock. Unless terminated earlier by resolution of the Board of Directors, the May 2008 Repurchase Program will expire when we have repurchased all shares authorized for repurchase thereunder. As of December 31, 2016, there were 108,006 shares remaining to repurchase under the plan. The Company did not repurchase any shares during the year ended December 31, 2016.

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ITEM 6. SELECTED FINANCIAL DATA

	At or for the years ended December 31,				
	2016	2015	2014	2013	2012
	(Dollars in thousands, except per share amounts)				
Selected Financial Data:					
Total assets	$911,382	$878,376	$863,470	$828,755	$614,067
Loans, net	420,461	419,923	416,190	414,016	315,914
Investment securities	390,862	357,935	352,938	305,517	218,538
Cash and cash equivalents	19,996	13,569	12,760	29,735	14,920
Deposits	741,521	714,727	704,555	687,486	482,500
Borrowings	72,867	70,658	76,547	68,744	59,967
Stockholders' equity	84,951	80,570	71,645	62,692	63,333
Selected Operating Data:					
Interest income	29,230	28,997	27,850	22,112	22,052
Interest expense	3,191	3,081	3,186	3,081	3,910
Net interest income	26,039	25,916	24,664	19,031	18,142
Provision for loan losses	500	(700)	600	800	1,900
Net interest income after provision for loan losses	25,539	26,616	24,064	18,231	16,242
Non-interest income	14,850	17,010	15,071	10,705	12,443
Non-interest expense	29,114	29,206	28,060	23,535	20,504
Earnings before income taxes	11,275	14,420	11,075	5,401	8,181
Income tax expense	2,314	3,914	3,026	746	1,814
Net earnings	8,961	10,506	8,049	4,655	6,367
Earnings per share (1):					
Basic	2.35	2.85	2.19	1.30	1.79
Diluted	2.31	2.77	2.16	1.29	1.78
Dividends per share (1)	0.76	0.69	0.66	0.63	0.60
Book value per common share outstanding (1)	21.96	21.73	19.50	17.24	17.83
Other Data:					
Return on average assets	1.00 %	1.21 %	0.96 %	0.70 %	1.01 %
Return on average equity	10.34 %	13.81 %	11.89 %	7.33 %	10.34 %
Equity to total assets	9.32 %	9.17 %	8.30 %	7.56 %	10.31 %
Net interest rate spread (2)	3.34 %	3.42 %	3.38 %	3.30 %	3.36 %
Net interest margin (2)	3.45 %	3.51 %	3.47 %	3.40 %	3.47 %
Non-performing assets to total assets	0.44 %	0.36 %	0.73 %	1.24 %	1.88 %
Non-performing loans to total gross loans	0.64 %	0.51 %	1.44 %	2.35 %	2.84 %
Allowance for loan losses to total gross loans	1.26 %	1.39 %	1.26 %	1.32 %	1.43 %
Dividend payout ratio	32.90 %	24.87 %	30.25 %	48.32 %	33.33 %
Number of full service banking offices	29	29	29	30	22

(1)

All per share amounts have been adjusted to give effect to the 5% stock dividends paid in December 2016, 2015, 2014, and 2013.

(2) Presented on a taxable equivalent basis, using a 34% federal tax rate.

Our selected consolidated financial data should be read in conjunction with, and is qualified in its entirety by, our consolidated financial statements, including the related notes.

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

CORPORATE PROFILE AND 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. The Company is listed on the Nasdaq Global Market under the symbol "LARK." The Bank is dedicated to providing quality financial and banking services to its local communities. Our strategy includes continuing a tradition of quality assets while growing our commercial, commercial real estate and agriculture loan portfolios. We are committed to developing relationships with our borrowers and providing a total banking service.

The 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 do 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, and certain non-interest related items. Our principal operating expenses, aside from interest expense, consist of compensation and employee benefits, occupancy costs, professional fees, 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 the interest rate pricing competition from other lending institutions.

Currently, our business consists of ownership of the Bank, with its main office in Manhattan, Kansas and twenty eight additional branch offices in central, eastern, southeast and southwest Kansas.

CRITICAL ACCOUNTING POLICIES

Critical accounting policies are those that 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 for goodwill and other intangible assets, 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, actual outcomes may differ significantly from estimated results. Additional explanation of the methodologies used in establishing this allowance is provided in the “Asset Quality and Distribution” section.

The Company has classified its investment securities portfolio as available-for-sale, with the exception of certain investments held for regulatory purposes. The Company carries its available-for-sale investment securities at fair value and employs valuation techniques which utilize quoted prices or observable inputs when those inputs are available. These observable inputs reflect assumptions that market participants would use in pricing the security, developed based on market data obtained from sources independent of the Company. When such information is not available, the Company employs valuation techniques which utilize unobservable inputs, or those which reflect the Company's own assumptions, based on the best information available in the circumstances. These valuation methods typically involve estimated cash flows and other financial modeling techniques. Changes in underlying factors, assumptions, estimates, or other inputs to the valuation techniques could have a material impact on the Company's future financial condition and results of operations. Fair value measurements are classified as Level 1 (quoted prices), Level 2 (based on observable inputs) or Level 3 (based on unobservable inputs). Available-for-sale securities are recorded at fair value with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders' equity, net of taxes, until realized. Purchase premiums and discounts on investment securities are amortized/accreted into interest income over the estimated lives of the securities using the interest method. Realized gains and losses on sales of available-for-sale securities are recorded on a trade date basis and are calculated using the specific identification method.

The Company performs quarterly reviews of the investment portfolio to determine if any 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 its judgment of the specific facts and circumstances impacting each individual security at the time such assessments are made. The Company reviews and considers factual information, including expected cash flows, the structure of the security, the credit quality of the underlying assets and the current and anticipated market conditions. Credit-related impairments on debt securities are recorded through a charge to earnings. If an equity security is determined to be other-than-temporarily impaired, the entire impairment is recorded through a charge to earnings.

We have completed several business and asset acquisitions since 2002, 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 our management. Goodwill and intangibles related to acquisitions are determined and based on purchase price allocations. The initial value assigned to goodwill is the residual of the purchase price over the fair value of all identifiable tangible and intangible assets acquired and liabilities assumed. Valuation of intangible assets is generally based on the estimated cash flows related to those assets. Performing discounted cash flow analyses involves the use of estimates and assumptions. Useful lives are 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, and the subsequent impairment testing of goodwill and intangible assets, as a critical accounting policy.

Goodwill is not amortized; however, it is tested for impairment at each calendar year end or more frequently when events or circumstances dictate. The impairment test compares the carrying value of goodwill to an implied fair value of the goodwill, which is based on a review of the Company's market capitalization adjusted for appropriate control premiums as well as an analysis of valuation multiples of recent, comparable acquisitions. The Company considers the result from each of these valuation methods to determine the implied fair value of its goodwill. A goodwill impairment would be recorded for the amount that the carrying value exceeds the implied fair value. The Company performed a step one impairment test as of December 31, 2016 by comparing the implied fair value of the Company's single reporting unit to its carrying value. Fair value was determined using observable market data, including the Company's market capitalization, with control premiums and valuation multiples, compared to recent financial industry acquisition multiples for similar institutions to estimate the fair value of the Company's single reporting unit. The Company's step one impairment test indicated that its goodwill was not impaired. The Company can make no assurances that future impairment tests will not result in goodwill impairments.

Intangible assets include core deposit intangibles, lease intangibles and mortgage servicing rights. Core deposit intangible assets are amortized over their estimated useful life of ten years on an accelerated basis. Lease intangible assets are amortized over the life of the lease. When facts and circumstances indicate potential impairment, the Company will evaluate the recoverability of the intangible asset carrying value, using estimates of undiscounted future cash flows over the asset's remaining life. Any impairment loss is measured by the excess of carrying value over fair value. Mortgage servicing assets are recognized as separate assets when rights are acquired through the sale of financial assets, primarily one-to-four family real estate loans. Mortgage servicing rights are amortized into non-interest expense in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are recorded at the lower of amortized cost or estimated fair value, and are evaluated for impairment based upon the fair value of the retained rights as compared to amortized cost.

The objective of accounting for income taxes is to recognize the 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 financial statements or tax returns. The Company recognizes an income tax position only if it is more likely than not that it will be sustained upon examination by the Internal Revenue Service (the "IRS"), based upon its technical merits. Once that standard is met, the amount recorded will be the largest amount of benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement. The Company recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense in our consolidated statements of earnings. The Company assesses it deferred tax assets to determine if the items are more likely than not to be realized and a valuation allowance is established for any amounts that are not more likely than not to be realized. Changes in estimates regarding 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.

COMPARISON OF OPERATING RESULTS FOR THE YEARS ENDED DECEMBER 31, 2016 AND DECEMBER 31, 2015

SUMMARY OF PERFORMANCE. Net earnings for 2016 decreased $1.5 million, or 14.7%, to $9.0 million as compared to $10.5 million for 2015. The decrease in net earnings was primarily due to a decline in gains on sales of loans and an increase in our provision for loan losses. Gains on sales of loans decreased primarily as a result of the departure of several mortgage lenders during 2016, which decreased the volume of one-to-four family residential real estate loans originated and sold during 2016 as compared to 2015. The increase in our provision for loan losses was primarily the result of a $1.7 million recovery on a previously charged-off construction loan, which contributed to a $700,000 credit provision for loan losses during 2015 compared to a $500,000 provision for loan losses during the same period of 2016.

Partially offsetting those effects was higher net interest income for 2016, which increased $123,000 to $26.0 million, or 0.5% higher than the $25.9 million recorded for 2015. Our net interest margin, on a tax equivalent basis, decreased from 3.51% during 2015 to 3.45% in 2016. The growth in net interest income was primarily the result of a 2.9% increase in average interest-earning assets, from $785.6 million in 2015 to $808.6 million in 2016. The current interest rate environment continues to restrain our ability to increase our net interest margin as higher short term interest rates may lead to increases in our costs of funds while competition for loans inhibits our ability to earn higher yields.

We distributed a 5% stock dividend for the 16th consecutive year in December 2016. All per share and average share data in this section reflect the 2016 and 2015 stock dividends.

Interest Income. Interest income for 2016 increased $233,000 to $29.2 million, an increase of 0.8% as compared to 2015. Interest income on loans decreased $91,000, or 0.4%, to $21.3 million for 2016 compared to 2015, due to lower tax equivalent yields on loans, which decreased from 5.01% in 2015 to 4.93% in 2016. Partially offsetting the decline in tax equivalent yields was an increase in our average loan balances from $428.8 million during 2015 to $433.7 million during 2016. Interest income on investment securities increased $324,000, or 4.2%, to $8.0 million during 2016, as compared to $7.7 million in 2015. The increase in interest income on investment securities was primarily the result of an increase in our average balance of investment securities from $354.0 million during 2015 to $371.8 million during 2016. Also contributing to the higher interest income on investment securities was an increase in our tax equivalent yield, which increased from 2.59% in 2015 to 2.60% during 2016.

Interest Expense. Interest expense during 2016 increased $110,000, or 3.6%, to $3.2 million as compared to 2015. Interest expense on interest-bearing deposits increased $63,000, or 5.9%, to $1.1 million for 2016 as compared to 2015. Our total cost of interest-bearing deposits increased from 0.19% during 2015 to 0.20% during 2016 as a result of higher rates paid on money market and checking accounts with rates that reprice based on market indexes. Also contributing to higher interest expense was an increase in our average interest-bearing deposit balances from $558.1 million during 2015 to $561.5 million during 2016. Interest expense on borrowings increased $47,000, or 2.3%, to $2.1 million during 2016 as compared 2015, due to an increase in our average outstanding borrowings and higher rates on those borrowings. Our average outstanding borrowings increased from $77.7 million in 2015 to $79.1 million during 2016, while our average rate on our borrowings increased from 2.59% in 2015 to 2.60% in 2016.

Net Interest Income. Net interest income represents the difference between income derived from interest-earning assets and the expense incurred on interest-bearing liabilities. Net interest income is affected by both the difference between the rates of interest earned on interest-earnings assets and the rates paid on interest-bearing liabilities ("interest rate spread") as well as the relative amounts of interest-earning assets and interest-bearing liabilities.

During 2016, net interest income increased $123,000, or 0.5%, to $26.0 million compared to $25.9 million in 2015. Our net interest margin, on a tax-equivalent basis, decreased to 3.45% during 2016 from 3.51% during 2015. The increase in net interest income was primarily the result of a 2.9% increase in our average interest-earning assets from $785.6 million in 2015 to $808.6 million in 2016. We do not expect increases in our net interest margin in the near term, and it is possible that our net interest margin will decline in future periods, as we may be unable to increase the yield on our loans and investment securities to the extent necessary to offset higher cost of deposits and borrowings due to higher interest rates.

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 or discounted cash flows of specifically identified impaired loans. Additionally, allowance 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.

During 2016, we recorded a provision for loan losses of $500,000 compared to a credit provision for loan losses of $700,000 during 2015. We recorded net loan recoveries of $1.3 million during 2015 compared to net loan charge-offs of $1.1 million during 2016. The net loan recoveries during 2015 were primarily associated with the recovery of $1.7 million on a $4.3 million construction loan which was fully charged-off during 2010 and 2011. As of December 31, 2016, the Company recovered approximately $2.4 million of the loan and continues to pursue collection of the remaining amount. The net loan recoveries during 2015 were the primary reason for the credit provision for loan losses during the year. For further discussion of the allowance for loan losses, refer to the "Asset Quality and Distribution" section.

Non-interest Income. Total non-interest income was $14.9 million in 2016, a decrease of $2.2 million, or 12.7%, compared to 2015. The decrease in non-interest income was primarily the result of a decrease of $2.5 million in gains on sales of loans. Gains on sales of loans decreased primarily as a result of decreased volumes of one-to-four family residential real estate loans originated and sold during 2016 as compared to the prior year. The lower origination volumes were the result of losing several mortgage lenders during 2016. Also contributing to the decrease in non-interest income in 2016 compared to 2015 was a gain of $236,000 on the sale of a closed branch facility during 2015, which was included in other non-interest income in 2015. Partially offsetting these effects was a net gain of

$558,000 was recorded on sales of investment securities during 2016 as compared to a loss of $119,000 on sales of investment securities in 2015.

Non-interest Expense. Non-interest expense decreased $92,000, or 0.3%, to $29.1 million in 2016 compared to $29.2 million in 2015. The decrease was primarily the result of a $444,000 decrease in other non-interest expense, due primarily to reduced mortgage banking activity in 2016 compared to 2015. Other non-interest expense in 2015 included a $163,000 impairment of the residual real estate collateral associated with an affordable housing investment. Partially offsetting those decreases was an increase of $193,000 in foreclosure and real estate owned expense as a result of additional real estate owned assets in 2016 compared to 2015.

INCOME TAXES. During 2016, we recorded income tax expense of $2.3 million, which constituted an effective tax rate of 20.5%, compared to an income tax expense of $3.9 million and an effective tax rate of 27.1% in 2015. The decrease in tax expense and our effective tax rate during 2016 was due to a lower level of taxable income and higher tax exempt income. The early adoption of ASU 2016-09 also decreased tax expense by $308,000 during 2016 as a result of recognizing excess tax benefits from the exercise of stock options as a component of income tax expense.

COMPARISON OF OPERATING RESULTS FOR THE YEARS ENDED DECEMBER 31, 2015 AND DECEMBER 31, 2014.

SUMMARY OF PERFORMANCE. Net earnings for 2015 increased $2.5 million, or 30.5%, to $10.5 million as compared to $8.0 million for 2014. The increase in net earnings was partially the result of a $1.7 million recovery on a previously charged-off construction loan, which contributed to a $700,000 credit provision for loan losses during 2015 compared to a $600,000 provision for loan losses during the same period of 2014. Higher net interest income and gains on sales of loans during 2015 also contributed to the increase in net earnings as compared to 2014. Gains on sales of loans increased primarily as a result of increased volumes of one-to-four family residential real estate loans originated and sold during 2015 as compared to 2014. The higher origination volumes were the result of adding mortgage lenders and increased refinancing demand.

Net interest income for 2015 increased $1.2 million to $25.9 million, or 5.1% higher than the $24.7 million recorded for 2014. Our net interest margin, on a tax equivalent basis, increased from 3.47% during 2014 to 3.51% in 2015. The growth in net interest income was primarily the result of a 4.4% increase in average interest-earning assets, from $752.8 million in 2014 to $785.6 million in 2015.

Interest Income. Interest income for 2015 increased $1.1 million to $29.0 million, an increase of 4.1% as compared to 2014. Interest income on loans increased $216,000, or 1.0%, to $21.3 million for 2015 compared to 2014, due to higher average loan balances. Our average loan balances increased from $422.3 million during the 2014 to $428.8 million during 2015. Partially offsetting the higher average loan balances was a decline in our tax equivalent yield on loans which decreased from 5.04% to 5.01% over the same periods. Interest income on investment securities increased $931,000, or 13.9%, to $7.7 million during 2015, as compared to $6.7 million in 2014. The increase in interest income on investment securities was primarily the result of an increase in our average balance of investment securities from $322.2 million during 2014 to $354.0 million during 2015. Also contributing to the higher interest income on investment securities was an increase in our tax equivalent yield, which increased from 2.48% in 2014 to 2.59% during 2015.

Interest Expense. Interest expense during 2015 decreased $105,000, or 3.3%, to $3.1 million as compared to 2014. Interest expense on interest-bearing deposits decreased $164,000, or 13.3%, to $1.1 million for 2015 as compared to 2014, despite increased average balances. Our total cost of interest-bearing deposits declined from 0.22% during 2014 to 0.19% during 2015 as a result of higher average balances in our lower-rate savings, money market and checking accounts and lower balances of higher-rate certificates of deposit. Our average interest-bearing deposit balances increased from $552.4 million during 2014 to $558.1 million during 2015. Interest expense on borrowings increased $59,000, or 3.0%, to $2.0 million during 2015 as compared 2014, due to an increase in our average outstanding borrowings. Our average outstanding borrowings increased from $71.3 million in 2014 to $77.7 million during 2015. Partially offsetting the increase in average outstanding borrowings was a lower average rate on our borrowings, which decreased from 2.74% in 2014 to 2.59% in 2015.

Net Interest Income. During 2015, net interest income increased $1.2 million, or 5.1%, to $25.9 million compared to $24.7 million in 2014. Our net interest margin, on a tax-equivalent basis, increased to 3.51% during 2015 from 3.47% during 2014. The increase in net interest income was primarily the result of a 4.4% increase in our average interest-earning assets from $752.8 million in 2014 to $785.6 million in 2015.

Provision for Loan Losses. During 2015, we recorded a credit provision for loan losses of $700,000 compared to a provision for loan losses of $600,000 during 2014. We recorded net loan recoveries of $1.3 million during 2015 compared to net loan charge-offs of $820,000 during 2014. The net loan recoveries during 2015 were primarily associated with the recovery of $1.7 million on a $4.3 million construction loan which was fully charged-off during 2010 and 2011. As of December 31, 2015, the Company had recovered approximately $2.4 million of the loan and continues to pursue collection of the remaining amount. The net loan recoveries during 2015 were the primary reason for the credit provision for loan losses during the year. For further discussion of the allowance for loan losses, refer to the “Asset Quality and Distribution” section.

Non-interest Income. Total non-interest income was $17.0 million in 2015, an increase of $1.9 million, or 12.9%, compared to 2014. The increase in non-interest income was primarily the result of an increase of $2.1 million in gains on sales of loans. Gains on sales of loans increased primarily as a result of increased volumes of one-to-four family residential real estate loans originated and sold during 2015 as compared to the prior year. The higher origination volumes were the result of adding mortgage lenders and increased refinancing demand. Also contributing to the increase in non-interest income was a gain of $236,000 on the sale of a closed branch facility during 2015, which was included in other non-interest income. Partially offsetting these increases was a net loss of $119,000 that was recorded on sales of investment securities during 2015 as we sold $30.6 million of our agency mortgage-backed investment securities portfolio to reduce exposure to rising interest rates. During 2014, we recognized $99,000 in gains on sales of investment securities.

Non-interest Expense. Non-interest expense increased $1.1 million, or 4.1%, to $29.2 million in 2015 compared to $28.1 million in 2014. The increase in non-interest expense was primarily the result of increases of $883,000 in compensation and benefits and $460,000 in other non-interest expense. The higher compensation and benefits expense in 2015 primarily reflected expenses associated with the expanded mortgage banking activity while the increase in other non-interest expense reflected a $163,000 impairment of an affordable housing investment and the expanded mortgage banking activity. The affordable housing investment had a residual equity value which was determined to be impaired based upon an updated appraisal. The Company does not have any other affordable housing investments which include residual equity values. Partially offsetting those increases were declines of $145,000 in occupancy and equipment and $85,000 in federal deposit insurance premiums.

INCOME TAXES. During 2015, we recorded income tax expense of $3.9 million, which constituted an effective tax rate of 27.1%, compared to an income tax expense of $3.0 million and an effective tax rate of 27.3% in 2014. The increase in tax expense during 2015 was due to a higher level of taxable income as our effective tax rate remained relatively stable.

QUARTERLY RESULTS OF OPERATIONS

(Dollars in thousands, except per share amounts)

	2016 Quarters Ended			
	March 31	June 30	September 30	December 31
Interest income	$7,174	$7,372	$ 7,350	$ 7,334
Interest expense	770	810	798	813
Net interest income	6,404	6,562	6,552	6,521
Provision for loan losses	50	300	150	-
Net interest income after provision for loan losses	6,354	6,262	6,402	6,521
Non-interest income	3,894	3,948	3,742	3,266
Non-interest expense	7,162	7,211	7,394	7,347
Earnings before income taxes	3,086	2,999	2,750	2,440
Income tax expense	693	673	594	354
Net earnings	$2,393	$2,326	$ 2,156	$ 2,086
Earnings per share (1)(2):				
Basic	$0.64	$0.61	$ 0.56	$ 0.54
Diluted	$0.63	$0.60	$ 0.55	$ 0.53

	2015 Quarters Ended			
	March 31	June 30	September 30	December 31
Interest income	$7,063	$7,393	$ 7,200	$ 7,341
Interest expense	769	769	773	770
Net interest income	6,294	6,624	6,427	6,571
Provision for loan losses	(1,000)	200	100	-
Net interest income after provision for loan losses	7,294	6,424	6,327	6,571
Non-interest income	3,763	4,682	4,476	4,089
Non-interest expense	7,111	7,443	7,308	7,344
Earnings before income taxes	3,946	3,663	3,495	3,316
Income tax expense	1,169	1,047	966	732
Net earnings	$2,777	$2,616	$ 2,529	$ 2,584
Earnings per share (1):				
Basic	$0.75	$0.71	$ 0.69	$ 0.70
Diluted	$0.73	$0.69	$ 0.67	$ 0.68

(1) All per share amounts have been adjusted to give effect to the 5% stock dividends paid during December 2016 and 2015.

(2) Income tax expense, net earnings and earnings per share for 2016 have been recast to reflect the early adoption of ASU 2016-09 in the fourth quarter of 2016.

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FINANCIAL CONDITION. Despite measured improvement in certain metrics, general uncertainty with respect to economic conditions in the United States continues to affect our asset quality and performance. The geographic markets in which the Company operates have also been impacted by an economic downturn in the agriculture sector. However, our loan portfolio is diversified across various types of loans and collateral throughout the markets in which we operate. Outside a few problem loans that management is working to resolve, our asset quality has generally improved over the past few years. Outside of identified problem assets, management believes that the Company continues to have a high quality asset base and solid core earnings, and anticipates that its efforts to run a high quality financial institution with a sound asset base will continue to create a strong foundation for continued growth and profitability in the future.

Asset Quality and Distribution. Our primary investing activities are the origination of one-to-four family residential real estate, construction and land, commercial real estate, commercial, agriculture, municipal and consumer loans and the purchase of investment securities. Total assets increased to $911.4 million at December 31, 2016, compared to $878.4 million at December 31, 2015. The increase in our total assets was primarily the result of an increase in our investment securities available for sale, which increased from $353.4 million at December 31, 2015 to $385.6 million at December 31, 2016. Net loans, excluding loans held for sale, increased slightly to $420.5 million at December 31, 2016 from $419.9 million at December 31, 2015.

The allowance for loan losses is established through a provision for loan losses based on our evaluation of the risk inherent in the loan portfolio and changes in the nature and volume of our loan activity. This evaluation, which includes a review of all loans with respect to which full collectability 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 appropriate allowance for loan losses. At December 31, 2016, our allowance for loan losses totaled $5.3 million, or 1.26% of gross loans outstanding, as compared to $5.9 million, or 1.39% of gross loans outstanding, at December 31, 2015.

As of December 31, 2016 and 2015, approximately $16.6 million and $15.3 million, respectively, of loans were considered classified and assigned a risk rating of special mention, substandard or doubtful. These ratings indicate that the loans identified as potential problem loans have more than normal risk which raised doubts as to the ability of the borrower to comply with present loan repayment terms. Even though these borrowers were experiencing moderate cash flow problems as well as some deterioration in collateral value, management believed the general allowance was sufficient to cover the risks and probable incurred losses related to such loans at December 31, 2016 and 2015, respectively.

Loans past due 30-89 days and still accruing interest totaled $758,000, or 0.18% of gross loans at December 31, 2016 compared to $1.4 million, or 0.33% of gross loans, at December 31, 2015. At December 31, 2016, $2.7 million of loans were on non-accrual status, or 0.64% of gross loans, compared to $2.2 million, or 0.51% of gross loans, at December 31, 2015. Non-accrual loans consist of loans 90 or more days past due and certain impaired loans. There were no loans 90 days delinquent and accruing interest at December 31, 2016 or December 31, 2015. Our impaired loans totaled $6.7 million at December 31, 2016 compared to $6.8 million at December 31, 2015. The difference in the Company's non-accrual loan balances and impaired loan balances at December 31, 2016 and December 31, 2015 was related to TDRs that were accruing interest but still classified as impaired.

At December 31, 2016, the Company had eleven loan relationships consisting of seventeen outstanding loans that were classified as TDRs compared to ten relationships consisting of fourteen outstanding loans classified as TDRs at December 31, 2015.

During 2016, the Company classified a $302,000 agriculture loan relationship consisting of three loans as a TDR after extending the maturities of the loans. The collateral securing the loans was deemed to be insufficient, resulting in a charge-off of $215,000. The Company also classified an $8,000 commercial loan as a TDR during 2016 after modifying the payments to interest only. Also during 2016, the Company classified a $188,000 one-to-four family residential real estate loan as a TDR after agreeing to a loan modification which adjusted the payment schedule.

During 2015, the Company classified a $2.0 million commercial real estate loan relationship as a TDR after agreeing to a bankruptcy plan with the borrower. The bankruptcy plan restarted the amortization period of the loans which extended the maturities. The commercial real estate loan relationship totaled $4.4 million in 2012 when the loans were placed on non-accrual status after the borrower declared bankruptcy. The outstanding balances have been partially paid down with proceeds from asset sales and cash flows from the properties securing the loans during the bankruptcy process and under the terms of the restructuring agreement. The relationship was returned to accrual status during 2015 based on a satisfactory payment performance by the borrower under the revised terms of the bankruptcy plan. The Company also classified a $50,000 agriculture loan relationship consisting of two loans as a TDR after extending the maturity of the loans during 2015. Since all of the loans were adequately secured, no charge-offs or impairments were recorded against the principal as of December 31, 2015. During 2015, a land loan relationship consisting of three loans totaling $1.6 million, which was previously classified as a TDR during 2012, paid off with proceeds from the sale of assets and a new loan originated at market terms on the remaining assets. Also during 2015, a $78,000 commercial loan, which was classified as a TDR during 2014, paid off.

As part of our credit risk management, we continue to manage the loan portfolio to identify problem loans and have placed additional emphasis on commercial real estate and construction and land relationships. We are working to resolve the remaining problem credits or move the non-performing credits out of the loan portfolio. At December 31, 2016, we had $1.3 million of real estate owned compared to $1.0 million at December 31, 2016. As of December 31, 2016, real estate owned primarily consisted of a few residential real estate properties and one commercial property. The Company is currently marketing all of the remaining properties in real estate owned.

Liability Distribution. Our primary ongoing sources of funds are deposits, FHLB borrowings, 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 and economic conditions. We experienced an increase of $26.8 million in total deposits during 2016, to $741.5 million at December 31, 2016, from $714.7 million at December 31, 2015. The increase in deposits was primarily due to higher non-interest bearing deposits, money market and checking accounts and savings accounts. The increases were partially offset by lower balances in certificates of deposit balances. Total borrowings increased $2.2 million to $72.9 million at December 31, 2016, from $70.7 million at December 31, 2015.

Non-interest-bearing deposits at December 31, 2016, were $152.0 million, or 20.5% of deposits, compared to $143.6 million, or 20.1%, at December 31, 2015. Money market and checking accounts were 48.7% of our deposit portfolio and totaled $361.4 million at December 31, 2016, compared to $346.1 million, or 48.4%, at December 31, 2015. Savings accounts increased to $88.3 million, or 11.9% of deposits, at December 31, 2016, from $81.1 million, or 11.3%, at December 31, 2015. Certificates of deposit totaled $139.8 million, or 18.9% of deposits, at December 31, 2016, compared to $143.9 million, or 20.2%, at December 31, 2015.

Certificates of deposit at December 31, 2016, scheduled to mature in one year or less totaled $100.1 million. Historically, maturing deposits have generally remained with the Bank, and we believe that a significant portion of the deposits maturing in one year or less will remain with us upon maturity in some type of deposit account.

CASH FLOWS. During 2016, our cash and cash equivalents increased by $6.4 million. Our operating activities provided net cash of $19.0 million in 2016 primarily due to a decrease in loans held for sale as more one-to-four family residential mortgage loans were sold than originated for sale in 2016. Our investing activities used net cash of $40.3 million during 2016, primarily as a result of purchasing more investment securities than were sold or matured in 2016. Our financing activities provided net cash of $27.7 million during 2016, primarily as a result of an increase in deposit balances.

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 year. These liquid assets totaled $405.6 million at December 31, 2016 and $367.0 million at December 31, 2015. During periods in which we are not able to originate a sufficient amount of loans and/or periods of high principal prepayments, we generally increase our liquid assets by investing in short-term, high-grade investments.

Liquidity management is both a daily and long-term function of our strategy. Excess funds are generally invested in short-term investments. Excess funds are typically generated as a result of increased deposit balances, while uses of excess funds are generally deposit withdrawals and loan advances. In the event we require funds beyond our ability to generate them internally, additional funds are generally available through the use of FHLB advances, a line of credit with the FHLB, other borrowings or through sales of investment securities. At December 31, 2016, we had outstanding FHLB advances of $35.0 million and $4.1 million of borrowings against our line of credit with the FHLB. At December 31, 2016, we had collateral pledged to the FHLB that would allow us to borrow an additional $38.7 million, subject to FHLB credit requirements and policies. At December 31, 2016, we had no borrowings through the Federal Reserve discount window, while our borrowing capacity with the Federal Reserve was $16.0 million. We also have various other federal funds agreements, both secured and unsecured, with correspondent banks totaling approximately $30.0 million in available credit under which we had no outstanding borrowings at December 31, 2016. At December 31, 2016, we had subordinated debentures totaling $21.3 million and other borrowings of $12.5 million, which consisted of repurchase agreements. At December 31, 2016, the Company had no borrowings against a $7.5 million line of credit from an unrelated financial institution that matures on November 1, 2017, with an interest rate that adjusts daily based on the prime rate plus 0.25%. This line of credit has covenants specific to capital and other financial ratios, which the Company was in compliance with at December 31, 2016.

OFF BALANCE SHEET ARRANGEMENTS. 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 $1.9 million at December 31, 2016.

At December 31, 2016, we had outstanding loan commitments, excluding standby letters of credit, of $75.8 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 has established capital requirements for bank holding companies which generally parallel the capital requirements for national banks under OCC regulations. The regulations provide that such standards will generally be applied on a consolidated (rather than a bank-only) basis in the case of bank holding companies other than “small bank holding companies” (generally, non-public bank holding companies with less than $1 billion in total consolidated assets).

At December 31, 2016, we maintained a leverage capital ratio of 10.04% and a total risk-based capital ratio of 18.46%. As shown by the following table, our capital exceeded the minimum capital requirements in effect at December 31, 2016 (dollars in thousands):

	Actual amount	Actual percent	Required amount	Required percent
Leverage	$88,819	10.04 %	$35,370	4.0 %
Common Equity Tier 1 capital (1)	68,263	13.32 %	26,265	5.1 %
Tier 1 capital (1)	88,819	17.33 %	33,952	6.6 %
Total risk-based capital (1)	94,596	18.46 %	44,201	8.6 %

(1) The required percent includes a capital conservation buffer of 0.625%.

At December 31, 2016, the Bank maintained a leverage ratio of 9.98% and a total risk-based capital ratio of 18.31%. As shown by the following table, the Bank's capital exceeded the minimum capital requirements in effect at December 31, 2016 (dollars in thousands):

	Actual amount	Actual percent	Required amount	Required percent
Leverage	$88,076	9.98 %	$35,284	4.0 %
Common Equity Tier 1 capital (1)	88,076	17.23 %	26,194	5.1 %
Tier 1 capital (1)	88,076	17.23 %	33,861	6.6 %
Total risk-based capital (1)	93,560	18.31 %	44,083	8.6 %

(1) The required percent includes a capital conservation buffer of 0.625%.

Banks and bank holding companies are generally expected to operate at or above the minimum capital requirements. The Company’s and the Bank’s ratios above are well in excess of regulatory minimums, and we expect that they will 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 December 31, 2016 and 2015, we exceeded the "well capitalized" thresholds, which is the highest rating available under this capital-based rating system. With the implementation of the Basel III Rule, which became effective January 1, 2015, these capital requirements, and the related prompt correction action provisions increased. There are no conditions or events, including the implementation of the Basel III Rule, since that notification that management believes have changed the institution’s category. We have $21.3 million in trust preferred securities which, in accordance with current capital guidelines, have been included in capital as of December 31, 2015. Cash distributions on the securities are payable quarterly, are deductible for income tax purposes and are included in interest expense in the consolidated financial statements.

DIVIDENDS

During the year ended December 31, 2016, we paid a quarterly cash dividend of $0.19 per share to our stockholders, as adjusted to give effect to a 5% stock dividend, which we distributed for the 16th consecutive year in December 2016. The 2015 quarterly cash dividends were $0.172 per share as adjusted to give effect to a 5% stock dividend.

The payment of dividends by any financial institution or its holding company is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations. As described above, the Bank exceeded its minimum capital requirements under applicable guidelines as of December 31, 2016. The National Bank Act imposes limitations on the amount of dividends that a national bank may pay without prior regulatory approval. Generally, the amount is limited to the bank's current year's net earnings plus the adjusted retained earnings for the two preceding years. As of December 31, 2016, approximately $23.7 million was available to be paid as dividends to the Company by the Bank without prior regulatory approval.

Additionally, our ability to pay dividends is limited by the subordinated debentures associated with the trust preferred securities that are held by three business trusts that we control. Interest payments on the debentures must be paid before we pay dividends on our capital stock, including our common stock. We have the right to defer interest payments on the debentures for up to 20 consecutive quarters. However, if we elect to defer interest payments, all deferred interest must be paid before we may pay dividends on our capital stock.

EFFECTS OF INFLATION

Our consolidated financial statements and accompanying footnotes have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"), which generally require the measurement of financial position and operating results in terms of historical dollars without consideration for changes in the relative purchasing power of money over time due to inflation. The impact of inflation can be found in the increased cost of our operations because our assets and liabilities are primarily monetary and interest rates have a greater impact on our performance than do the effects of inflation.

ITEM 7A. 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 decisions on pricing our assets and liabilities which impacts our 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.

In the past, 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 using rates at December 31, 2016 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 100 basis points falling with an impact to our net interest income on a one-year horizon as follows:

Scenario	$000's change in net interest income	% change in net interest income
200 basis point rising	$ (1,774)	-6.6 %
100 basis point rising	(914)	-3.4 %
100 basis point falling	(267)	-1.0 %

ASSET/LIABILITY MANAGEMENT

Interest rate "gap" analysis is a common, though imperfect, measure of interest rate risk which measures the relative dollar amounts of interest-earning assets and interest-bearing liabilities which reprice within a specific time period, either through maturity or rate adjustment. The "gap" is the difference between the amounts of such assets and liabilities that are subject to such repricing. A "positive" gap for a given period means that the amount of interest-earning assets maturing or otherwise repricing within that period exceeds the amount of interest-bearing liabilities maturing or otherwise repricing during that same period. In a rising interest rate environment, an institution with a positive gap would generally be expected, absent the effects of other factors, to experience a greater increase in the yield of its assets relative to the cost of its liabilities. Conversely, the cost of funds for an institution with a positive gap would generally be expected to decline less quickly than the yield on its assets in a falling interest rate environment. Changes in interest rates generally have the opposite effect on an institution with a "negative" gap.

Following is our "static gap" schedule. One-to-four family and consumer loans include prepayment assumptions, while all other loans assume no prepayments. Mortgage-backed securities include published prepayment assumptions, while all other investments assume no prepayments.

Certificates of deposit reflect contractual maturities only. Money market accounts are rate sensitive and accordingly, a higher percentage of the accounts have been included as repricing immediately in the first period. Savings and NOW accounts are not as rate sensitive as money market accounts and for that reason a significant percentage of the accounts are reflected in the 1-to-5 year category.

Given the historically low interest rates that have persisted for the last several years, we believe it is unlikely that interest rates will move much lower than experienced in 2016. We have been successful in meeting the interest sensitivity objectives set forth in our policy. This has been accomplished primarily by managing the assets and liabilities while maintaining our traditional high credit standards.

INTEREST-EARNING ASSETS AND INTEREST-BEARING LIABILITIES REPRICING SCHEDULE

("GAP" TABLE)

As of December 31, 2016	3 months or less	3 to 12 months	1 to 5 years	Over 5 years	Total
	(Dollars in thousands)				
Interest-earning assets:					
Investment securities	$20,797	$56,395	$ 175,414	$138,256	$390,862
Loans	74,832	134,899	193,118	23,129	425,978
Total interest-earning assets	$95,629	$191,294	$ 368,532	$161,385	$816,840
Interest-bearing liabilities:					
Certificates of deposit	$37,150	$62,966	$ 39,647	$75	$139,838
Money market and checking accounts	3,493	10,478	282,258	65,169	361,398
Savings accounts	-	-	70,618	17,655	88,273
Borrowed money	42,867	5,000	25,000	-	72,867
Total interest-bearing liabilities	$83,510	$78,444	$ 417,523	$82,899	$662,376
Interest sensitivity gap per period	$12,119	$112,850	$ (48,991)	$78,486	$154,464
Cumulative interest sensitivity gap	12,119	124,969	75,978	154,464	
Cumulative gap as a percent of total interest-earning assets	1.48 %	15.30 %	9.30 %	18.91 %	
Cumulative interest sensitive assets as a percent of cumulative interest sensitive liabilities	114.51%	177.16 %	113.11 %	123.32 %	

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Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995

Forward-Looking Statements

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

Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on operations and future prospects by us and our subsidiaries include, but are not limited to, the following:

- The strength of the United States economy in general and the strength of the local economies in which we conduct our operations which may be less favorable than expected and may result in, among other things, a deterioration in the credit quality and value of our assets.
- The effects of, and changes in, federal, state and local laws, regulations and policies affecting banking, securities, insurance and monetary and financial matters (including the Dodd-Frank Act and the rules and regulations promulgated thereunder, as well as the Basel III Rule, and the effects of increases in FDIC premiums).
- The effects of changes in interest rates (including the effects of changes in the rate of prepayments of our assets) and the policies of the Federal Reserve.
- Our ability to compete with other financial institutions as effectively as we currently do due to increases in competitive pressures in the financial services sector.
- Our inability to obtain new customers and to retain existing customers.
- The timely development and acceptance of products and services, including products and services offered through alternative delivery channels such as the Internet.
- Technological changes implemented by us and by other parties, including third party vendors, which may be more difficult or more expensive than anticipated or which may have unforeseen consequences to us and our customers.
- Our ability to develop and maintain secure and reliable electronic systems.
- Our ability to retain key executives and employees and the difficulty that we may experience in replacing key executives and employees in an effective manner.
- Consumer spending and saving habits which may change in a manner that affects our business adversely.
- Our ability to successfully integrate acquired businesses and future growth.
- The costs, effects and outcomes of existing or future litigation.

- Changes in accounting policies and practices, as may be adopted by state and federal regulatory agencies and the FASB.
- The economic impact of past and any future terrorist attacks, acts of war or threats thereof, and the response of the United States to any such threats and attacks.
- Our ability to effectively manage our credit risk.
- Our ability to forecast probable loan losses and maintain an adequate allowance for loan losses.
- The effects of declines in the value of our investment portfolio.
- Our ability to raise additional capital if needed.
- The effects of cyber-attacks.
- The effects of declines in real estate markets.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Additional information concerning us and our business, including other factors that could materially affect our financial results, is included in "Item 1A. Risk Factors".

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

Landmark Bancorp, Inc. and Subsidiary

Manhattan, Kansas

We have audited the accompanying consolidated balance sheets of Landmark Bancorp, Inc. and Subsidiary (the “Company”) as of December 31, 2016 and 2015, and the related consolidated statements of earnings, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2016. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Landmark Bancorp, Inc. and Subsidiary as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

/s/ Crowe Chizek LLP

Oak Brook, Illinois

March 14, 2017

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LANDMARK BANCORP, INC. AND SUBSIDIARY

Consolidated Balance Sheets

(Dollars in thousands)	December 31, 2016	2015
Assets		
Cash and cash equivalents	$19,996	$13,569
Investment securities available-for-sale, at fair value	385,563	353,438
Bank stocks, at cost	5,299	4,497
Loans, net of allowance for loans losses of $5,344 and $5,922	420,461	419,923
Loans held for sale	5,517	14,465
Premises and equipment, net	20,407	20,958
Bank owned life insurance	18,314	18,164
Goodwill	17,532	17,532
Other intangible assets, net	3,986	4,304
Real estate owned, net	1,279	1,000
Accrued interest and other assets	13,028	10,526
Total assets	$911,382	$878,376
Liabilities and Stockholders' Equity		
Liabilities:		
Deposits:		
Non-interest bearing demand	$152,012	$143,616
Money market and checking	361,398	346,106
Savings	88,273	81,062
Time	139,838	143,943
Total deposits	741,521	714,727
Federal Home Loan Bank borrowings	39,100	37,600
Subordinated debentures	21,284	21,084
Other borrowings	12,483	11,974
Accrued interest and other liabilities	12,043	12,421
Total liabilities	826,431	797,806
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; 3,868,077 and 3,707,588 shares issued and outstanding at December 31, 2016 and 2015, respectively	38	35
Additional paid-in capital	51,968	45,372
Retained earnings	34,293	32,988
Accumulated other comprehensive (loss) income	(1,348)	2,175
Total stockholders' equity	84,951	80,570

Total liabilities and stockholders' equity	$911,382	$878,376

See Notes to Consolidated Financial Statements.

LANDMARK BANCORP, INC. AND SUBSIDIARY

Consolidated Statements of Earnings

(Dollars in thousands, except per share amounts)	Years ended December 31,		
	2016	2015	2014
Interest income:			
Loans:			
Taxable	$21,010	$21,077	$20,802
Tax-exempt	244	268	328
Investment securities:			
Taxable	4,551	4,584	4,119
Tax-exempt	3,425	3,068	2,601
Total interest income	29,230	28,997	27,850
Interest expense:			
Deposits	1,134	1,071	1,235
Subordinated debentures	787	699	686
Borrowings	1,270	1,311	1,265
Total interest expense	3,191	3,081	3,186
Net interest income	26,039	25,916	24,664
Provision for loan losses	500	(700)	600
Net interest income after provision for loan losses	25,539	26,616	24,064
Non-interest income:			
Fees and service charges	7,268	7,331	7,424
Gains on sales of loans, net	5,476	7,993	5,880
Increase in cash surrender value of bank owned life insurance	508	514	523
Gains (losses) on sales of investment securities, net	558	(119)	99
Other	1,040	1,291	1,145
Total non-interest income	14,850	17,010	15,071
Non-interest expense:			
Compensation and benefits	15,313	15,230	14,347
Occupancy and equipment	4,334	4,252	4,397
Data processing	1,419	1,391	1,416
Amortization of intangibles	1,397	1,355	1,296
Professional fees	1,081	1,048	1,096
Advertising	573	618	534
Federal deposit insurance premiums	369	433	518
Foreclosure and real estate owned expense	258	65	102
Other	4,370	4,814	4,354
Total non-interest expense	29,114	29,206	28,060
Earnings before income taxes	11,275	14,420	11,075
Income tax expense	2,314	3,914	3,026
Net earnings	$8,961	$10,506	$8,049
Earnings per share:			
Basic (1)	$2.35	$2.85	$2.19

Diluted (1)	$2.31	$2.77	$2.16

(1) All per share amounts have been adjusted to give effect to the 5% stock dividends paid during December 2016, 2015 and 2014.

See Notes to Consolidated Financial Statements.

LANDMARK BANCORP, INC. AND SUBSIDIARY

Consolidated Statements of Comprehensive Income

(Dollars in thousands)	Years ended December 31,		
	2016	2015	2014
Net earnings	$ 8,961	$ 10,506	$ 8,049