ASPEN TECHNOLOGY INC /DE/
Form 10-Q
October 28, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

or

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

For the transition period from to

Commission file number: 001-34630

ASPEN TECHNOLOGY, INC.

(Exact name of registrant as specified in its charter)

Delaware	**04-2739697**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
200 Wheeler Road **Burlington, Massachusetts**	**01803**
(Address of principal executive offices)	(Zip Code)

(781) 221-6400

(Registrant s telephone number, including area code)

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

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

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.

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

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

As of October 21, 2014, there were 90,471,242 shares of the registrant s common stock (par value $0.10 per share) outstanding.

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ASPENONE is one of our registered trademarks. All other trade names, trademarks and service marks appearing in this Form 10-Q are the property of their respective owners.

Our fiscal year ends on June 30, and references to a specific fiscal year are the twelve months ended June 30 of such year (for example, fiscal 2015 refers to the year ended June 30, 2015).

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

Consolidated Financial Statements (unaudited)

ASPEN TECHNOLOGY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended September 30,	
	2014	2013
	(Dollars in Thousands, Except per Share Data)	
Revenue:		
Subscription and software	$ 98,743	$ 78,683
Services and other	8,383	8,882
Total revenue	107,126	87,565
Cost of revenue:		
Subscription and software	5,201	4,620
Services and other	7,180	7,458
Total cost of revenue	12,381	12,078
Gross profit	94,745	75,487
Operating expenses:		
Selling and marketing	21,618	22,931
Research and development	16,268	15,834
General and administrative	12,225	11,876
Restructuring charges		(3)
Total operating expenses	50,111	50,638
Income from operations	44,634	24,849
Interest income	135	387
Interest expense	(3)	(18)
Other income (expense), net	188	(804)
Income before provision for income taxes	44,954	24,414
Provision for income taxes	15,987	9,415
Net income	$ 28,967	$ 14,999
Net income per common share:		
Basic	$ 0.32	$ 0.16
Diluted	$ 0.32	$ 0.16
Weighted average shares outstanding:		
Basic	91,183	93,410
Diluted	91,891	94,522

See accompanying Notes to these unaudited consolidated financial statements.

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ASPEN TECHNOLOGY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended September 30,	
	2014	2013
	(Dollars in Thousands)	
Net income	$ 28,967	$ 14,999
Other comprehensive income (loss):		
Net unrealized gains (losses) on available for sale securities, net of tax effects of $21 and ($42) for the three months ended September 30, 2014 and 2013	(39)	77
Foreign currency translation adjustments	(1,529)	1,336
Total other comprehensive income (loss)	(1,568)	1,413
Comprehensive income	$ 27,399	$ 16,412

See accompanying Notes to these unaudited consolidated financial statements.

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ASPEN TECHNOLOGY, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Unaudited)

	September 30, 2014	June 30, 2014
	(Dollars in Thousands, Except Share Data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 193,134	$ 199,526
Short-term marketable securities	72,352	67,619
Accounts receivable, net	24,775	38,532
Current portion of installments receivable, net	412	640
Unbilled services	1,113	1,656
Prepaid expenses and other current assets	9,065	10,567
Prepaid income taxes	701	605
Current deferred tax assets	7,104	10,537
Total current assets	308,656	329,682
Long-term marketable securities	23,635	31,270
Non-current installments receivable, net	551	811
Property, equipment and leasehold improvements, net	9,513	7,588
Computer software development costs, net	1,349	1,390
Goodwill	18,596	19,276
Non-current deferred tax assets	11,207	12,765
Other non-current assets	4,728	5,190
Total assets	$ 378,235	$ 407,972
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,961	$ 412
Accrued expenses and other current liabilities	26,136	34,984
Income taxes payable	997	2,168
Current deferred revenue	213,545	228,940
Total current liabilities	242,639	266,504
Non-current deferred revenue	43,267	45,942
Other non-current liabilities	22,340	11,850
Commitments and contingencies (Note 11)		
Series D redeemable convertible preferred stock, $0.10 par value		
Authorized 3,636 shares as of September 30, 2014 and June 30, 2014		
Issued and outstanding none as of September 30, 2014 and June 30, 2014		
Stockholders equity:		
Common stock, $0.10 par value Authorized 210,000,000 shares		
Issued 101,188,994 shares at September 30, 2014 and 101,033,740 shares at June 30, 2014		
Outstanding 90,766,389 shares at September 30, 2014 and 91,661,850 shares at June 30, 2014	10,119	10,103
Additional paid-in capital	595,223	591,324
Accumulated deficit	(235,067)	(264,034)
Accumulated other comprehensive income	7,803	9,372
Treasury stock, at cost 10,422,605 shares of common stock at September 30, 2014 and 9,371,890 shares at June 30, 2014	(308,089)	(263,089)

Total stockholders equity		69,989		83,676
Total liabilities and stockholders equity	$	378,235	$	407,972

See accompanying Notes to these unaudited consolidated financial statements.

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ASPEN TECHNOLOGY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three Months Ended September 30,	
	2014	2013
	(Dollars in Thousands)	
Cash flows from operating activities:		
Net income	$ 28,967	$ 14,999
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,352	1,202
Net foreign currency (gains) losses	(660)	564
Stock-based compensation	4,204	4,387
Deferred income taxes	15,560	8,618
Provision for bad debts	(1,329)	20
Excess tax benefits from stock-based compensation	(72)	(41)
Other non-cash operating activities	462	73
Changes in assets and liabilities:		
Accounts receivable	14,990	1,152
Unbilled services	527	194
Prepaid expenses, prepaid income taxes, and other assets	1,242	870
Installments receivable	253	3,029
Accounts payable, accrued expenses, and other liabilities	(7,889)	(9,477)
Deferred revenue	(17,664)	323
Net cash provided by operating activities	39,943	25,913
Cash flows from investing activities:		
Purchase of marketable securities	(11,985)	(7,974)
Maturities of marketable securities	14,513	4,538
Purchase of property, equipment and leasehold improvements	(2,891)	(915)
Capitalized computer software development costs	(136)	(219)
Net cash used in investing activities	(499)	(4,570)
Cash flows from financing activities:		
Exercise of stock options	1,050	2,933
Repurchases of common stock	(45,000)	(28,919)
Payment of tax withholding obligations related to restricted stock	(1,411)	(2,449)
Excess tax benefits from stock-based compensation	72	41
Net cash used in financing activities	(45,289)	(28,394)
Effect of exchange rate changes on cash and cash equivalents	(547)	223
Decrease in cash and cash equivalents	(6,392)	(6,828)
Cash and cash equivalents, beginning of period	199,526	132,432
Cash and cash equivalents, end of period	$ 193,134	$ 125,604
Supplemental disclosure of cash flow information:		
Income taxes paid, net	$ 1,551	$ 1,330
Interest paid	3	18

See accompanying Notes to these unaudited consolidated financial statements.

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ASPEN TECHNOLOGY, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Interim Unaudited Consolidated Financial Statements

The accompanying interim unaudited consolidated financial statements of Aspen Technology, Inc. and its subsidiaries have been prepared on the same basis as our annual consolidated financial statements. We have omitted certain information and footnote disclosures normally included in our annual consolidated financial statements. Such interim unaudited consolidated financial statements have been prepared in conformity with U.S. Generally Accepted Accounting Principles (GAAP), as defined in the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 270, *Interim Reporting*, for interim financial information and with the instructions to Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. It is suggested that these unaudited consolidated financial statements be read in conjunction with the audited consolidated financial statements for the year ended June 30, 2014, which are contained in our Annual Report on Form 10-K, as previously filed with the U.S. Securities and Exchange Commission (SEC). In the opinion of management, all adjustments, consisting of normal and recurring adjustments, considered necessary for a fair presentation of the financial position, results of operations, and cash flows at the dates and for the periods presented have been included and all intercompany accounts and transactions have been eliminated in consolidation. The results of operations for the three months ended September 30, 2014 are not necessarily indicative of the results to be expected for any subsequent quarter or for the full fiscal year.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Unless the context requires otherwise, references to we, our and us refer to Aspen Technology, Inc. and its subsidiaries.

2. Significant Accounting Policies

(a) Overview of Licensing Model Changes

Transition to the aspenONE Licensing Model

Prior to fiscal 2010, we offered term or perpetual licenses to specific products, or specifically defined sets of products, which we refer to as point products. The majority of our license revenue was recognized under an upfront revenue model, in which the net present value of the aggregate license fees was recognized as revenue upon shipment of the point products. Customers typically received one year of post-contract software maintenance and support, or SMS, with their license agreements and then could elect to renew SMS annually. Revenue from SMS was recognized ratably over the period in which the SMS was delivered.

In fiscal 2010, we introduced the following changes to our licensing model:

(i) We began offering our software on a subscription basis, allowing our customers access to all products within a licensed suite (aspenONE Engineering or aspenONE Manufacturing and Supply Chain). SMS is included for the entire term of the arrangement and customers are entitled to any software products or updates introduced into the licensed suite. We refer to this license arrangement as our aspenONE licensing model.

(ii) We began to include SMS for the entire term on our point product term arrangements.

Beginning in fiscal 2012, we introduced our Premier Plus SMS offering to provide more value to our customers. As a part of this offering, customers receive 24x7 support, faster response times, dedicated technical advocates and access to web-based training modules.

Revenue related to our aspenONE licensing model and to term point product license arrangements with Premier Plus SMS is recognized over the term of the arrangement on a ratable basis. The changes to our licensing model introduced in fiscal 2010 did not change the method or timing of customer billings or cash collections.

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Impact of Licensing Model Changes

The principal accounting implications of the changes to our licensing model in fiscal 2010 are as follows:

- Prior to fiscal 2010, the majority of our license revenue was recognized on an upfront basis. Since the upfront model resulted in the net present value of multiple years of future installments being recognized at the time of shipment, the changes to our licensing model resulted in a reduction in our software license revenue for fiscal 2010, 2011 and 2012 as compared to the fiscal years preceding our licensing model changes. These changes did not impact the incurrence or timing of our expenses, and there was no corresponding expense reduction to offset the lower revenue, resulting in operating losses for fiscal 2010, 2011 and 2012. By fiscal 2013, a sufficient number of license arrangements had been renewed on the aspenONE licensing model to generate ratable revenue sufficient to support an operating profit.

- Since fiscal 2010, revenue from annually renewable SMS arrangements (legacy SMS revenue) has decreased, and been offset by a corresponding increase in subscription and software revenue as customers have transitioned to our aspenONE licensing model. Under our aspenONE licensing model and for point product arrangements with Premier Plus SMS included for the full contract term, the entire arrangement fee, including the SMS component, is included within subscription and software revenue.

- Installment payments from aspenONE agreements and from point product arrangements with SMS included for the contract term are not considered fixed or determinable, and as a result, are not included in installments receivable. Accordingly, our installments receivable balance has decreased as licenses previously executed under our upfront revenue model reached the end of their terms.

- The amount of our deferred revenue has increased as more revenue from our term license portfolio has been recognized on a ratable basis.

(b) Revenue Recognition

We generate revenue from the following sources: (1) licensing software products and SMS; and (2) providing professional services and training. We sell our software products to end users under fixed-term and perpetual licenses. As a standard business practice, we offer extended payment term options for our fixed-term license arrangements, which are generally payable on an annual basis. Many of our fixed-term license agreements include product mixing rights that allow customers the flexibility to change or alternate the use of multiple products included in the license arrangement after those products are delivered to the customer. We refer to these arrangements as token arrangements. Tokens are fixed units of measure. The amount of software usage is limited by the number of tokens purchased by the customer.

Four basic criteria must be satisfied before software license revenue can be recognized: persuasive evidence of an arrangement between us and an end user; delivery of our product has occurred; the fee for the product is fixed or determinable; and collection of the fee is probable.

Persuasive evidence of an arrangement We use a signed contract as evidence of an arrangement for software licenses and SMS. For professional services we use a signed contract and a work proposal to evidence an arrangement. In cases where both a signed contract and a purchase order are required by the customer, we consider both taken together as evidence of the arrangement.

Delivery of our product Software and the corresponding access keys are generally delivered to customers electronically or via disk media with standard shipping terms of FOB Origin. Our software license agreements do not contain conditions for acceptance.

Fee is fixed or determinable We assess whether a fee is fixed or determinable at the outset of the arrangement. Significant judgment is involved in making this assessment.

Under our upfront revenue model, we are able to demonstrate that the fees are fixed or determinable for all arrangements, including those for our term licenses that contain extended payment terms. We have an established history of collecting under the terms of these contracts without providing concessions to customers. In addition, we also assess whether a contract modification to an existing term arrangement constitutes a concession. In making this assessment, significant analysis is performed to ensure that no concessions are given. Our software license agreements do not include a right of return or exchange. For license arrangements executed under the upfront revenue model, we recognize license revenue upon delivery of the software product, provided all other

Deposits in domestic offices noninterest-bearing	$ 9,175,434	$ 9,704,773	$ 6,670,922
interest-bearing (includes $1.2 billion, $707.4 million and $554.8 million measured at fair value at September 30, 2010, December 31, 2009 and September 30, 2009, respectively)	21,690,912	18,968,058	18,794,752
Deposits in foreign offices interest-bearing	1,475,984	1,622,410	1,335,451
Total deposits	$ 32,342,330	$ 30,295,241	$ 26,801,125
Federal funds purchased	119,574	236,099	246,363
Securities sold under agreement to repurchase	1,206,380	2,512,490	2,194,755
Short-term borrowings	762,530	717,050	585,341
Accrued interest, taxes and other expenses	194,974	172,618	188,452
Accrued pension and post-retirement	19,124	58,393	106,971
Other liabilities	832,901	643,289	581,463
Long-term notes senior/unsecured	2,396,500	2,396,500	2,396,500
Long-term notes senior/secured	2,375,000	2,375,000	2,375,000
Long-term notes subordinated	200,000	292,750	292,750
Total liabilities	$ 40,449,313	$ 39,699,430	$ 35,768,720

STOCKHOLDER S EQUITY

Common stock ($10 par value); authorized 40,000,000 shares; issued and outstanding 19,989,512 shares at September 30, 2010, 17,534,512 shares at December 31, 2009, and 17,149,512 shares at September 30, 2009
$ 199,895 $ 175,345 $ 171,495
Surplus
3,291,876 2,322,917 2,174,661
Retained earnings
1,642,284 1,621,719 1,640,337
Accumulated other comprehensive loss
(111,119) (97,784) (144,015)
Stockholder s equity before noncontrolling interest preferred stock of subsidiary
$ 5,022,936 $ 4,022,197 $ 3,842,478
Noncontrolling interest preferred stock of subsidiary
250,055 250,000 250,000
Total stockholder s equity
$ 5,272,991 $ 4,272,197 $ 4,092,478
Total liabilities and stockholder s equity
$ 45,722,304 $ 43,971,627 $ 39,861,198

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

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HARRIS N.A. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Interest Income				
Loans	$ 261,444	$ 282,715	$ 793,690	$ 882,658
Money market assets:				
Deposits at banks	8,157	4,332	20,569	14,411
Federal funds sold and securities purchased under agreements to resell	47	22	131	167
Trading account assets	2,248	1,786	7,995	6,882
Securities available-for-sale:				
U.S. Treasury and federal agency	10,757	22,168	38,942	82,489
State and municipal	12,306	13,435	36,794	40,840
Other	2,753	2,204	8,620	11,921
Total interest income	$ 297,712	$ 326,662	$ 906,741	$ 1,039,368
Interest Expense				
Deposits	$ 46,240	$ 61,733	$ 134,899	$ 256,522
Short-term borrowings	1,432	2,057	5,095	6,367
Short-term senior notes		407		1,726
Long-term notes senior/unsecured	23,365	24,386	68,626	65,240
Long-term notes senior/secured	6,920	13,448	27,532	34,025
Long-term notes subordinated	419	728	1,250	3,459
Total interest expense	$ 78,376	$ 102,759	$ 237,402	$ 367,339
Net Interest Income	$ 219,336	$ 223,903	$ 669,339	$ 672,029
Provision for loan losses	35,828	181,652	219,574	421,888
Net Interest Income after Provision for Loan Losses	$ 183,508	$ 42,251	$ 449,765	$ 250,141
Noninterest Income				
Trust and investment management fees	$ 22,713	$ 19,247	$ 66,708	$ 57,886
Net money market and bond trading income, including derivative activity	2,898	6,522	28,038	15,731
Foreign exchange trading (losses) gains, net	(685)	2,912	3,531	8,312
Service charges and fees	48,047	52,365	148,288	151,827
Charge card income	27,251	45	85,999	378
Equity securities gains, net	1,994	2,301	6,082	6,238
Net securities gains, other than trading	2,910	737	5,225	30,756

Other-than-temporary impairment of securities		(4,636)		(60)		(4,767)		(1,093)
Bank-owned insurance		11,042		11,139		34,179		33,665
Letter of credit fees		4,901		4,998		16,494		15,359
Net gains on loans held for sale		4,188		6,331		11,855		17,463
Other		14,209		11,742		34,406		30,646
Total noninterest income	$	134,832	$	118,279	$	436,038	$	367,168
Noninterest Expenses								
Salaries and other compensation	$	113,720	$	104,844	$	319,481	$	302,961
Pension, profit sharing and other employee benefits		22,808		23,451		77,213		77,758
Net occupancy		27,893		24,922		76,913		75,940
Equipment		18,848		16,622		57,380		51,203
Marketing		22,549		13,283		49,192		31,900
Communication and delivery		9,573		7,520		25,075		22,416
Professional fees		32,023		19,388		80,821		68,766
Outside information processing, database and network fees		10,518		9,098		26,374		26,779
FDIC Insurance		11,030		8,983		34,401		52,687
Intercompany services, net		(2,150)		2,368		(7,412)		1,986
Visa indemnification reversal				(3,000)		(2,800)		(3,000)
Charge card expense		6,270				20,572		
Amortization of intangibles		6,935		5,746		19,177		19,933
Other		40,318		19,768		98,912		60,800
Total noninterest expenses	$	320,335	$	252,993	$	875,299	$	790,129
(Loss) Income before income tax benefit	$	(1,995)	$	(92,463)	$	10,504	$	(172,820)
Applicable income tax benefit		(11,071)		(43,829)		(23,888)		(92,513)
Net income (loss)	$	9,076	$	(48,634)	$	34,392	$	(80,307)
Less: noncontrolling interest dividends on preferred stock of subsidiary		4,609		4,609		13,827		13,827
Net Income (Loss) Available for Common Stockholder	$	4,467	$	(53,243)	$	20,565	$	(94,134)

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

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HARRIS N.A. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Net income (loss)	$ 9,076	$ (48,634)	$ 34,392	$ (80,307)
Other comprehensive income (loss):				
Cash flow hedges:				
Net unrealized (loss) gain on derivative instruments, net of tax benefit for the quarter of $3,199 in 2010 and $17,651 in 2009 and net of tax (benefit) expense for the year-to-date period of ($20,378) in 2010 and $12,266 in 2009	(5,942)	(32,780)	(37,847)	22,781
Reclassification adjustment for realized loss included in net income (loss), net of tax benefit for the quarter of $637 in 2010 and $853 in 2009 and net of tax benefit for the year-to-date period of $1,575 in 2010 and $2,935 in 2009	1,183	1,585	2,926	5,450
Pension and postretirement medical benefit plans:				
Net (loss) gain and net prior service cost included in net income (loss), net of tax benefit for the quarter of $0 in 2010 and 2009 and net of tax expense for the year-to-date period of $1,318 in 2010 and $3,531 in 2009	(406)		4,168	6,556
Reclassification adjustment for amortization included in net income (loss), net of tax benefit for the quarter of $663 in 2010 and $366 in 2009 and net of tax benefit for the year-to-date period of $1,989 in 2010 and $1,100 in 2009	1,232	681	3,694	2,042
Available-for-sale securities:				
Unrealized holding gain arising during the period, net of tax expense for the quarter of $7,538 in 2010 and $9,247 in 2009 and net of tax expense for the year-to-date period of $5,383 in 2010 and $16,194 in 2009	12,946	32,266	17,120	45,187
Reclassification adjustment for realized gain included in net income (loss), net of tax expense for the quarter of $1,018 in 2010 and $258 in 2009 and net of tax expense for the year-to-date period of $1,829 in 2010 and $10,765 in 2009	(1,891)	(480)	(3,396)	(19,992)
Other comprehensive income (loss)	$ 7,122	$ 1,272	$ (13,335)	$ 62,024
Comprehensive income (loss)	$ 16,198	$ (47,362)	$ 21,057	$ (18,283)
Comprehensive income related to noncontrolling interest	4,609	4,609	13,827	13,827
Comprehensive income (loss) available for common stockholder	$ 11,589	$ (51,971)	$ 7,230	$ (32,110)

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

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HARRIS N.A. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDER S EQUITY
(Unaudited)

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Noncontrolling Interest Preferred Stock of Subsidiary	Total Stockholder s Equity
	(in thousands)					
Balance at December 31, 2009	$ 175,345	$ 2,322,917	$ 1,621,719	$ (97,784)	$ 250,000	$ 4,272,197
Stock option exercise		509				509
Net income			20,565		13,827	34,392
Dividends preferred stock of subsidiary					(13,827)	(13,827)
Change in noncontrolling interest ownership					55	55
Other comprehensive loss				(13,335)		(13,335)
Issuance of common stock and contribution to capital surplus	24,550	968,450				993,000
Balance at September 30, 2010	$ 199,895	$ 3,291,876	$ 1,642,284	$ (111,119)	$ 250,055	$ 5,272,991
Balance at December 31, 2008	$ 171,495	$ 2,172,030	$ 1,734,471	$ (206,039)	$ 250,000	$ 4,121,957
Stock option exercise		800				800
Tax benefit from stock option exercise		1,831				1,831
Net income			(94,134)		13,827	(80,307)
Dividends preferred stock of subsidiary					(13,827)	(13,827)
Other comprehensive income				62,024		62,024
Balance at September 30, 2009	$ 171,495	$ 2,174,661	$ 1,640,337	$ (144,015)	$ 250,000	$ 4,092,478

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

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HARRIS N.A. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30	
	2010	2009
	(in thousands)	
Cash Flows from Operating Activities:		
Net income (loss)	$ 34,392	$ (80,307)
Less: noncontrolling interest dividends on preferred stock of subsidiary	13,827	13,827
Net income (loss) available for common stockholder	$ 20,565	$ (94,134)
Adjustments to determine net cash flows provided by operating activities:		
Provision for loan losses	219,574	421,888
Depreciation and amortization, including intangibles	81,348	80,747
Deferred tax expense (benefit)	57,237	(31,057)
Excess tax expense from stock options exercise	178	1,831
Other-than-temporary impairment on securities	4,767	1,093
Net gains on securities, other than trading	(5,225)	(30,756)
Net equity investment gains	(6,082)	(6,238)
Increase in bank-owned insurance	(25,312)	(25,085)
Net decrease in trading securities	113,958	560,117
Decrease in accrued interest receivable	10,190	37,408
(Increase) decrease in prepaid expenses	(86,179)	4,699
Decrease in accrued interest payable	(3,786)	(57,196)
Net increase in accrued tax payable	(79,668)	(29,126)
Net (decrease) increase in other accrued expenses	(33,806)	41,255
Net increase in pension and post retirement benefits	(28,100)	(53,933)
Origination of loans held for sale	(526,378)	(1,163,177)
Proceeds from sale of loans held for sale	559,408	1,163,360
Net gains on loans held for sale	(11,855)	(17,463)
Net gains on sale of premises and equipment	(788)	(2,596)
Net increase (decrease) in foreign exchange contracts	19,080	(25,239)
Recoveries on charged-off loans	53,777	56,282
Net increase (decrease) in trading hedging derivatives	36,555	(36,216)
Visa indemnification reversal	(2,800)	(3,000)
Other, net	116,364	66,586
Net cash provided by operating activities	$ 483,022	$ 860,050
Cash Flows from Investing Activities:		
Proceeds from sales of securities available-for-sale	$ 514,900	$ 3,339,104
Proceeds from maturities of securities available-for-sale	3,027,567	3,282,450
Purchases of securities available-for-sale	(3,414,559)	(4,112,830)
Net decrease in loans	1,353,972	3,006,437

Proceeds from loans sold to affiliates		273,522		
Purchases of premises and equipment		(69,501)		(76,112)
Sales of premises and equipment		10,250		26,516
Acquisitions, net of cash received		191,663		(3,423)
Net cash provided by investing activities	$	1,887,814	$	5,462,142
Cash flows from Financing Activities:				
Net decrease in deposits	$	(576,032)	$	(27,029,801)
Net increase in deposits measured at fair value		450,579		477,082
Net decrease in Federal funds purchased and securities sold under agreement to repurchase		(1,422,635)		(1,139,165)
Net increase in other short-term borrowings		45,480		225,865
Net decrease in short-term senior notes				(75,000)
Repayment of long-term notes senior/secured		(137,409)		
Proceeds from issuance long-term notes senior/unsecured				300,000
Repayment of long-term notes subordinated		(92,750)		
Net proceeds from stock options exercise		509		800
Excess tax expense from stock options exercise		(178)		(280)
Capital contributions		993,000		
Cash dividends paid on preferred stock		(13,827)		(13,827)
Net cash used in financing activities	$	(753,263)	$	(27,254,326)
Net increase (decrease) in cash and cash equivalents	$	1,617,573	$	(20,932,134)
Cash and cash equivalents at January 1		10,311,425		27,285,609
Cash and cash equivalents at September 30	$	11,928,998	$	6,353,475

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

HARRIS N.A. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

Harris N.A. (the Bank or HNA) is a wholly-owned subsidiary of Harris Bankcorp, Inc. (Bankcorp), a wholly-owned subsidiary of Harris Financial Corp. (HFC), a wholly-owned U.S. subsidiary of Bank of Montreal (BMO). The consolidated financial statements of the Bank include the accounts of the Bank and its wholly-owned subsidiaries. Significant inter-company accounts and transactions have been eliminated. Certain reclassifications were made to conform prior year s financial statements to the current year s presentation.

On April 23, 2010, the Bank acquired certain assets and liabilities of Rockford, Illinois-based, AMCORE Bank N.A. (AMCORE) from the FDIC for $221.5 million. The Bank assumed approximately $2.5 billion in assets, including approximately $2.1 billion in loans, and $2.2 billion in deposits. The Bank recorded a core deposit intangible of $22.1 million to be amortized over 10 years on an accelerated basis and a customer relationship intangible of $1.3 million to be amortized over 13 years on an accelerated basis. The acquisition includes a loss share agreement with the FDIC and the related indemnification asset was estimated at $427.5 million. The Bank recorded goodwill of $84.3 million which is expected to be deductible for tax purposes. Acquisition costs of $4.4 million were recorded to noninterest expense during the quarter ended June 30, 2010. The acquisition provides the Bank with an opportunity to expand its branch network into communities in northern Illinois and southern Wisconsin. The results of AMCORE s operations have been included in the Bank s consolidated financial statements since April 23, 2010.

On December 31, 2009, BMO and the Bank acquired the net cardholder receivables and other assets and obligations of the Diners Club North American franchise (Diners Club) from Citigroup for initial cash consideration of $678 million, subject to a post-closing adjustment based on all parties final agreement of the net asset value transferred. The acquisition of the net cardholder receivables of Diners Club gives the Bank the right to issue Diners Club cards to corporate and professional clients in the United States and will accelerate the Bank s initiative to expand in the travel-and-entertainment card sector. As part of this acquisition, the Bank recorded a purchased credit card relationship intangible asset estimated at $44.3 million which will be amortized on an accelerated basis over 15 years. The Bank recorded goodwill of $17.8 million which is expected to be deductible for tax purposes. The gross contractual amount of receivables was $743.2 million and the fair value was $704.6 million. Acquisition-related costs of $0.6 million for the year ended December 31, 2009 were recorded to noninterest expense. The results of the operations have been included in the Bank s consolidated financial statements since January 1, 2010. As of March 31, 2010 a preliminary contractual true up of $48.4 million was received from Citigroup mainly due to the overestimation of initial credit card loan balances of $56.7 million. As a result, goodwill was decreased by $6.3 million and the credit card relationship intangible asset was increased by $3.4 million. During the quarter ended June 30, 2010 a $15.2 million fair value adjustment to credit card receivables was recorded as an increase to interest income.

On February 13, 2009, the Bank completed the acquisition of selected assets of Pierce, Givens & Associates, LLC (Pierce Givens) for cash consideration of $3.4 million. The Bank acquired a customer relationship intangible asset estimated at $3.0 million with an expected life of 5 years. No goodwill was recorded in the transaction. Acquisition-related costs of $0.4 million for the year-ended December 31, 2009 were recorded to noninterest expense. The acquisition provides the Bank with the opportunity to expand its tax planning and compliance capabilities in the ultra high-net-worth market. The results of Pierce Givens operations have been included in the Bank s consolidated financial statements since February 14, 2009.

The interim consolidated financial statements have been prepared by management from the books and records of the Bank, without audit by independent certified public accountants. However, these statements reflect all adjustments

and disclosures which are, in the opinion of management, necessary for a fair presentation of the results for the interim periods presented. Events occurring subsequent to the date of the balance sheet have been evaluated for potential recognition or disclosure in the consolidated financial statements.

HARRIS N.A. AND SUBSIDIARIES

Because the results of operations are so closely related to and responsive to changes in economic conditions, the results for any interim period are not necessarily indicative of the results that can be expected for the entire year.

2. Contingent Liabilities and Litigation

Harris N.A. and certain of its subsidiaries are party to legal proceedings in the ordinary course of their businesses. While there is inherent difficulty in predicting the outcome of these proceedings, management does not expect the outcome of any of these proceedings, individually or in the aggregate, to have a material adverse effect on the Bank s consolidated financial position or results of operations.

3. Cash Flows

In the Consolidated Statements of Cash Flows, cash and cash equivalents include cash and demand balances due from banks, interest-bearing deposits at banks and federal funds sold and securities purchased under agreement to resell. Cash interest payments for the nine months ended September 30 totaled $245.0 million and $355.0 million in 2010 and 2009, respectively. Cash income tax refunds received for the nine months ended September 30, 2010 and 2009 totaled $4.0 million and $59.7 million, respectively.

4. Visa Indemnification Charge

HNA was a member of Visa U.S.A. Inc. (Visa U.S.A.) and in 2007 received shares of restricted stock in Visa, Inc. (Visa) as a result of its participation in the global restructuring of Visa U.S.A., Visa Canada Association, and Visa International Service Association in preparation for an initial public offering by Visa. HNA and other Visa U.S.A. member banks are obligated to share in potential losses resulting from certain indemnified litigation involving Visa that has been settled.

A member bank such as HNA is also required to recognize the contingent obligation to indemnify Visa under Visa s bylaws (as those bylaws were modified at the time of the Visa restructuring on October 3, 2007) for potential losses arising from the other indemnified litigation that has not yet settled at its estimated fair value. HNA is not a direct party to this litigation and does not have access to any specific, non-public information concerning the matters that are the subject of the indemnification obligations. While the estimation of any potential losses is highly judgmental, as of December 31, 2007, HNA recorded a liability and corresponding charge of $34 million (pretax) for the remaining litigation.

The initial public offering (IPO) occurred on March 25, 2008 followed by a mandatory partial redemption of Harris restricted stock in Visa that took place in two parts: exchange for cash and funding of the covered litigation escrow account. During the first quarter of 2008, HNA received $37.8 million in cash in conjunction with the mandatory partial redemption which was recognized as an equity security gain in the Consolidated Statements of Operations since there was no basis in the stock. In addition, Visa funded the U.S. litigation escrow account with IPO proceeds. Harris share of the U.S. litigation escrow account funding was $17 million which was recognized as a reversal to the litigation reserve and as a decrease to non-interest expense.

In June 2010, July 2009 and December 2008, HNA recorded decreases to non-interest expense of $2.8 million, $3.0 million and $6.3 million, respectively, as a reduction in the Visa litigation reserve to reflect Visa s use of a portion of the Bank s restricted Visa stock to fund the escrow account available to settle certain litigation matters. Visa s funding of amounts required beyond the current escrow, if any, will be obtained via additional mandatory redemptions of restricted shares. As of September 30, 2010, December 31, 2009 and September 30, 2009, the recorded reserve

relating to the Visa litigation matter included in the Consolidated Statements of Condition was $12.0 million, $14.8 million and $14.8 million, respectively. In October 2010, HNA recorded an additional decrease to non-interest expense of $4.7 million as a reduction in the Visa litigation reserve, reflecting additional sales of the Bank s VISA shares and subsequent contribution to the escrow account.

HARRIS N.A. AND SUBSIDIARIES

5. Auction Rate Securities Purchase Program

Auction-rate securities (ARS) are typically short-term notes issued in the United States to fund long-term, fixed rate debt instruments (corporate or municipal bonds primarily issued by municipalities, student loan authorities and other sponsors). The interest rate on ARS is regularly reset every 7 to 35 days through auctions managed by financial institutions. A disruption in the market for ARS occurred in the early part of 2008. Certain customer-managed portfolios held these securities, which were no longer liquid. Certain of the Bank s affiliates voluntarily offered to purchase such securities from customers, at par value.

In addition, in 2008 a settlement with the Financial Industry Regulatory Authority (FINRA) required Harris Investor Services, Inc. (HIS), an affiliate of the Bank, to purchase specific holdings of ARS from certain client accounts at par value plus accrued interest. In addition to the required terms of the FINRA settlement, management of certain other legal entities within HFC offered to purchase certain other customer ARS holdings under similar terms. For the ARS holdings purchased by the Bank, the gross par value of ARS holdings purchased was $93.1 million plus accrued interest. A discounted cash flow valuation methodology was applied to estimate the fair value of the securities. The methodology included management assumptions about future cash flows, discount rates, market liquidity and credit spreads.

Remaining ARS were purchased during 2009 and had a gross par value of $8.6 million. A minimal pre-tax charge was recorded for the year ended December 31, 2009 for the difference between the estimated fair values and the par values paid by the Bank. The charge was recorded in noninterest expense in the Consolidated Statements of Operations. During the nine months ended September 30, 2010 ARS with a gross par value of $51.4 million were sold or called and a gain of $5.3 million was recorded to net securities gains, other than trading in the Consolidated Statements of Operations. During the quarter ended September 30, 2010 an impairment charge of $4.0 million was recorded to other-than-temporary impairment on securities on the Consolidated Statements of Operations. The fair value of remaining ARS was $16.3 million as of September 30, 2010, $73.6 million as of December 31, 2009 and $75.7 million as of September 30, 2009. The par value of remaining ARS was $27.1 million as of September 30, 2010, $78.4 million as of December 31, 2009 and $81.1 million as of September 30, 2009. The ARS purchased are classified as available-for-sale.

6. Health Care Legislation

In March 2010, new health care legislation (The Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act) was enacted that changed the tax treatment of the subsidy associated with postretirement medical benefits. The legislation reduced the tax deductions for the cost of providing postretirement prescription drug coverage by the amount of subsidies received. With enactment of the legislation, the Bank was required to write off any deferred tax asset as a tax expense through the income statement, even if a portion of such asset had initially been established through OCI. As a result of this legislation, the Bank recorded tax expense of $5.5 million during the quarter ended March 31, 2010. No other significant tax expense related to this legislation was recorded subsequent to March 31, 2010.

7. Noncontrolling Interests

The Bank adopted Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 160, Noncontrolling Interests in Consolidated Financial Statements-An Amendment of ARB 51, (subsequently codified in Accounting Standards Codification (ASC) Topic 810-10-65) on January 1, 2009. The standard requires noncontrolling interests held by parties other than the parent to be reported as equity in the

consolidated financial statements. The Bank has two subsidiaries that are less than wholly-owned and the noncontrolling interest in the preferred stock of the subsidiaries is held by third parties. The noncontrolling interest in the preferred stock of the subsidiaries is presented as a component of stockholder s equity in the Consolidated Statements of Condition. Net income attributable to the noncontrolling interest is separately presented in the Consolidated Statements of Operations, outside of net income (loss).

HARRIS N.A. AND SUBSIDIARIES

8. FDIC Special Assessment

On May 22, 2009 the Board of Directors of the Federal Deposit Insurance Corporation (FDIC) voted to levy a special assessment on insured institutions as part of the agency s efforts to rebuild the Deposit Insurance Fund and help maintain public confidence in the banking system. The rule establishes a special assessment of five basis points on each FDIC insured depository institution s assets, less its Tier 1 capital, as of June 30, 2009, to be collected September 30, 2009. In June 2009, the Bank accrued an estimated $19 million in additional FDIC insurance expense related to this special assessment. The Bank paid this amount in September 2009.

On December 30, 2009 the FDIC required insured depository institutions to prepay their estimated quarterly risk-based assessments for all of 2010, 2011, and 2012. The Bank made a payment of $114 million which was recorded as prepaid expense within other assets. As the Bank is charged monthly for FDIC insurance, the Bank will decrease the prepaid expense and charge FDIC insurance expense until the prepaid amount is exhausted. The prepaid balance for FDIC insurance was $79 million at September 30, 2010. Any prepaid amounts unused at June 30, 2013 will be returned to the Bank.

9. Other-than-temporary impairment

During the nine months ended September 30, 2010, the Bank recorded other-than-temporary impairment of $4.8 million. Of this amount, $4.0 million was recorded on auction rate securities, $0.6 million on municipal bonds and $0.2 million on CRA investments. During the nine months ended September 30, 2009, the Bank recorded other-than-temporary impairment of $1.1 million on CRA investments. The entire amount of the impairment was related to credit deterioration. Losses related to declines in the estimated fair value of the investments were recorded in the Consolidated Statements of Operations to other-than-temporary impairment of securities.

10. Recent accounting standards

The FASB issued Statement of Financial Accounting Standards (SFAS) No. 166, Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140, (subsequently codified in FASB ASC 860) in June 2009. The standard removes the concept of a qualifying special-purpose entity (QSPE). It also creates more stringent conditions for reporting a transfer of a portion of a financial asset as a sale. The standard was effective January 1, 2010. The adoption of the standard did not impact the Bank s financial position or results of operations.

The FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R), (subsequently codified in FASB ASC 810) in June 2009. The standard changes the criteria by which an enterprise determines whether it must consolidate a variable interest entity (VIE). It amends the existing guidance to require an enterprise to consolidate a VIE if it has both the power to direct the activities that most significantly impact the VIE s economic performance and the obligation to absorb losses or the right to receive benefits from the VIE. Existing guidance requires an enterprise to consolidate a VIE if it absorbs a majority of the expected losses or residual returns, or both. A continuous assessment of which party must consolidate a VIE will be required, rather than an assessment only when certain trigger events occur. In addition, the new standard requires an enterprise to assess if VIEs that were previously QSPEs must be consolidated by the enterprise. The standard was effective January 1, 2010. The adoption of this standard did not impact the Bank s financial position or results of operations.

The FASB issued Accounting Standards Update (ASU) 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, in July 2010. The standard requires companies to significantly increase disclosures about the credit quality of financing receivables and the credit reserves held against them. The

additional disclosures include aging of past due receivables, credit quality information such as credit risk scores or external credit agency ratings and the modification of financing receivables. Further disaggregation of information by certain classification of the total portfolio will be required. The FASB also amended ASC 310-10-50, *Receivables Overall Disclosure*, in order to expand the requirements for separate reporting and disclosure of allowances for credit losses and the policies for managing credit exposures. The disclosures will be effective for the Bank for the annual reporting period ending December 31, 2011. The Bank does not expect the adoption of this standard to impact it s financial position or results of operations.

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HARRIS N.A. AND SUBSIDIARIES

FINANCIAL REVIEW

Third Quarter 2010 Compared with Third Quarter 2009

Summary

For the third quarter 2010, Harris N.A. and subsidiaries (Bank) reported net income available for common stockholder of $4.5 million, an increase of $57.7 million from the third quarter 2009 net loss of $53.2 million primarily due to a significant reduction in the provision for loan losses. Results for 2010 include the impact associated with both the Diners Club North American (Diners Club) franchise purchased from Citigroup, which closed on December 31, 2009, and the acquisition of certain assets and liabilities of Rockford, IL based AMCORE Bank, N.A. (AMCORE) from the Federal Deposit Insurance Corporation (FDIC) on April 23, 2010.

Net interest income was $219.3 million, down $4.6 million or 2.0 percent from a year ago, largely due to lower earnings on loans and securities available for sale partially offset by a reduction in the cost of deposits and the additional net interest income associated with the acquisition of AMCORE and Diners Club. Average earning assets increased to $41.0 billion in the third quarter of 2010 from $37.6 billion in 2009. This primarily reflects an increase in interest bearing deposits placed at the Federal Reserve Bank ($5.5 billion) largely offset by decreases in loan balances ($1.0 billion) and the available-for-sale securities portfolio ($1.3 billion). The higher average earning asset level was partially offset by a 24 basis point decrease in the net interest margin to 2.19 percent from 2.43 percent in the third quarter of 2009. The lower margin reflects a lower rate of return on securities available-for-sale as well as an increase in the level of low-yielding interest bearing deposits placed at the Federal Reserve Bank, largely offset by reduced interest costs on deposits and improved loan yields.

Provision for loan losses for the third quarter 2010 was $35.8 million, a decrease of $145.8 million or 80.3 percent from the third quarter 2009 mainly attributable to decreases in both commercial and consumer net charge-offs as well as a reduction in the general provision for consumer loan losses. Net loan charge-offs during the quarter were $63.0 million compared to $134.7 million in the same period last year. The provision for loan losses is based on past loss experience, management s evaluation of the loan portfolio under current economic conditions and management s estimate of losses inherent in the portfolio.

Noninterest income for the third quarter 2010 was $134.8 million, an increase of $16.6 million or 14.0 percent. The $27.2 million of additional charge card income associated with the Diners Club credit card portfolio and higher trust fees ($3.5 million) were partially offset by a year over year decline in service charges and fees ($4.3 million) and foreign exchange trading gains ($3.6 million) as well as an increase in other than temporary impairment on securities ($4.6 million).

Third quarter 2010 noninterest expenses were $320.3 million, up $67.3 million or 26.6 percent from third quarter 2009. Higher costs associated with the Diners Club credit card portfolio ($10.7 million) and the acquisition of AMCORE ($41.2 million of which $17.8 million is directly related to integration activities) account for most of the increase. Excluding these costs, noninterest expenses increased $15.4 million or 6.1 percent largely due to higher costs associated with recent marketing campaigns ($8.1 million) and professional fees ($7.5 million). The income tax benefit decreased $32.8 million from the third quarter of 2009 primarily due to the increase in pre-tax income between periods. The tax benefit recorded this quarter exceeded pre-tax earnings primarily due to the benefit of certain tax exempt loans and investments as well as bank owned life insurance.

Nonperforming loans at September 30, 2010 totaled $813.1 million or 3.57 percent of total loans, up from $486.0 million or 2.10 percent of total loans at December 31, 2009 and $638.0 million or 2.77 percent a year earlier, primarily attributable to higher non-performing commercial loans. At September 30, 2010, the allowance for loan losses was $674.0 million, equal to 2.96 percent of loans outstanding compared to $680.8 million or 2.94 percent of loans outstanding and $693.1 million or 3.01 percent of loans outstanding at December 31, 2009 and September 30, 2009, respectively. Coverage of nonperforming loans by the allowance for loan losses decreased from 109 percent at September 30, 2009 to 83 percent at September 30, 2010, largely due to higher non-performing loan levels. At December 31, 2009, the ratio was 140 percent. Ratios reflect the sale of loans totaling $502.7 million to psps Holdings, LLC, a subsidiary of Harris Financial Corp., during the full year 2009 and $273.5 million in the second quarter of 2010.

At September 30, 2010 consolidated stockholder s equity amounted to $5.3 billion, up $1.0 billion from December 31, 2009, mainly due to capital contributions from Harris Bankcorp, Inc. of approximately $1.0 billion during the year. Return (loss) on equity was 0.36 percent in the current quarter, compared to (5.52) percent in last year s third quarter. Return (loss) on assets was 0.04 percent compared to (0.51) percent a year ago. The Bank did not declare any dividends on common stock in either the current quarter or in the year-ago quarter.

At September 30, 2010 Tier 1 capital of the Bank amounted to $4.5 billion, up $1.1 billion from a year ago, while risk-weighted assets declined by $1.5 billion to $28.5 billion. The Bank s September 30, 2010 Tier 1 and total risk-based capital ratios were 15.66 percent and 17.53 percent compared to respective ratios of 11.46 percent and 13.55 percent at December 31, 2009 and 11.10 percent and 13.20 percent at September 30, 2009. The regulatory leverage capital ratio was 10.07 percent for the third quarter of 2010 compared to 8.82 percent at year-end 2009 and 8.15 percent a year ago. The Bank s capital ratios significantly exceed the prescribed regulatory minimum for well-capitalized banks.

Nine Months Ended September 30, 2010 Compared with Nine Months Ended September 30, 2009

Summary

For the nine months ended September 30, 2010, the Bank reported net income available for common stockholder of $20.6 million, an increase of $114.7 million from the net loss of $94.1 million for the same period last year, primarily due to a significant reduction in the provision for loan losses and higher charge card fees resulting from the purchase of the Diners Club North American franchise from Citigroup. The results also include the acquisition of certain assets and liabilities of Rockford, IL based AMCORE Bank, N.A from the Federal Deposit Insurance Corporation (FDIC) on April 23, 2010. Return (loss) on equity was 0.63 percent in the current year, compared to (3.27) percent for first nine months of last year. Return (loss) on assets was 0.06 percent compared to (0.28) percent a year ago.

Net interest income was $669.3 million, down slightly from the $672.0 million reported a year ago as reduced loan income and interest on securities available for sale were largely offset by reduced interest costs on deposits. Net interest margin increased to 2.30 percent in 2010 from 2.24 percent in the same period in 2009, reflecting lower costs of deposits and improved yield on loans offset by a lower rate of return on securities available-for-sale as well as an increase in the level of low-yielding interest bearing deposits placed at the Federal Reserve Bank. Average earning assets of $39.9 billion decreased $1.5 billion with a $1.9 billion decline in loans and a decrease of $1.9 billion in available-for-sale securities due to maturities partially offset by a $2.3 billion increase in Federal Reserve Bank deposits.

Year-to-date 2010 provision for loan losses was $219.6 million compared to $421.9 million in 2009. The decline is primarily attributable to a decrease in both commercial and consumer net charge-offs as well as a reduction in the general provision for consumer loan losses partially offset by $33.7 million provision associated with the Diners Club credit card portfolio. Net charge-offs decreased to $226.2 million from $301.5 million in the prior year.

Noninterest income was $436.0 million, up $68.9 million or 18.8 percent from a year ago. This reflects $86.0 million of charge card income associated with the Diners Club credit card portfolio plus higher trading revenues ($12.3 million) and trust fees ($8.8 million) partially offset by a decrease in net gains on portfolio securities ($25.5 million), net gains on loans held for sale ($5.6 million) and net foreign exchange trading gains ($4.8 million).

Noninterest expenses were $875.3 million, an increase of $85.2 million or 10.8 percent. Several items affect the year over year comparison including higher costs associated with the Diners Club credit card portfolio ($33.3 million) and the acquisition of AMCORE ($64.2 million, including integration expense of $24.5 million). These additional costs were partially offset by a $19.2 million reduction in FDIC insurance expense, which reflects a $19.0 million FDIC

special assessment in 2009. Excluding the impact of these items, expenses were up $6.8 million or 0.9 percent mainly due to higher marketing costs ($15.6 million), additional reserves for off balance sheet credit exposures ($10.3 million) and mortgage servicing rights impairment ($7.8 million), largely offset by lower employment costs ($11.9 million) and inter-company service charges ($11.0 million). The income tax benefit decreased $68.6 million from the first nine months of 2009 primarily due to the increase in pre-tax income between periods. Results reflect a tax benefit despite positive pre-tax earnings primarily due to the benefit of certain tax exempt loans and investments as well as bank owned life insurance.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

See Liquidity Risk Management and Market Risk Management under Management s Discussion and Analysis of Financial Condition and Results of Operations on page 6.

The following table stratifies the Company s available-for-sale securities by maturity date (dollars in thousands):

	October 1, 2010 to Dec. 31, 2010	Year Ending December 31, 2011	2012	2013	2014	Thereafter	Total	Fair Value at September 30, 2010
Residential mortgage-backed								
Amortized cost	$ 1,202	$ 9,578	$	$ 8,685	$ 4,850	$ 465,800	$ 490,115	$ 512,370
Average Yield	4.00%	4.00%		4.00%	4.00%	4.35%	4.33%	
U.S. Treasury Bills								
Amortized cost	$ 61,999	$	$	$	$	$	$ 61,999	$ 61,999
Average Yield	0.070%						0.070%	

At September 30, 2010 the Company s investments held in mortgage-backed securities are secured by adjustable and fixed interest rate residential mortgage loans. The yield to maturity on each security depends on, among other things, the price at which each such security is purchased, the rate and timing of principal payments (including prepayment rates as well as default rates, which in turn would impact the value and yield to maturity of the Company s mortgage-backed securities. These investments are guaranteed by the Federal National Mortgage Association, (FNMA) or Federal Home Loan Mortgage Corporation (Freddie Mac) and none of the underlying loan collateral is represented by sub-prime mortgages.

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Item 4T. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

Harris Preferred Capital Corporation s management, with the participation of the Chief Executive Officer and Chief Financial Officer, has evaluated the Company s disclosure controls and procedures as of September 30, 2010. Based on this evaluation, management has concluded that the disclosure controls and procedures are effective to provide reasonable assurance that the information required to be disclosed by the Company in the reports filed under the Securities Exchange Act of 1934, as amended is (i) recorded, processed, summarized and reported within the time period specified in the Securities and Exchange Commission s rules and forms, and (ii) accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2010 that has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

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Part II. OTHER INFORMATION

Items 1, 1A, 2, 3 and 5 are being omitted from this Report because such items are not applicable to the reporting period.

None

Item 6. Exhibits

31.1 Certification of Pamela C. Piarowski pursuant to rule 13a-14(a)

31.2 Certification of Paul R. Skubic pursuant to rule 13a-14(a)

32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, Harris Preferred Capital Corporation has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized on the 15th day of November 2010.

/s/ Paul R. Skubic
Paul R. Skubic
Chairman of the Board and President

/s/ Pamela C. Piarowski
Pamela C. Piarowski
Chief Financial Officer

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