FIRST MERCHANTS CORP
Form 10-K
March 15, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

[Mark One]
[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2012
OR
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________to_________
Commission file number 0-17071
FIRST MERCHANTS CORPORATION
(Exact name of registrant as specified in its charter)

Indiana	35-1544218
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
200 East Jackson Muncie, Indiana	47305-2814
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (765)747-1500
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of each exchange on which registered
Common Stock, $0.125 stated value per share	The NASDAQ Stock 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 website, if any, every interactive data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) Yes [X] No [ ]
Indicate by check mark 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 or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. Large accelerated filer [ ] Accelerated filer[X] Non-accelerated filer [ ] Small Reporting Company [ ]
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 (not necessarily a reliable indication of the price at which more than a limited number of shares would trade) of the voting stock held by non-affiliates of the registrant was $356,895,000 as of the last business day of the registrant's most recently completed second fiscal quarter (June 30, 2012).

As of February 28, 2013 there were 28,695,887 outstanding common shares, without par value, of the registrant.

DOCUMENTS INCORPORATED BY REFERENCE

Documents	Part of Form 10-K into which incorporated
Portions of the Registrant's Definitive Proxy Statement for Annual Meeting of Shareholders to be held May 9, 2013	Part III (Items 10 through 14)

TABLE OF CONTENTS

FIRST MERCHANTS CORPORATION

Five-Year Summary of Selected Financial Data		3
Statement Regarding Forward-Looking Statements		4
PART I		
Item 1.	Business	5
Item 1A.	Risk Factors	22
Item 1B.	Unresolved Staff Comments	25
Item 2.	Properties	26
Item 3.	Legal Proceedings	26
Item 4.	Mine Safety Disclosures	26
	Supplemental Information - Executive Officers of the Registrant	27
PART II		
Item 5.	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	28
Item 6.	Selected Financial Data	30
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	31
Item 7A.	Quantitative and Qualitative Disclosure about Market Risk	44
Item 8.	Financial Statements and Supplementary Data	45
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	95
Item 9A.	Controls and Procedures	95
Item 9B.	Other Information	96
PART III		
Item 10.	Directors, Executive Officers and Corporate Governance	97
Item 11.	Executive Compensation	97
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	97
Item 13.	Certain Relationships, Related Transactions and Director Independence	97
Item 14.	Principal Accountant Fees and Services	97
PART IV		
Item 15.	Exhibits and Financial Statement Schedules	98

Table of Contents

FIVE-YEAR SUMMARY OF SELECTED FINANCIAL DATA

(Dollars in Thousands, Except Share Data)	2012	2011	2010	2009	2008
Operations [1] [2]					
Net Interest Income Fully Taxable Equivalent (FTE) Basis	$158,081	$149,114	$149,434	$159,068	$133,083
Less Tax Equivalent Adjustment	5,745	5,759	5,865	5,722	3,699
Net Interest Income	152,336	143,355	143,569	153,346	129,384
Provision for Loan Losses	18,534	22,630	46,483	122,176	28,238
Net Interest Income After Provision for Loan Losses	133,802	120,725	97,086	31,170	101,146
Total Other Income	64,302	49,120	48,544	51,201	36,367
Total Other Expenses	137,115	135,938	142,311	151,558	108,792
Income (Loss) Before Income Tax Expense (Benefit)	60,989	33,907	3,319	(69,187)	28,721
Income Tax Expense (Benefit)	15,867	8,655	(3,590)	(28,424)	8,083
Net Income (Loss)	45,122	25,252	6,909	(40,763)	20,638
Gain on Exchange of Preferred Stock to Trust Preferred Debt			11,353		
Loss on CPP Unamortized Discount		(1,401)	(1,301)		
Loss on Extinguishment of Trust Preferred Securities		(10,857)			
Preferred Stock Dividends and Discount Accretion	(4,539)	(3,981)	(5,239)	(4,979)	
Net Income (Loss) Available to Common Stockholders	$40,583	$9,013	$11,722	$(45,742)	$20,638
Per Share Data					
Basic Net Income (Loss) Available to Common Stockholders	$1.42	$0.34	$0.48	$(2.17)	$1.14
Diluted Net Income (Loss) Available to Common Stockholders	1.41	0.34	0.48	(2.17)	1.14
Cash Dividends Paid - Common	0.10	0.04	0.04	0.47	0.92
December 31 Book Value - Common	16.08	14.83	15.11	16.55	18.69
December 31 Tangible Book Value - Common	10.95	9.64	9.21	9.25	10.93
December 31 Market Value (Bid Price) - Common	14.84	8.47	8.86	5.94	22.21
Average Balances [1] [2]					
Total Assets	$4,245,996	$4,143,850	$4,271,715	$4,674,590	$3,811,166
Total Loans [3]	2,819,816	2,748,684	3,050,850	3,546,316	3,002,628
Total Deposits	3,263,020	3,175,762	3,337,747	3,603,509	2,902,902
Securities Sold Under Repurchase Agreements (long-term portion)	10,000	12,773	24,250	24,250	34,250
Total Federal Home Loan Bank Advances	113,730	110,729	107,753	243,105	237,791

Total Subordinated Debentures, Revolving Credit Lines and Term Loans	109,339	133,673	126,650	110,826	107,752
Total Stockholders' Equity	535,497	478,440	470,379	477,148	349,594
Year-End Balances [1] [2]					
Total Assets	$4,304,821	$4,173,076	$4,170,848	$4,480,952	$4,784,155
Total Loans [3]	2,924,509	2,731,279	2,857,152	3,277,824	3,726,247
Total Deposits	3,346,383	3,134,655	3,268,880	3,536,536	3,718,811
Securities Sold Under Repurchase Agreements (long-term portion)	10,000	10,000	24,250	24,250	34,250
Total Federal Home Loan Bank Advances	94,238	138,095	82,684	129,749	360,217
Total Subordinated Debentures, Revolving Credit Lines and Term Loans	112,161	194,974	226,440	194,790	135,826
Total Stockholders' Equity	552,236	514,467	454,408	463,785	395,903
Financial Ratios [1] [2]					
Return on Average Assets	0.96 %	0.22 %	0.27 %	(0.98)%	0.54 %
Return on Average Stockholders' Equity	7.58	1.88	2.49	(9.59)	5.90
Average Earning Assets to Total Assets	90.28	90.35	90.42	94.74	72.39
Allowance for Loan Losses as % of Total Loans	2.37	2.60	2.90	2.81	1.33
Dividend Payout Ratio	7.09	11.76	8.33	n/m [4]	80.70
Average Stockholders' Equity to Average Assets	12.61	11.55	11.01	10.21	9.17
Tax Equivalent Yield on Earning Assets	4.74	4.99	5.32	5.56	6.44
Cost of Supporting Liabilities	0.62	1.01	1.45	1.82	2.60
Net Interest Margin on Earning Assets	4.12	3.98	3.87	3.74	3.84

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(1) On December 31, 2008, the Corporation acquired 100 percent of the outstanding stock of Lincoln Bancorp, the holding company of Lincoln Bank, which was headquartered in Plainfield, Indiana. Lincoln Bank was a state chartered bank with branches in central Indiana. Lincoln Bancorp was merged into the Corporation and in 2009, Lincoln Bank was ultimately merged into First Merchants Bank, National Association, a subsidiary of the Corporation. The Corporation issued approximately 3,040,415 shares of its common stock at a cost of $19.78 per share and approximately $16.8 million in cash to complete the transaction. As a result of the acquisition, the Corporation increased its customer base and market share. The purchase had a recorded acquisition price of $77,290,000, including investments of $122,093,000; loans of $628,277,000, premises and equipment of $15,624,000; other assets of $86,091,000; deposits of $655,370,000; other liabilities of $136,280,000 and goodwill of $19,813,000. Additionally, core deposit intangibles totaling $12,461,000 were recognized and are amortizing over ten years. The combination was accounted for under the purchase method of accounting. All assets and liabilities were recorded at their fair values as of December 31, 2008. The purchase accounting adjustments are being amortized over the life of the respective asset or liability.

(2) Effective February 10, 2012, the Bank assumed substantially all of the deposits and certain other liabilities and acquired certain assets of SCB Bank, a federal savings bank headquartered in Shelbyville, Indiana, from the Federal Deposit Insurance Corporation (“FDIC”), as receiver for SCB Bank (the “Acquisition”), pursuant to the terms of the Purchase and Assumption Agreement - Modified Whole Bank; All Deposits (the “Agreement”), entered into by the Bank, the FDIC as receiver of SCB Bank and the FDIC. Under the terms of the Agreement, the Bank acquired

$147,700,000 in assets, including approximately $11,900,000 of cash and cash equivalents, $18,900,000 of marketable securities, $1,800,000 in Federal Home Loan Bank stock, $113,000,000 in loans and $2,100,000 of premises and other assets. The asset balances are book balances and do not reflect the fair value discount of $29,000,000 from book value. The Bank assumed approximately $135,700,000 of liabilities, including approximately $125,900,000 in customer deposits, $9,600,000 of other borrowed money and $402,000 in other liabilities. The bid accepted by the FDIC included no deposit premium.

(3) Includes loans held for sale.

(4) Not meaningful.

Table of Contents

FORWARD-LOOKING STATEMENTS

First Merchants Corporation (the "Corporation") from time to time includes forward-looking statements in its oral and written communication. The Corporation may include forward-looking statements in filings with The Securities and Exchange Commission ("SEC"), such as Form 10-K and Form 10-Q, in other written materials and oral statements made by senior management to analysts, investors, representatives of the media and others. The Corporation intends these forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and the Corporation is including this statement for purposes of these safe harbor provisions. Forward-looking statements can often be identified by the use of words like "believe", "continue", "pattern", "estimate", "project", "intend", "anticipate", "expect" and similar expressions or future or conditional ve such as "will", "would", "should", "could", "might", "can", "may" or similar expressions. These forward-looking statements in

- statements of the Corporation's goals, intentions and expectations;
- statements regarding the Corporation's business plan and growth strategies;
- statements regarding the asset quality of the Corporation's loan and investment portfolios; and
- estimates of the Corporation's risks and future costs and benefits.

These forward-looking statements are subject to significant risks, assumptions and uncertainties, including, among other things, those discussed in Item 1A, "RISK FACTORS".

Because of these and other uncertainties, the Corporation's actual future results may be materially different from the results indicated by these forward-looking statements. In addition, the Corporation's past results of operations do not necessarily indicate its future results.

Table of Contents
PART I: ITEM 1. BUSINESS

PART I

ITEM 1. BUSINESS

GENERAL

First Merchants Corporation (the "Corporation") is a financial holding company headquartered in Muncie, Indiana and was organized in September 1982. The Corporation's Common Stock is traded on NASDAQ's Global Select Market System under the symbol FRME. The Corporation has one full-service bank charter, First Merchants Bank, National Association (the "Bank"), which opened for business in Muncie, Indiana, in March 1893. The Bank also operates Lafayette Bank and Trust, Commerce National Bank and First Merchants Trust Company as divisions of First Merchants Bank, N.A. The Bank includes seventy-six banking locations in twenty-four Indiana and two Ohio counties. In addition to its branch network, the Corporation's delivery channels include ATMs, check cards, remote deposit capture, interactive voice response systems and internet technology. The Corporation's business activities are currently limited to one significant business segment, which is community banking.

Through the Bank, the Corporation offers a broad range of financial services, including accepting time deposits, savings and demand deposits; making consumer, commercial, agri-business and real estate mortgage loans; renting safe deposit facilities; providing personal and corporate trust services; providing full-service brokerage; and providing other corporate services, letters of credit and repurchase agreements.

The Corporation also operates First Merchants Insurance Services, Inc., operating as First Merchants Insurance Group, a full-service property, casualty, personal lines, and employee benefit insurance agency headquartered in Muncie, Indiana.

The Corporation had operated First Merchants Reinsurance Co. Ltd. ("FMRC"), a small life reinsurance company whose primary business included short-duration credit life, accidental/health insurance and debt cancellation contracts. This company was dissolved in December of 2011. There is no remaining exposure for the Corporation.

All inter-company transactions are eliminated during the preparation of consolidated financial statements.

As of December 31, 2012, the Corporation had consolidated assets of $4.3 billion, consolidated deposits of $3.3 billion and stockholders' equity of $552 million. As of December 31, 2012, the Corporation and its subsidiaries had 1,149 full-time equivalent employees.

AVAILABLE INFORMATION

The Corporation makes 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 Securities Exchange Act of 1934, as amended, available on its website at www.firstmerchants.com without charge, as soon as reasonably practicable, after such reports are electronically filed with, or furnished to, the Securities and Exchange Commission. These documents can also be read and copied at the Securities and Exchange Commission's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Please call the Securities and Exchange Commission at 1-800-SEC-0330 for further information on the public reference room. SEC filings are also available to the public at the Securities and Exchange Commission's website at www.sec.gov. Additionally, the Corporation will also provide without charge, a copy of its Annual Report on Form 10-K to any shareholder by mail. Requests should be sent to Cynthia Holaday, Shareholder Relations, First Merchants Corporation, P.O. Box 792, Muncie, IN 47308-0792.

ACQUISITION POLICY

The Corporation anticipates that it will continue its policy of geographic expansion of its banking business through the acquisition of banks whose operations are consistent with its banking philosophy. Management routinely explores opportunities to acquire financial institutions and other financial services-related businesses and to enter into strategic alliances to expand the scope of its services and its customer base.

Effective February 10, 2012, the Bank assumed substantially all of the deposits and certain other liabilities and acquired certain assets of SCB Bank, a federal savings bank headquartered in Shelbyville, Indiana, from the Federal Deposit Insurance Corporation ("FDIC"), as receiver for SCB Bank (the "Acquisition"), pursuant to the terms of the Purchase and Assumption Agreement - Modified Whole Bank; All Deposits (the "Agreement"), entered into by the Bank, the FDIC as receiver of SCB Bank and the FDIC. Under the terms of the Agreement, the Bank acquired $147,700,000 in assets, including approximately $11,900,000 of cash and cash equivalents, $18,900,000 of marketable securities, $1,800,000 in Federal Home Loan Bank stock, $113,000,000 in loans and $2,100,000 of premises and other assets. The asset balances are book balances and do not reflect the fair value discount of $29,000,000 from book value. The Bank assumed approximately $135,700,000 of liabilities, including approximately $125,900,000 in customer deposits, $9,600,000 of other borrowed money and $402,000 in other liabilities. The bid accepted by the FDIC included no deposit premium.

COMPETITION

The Bank is located in Indiana and Ohio counties where other financial services companies provide similar banking services. In addition to the competition provided by the lending and deposit gathering subsidiaries of national manufacturers, retailers, insurance companies and investment brokers, the Bank competes vigorously with other banks, thrift institutions, credit unions and finance companies located within their service areas.

Table of Contents

REGULATION AND SUPERVISION OF FIRST MERCHANTS CORPORATION AND SUBSIDIARIES

Bank Holding Company Regulation

The Corporation is registered as a bank holding company and has elected to be a financial holding company. It is subject to the supervision of, and regulation by the Board of Governors of the Federal Reserve System ("Federal Reserve") under the Bank Holding Company Act of 1956 (the "BHC Act"), as amended. Bank holding companies are required to file periodic reports with and are subject to periodic examination by the Federal Reserve. The Federal Reserve has issued regulations under the BHC Act requiring a bank holding company to serve as a source of financial and managerial strength to the Bank. Thus, it is the policy of the Federal Reserve that a bank holding company should stand ready to use its resources to provide adequate capital funds to the Bank during periods of financial stress or adversity. Additionally, under the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), a bank holding company is required to guarantee the compliance of any subsidiary bank that may become "undercapitalized" (as defined in the FDICIA section of this Form 10-K) with the terms of any capital restoration plan filed by such subsidiary with its appropriate federal banking agency. Under the BHC Act, the Federal Reserve has the authority to require a bank holding company to terminate any activity or relinquish control of a non-bank subsidiary (other than a non-bank subsidiary of a bank) upon the determination that such activity constitutes a serious risk to the financial stability of any bank subsidiary.

The BHC Act requires the Corporation to obtain the prior approval of the Federal Reserve before:

- acquiring direct or indirect control or ownership of any voting shares of any bank or bank holding company if, after such acquisition, the bank holding company will directly or indirectly own or control more than 5 percent of the voting shares of the bank or bank holding company;
- merging or consolidating with another bank holding company; or
- acquiring substantially all of the assets of any bank.

The BHC Act generally prohibits bank holding companies that have not become financial holding companies from (i) engaging in activities other than banking or managing or controlling banks or other permissible subsidiaries, and (ii) acquiring or retaining direct or indirect control of any company engaged in the activities other than those activities determined by the Federal Reserve to be closely related to banking or managing or controlling banks.

Capital Adequacy Guidelines for Bank Holding Companies

The BHC Act does not place territorial restrictions on such non-banking related activities. The Corporation is required to comply with the Federal Reserve's risk-based capital guidelines. These guidelines require a minimum ratio of capital to risk-weighted assets of 8 percent (including certain off-balance sheet activities such as standby letters of credit). At least half of the total required capital must be "Tier 1 capital," consisting principally of stockholders' equity, noncumulative perpetual preferred stock, a limited amount of cumulative perpetual preferred stock and minority interest in the equity accounts of consolidated subsidiaries, less certain goodwill items. The remainder may consist of a limited amount of subordinate debt and intermediate-term preferred stock, certain hybrid capital instruments and other debt securities, cumulative perpetual preferred stock, and a limited amount of the general loan loss allowance.

In addition to the risk-based capital guidelines, the Federal Reserve has adopted a Tier 1 (leverage) capital ratio under which the Corporation must maintain a minimum level of Tier 1 capital to average total consolidated assets. The ratio is 3 percent in the case of bank holding companies, which have the highest regulatory examination ratings and are not contemplating significant growth or expansion.

The following are the Corporation’s regulatory capital ratios as of December 31, 2012:

	Corporation	Regulatory Minimum Requirement
Tier 1 risk-based capital ratio	14.15 %	4.00 %
Total risk-based capital ratio	16.34 %	8.00 %

Bank Regulation

The Bank is supervised, regulated and examined by the Office of the Comptroller of the Currency (the “OCC”). The OCC has the authority to issue cease-and-desist orders if it determines that activities of the Bank regularly represent an unsafe and unsound banking practice or a violation of law. Federal law extensively regulates various aspects of the banking business such as reserve requirements, truth-in-lending and truth-in-savings disclosures, equal credit opportunity, fair credit reporting, trading in securities and other aspects of banking operations. Current federal law also requires banks, among other things, to make deposited funds available within specified time periods.

Bank Capital Requirements

The OCC has adopted risk-based capital ratio guidelines to which national banks are subject. The guidelines establish a framework that makes regulatory capital requirements more sensitive to differences in risk profiles. Risk-based capital ratios are determined by allocating assets and specified off-balance sheet commitments to four risk-weighted categories, with higher levels of capital being required for the categories perceived as representing greater risk.

Like the capital guidelines established by the Federal Reserve, these guidelines divide a bank's capital into tiers. Banks are required to maintain a total risk-based capital ratio of 8 percent. The OCC may, however, set higher capital requirements when a bank's particular circumstances warrant. Banks experiencing or anticipating significant growth are expected to maintain capital ratios, including tangible capital positions, well above the minimum levels.

In addition, the OCC established guidelines prescribing a minimum Tier 1 leverage ratio (Tier 1 capital to adjusted total assets as specified in the guidelines). These guidelines provide for a minimum Tier 1 leverage ratio of 3 percent for banks that meet specified criteria, including that they have the highest regulatory rating and are not experiencing or anticipating significant growth. All other banks are required to maintain a Tier 1 leverage ratio of 3 percent plus an additional 1 to 2 percent.

The Bank exceeded the minimum risk-based capital guidelines of the OCC as of December 31, 2012.

FDIC Improvement Act of 1991

The FDICIA requires, among other things, federal bank regulatory authorities to take "prompt corrective action" with respect to banks, which do not meet minimum capital requirements. For these purposes, FDICIA establishes five capital tiers: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. The Federal Deposit Insurance Corporation ("FDIC") has adopted regulations to implement the prompt corrective action provisions of FDICIA.

"Undercapitalized" banks are subject to growth limitations and are required to submit a capital restoration plan. A bank's compliance with such plan is required to be guaranteed by the bank's parent holding company. If an "undercapitalized" bank fails to submit an acceptable plan, it is treated as if it is significantly undercapitalized. "Significantly undercapitalized" banks are subject to one or more restrictions, including an order by the FDIC to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets and cease receipt of deposits from correspondent banks, and restrictions on compensation of executive officers. "Critically undercapitalized" institutions may not, beginning 60 days after becoming "critically undercapitalized," make any payment of principal or interest on certain subordinated debt or extend credit for a highly leveraged transaction or enter into any transaction outside the ordinary course of business. In addition, "critically undercapitalized" institutions are subject to appointment of a receiver or conservator.

As of December 31, 2012, the Bank was "well capitalized" based on the "prompt corrective action" ratios described above. It should be noted that a bank's capital category is determined solely for the purpose of applying the OCC's "prompt corrective action" regulations and that the capital category may not constitute an accurate representation of the bank's overall financial condition or prospects.

LEGISLATIVE AND REGULATORY INITIATIVES TO ADDRESS FINANCIAL AND ECONOMIC CRISES

Troubled Asset Relief Program; Capital Purchase Program

Congress, The United States Department of the Treasury (the "Treasury") and the federal banking regulators, including the FDIC, have taken broad action since early September 2008 to address volatility in the U.S. banking system and financial markets.

In October 2008, the Emergency Economic Stabilization Act of 2008 ("EESA") was enacted. The EESA authorized the Treasury to purchase from financial institutions and their holding companies up to $700 billion in mortgage loans, mortgage-related securities and certain other financial instruments, including debt and equity securities issued by financial institutions and their holding companies in a Troubled Asset Relief Program ("TARP"). The purpose of TARP was to restore confidence and stability to the U.S. banking system and to encourage financial institutions to increase their lending to customers and to each other. The Treasury allocated $250 billion towards the TARP Capital Purchase Program. Under the TARP Capital Purchase Program, the Treasury purchased debt or equity securities from participating institutions. TARP also included direct purchases or guarantees of troubled assets of financial institutions. Participants in the TARP Capital Purchase Program are subject to executive compensation limits and are encouraged to expand their lending and mortgage loan modifications.

On February 20, 2009, the Corporation entered into a Letter Agreement (Purchase Agreement) with the Treasury, pursuant to which the Corporation sold (a) 116,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the "Series A Preferred Stock") and (b) a warrant to purchase 991,453 shares of the Corporation's common stock for an aggregate purchase price of $116 million in cash ("Warrant").

The Preferred Stock qualified as Tier I capital and was to pay cumulative dividends at a rate of 5 percent per annum for the first five years and 9 percent per annum thereafter. The Series A Preferred Stock was non-voting except with respect to certain matters affecting the rights of the holders thereof, and was redeemable by the Corporation after three years. The Warrant had a ten year term and was immediately exercisable with an exercise price of $17.55 per share of common stock. Pursuant to the Purchase Agreement, the Treasury had agreed not to exercise voting power with respect to any shares of common stock issued upon exercise of the Warrant.

On June 30, 2010, the Corporation entered into an Exchange Agreement with the Treasury whereby the Treasury exchanged 46,400 shares of the Series A Preferred Stock for 46,400 shares of trust preferred securities, having a liquidation amount of $1,000 per share (the “Capital Securities”) issued by the Corporation’s wholly-owned subsidiary trust, First Merchants Capital Trust III, a Delaware Statutory Trust (the “Trust”). The Trust simultaneously issued 1,435 shares of the Trust’s common securities (the “Common Securities”) to the Corporation for the purchase price of $1.4 million which constituted all of the issued and outstanding common securities of the Trust. The Trust used the tendered Series A Preferred Stock and the proceeds from the sale of the Common Securities to purchase $47.8 million in aggregate principal amount of Fixed Rate Perpetual Junior Subordinated Debentures, Series A issued by the Corporation (the “Debentures”). The Capital Securities and the Debentures bore interest, payable quarterly, at a rate of 5 percent until February 20, 2014 when the rate would increase to 9 percent. The Capital Securities and Debentures were redeemable by the Corporation upon proper notice and regulatory approval (a) at any time, so long as the Capital Securities were held by the Treasury and (b) at any time after June 30, 2015, if the Capital Securities were held by a person or entity other than the Treasury. The 46,400 shares of Series A Preferred Stock, purchased from the Treasury were cancelled. Following the exchange, the Treasury continued to hold 69,600 shares of Series A Preferred Stock along with the Warrant to initially purchase up to 991,453 shares of the Corporation’s common stock. This particular exchange resulted in a gain on retirement of Preferred Stock and favorably impacted retained earnings by $10.1 million (net of deferred taxes), which was also considered as part of earnings available to common stockholders in the earnings per common share (“EPS”) computations.

On September 22, 2011, the Corporation entered into a Securities Purchase Agreement (the “Purchase Agreement”) with the Treasury, pursuant to which the Corporation issued 90,782.94 shares of the Corporation’s Senior Non-Cumulative Perpetual Preferred Stock, Series B (the “Series B Preferred Stock”), having a liquidation amount per share equal to $1,000, for a total purchase price of $90,782,940. The Purchase Agreement was entered into, and the Series B Preferred Stock was issued, pursuant to the Small Business Lending Fund (“SBLF”) program, a $30 billion fund established under the Small Business Jobs Act of 2010, that encourages lending to small businesses by providing capital to qualified community banks with assets of less than $10 billion.

The Series B Preferred Stock is entitled to receive non-cumulative dividends, payable quarterly, on each January 1, April 1, July 1 and October 1, beginning October 1, 2011. The Purchase Agreement defines the dividend rate as a percentage of the liquidation amount, and can fluctuate on a quarterly basis during the first ten quarters during which the Series B Preferred Stock is outstanding, based upon changes in the level of Qualified Small Business Lending (“QSBL”) by the Bank. Based upon the Bank’s level of QSBL over the baseline level calculated under the terms of the Purchase Agreement (the “Baseline”), the dividend rate for the initial dividend period has been set at 5 percent. For the second through tenth dividend periods, the dividend rate may be adjusted to between 1 percent and 5 percent per annum, to reflect the amount of change in the Bank’s level of QSBL. In addition to the dividend, in the event the Bank’s level of QSBL has not increased relative to the Baseline, at the beginning of the tenth calendar quarter, the Corporation will be subject to an additional lending incentive fee equal to 2 percent per annum. For the eleventh dividend period through the eighteenth dividend period, inclusive, and that portion of the nineteenth dividend period before, but not including, the four and one half year anniversary of the date of issuance, the dividend rate will be fixed at between 1 percent and 7 percent per annum based upon the increase in QSBL as compared to the baseline. After four and one half years from issuance, the dividend rate will increase to 9 percent.

The Series B Preferred Stock is non-voting, except in limited circumstances. In the event that the Corporation misses five dividend payments, whether or not consecutive, the holder of the Series B Preferred Stock will have the right, but not the obligation, to appoint a representative as an observer on the Corporation’s Board of Directors. In the event that the Corporation misses six dividend payments, whether or not consecutive, and if the then outstanding aggregate liquidation amount of the Series B Preferred Stock is at least $25,000,000, then the holder of the Series B Preferred

Stock will have the right to designate two directors to the Board of Directors of the Corporation.

The Series B Preferred Stock may be redeemed at any time at the Corporation's option, at a redemption price of 100 percent of the liquidation amount plus accrued but unpaid dividends to the date of redemption for the current period, subject to the approval of its federal banking regulator.

The Series B Preferred Stock was issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. The Corporation has agreed to register the Series B Preferred Stock under certain circumstances set forth in Annex E to the Purchase Agreement. The Series B Preferred Stock is not subject to any contractual restrictions on transfer.

Also on September 22, 2011, the Corporation entered into and consummated two letter agreements (each, a "Repurchase Letter") with the Treasury, pursuant to which the Corporation redeemed, out of the proceeds of the issuance of the Series B Preferred Stock in the amount of $90,782,940 and cash of $25,813,171 (of which $21,165,000 was raised through a private placement of the Corporation's common stock on September 9, 2011) for an aggregate redemption price of $116,596,111, including accrued but unpaid dividends to the date of redemption: (i) the remaining 69,600 shares of the Corporation's Series A Preferred Stock, and (ii) all 46,400 Capital Securities held by the Treasury .

The foregoing summary of the terms of the Repurchase Letters is subject to, and qualified in its entirety by, the full text of the Repurchase Letters.

On November 23, 2011, the Corporation also repurchased the Warrant to purchase 991,453 shares of the Corporation's common stock at an exercise price of $17.55 per share with an expiration date of February 20, 2019 held by the Treasury. The Corporation was the successful bidder in a private auction for the Warrant conducted by the Treasury with a winning bid of $367,500.

Table of Contents

Dodd-Frank Wall Street Reform and Consumer Protection Act

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") into law. The Dodd-Frank Act is likely to have a broad impact on the financial services industry, including significant regulatory and compliance changes. Many of the requirements called for in the Dodd-Frank Act will be implemented over time and most will be subject to various federal agencies implementing regulations over the course of several years. Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the various regulatory agencies through regulatory guidance, the full extent of the impact such requirements will have on the financial services industry, and on operations specifically, is currently unclear. The changes resulting from the Dodd-Frank Act may materially impact the profitability of the Corporation's business activities, require changes to certain business practices, impose more stringent capital, liquidity and leverage requirements or otherwise adversely affect the business. At a minimum, the Dodd-Frank Act is likely to:

- increase the cost of operations due to greater regulatory oversight, supervision and examination of banks and bank holding companies, including higher deposit insurance premiums;
- limit the Corporation's ability to raise additional capital through the use of trust preferred securities as new issuances of these securities may no longer be included as Tier 1 capital;
- reduce the flexibility to generate or originate certain revenue-producing assets based on increased regulatory capital standards; and
- limit the ability to expand consumer product and service offerings due to anticipated stricter consumer protection laws and regulations.

The timing and extent of these increases and limitations will remain unclear until the underlying implementing regulations are promulgated by the applicable federal agencies. In the interim, the Corporation's management is currently taking steps to best prepare for the implementation and to minimize the adverse impact on the business, financial condition and results of operation.

On February 7, 2011, the FDIC adopted final rules implementing a portion of the Dodd-Frank Act relating to deposit insurance assessments. The rules modify the base amount for a financial institution's insurance assessments from an institution's insured deposits to the difference between an institution's daily average consolidated assets and its daily average tangible equity. The rules also eliminated the requirement that the FDIC provide rebates to institutions on their deposit premiums once the reserve ratio exceeded 1.5 percent. These new rules became effective on April 1, 2011.

Deposit Insurance

The Bank is insured up to regulatory limits by the FDIC; and, accordingly, is subject to deposit insurance assessments to maintain the Deposit Insurance Fund administered by the FDIC. The FDIC has adopted regulations establishing a permanent risk-related deposit insurance assessment system. Under this system, the FDIC places each insured bank in one of four risk categories based on (i) the bank's capital evaluation, and (ii) supervisory evaluations provided to the FDIC by the bank's primary federal regulator. Each insured bank's annual assessment rate is then determined by the risk category in which it is classified by the FDIC.

When Dodd-Frank became effective, it permanently raised the previous Standard Maximum Deposit Insurance Amount ("SMDIA") to $250,000. The FDIC insurance coverage limit applies per depositor, per insured depository institution for each account ownership category. This provision became effective for depositors December 31, 2010.

On November 9, 2010, the FDIC implemented section 343 of the Dodd-Frank Act providing unlimited insurance coverage on noninterest-bearing transaction accounts. Beginning December 31, 2010, through December 31, 2012, all noninterest-bearing transaction accounts were fully insured, regardless of the balance of the account, at all FDIC-insured institutions. As of January 1, 2013, noninterest-bearing transaction deposit accounts are no longer insured separately from other accounts at the same FDIC-insured institution. Instead, noninterest-bearing transaction accounts will be added to other accounts, and the aggregate balance insured up to at least the Standard Maximum Deposit Insurance Amount of $250,000, at each institution.

Temporary Liquidity Guarantee Program

Following a systemic risk determination, on October 14, 2008, the FDIC established the Temporary Liquidity Guarantee Program (“TLGP”). The TLGP included the Transaction Account Guarantee Program ("TAGP"), which provided unlimited deposit insurance coverage for noninterest-bearing transaction accounts (typically business checking accounts) and certain funds swept into noninterest-bearing savings accounts. Prior to December 31, 2009, institutions participating in the TAGP paid a 10 basis points fee (annualized) on the balance of each covered account in excess of $250,000, while the extra deposit insurance is in place. After December 31, 2009, those institutions that have not opted out of the TAGP extension will be charged an assessment rate ranging from 15 to 25 basis points, depending on the institution’s risk category. This program was extended to December 31, 2010 and the Bank continued its participation until the program expired on December 31, 2010, when the Dodd-Frank Wall Street Reform and Consumer Protection Act became effective which, in part, permanently raised the previous SMDIA to $250,000.

The TLGP also included the Debt Guarantee Program (“DGP”), under which the FDIC guaranteed certain senior unsecured debt of FDIC-insured institutions and their holding companies. The guarantee was effective through the earlier of the maturity date or June 30, 2012. Depending on the term of the debt maturity, the nonrefundable DGP fee ranged from 50 to 100 basis points (annualized) for covered debt outstanding until the earlier of maturity or June 30, 2012. The TAGP and the DGP were in effect for all eligible entities, unless the entity opted out on or before December 5, 2008. On March 17, 2009, the FDIC extended the DGP to June 30, 2009 from the original expiration date of April 30, 2009. In addition, beginning in the second quarter of 2009, the FDIC determined to impose a surcharge on debt issued under the DGP with a maturity of one-year or more.

Table of Contents

On March 31, 2009, the Bank completed the issuance and sale of an aggregate of $79,000,000 of 2.625 percent Senior Notes (the "Notes") due March 30, 2012 through a pooled offering under the DGP. Including the FDIC fee, underwriting, legal and accounting expenses the effective rate was 3.812 percent. The Notes were issued by the Bank and were not obligations of, or guaranteed by, the Corporation. In connection with the terms of the TLGP, the Bank entered into a Master Agreement with the FDIC on January 16, 2009. The Master Agreement contained, among other things, certain terms and conditions that must be included in the governing documents for any senior debt securities issued by the Bank that are guaranteed pursuant to the FDIC's TLGP. On March 30, 2012, the Bank completed repayment of these Notes.

DIVIDEND LIMITATIONS

National banking laws restrict the amount of dividends that an affiliate bank may declare in a year without obtaining prior regulatory approval. National banks are limited to the bank's retained net income (as defined) for the current year plus those for the previous two years. At December 31, 2012, the Corporation's affiliates (including the Bank and other affiliates) had a total of $70,704,000 retained net profits available for 2013 dividends to the Corporation without prior regulatory approval.

BROKERED DEPOSITS

Under FDIC regulations, no FDIC-insured depository institution can accept brokered deposits unless it (i) is well capitalized, or (ii) is adequately capitalized and received a waiver from the FDIC. In addition, these regulations prohibit any depository institution that is not well capitalized from (a) paying an interest rate on deposits in excess of 76 basis points over certain prevailing market rates or (b) offering "pass through" deposit insurance on certain employee benefit plan accounts unless it provides certain notice to affected depositors.

INTERSTATE BANKING AND BRANCHING

Under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ("Riegle-Neal"), subject to certain concentration limits, required regulatory approvals and other requirements, (i) financial holding companies such as the Corporation are permitted to acquire banks and bank holding companies located in any state; (ii) any bank that is a subsidiary of a bank holding company is permitted to receive deposits, renew time deposits, close loans, service loans and receive loan payments as an agent for any other bank subsidiary of that holding company; and (iii) banks are permitted to acquire branch offices outside their home states by merging with out-of-state banks, purchasing branches in other states, and establishing de novo branch offices in other states.

FINANCIAL SERVICES MODERNIZATION ACT

The Gramm-Leach-Bliley Act of 1999 (the "Financial Services Modernization Act") establishes a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms, and other financial service providers by revising and expanding the existing BHC Act. Under this legislation, bank holding companies would be permitted to conduct essentially unlimited securities and insurance activities as well as other activities determined by the Federal Reserve Board to be financial in nature or related to financial services. As a result, the Corporation is able to provide securities and insurance services. Furthermore, under this legislation, the Corporation is able to acquire, or be acquired, by brokerage and securities firms and insurance underwriters. In addition, the Financial Services Modernization Act broadens the activities that may be conducted by national banks through the formation of financial subsidiaries. Finally, the Financial Services Modernization

Act modifies the laws governing the implementation of the Community Reinvestment Act and addresses a variety of other legal and regulatory issues affecting both day-to-day operations and long-term activities of financial institutions.

A bank holding company may become a financial holding company if each of its subsidiary banks is well capitalized, is well managed and has at least a satisfactory rating under the Community Reinvestment Act, by filing a declaration that the bank holding company wishes to become a financial holding company. Also effective March 11, 2000, no regulatory approval is required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve Board. The Federal Reserve Bank of Chicago approved the Corporation's application to become a Financial Holding Company effective September 13, 2000.

USA PATRIOT ACT

As part of the USA Patriot Act, signed into law on October 26, 2001, Congress adopted the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 (the "Act"). The Act authorizes the Secretary of the Treasury, in consultation with the heads of other government agencies, to adopt special measures applicable to financial institutions such as banks, bank holding companies, broker-dealers and insurance companies. Among its other provisions, the Act requires each financial institution: (i) to establish an anti-money laundering program; (ii) to establish due diligence policies, procedures and controls that are reasonably designed to detect and report instances of money laundering in United States private banking accounts and correspondent accounts maintained for non-United States persons or their representatives; and (iii) to avoid establishing, maintaining, administering, or managing correspondent accounts in the United States for, or on behalf of, a foreign shell bank that does not have a physical presence in any country. In addition, the Act expands the circumstances under which funds in a bank account may be forfeited and requires covered financial institutions to respond under certain circumstances to requests for information from federal banking agencies within 120 hours.

Treasury regulations implementing the due diligence requirements were issued in 2002. These regulations required minimum standards to verify customer identity, encouraged cooperation among financial institutions, federal banking agencies, and law enforcement authorities regarding possible money laundering or terrorist activities, prohibited the anonymous use of "concentration accounts," and required all covered financial institutions to have in place an anti-money laundering compliance program.

The Act also amended the Bank Holding Company Act and the Bank Merger Act to require the federal banking agencies to consider the effectiveness of a financial institution's anti-money laundering activities when reviewing an application under these acts.

Table of Contents
PART I: ITEM 1. BUSINESS

THE SARBANES-OXLEY ACT

The Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley Act”), which became law on July 30, 2002, added new legal requirements for public companies affecting corporate governance, accounting and corporate reporting. The Sarbanes-Oxley Act provides for, among other things:

- a prohibition on personal loans made or arranged by the issuer to its directors and executive officers (except for loans made by a bank subject to Regulation O);
- independence requirements for audit committee members;
- independence requirements for company auditors;
- certification of financial statements on Forms 10-K and 10-Q reports by the chief executive officer and the chief financial officer;
- the forfeiture by the chief executive officer and chief financial officer of bonuses or other incentive-based compensation and profits from the sale of an issuer’s securities by such officers in the twelve-month period following initial publication of any financial statements that later require restatement due to corporate misconduct;
- disclosure of off-balance sheet transactions;
- two-business day filing requirements for insiders filing Form 4s;
- disclosure of a code of ethics for financial officers and filing a Form 8-K for a change in or waiver of such code;
- the reporting of securities violations “up the ladder” by both in-house and outside attorneys;
- restrictions on the use of non-GAAP financial measures in press releases and SEC filings;
- the formation of a public accounting oversight board; and
- various increased criminal penalties for violations of securities laws.

The Sarbanes-Oxley Act contains provisions, which became effective upon enactment on July 30, 2002, including provisions, which became effective from within 30 days to one year from enactment. The SEC has been delegated the task of enacting rules to implement various provisions. In addition, each of the national stock exchanges developed new corporate governance rules, including rules strengthening director independence requirements for boards, the adoption of corporate governance codes and charters for the nominating, corporate governance and audit committees.

ADDITIONAL MATTERS

The Corporation and the Bank are subject to the Federal Reserve Act, which restricts financial transactions between banks and affiliated companies. The statute limits credit transactions between banks, affiliated companies and its executive officers and its affiliates. The statute prescribes terms and conditions for bank affiliate transactions deemed to be consistent with safe and sound banking practices. It also restricts the types of collateral security permitted in connection with the bank’s extension of credit to an affiliate. Additionally, all transactions with an affiliate must be on terms substantially the same or at least as favorable to the institution as those prevailing at the time for comparable transactions with non-affiliated parties.

In addition to the matters discussed above, the Bank is subject to additional regulation of its activities, including a variety of consumer protection regulations affecting its lending, deposit and collection activities and regulations affecting secondary mortgage market activities.

The earnings of financial institutions are also affected by general economic conditions and prevailing interest rates, both domestic and foreign, and by the monetary and fiscal policies of the United States Government and its various agencies, particularly the Federal Reserve. The Federal Reserve regulates the supply of credit in order to influence general economic conditions, primarily through open market operations in United States Government obligations,

varying the discount rate on financial institution borrowings, varying reserve requirements against financial institution deposits, and restricting certain borrowings by financial institutions and their subsidiaries. The monetary policies of the Federal Reserve have had a significant effect on the operating results of the Bank in the past and are expected to continue to do so in the future.

Additional legislation and administrative actions affecting the banking industry may be considered by the United States Congress, state legislatures and various regulatory agencies, including those referred to above. It cannot be predicted with certainty whether such legislation or administrative action will be enacted or the extent to which the banking industry, the Corporation or the Bank would be affected.

Table of Contents

STATISTICAL DATA

The following tables set forth statistical data on the Corporation and its subsidiaries.

DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS’ EQUITY; INTEREST RATES AND INTEREST DIFFERENTIAL

The daily average balance sheet amounts, the related interest income or interest expense, and average rates earned or paid are presented in the following table:

	Average Balance	Interest Income / Expense	Average Rate	Average Balance	Interest Income / Expense	Average Rate	Average Balance	Interest Income / Expense	Average Rate
(Dollars in Thousands)	2012			2011			2010		
Assets:									
Federal Funds Sold				$3,270	$3	0.1 %	$21,524	$26	0.1 %
Interest-bearing Deposits	$57,842	$100	0.2 %	69,030	282	0.4	106,820	381	0.4
Federal Reserve and Federal Home Loan Bank Stock	32,819	1,408	4.3	32,396	1,319	4.1	36,338	1,252	3.4
Securities: [1]									
Taxable	670,973	17,027	2.5	648,167	19,230	3.0	399,721	12,957	3.2
Tax-Exempt [2]	251,724	15,675	6.2	242,480	15,642	6.5	247,240	15,965	6.5
Total Securities	922,697	32,702	3.5	890,647	34,872	3.9	646,961	28,922	4.5
Mortgage Loans Held for Sale	20,648	1,024	5.0	9,322	554	5.9	11,878	684	5.8
Loans: [3]									
Commercial	2,166,238	114,078	5.3	2,102,933	114,079	5.4	2,288,883	130,276	5.7
Real Estate Mortgage	293,384	13,848	4.7	306,567	15,810	5.2	350,646	19,473	5.6
Installment	324,553	17,795	5.5	320,570	19,273	6.0	380,293	23,637	6.2
Tax-Exempt [2]	14,993	739	4.9	9,292	812	8.7	19,150	792	4.1
Total Loans	2,819,816	147,484	5.2	2,748,684	150,528	5.5	3,050,850	174,862	5.7
Total Earning Assets	3,833,174	181,694	4.7 %	3,744,027	187,004	5.0 %	3,862,493	205,443	5.3 %
Net Unrealized Gain on Securities Available for Sale	16,116			9,225			14,245		
Allowance for Loan Losses	(71,038)			(78,500)			(87,058)		
Cash and Due from Banks	66,109			62,659			56,635		
Premises and Equipment	51,692			51,895			53,870		
Other Assets	349,943			354,544			371,530		
Total Assets	$4,245,996			$4,143,850			$4,271,715		
Liabilities:									
Interest-bearing Deposits:									
NOW Accounts	$814,831	$1,007	0.1 %	$774,593	$1,453	0.2 %	$755,793	$3,300	0.4 %

Money Market Deposit Accounts	501,537	1,370	0.3	469,621	1,557	0.3	467,313	2,520	0.5
Savings Deposits	327,644	528	0.2	297,073	668	0.2	285,760	812	0.3
Certificates and Other Time Deposits	935,713	11,895	1.3	1,032,781	18,603	1.8	1,295,367	33,244	2.6
Total Interest-bearing Deposits	2,579,725	14,800	0.6	2,574,068	22,281	0.9	2,804,233	39,876	1.4
Borrowings	411,915	8,813	2.1	455,135	15,609	3.4	427,242	16,133	3.8
Total Interest-bearing Liabilities	2,991,640	23,613	0.8	3,029,203	37,890	1.3	3,231,475	56,009	1.7
Noninterest-bearing Deposits	683,295			601,694			533,514		
Other Liabilities	35,564			34,513			36,347		
Total Liabilities	3,710,499			3,665,410			3,801,336		
Stockholders' Equity	535,497			478,440			470,379		
Total Liabilities and Stockholders' Equity	$4,245,996	23,613	0.6	$4,143,850	37,890	1.0	$4,271,715	56,009	1.5
Net Interest Income		$158,081			$149,114			$149,434	
Net Interest Margin			4.1 %			4.0 %			3.9 %

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(1) Average balance of securities is computed based on the average of the historical amortized cost balances without the effects of the fair value adjustment.

(2) Tax-exempt securities and loans are presented on a fully taxable equivalent basis, using a marginal tax rate of 35 percent for 2012, 2011 and 2010. These totals equal $5,745, $5,759 and $5,865, respectively.

(3) Non-accruing loans have been included in the average balances.

Table of Contents
PART I: ITEM 1. BUSINESS

ANALYSIS OF CHANGES IN NET INTEREST INCOME

The following table presents net interest income components on a tax-equivalent basis and reflects changes between periods attributable to movement in either the average balance or average interest rate for both earning assets and interest-bearing liabilities. The volume differences were computed as the difference in volume between the current and prior year times the interest rate of the prior year, while the interest rate changes were computed as the difference in rate between the current and prior year times the volume of the prior year. Volume/rate variances have been allocated on the basis of the absolute relationship between volume variances and rate variances.

	2012 Compared to 2011 Increase (Decrease) Due To			2011 Compared to 2010 Increase (Decrease) Due To			2010 Compared to 2009 Increase (Decrease) Due To		
(Dollars in Thousands, Fully Taxable Equivalent Basis)	Volume	Rate	Total	Volume	Rate	Total	Volume	Rate	Total
Interest Income:									
Federal Funds Sold	$(3)		$(3)	$(18)	$(5)	$(23)	$(73)	$(19)	$(92)
Interest-bearing Deposits	(40)	(142)	(182)	(149)	50	(99)	119	(104)	15
Federal Reserve and Federal Home Loan Bank Stock	17	72	89	(145)	212	67	32	(159)	(127)
Securities	1,222	(3,392)	(2,170)	9,877	(3,927)	5,950	6,686	(4,849)	1,837
Mortgage Loans Held for Sale	575	(105)	470	(151)	21	(130)	(136)	(34)	(170)
Loans	3,226	(6,740)	(3,514)	(16,643)	(7,561)	(24,204)	(28,329)	(3,852)	(32,181)
Totals	4,997	(10,307)	(5,310)	(7,229)	(11,210)	(18,439)	(21,701)	(9,017)	(30,718)
Interest Expense:									
NOW Accounts	72	(518)	(446)	80	(1,927)	(1,847)	274	(580)	(306)
Money Market Deposit Accounts	101	(288)	(187)	12	(975)	(963)	275	(1,305)	(1,030)
Savings Deposits	64	(204)	(140)	31	(175)	(144)	(60)	(347)	(407)
Certificates and Other Time Deposits	(1,624)	(5,084)	(6,708)	(5,926)	(8,715)	(14,641)	(10,619)	(6,153)	(16,772)
Borrowings	(1,370)	(5,426)	(6,796)	1,013	(1,537)	(524)	(5,050)	2,481	(2,569)
Totals	(2,757)	(11,520)	(14,277)	(4,790)	(13,329)	(18,119)	(15,180)	(5,904)	(21,084)
Change in Net Interest Income (Fully Taxable Equivalent Basis)	$7,754	$1,213	8,967	$(2,439)	$2,119	(320)	$(6,521)	$(3,113)	(9,634)
Tax Equivalent Adjustment Using Marginal Rate of 35% for 2012, 2011, and 2010			14			106			(143)
Change in Net Interest Income			$8,981			$(214)			$(9,777)

INVESTMENT SECURITIES

Management evaluates securities for other-than-temporary impairment ("OTTI") at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. The investment securities portfolio is evaluated for OTTI by segregating the portfolio into two general segments and applying the appropriate OTTI model. Investment securities are generally evaluated for OTTI under Accounting Standards Codification ("ASC") 320,

Investments – Debt and Equity Securities. However, certain purchased beneficial interest, including certain non-agency government-sponsored mortgage-backed securities, asset-backed securities and collateralized debt obligations are evaluated using the model outlined in ASC 325-10, Investments - Other.

In determining OTTI under ASC 320, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Corporation has the intent to sell the debt security or more likely than not, will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

When OTTI occurs, the amount of OTTI recognized in the income statement depends on whether the Corporation intends to sell the security or it is more likely than not that the Corporation will be required to sell the security before recovery of its amortized cost basis, less any recognized credit loss. If the intent is to sell or it is more likely than not that the Corporation will be required to sell the security before recovery of its amortized cost basis, less any recognized credit loss, the OTTI shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis, less any recognized credit loss, and its fair value at the balance sheet date. If the intent is not to sell the security and it is not more likely than not that the Corporation will be required to sell the security before the recovery of its amortized cost basis less any recognized credit loss, the OTTI has been separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized in earnings. The amount of the total OTTI related to other factors has been recognized in other comprehensive income, net of applicable income taxes. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment. The Corporation's management has evaluated all securities with unrealized losses for other-than-temporary impairment as of December 31, 2012.

The current unrealized losses are primarily concentrated within trust preferred securities held by the Corporation. Such investments have an amortized cost of $6.1 million and a fair value of $194,000, which is less than 1 percent of the Corporation's entire investment portfolio. On all but one small pool investment, the Corporation utilized Moody's to determine their fair value.

Table of Contents

During 2012, management reviewed the trust preferred pool securities for OTTI related to credit losses using a cash flow analysis of the present value of cash flows expected to be collected. These cash flow analyses included forecasted loss rates applied at an individual security level based upon the characteristics of that individual security. Of the six partially impaired securities, remaining book values represent between 33 percent and 83 percent of par value. Discount rates used in the cash flow analyses on these variable rate securities were those margins in effect at the inception of the security added to the appropriate three-month LIBOR spot rate obtained from the forward LIBOR curve used to project future principal and interest payments. These spreads ranged from .85 percent to 1.57 percent spread over three-month LIBOR.

In determining the fair value of the trust preferred securities, the Corporation utilizes a third party for portfolio accounting services, including market value input. The Corporation has obtained an understanding of what inputs were used by the vendor in pricing the portfolio and how the vendor classified the securities based upon these inputs. From these discussions, the Corporation's management is comfortable that the classifications are proper. The Corporation has gained trust in the data for two reasons: (a) independent spot testing of the data is conducted by the Corporation through obtaining market quotes from various brokers on a periodic basis and (b) actual gains or loss resulting from the sale of certain securities has proven the data to be accurate over time.

See additional information regarding the analysis of the investment portfolio in Note 4. INVESTMENT SECURITIES, in the Notes to Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

The amortized cost, gross unrealized gains, gross unrealized losses and approximate market value of the investment securities at the dates indicated were:

(Dollars in Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at December 31, 2012				
U.S. Government-sponsored agency securities	$4,475	$165		$4,640
State and municipal	148,187	10,025	$18	158,194
U.S. Government-sponsored mortgage-backed securities	337,631	10,994	46	348,579
Corporate obligations	6,105		5,881	224
Equity securities	1,706			1,706
Total available for sale	498,104	21,184	5,945	513,343
Held to maturity at December 31, 2012				
State and municipal	117,227	5,489	1	122,715
U.S. Government-sponsored mortgage-backed securities	243,793	11,681	15	255,459
Total held to maturity	361,020	17,170	16	378,174
Total Investment Securities	$859,124	$38,354	$5,961	$891,517

(Dollars in Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at December 31, 2011				
U.S. Government-sponsored agency securities	$99	$18		$117
State and municipal	136,857	10,496		147,353

U.S. Government-sponsored mortgage-backed securities	358,928	10,086	$16	368,998
Corporate obligations	5,765		5,572	193
Equity securities	1,830			1,830
Total available for sale	503,479	20,600	5,588	518,491
Held to maturity at December 31, 2011				
State and municipal	120,171	3,785		123,956
U.S. Government-sponsored mortgage-backed securities	307,738	10,775		318,513
Total held to maturity	427,909	14,560		442,469
Total Investment Securities	$931,388	$35,160	$5,588	$960,960

(Dollars in Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at December 31, 2010				
U.S. Government-sponsored agency securities	$600	$16		$616
State and municipal	233,622	7,108	$740	239,990
U.S. Government-sponsored mortgage-backed securities	293,311	4,293	2,287	295,317
Corporate obligations	5,856		5,674	182
Equity securities	3,265			3,265
Total available for sale	536,654	11,417	8,701	539,370
Held to maturity at December 31, 2010				
State and municipal	10,070	389	5	10,454
U.S. Government-sponsored mortgage-backed securities	277,357	2,064	3,605	275,816
Total held to maturity	287,427	2,453	3,610	286,270
Total Investment Securities	$824,081	$13,870	$12,311	$825,640

Table of Contents

The cost and yields for Federal Reserve and Federal Home Loan Bank stock are included in the table below.

(Dollars in Thousands)	2012 Cost	Yield		2011 Cost	Yield		2010 Cost	Yield	
Federal Reserve and Federal Home Loan Bank Stock at December 31:									
Federal Reserve Bank Stock	$13,261	6.0	%	$13,238	6.0	%	$13,522	6.0	%
Federal Home Loan Bank Stock	19,524	2.0	%	18,032	2.0	%	20,362	1.6	%
Total	$32,785	3.6	%	$31,270	4.0	%	$33,884	3.3	%

Federal Reserve and Federal Home Loan Bank stock have been reviewed for impairment and the analysis reflected no impairment. The Corporation’s Federal Home Loan Bank stock is primarily in the Federal Home Loan Bank of Indianapolis and it continues to produce sufficient financial results to pay dividends.

There were no issuers included in the investment security portfolio at December 31, 2012, 2011 or 2010 where the aggregate carrying value of any one issuer exceeded 10 percent of the Corporation's stockholders' equity at those dates. The term "issuer" excludes the U.S. Government and its sponsored agencies and corporations.

The maturity distribution and average yields for the securities portfolio at December 31, 2012 were:

(Dollars in Thousands)	Within 1 Year Amount	Yield (1)		1-5 Years Amount	Yield (1)		5-10 Years Amount	Yield (1)	
Securities available for sale December 31, 2012									
U.S. Government-sponsored agency securities				$116	4.9	%			
State and municipal	$4,415	7.8	%	15,322	5.7	%	$57,442	5.5	%
Equity securities									
Corporate obligations				30	0.0	%			
U.S. Government-sponsored mortgage-backed securities									
	$4,415	7.8	%	$15,468	5.6	%	$57,442	5.5	%

	Due After Ten Years Amount	Yield (1)		Equity and U.S. Government-Sponsored Mortgage - Backed Securities Amount	Yield (1)		Total Amount	Yield (1)	
U.S. Government-sponsored agency securities	$4,524	3.5	%				$4,640	3.5	%
State and municipal	81,015	6.0	%				158,194	5.8	%
Equity securities	194	3.7	%				224	3.7	%
Corporate obligations				$1,706	6.5	%	1,706	6.5	%
U.S. Government-sponsored mortgage-backed securities				348,579	2.7	%	348,579	2.7	%
	$85,733	5.6	%	$350,285	2.7	%	$513,343	3.7	%

(Dollars in Thousands)	Within 1 Year Amount	Yield [1]		1-5 Years Amount	Yield [1]		5-10 Years Amount	Yield [1]	
Securities held to maturity at December 31, 2012									
State and municipal	$2,590	2.2	%	$2,554	3.3	%	$57,811	6.2	%
U.S. Government-sponsored mortgage-backed securities									
	$2,590	2.2	%	$2,554	3.3	%	$57,811	6.2	%

	Due After Ten Years			Equity and U.S. Government-Sponsored Mortgage - Backed Securities			Total		
	Amount	Yield [1]		Amount	Yield [1]		Amount	Yield [1]	
State and municipal	$54,272	6.4	%				$117,227	6.1	%
U.S. Government-sponsored mortgage-backed securities				$243,793	3.1	%	243,793	3.1	%
	$54,272	6.4	%	$243,793	3.1	%	$361,020	4.1	%

(1) Interest yields are presented on a fully taxable equivalent basis using a 35 percent tax rate.

Table of Contents
PART I: ITEM 1. BUSINESS

The following tables show the Corporation's gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2012 and 2011:

	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
(Dollars in Thousands)	Less than 12 Months		12 Months or Longer		Total	
Temporarily Impaired Investment Securities at December 31, 2012:						
State and municipal	$4,524	$ (19)			$4,524	$ (19)
U.S. Government-sponsored mortgage-backed securities	11,685	(49)	$635	$ (12)	12,320	(61)
Corporate obligations			194	(5,881)	194	(5,881)
Total Temporarily Impaired Investment Securities	$16,209	$ (68)	$829	$ (5,893)	$17,038	$ (5,961)

	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
(Dollars in Thousands)	Less than 12 Months		12 Months or Longer		Total	
Temporarily Impaired Investment Securities at December 31, 2011:						
U.S. Government-sponsored mortgage-backed securities	$6,176	$ (16)			$6,176	$ (16)
Corporate obligations			$163	$ (5,572)	163	(5,572)
Total Temporarily Impaired Investment Securities	$6,176	$ (16)	$163	$ (5,572)	$6,339	$ (5,588)

LOAN PORTFOLIO

The following table shows the composition of the Corporation's loan portfolio for the years indicated:

	2012		2011		2010		2009		2008	
(Dollars in Thousands)	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Loans at December 31:										
Commercial and Industrial Loans	$622,579	21.5 %	$532,523	19.6 %	$530,322	18.7 %	$675,860	20.7 %	$904,646	24.3 %
Agricultural Production Financing and Other	112,527	3.9	104,526	3.9	95,516	3.4	121,031	3.7	135,099	3.6

Loans to Farmers										
Real Estate Loans:										
Construction	98,639	3.4	81,780	3.0	106,615	3.8	158,725	4.9	252,487	6.8
Commercial and Farm Land	1,266,682	43.6	1,194,230	44.0	1,229,037	43.3	1,276,164	39.0	1,230,442	33.1
Residential	473,537	16.3	481,493	17.7	522,051	18.4	621,442	19.0	806,765	21.7
Home Equity	203,406	7.0	191,631	7.1	201,969	7.1	220,142	6.7	149,480	4.0
Individuals' Loans for Household and Other Personal Expenditures	75,748	2.6	84,172	3.1	115,295	4.1	154,132	4.7	201,632	5.4
Lease Financing Receivables, Net of Unearned Income	2,590	0.1	3,555	0.1	5,157	0.2	7,135	0.2	8,996	0.2
Other Loans	46,501	1.6	39,505	1.5	29,721	1.0	35,157	1.1	32,405	0.9
Loans	2,902,209	100.0%	2,713,415	100.0%	2,835,683	100.0%	3,269,788	100.0%	3,721,952	100.0%
Allowance for Loan Losses	(69,366)		(70,898)		(82,977)		(92,131)		(49,543)	
Net Loans	$2,832,843		$2,642,517		$2,752,706		$3,177,657		$3,672,409	

Residential Real Estate Loans Held for Sale at December 31, 2012, 2011, 2010, 2009 and 2008 were $22,300,000, $17,864,000, $21,469,000, $8,036,000 and $4,295,000, respectively.

The majority of the Corporation’s loan portfolio is comprised of commercial and industrial, commercial real estate and residential real estate loans. Commercial and industrial loans made up 21.5 percent and 19.6 percent of total loans at December 31, 2012, and 2011. Commercial real estate loans made up 43.6 percent and 44 percent of total loans and residential real estate loans, including home equity, made up 23.3 percent and 24.8 percent of total loans at December 31, 2012, and 2011, respectively. The Bank generates loans from customers primarily in central Indiana, and Butler and Franklin counties in Ohio. The Bank’s loans are generally secured by specific items of collateral, including real property, consumer assets, and business assets.

Table of Contents
PART I: ITEM 1. BUSINESS

LOAN MATURITIES

Presented in the table below are the maturities of loans (excluding residential real estate, home equity, individuals' loans for household and other personal expenditures and lease financing) outstanding as of December 31, 2012. Also presented are the amounts due after one year classified according to the sensitivity to changes in interest rates.

(Dollars in Thousands)	Maturing Within 1 Year	Maturing 1-5 Years	Maturing Over 5 Years	Total
Commercial and Industrial Loans	$403,463	$143,323	$75,793	$622,579
Agricultural Production Financing and Other Loans to Farmers	98,833	11,703	1,991	112,527
Real Estate - Construction	52,768	43,086	2,785	98,639
Real Estate - Commercial and Farm Land	512,532	536,197	217,953	1,266,682
Other Loans	27,343	16,263	2,895	46,501
Total	$1,094,939	$750,572	$301,417	$2,146,928

(Dollars in Thousands)	Maturing 1-5 Years	Maturing Over 5 Years
Loans Maturing After One Year with:		
Fixed Rate	$504,583	$285,584
Variable Rate	245,989	15,833
Total	$750,572	$301,417

NON-PERFORMING ASSETS

The table below summarizes non-performing assets and impaired loans for the years indicated:

(Dollars in Thousands)	December 31, 2012	December 31, 2011	December 31, 2010	December 31, 2009	December 31, 2008
Non-Performing Assets:					
Non-accrual loans	$53,399	$69,592	$90,591	$118,409	$87,546
Renegotiated loans	12,681	14,308	7,139	8,833	130
Non-performing loans (NPL)	66,080	83,900	97,730	127,242	87,676
Other real estate owned	13,263	16,289	20,927	14,879	18,458
Non-performing assets (NPA)	79,343	100,189	118,657	142,121	106,134
90+ days delinquent and still accruing	2,037	580	1,330	3,967	5,982
NPAs & 90+ days delinquent	$81,380	$100,769	$119,987	$146,088	$112,116
Impaired Loans	$79,179	$79,775	$116,204	$178,754	$206,126

Loans are reclassified to a non-accruing status when, in management's judgment, the collateral value and financial condition of the borrower do not justify accruing interest. Interest previously recorded, but not deemed collectible, is reversed and charged against current income. Interest income on these loans is then recognized when collected.

Renegotiated loans are loans for which concessions are granted to the borrower due to deterioration in the financial condition of the borrower resulting in the inability of the borrower to meet the original contractual terms of the loans. These concessions may include interest rate reductions, principal forgiveness, extensions of maturity date or other actions intended to minimize losses. Certain loans restructured may be excluded from restructured loan disclosures in years subsequent to the restructuring if the loans are in compliance with their modified terms. A non-accrual loan that is restructured may remain non-accrual for a period of approximately six months until the borrower can demonstrate their ability to meet the restructured terms. A borrower's performance prior to the restructuring, as well as after, will be considered in assessing whether the borrower can meet the new terms resulting in the loan being returned to accruing status in a shorter or longer period of time than the standard six months. If the borrower’s performance under the modified terms is not reasonably assured, the loan will remain non-accrual.

Interest income of $2,369,000 for the year ended December 31, 2012, was recognized on the non-accruing and renegotiated loans listed in the table above, whereas interest income of $8,365,000 would have been recognized under their original loan terms.

In years prior to 2009, the Corporation globally included all classified loans, including substandard, doubtful and loss credits in impaired loans. At December 31, 2009, management refined the definition of impaired loans to be more specific and include all non-accrual loans and renegotiated loans as well as substandard, doubtful and loss grade loans that were still accruing but deemed impaired according to guidance set forth in ASC 310. Also included in impaired loans are accruing loans that are contractually past due 90 days or more. Furthermore, at December 31, 2012, the Corporation included loans accounted for under SOP 03-3 in the impaired loan total. A loan is deemed impaired under ASC310 when, based on current information or events, it is probable that all amounts due of principal and interest according to the contractual terms of the loan agreement will not be collected. At December 31, 2012, commercial impaired loans totaled $79,179,000. A specific allowance for losses was not deemed necessary for a subset of the impaired loans totaling $67,333,000, but a specific allowance of $4,243,000 was recorded for the remaining balance of $11,846,000 and is included in the Corporation's allowance for loan losses at December 31, 2012. The average balance of the total aforementioned impaired loans for 2012 was $88,614,000.

Allowable methods for determining the amount of impairment include estimating fair value using the fair value of the collateral for collateral dependent loans. If the impaired loan is identified as collateral dependent, then the fair value method of measuring the amount of impairment is utilized. This method requires obtaining a current independent appraisal of the collateral and applying a discount factor to the value. The fair value of real estate is generally based on appraisals by qualified licensed appraisers. The appraisers typically determine the value of the real estate by utilizing an income or market valuation approach. If an appraisal is not available, the fair value may be determined by using a cash flow analysis. Fair value on other collateral such as business assets is typically ascertained by assessing, either singularly or some combination of, asset appraisals, accounts receivable aging reports, inventory listings and or customer financial statements. Both appraised values and values based on borrower's financial information are discounted as considered appropriate based on age and quality of the information and current market conditions.

In addition to the impaired loans discussed above, management has also identified loans totaling $143,991,000 as of December 31, 2012 that are deemed to be criticized, but not impaired. These loans are not included in the table above, or the impaired loan table in the footnotes to the consolidated financial statements. A criticized loan is a loan in which there are concerns as to the borrower's ability to comply with present repayment terms, whether or not those concerns rise to the level of serious doubt.

See additional information regarding loan credit quality in Note 5. LOANS AND ALLOWANCE, in the Notes to Consolidated Financial Statements included as Item 8 of this Annual Report on Form 10-K.

Table of Contents
PART I: ITEM 1. BUSINESS

SUMMARY OF LOAN LOSS EXPERIENCE

The following table summarizes the loan loss experience for the years indicated:

(Dollars in Thousands)	2012	2011	2010	2009	2008
Allowance for Loans Losses:					
Balance at January 1	$70,898	$82,977	$92,131	$49,543	$28,228
Charge Offs:					
Commercial (1)	8,311	9,818	22,832	42,147	7,475
Commercial Real Estate (2)	12,322	29,807	32,823	34,775	6,580
Consumer	1,130	1,441	2,426	3,770	3,018
Residential	5,475	7,407	9,437	8,491	5,536
Finance Leases	34		54	411	17
Total Charge Offs	27,272	48,473	67,572	89,594	22,626
Recoveries:					
Commercial (3)	1,744	8,828	6,750	5,248	1,354
Commercial Real Estate (4)	3,652	2,811	1,420	993	3,435
Consumer	695	942	938	1,015	1,002
Residential	1,113	1,176	2,827	701	1,233
Finance Leases	2	7		9	
Total Recoveries	7,206	13,764	11,935	7,966	7,024
Net Charge Offs	20,066	34,709	55,637	81,628	15,602
Provisions for Loan Losses	18,534	22,630			