FIRST MERCHANTS CORP
Form 10-Q
November 09, 2012

FORM 10-Q
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2012

OR

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

SECURITIES EXCHANGE ACT OF 1934

For the Transition Period from _______ to _______

Commission File Number 0-17071

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 Street, Muncie, IN	47305-2814
(Address of principal executive offices)	(Zip code)

(Registrant's telephone number, including area code): (765) 747-1500

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer [ ] Accelerated filer [X] Non-accelerated filer [ ] (Do not check if smaller reporting company) Smaller reporting company [ ]

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

As of October 31, 2012, there were 28,672,461 outstanding common shares of the registrant.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
CONSOLIDATED CONDENSED BALANCE SHEETS
(Dollars in thousands)

	September 30, 2012 (Unaudited)	December 31, 2011
ASSETS		
Cash and cash equivalents	$ 57,027	$ 73,312
Interest-bearing time deposits	35,324	52,851
Investment securities available for sale	551,619	518,491
Investment securities held to maturity (fair value of $396,217 and $442,469)	377,097	427,909
Mortgage loans held for sale	27,711	17,864
Loans, net of allowance for loan losses of $69,493 and $70,898	2,766,831	2,642,517
Premises and equipment	51,373	51,013
Federal Reserve and Federal Home Loan Bank stock	32,824	31,270
Interest receivable	17,519	17,723
Core deposit intangibles	8,644	9,114
Goodwill	141,375	141,357
Cash surrender value of life insurance	124,702	124,329
Other real estate owned	13,780	16,289
Tax asset, deferred and receivable	29,344	36,424
Other assets	14,998	12,613
TOTAL ASSETS	$ 4,250,168	$ 4,173,076
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 679,818	$ 646,508
Interest-bearing	2,514,933	2,488,147
Total Deposits	3,194,751	3,134,655
Borrowings:		
Federal funds purchased	57,024	
Securities sold under repurchase agreements	153,454	156,305
Federal Home Loan Bank advances	145,467	138,095
Subordinated debentures and term loans	112,169	194,974
Total Borrowings	468,114	489,374
Interest payable	1,591	2,925
Other liabilities	38,857	31,655
Total Liabilities	3,703,313	3,658,609
COMMITMENTS AND CONTINGENT LIABILITIES		
STOCKHOLDERS' EQUITY		
Preferred Stock, no-par value, $1,000 liquidation value:		
Authorized - 500,000 shares		
Senior Non-Cumulative Perpetual Preferred Stock, Series B		
Issued and outstanding - 90,782.94 shares	90,783	90,783
Cumulative Preferred Stock, $1,000 par value, $1,000 liquidation value:		
Authorized - 600 shares		
Issued and outstanding - 125 shares	125	125

Common Stock, $.125 stated value:		
Authorized - 50,000,000 shares		
Issued and outstanding - 28,672,177 and 28,559,707 shares	3,584	3,570
Additional paid-in capital	256,290	254,874
Retained earnings	198,094	168,717
Accumulated other comprehensive loss	(2,021)	(3,602)
Total Stockholders' Equity	546,855	514,467
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 4,250,168	$ 4,173,076

See notes to consolidated condensed financial statements.

CONSOLIDATED CONDENSED STATEMENTS OF INCOME
(Dollars in thousands, except per share amounts)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
INTEREST INCOME				
Loans receivable:				
Taxable	$ 38,160	$ 37,024	$ 110,660	$ 113,219
Tax exempt	118	86	358	435
Investment securities:				
Taxable	4,176	5,078	13,218	14,665
Tax exempt	2,532	2,529	7,645	7,617
Federal funds sold				3
Deposits with financial institutions	16	45	69	228
Federal Reserve and Federal Home Loan Bank stock	345	323	1,035	1,005
Total Interest Income	45,347	45,085	132,985	137,172
INTEREST EXPENSE				
Deposits	3,517	5,046	11,566	17,776
Federal funds purchased	38	16	62	22
Securities sold under repurchase agreements	211	384	703	1,148
Federal Home Loan Bank advances	492	1,089	2,123	3,067
Subordinated debentures and term loans	1,187	2,699	4,460	7,984
Total Interest Expense	5,445	9,234	18,914	29,997
NET INTEREST INCOME	39,902	35,851	114,071	107,175
Provision for loan losses	4,609	5,556	14,029	16,775
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	35,293	30,295	100,042	90,400
OTHER INCOME				
Service charges on deposit accounts	2,913	3,169	8,625	8,945
Fiduciary activities	1,986	1,881	5,907	5,846
Other customer fees	2,740	2,583	8,476	7,452
Commission income	1,618	1,528	4,770	4,440
Earnings on cash surrender value of life insurance	685	644	2,725	1,793
Net gains and fees on sales of loans	2,849	1,768	7,115	4,671
Net realized gains on sales of available for sale securities	843	861	2,134	2,149
Other-than-temporary impairment on available for sale securities				(2,780)
Portion of loss recognized in other comprehensive income before taxes				2,380
Net impairment losses recognized in earnings				(400)
Gain on FDIC modified whole bank transaction			9,124	
Other income	639	796	1,220	1,253
Total Other Income	14,273	13,230	50,096	36,149
OTHER EXPENSES				
Salaries and employee benefits	20,083	19,964	59,078	55,700
Net occupancy	2,568	2,530	7,692	7,690
Equipment	1,798	1,662	5,259	5,122

Marketing		536		534		1,542		1,352
Outside data processing fees		1,413		1,391		4,295		4,294
Printing and office supplies		287		301		848		902
Core deposit amortization		489		755		1,438		2,957
FDIC assessments		792		1,201		2,771		4,756
Other real estate owned and credit-related expenses		2,104		2,007		6,412		8,045
Other expenses		4,334		3,877		13,277		11,684
Total Other Expenses		34,404		34,222		102,612		102,502
INCOME BEFORE INCOME TAX		15,162		9,303		47,526		24,047
Income tax expense		3,926		2,561		12,714		6,356
NET INCOME		11,236		6,742		34,812		17,691
Loss on retirement of CPP preferred stock				(1,401)				(1,401)
Loss on extinguishment of trust preferred securities				(10,857)				(10,857)
Preferred stock dividends and discount accretion		(1,134)		(868)		(3,404)		(2,846)
NET INCOME (LOSS) AVAILABLE TO COMMON STOCKHOLDERS	$	10,102	$	(6,384)	$	31,408	$	2,587
Per Share Data:								
Basic Net Income (Loss) Available to Common Stockholders	$	0.35	$	(0.25)	$	1.09	$	0.10
Diluted Net Income (Loss) Available to Common Stockholders	$	0.35	$	(0.25)	$	1.09	$	0.10
Cash Dividends Paid	$	0.03	$	0.01	$	0.07	$	0.03
Average Diluted Shares Outstanding (in thousands)		28,888		26,367		28,819		26,019

See notes to consolidated condensed financial statements.

CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME
(Dollars in thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income	$ 11,236	$ 6,742	$ 34,812	$ 17,691
Other comprehensive income net of tax:				
Unrealized holding gain on securities available for sale arising during the period, net of income tax of $1,018, $4,553, $1,670, and $8,212	1,891	8,457	3,102	15,255
Unrealized loss on securities available for sale for which a portion of an other than temporary impairment has been recognized in income, net of tax of $12, $0, $43, and $831	(22)		(80)	(1,546)
Unrealized loss on cash flow hedges arising during the period, net of income tax of $131, $778, $535, and $949	(244)	(1,446)	(994)	(1,762)
Amortization of items previously recorded in accumulated other comprehensive income (loss), net of income tax of $113, $10, $506, and $29	210	(18)	940	(53)
Reclassification adjustment for gains included in net income net of income tax expense of $295, $301, $747, and $612	(549)	(560)	(1,387)	(1,137)
	1,286	6,433	1,581	10,757
Comprehensive income	$ 12,522	$ 13,175	$ 36,393	$ 28,448

The components of accumulated other comprehensive loss, net of tax, included in stockholders' equity, are as follows:

	September 30, 2012	December 31, 2011
Net unrealized gain on securities available for sale	$ 19,959	$ 18,244
Net unrealized loss on securities available for sale for which a portion of an other-than-temporary impairment has been recognized in income	(3,248)	(3,168)
Net unrealized loss on cash flow hedges	(2,834)	(1,841)
Defined benefit plans	(15,898)	(16,837)
	$ (2,021)	$ (3,602)

See notes to consolidated condensed financial statements.

CONSOLIDATED CONDENSED STATEMENT OF STOCKHOLDERS' EQUITY
(Dollars in thousands, except per share data)
(Unaudited)

	Preferred		Common Stock		Additional Paid in	Retained	Accumulated Other Comprehensive Income	
	Shares	Amount	Shares	Amount	Capital	Earnings	(Loss)	Total
Balances, December 31, 2011	90,908	$ 90,908	28,559,707	$ 3,570	$ 254,874	$ 168,717	$ (3,602)	$ 514,467
Comprehensive Income								
Net Income						34,812		34,812
Other Comprehensive Income, net of tax							1,581	1,581
Cash Dividends on Common Stock ($.07 per Share)						(2,031)		(2,031)
Cash Dividends on Preferred Stock under Small Business Lending Fund						(3,404)		(3,404)
Share-based Compensation			79,385	10	1,091			1,101
Stock Issued Under Employee Benefit Plans			34,352	4	350			354
Stock Issued Under Dividend Reinvestment and Stock Purchase Plan			11,475	1	142			143
Stock options exercised			8,750	1	66			67
Stock Redeemed			(21,492)	(2)	(233)			(235)
Balances, September 30, 2012	90,908	$ 90,908	28,672,177	$ 3,584	$ 256,290	$ 198,094	$ (2,021)	$ 546,855

See notes to consolidated condensed financial statements.

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	September 30, 2012	September 30, 2011
Cash Flow From Operating Activities:		
Net income	$ 34,812	$ 17,691
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	14,029	16,775
Depreciation and amortization	3,432	3,998
Change in deferred taxes	11,239	7,211
Share-based compensation	1,101	1,009
Mortgage loans originated for sale	(314,240)	(185,658)
Proceeds from sales of mortgage loans	304,393	194,870
Gain on acquisition	(9,124)	
Gains on sales of securities available for sale	(2,134)	(2,149)
Recognized loss on other-than-temporary-impairment		400
Change in interest receivable	732	904
Change in interest payable	(1,701)	(2,076)
Other adjustments	4,650	14,171
Net cash provided by operating activities	$ 47,189	$ 67,146
Cash Flows from Investing Activities:		
Net change in interest-bearing deposits	$ 17,527	$ 49,101
Purchases of:		
Securities available for sale	(129,297)	(133,526)
Securities held to maturity	(566)	(77,678)
Proceeds from sales of securities available for sale	43,147	54,606
Proceeds from maturities of:		
Securities available for sale	77,898	37,894
Securities held to maturity	49,073	28,120
Change in Federal Reserve and Federal Home Loan Bank stock	207	2,503
Purchase of bank owned life insurance		(25,000)
Net change in loans	(52,442)	73,520
Net cash received from acquisition	29,113	
Proceeds from the sale of other real estate owned	4,295	9,916
Other adjustments	351	6,921
Net cash provided by investing activities	$ 39,306	$ 26,377
Cash Flows from Financing Activities:		
Net change in :		
Demand and savings deposits	$ 42,994	$ (54,157)
Certificates of deposit and other time deposits	(108,807)	(150,473)
Borrowings	138,127	242,323
Repayment of borrowings	(169,988)	(168,894)
Cash dividends on common stock	(2,031)	(778)
Cash dividends on preferred stock	(3,404)	(2,527)
Stock issued in private equity placement		21,165
Stock issued under employee benefit plans	354	561
Stock issued under dividend reinvestment and stock purchase plans	143	60

Stock options exercised	67	
Stock redeemed	(235)	(127)
Cumulative preferred stock issued (SBLF)		90,783
Cumulative preferred stock redeemed (CPP)		(69,600)
Net cash used in financing activities	$ (102,780)	$ (91,664)
Net Change in Cash and Cash Equivalents	(16,285)	1,859
Cash and Cash Equivalents, January 1	73,312	58,307
Cash and Cash Equivalents, September 30	$ 57,027	$ 60,166
Additional cash flow information:		
Interest paid	$ 20,248	$ 32,073
Income tax paid (refunded)	$ 5,988	$ (2,977)
Loans transferred to other real estate owned	$ 4,364	$ 12,646
Non-cash investing activities using trade date accounting	$ 3,043	$ 2,298

See notes to consolidated condensed financial statements.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Table dollars in thousands)
(Unaudited)

NOTE 1. General

Financial Statement Preparation

The significant accounting policies followed by First Merchants Corporation (the "Corporation") and its wholly owned subsidiaries for interim financial reporting are consistent with the accounting policies followed for annual financial reporting. All adjustments, which are of a normal recurring nature and are in the opinion of management necessary for a fair statement of the results for the periods reported, have been included in the accompanying consolidated condensed financial statements.

The consolidated condensed balance sheet of the Corporation as of December 31, 2011, has been derived from the audited consolidated balance sheet of the Corporation as of that date. Certain information and note disclosures normally included in the Corporation's annual financial statements, prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted. These consolidated condensed financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Corporation's Form 10-K annual report filed with the Securities and Exchange Commission. The results of operations for the nine months ended September 30, 2012, are not necessarily indicative of the results to be expected for the year.

NOTE 2. Purchase and Assumption

Effective February 10, 2012, First Merchants Bank, National Association (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 $147.7 million in assets, including approximately $11.9 million of cash and cash equivalents, $18.9 million of marketable securities, $1.8 million in Federal Home Loan Bank stock, $113.0 million in loans and $2.1 million of premises and other assets. The Bank assumed approximately $135.7 million of liabilities, including approximately $125.7 million in customer deposits, $9.6 million of other borrowed money and $402,000 in other liabilities. These balances are book balances and do not reflect the fair value adjustments which are shown on the following table. The acquisition did not include any loss sharing agreement with the FDIC.

The bid accepted by the FDIC included no deposit premium. The assets were acquired at a discount of $29.0 million from book value. The FDIC made a payment of $17.2 million to the Bank upon the final closing date balance sheet for SCB Bank that reflected the difference between the purchase price of the assets acquired and the value of the liabilities assumed.

The Bank engaged in this transaction with the expectation that it would be immediately accretive and add a new market area with a demographic profile consistent with many of the current Indiana markets served by the Bank.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Table dollars in thousands)
(Unaudited)

NOTE 2. Purchase and Assumption continued

The transaction was accounted for under the acquisition method of accounting in accordance with the Business Combination topic of the FASB Accounting Standards Codification ("ASC 310-20 and 310-30"). The statement of net assets and liabilities acquired as of February 10, 2012, are presented below. The assets and liabilities of SCB were recorded at the respective acquisition date provisional fair values, and identifiable intangible assets were recorded at provisional fair value.

Assets			Liabilities		
Cash and due from banks (1)	$	29,113	Deposits:		
Investment securities, available for sale		18,896	Non-interest bearing	$	13,715
Federal Home Loan Bank stock		1,761	NOW accounts		14,746
Loans:			Savings and money market		25,843
Commercial		51,042	Certificate of deposit		71,605
Residential mortgage		11,181	Total Deposits		125,909
Installment		31,570			
Total Loans		93,793	Federal Home Loan Bank advances		10,286
			Other liabilities		804
Premises		1,516	Total Liabilities Assumed	$	136,999
Core deposit intangible		484			
Other assets		560	Net Gain on Acquisition	$	9,124
Total Assets Purchased	$	146,123			

(1) Includes $17,200,000 cash received from the FDIC.

In many cases, the fair values of assets acquired and liabilities assumed were determined by estimating cash flows expected to result from those assets and liabilities and discounting them at appropriate market rates. The most significant category of assets for which this procedure was used was acquired loans. The Bank acquired the $113.0 million loan portfolio at a fair value discount of $19.2 million. The performing portion of the portfolio, $86.3 million, had an estimated fair value of $76.5 million. The excess of expected cash flows above the fair value of the performing portion of loans will be accreted to interest income over the remaining lives of the loans in accordance with ASC 310-20.

Certain loans for which specific credit-related deterioration has occurred since origination are recorded at fair value which is derived from calculating the present value of the amounts expected to be collected. Income recognition on these loans is based on reasonable expectation about the timing and amount of cash flows to be collected. Many of the acquired loans deemed impaired and considered collateral dependent, with the timing of a sale of loan collateral indeterminate, remain on non-accrual status and have no accretable yield.

In accordance with ASC 310-30 (formerly Statement of Position ("SOP") 03-3 as of February 10, 2012, loans acquired during 2012 for which it was probable at acquisition that all contractually required payments would not be collected are as follows:

Preliminary estimate of contractually required principal and interest at acquisition	$	31,143
Preliminary estimate of contractual cash flows not expected to be collected (nonaccretable differences)		9,688

Preliminary estimate of expected cash flows at acquisition		21,455
Preliminary estimate of interest component of expected cash flows (accretable discount)		4,152
Preliminary estimate of fair value of acquired loans accounted for under ASC 310-30	$	17,303

Pro-forma statements were determined to be impracticable due to the nature of the transaction as certain assets were not purchased.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Table dollars in thousands)
(Unaudited)

NOTE 2. Purchase and Assumption continued

The carrying amount of these loans is included in the balance sheet amounts of loans receivable at September 30, 2012. The amounts are as follows:

	September 30, 2012
Commercial and industrial loans	$ 12,494
Agricultural production finance and other loans to farmers	1,531
Real estate loans	
Construction	92
Commercial and farmland	23,724
Residential	32,936
Individuals' loans for household and other personal expenditures	922
Tax exempt	
Lease financing	
Other loans	987
Total	$ 72,686

Accretable yield, or income expected to be collected, is as follows:

	Three Months ended September 30, 2012
Beginning balance, June 30, 2012	$ 9,048
Accretions	(2,612)
Ending balance, September 30, 2012	$ 6,436

	Nine Months ended September 30, 2012
Beginning balance, February 10, 2012	$ 9,774
Accretions	(3,338)
Ending balance, September 30, 2012	$ 6,436

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Table dollars in thousands)
(Unaudited)

NOTE 3. Investment Securities

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at September 30, 2012				
U.S. Government-sponsored agency securities	$ 4,610	$ 172		$ 4,782
State and municipal	150,281	10,761	$ 25	161,017
U.S. Government-sponsored mortgage-backed securities	370,800	13,142	30	383,912
Corporate obligations	6,008		5,806	202
Equity securities	1,706			1,706
Total available for sale	533,405	24,075	5,861	551,619
Held to maturity at September 30, 2012				
State and municipal	116,966	5,698		122,664
U.S. Government-sponsored mortgage-backed securities	260,131	13,422		273,553
Total held to maturity	377,097	19,120		396,217
Total Investment Securities	$ 910,502	$ 43,195	$ 5,861	$ 947,836

	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

The amortized cost and fair value of available for sale securities and held to maturity securities at September 30, 2012, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available for Sale		Held to Maturity	
	Amortized	Fair	Amortized	Fair

	Cost	Value	Cost	Value
Maturity Distribution at September 30, 2012:				
Due in one year or less	$ 4,802	$ 4,846	$ 2,425	$ 2,431
Due after one through five years	14,559	15,277	2,208	2,233
Due after five through ten years	48,134	51,156	55,679	57,975
Due after ten years	93,404	94,722	56,654	60,025
	160,899	166,001	116,966	122,664
U.S. Government-sponsored mortgage-backed securities	370,800	383,912	260,131	273,553
Equity securities	1,706	1,706		
Total Investment Securities	$ 533,405	$ 551,619	$ 377,097	$ 396,217

The carrying value of securities pledged as collateral, to secure public deposits and for other purposes, was $348,748,000 at September 30, 2012, and $299,478,000 at December 31, 2011.

The book value of securities sold under agreements to repurchase amounted to $148,486,000 at September 30, 2012, and $129,311,000 at December 31, 2011.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Table dollars in thousands)
(Unaudited)

NOTE 3. Investment Securities continued

Gross gains and losses on the sales and redemptions of available for sale securities, and other-than-temporary impairment ("OTTI") losses recognized for the three and nine months ended September 30, 2012 and 2011 are shown below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Sales and Redemptions of Available for Sale Securities:				
Gross gains	$ 843	$ 861	$ 2,134	$ 2,149
Gross losses				
Other-than-temporary impairment losses				$ 400

The Corporation's management has evaluated all securities with unrealized losses for OTTI as of September 30, 2012. The evaluations are based on the nature of the securities, the extent and duration of the loss and the intent and ability of the Corporation to hold these securities either to maturity or through the expected recovery period.

The current unrealized losses are primarily concentrated within trust preferred securities held by the Corporation. Such investments have an amortized cost of $6.0 million and a fair value of $171,000, 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.

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 are being used by the vendor in pricing the portfolio and how the vendor was classifying these 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.

Discount rates used in the OTTI cash flow analysis 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 LIBOR.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Table dollars in thousands)
(Unaudited)

NOTE 3. Investment Securities continued

The following table shows the Corporation's investments' 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 September 30, 2012, and December 31, 2011:

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Temporarily Impaired Investment Securities at September 30, 2012						
State and municipal	$ 3,868	$ (25)			$ 3,868	$ (25)
U.S. Government-sponsored mortgage-backed securities	6,463	(30)			6,463	(30)
Corporate obligations			$ 171	$ (5,806)	171	(5,806)
Total Temporarily Impaired Investment Securities	$ 10,331	$ (55)	$ 171	$ (5,806)	$ 10,502	$ (5,861)

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Temporarily Impaired Investment Securities at December 31, 2011						
State and municipal						
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)

Certain investments in debt and equity securities are reported in the financial statements at an amount less than their historical cost as indicated in the table below.

	September 30, 2012	December 31, 2011
Investments reported at less than historical cost:		
Historical cost	$ 16,364	$ 11,925
Fair value	$ 10,502	$ 6,339

Percent of the Corporation's available for sale and held to maturity portfolio	1.1%	0.7%

Except as discussed below, management believes the declines in fair value for these securities are temporary. Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the OTTI is identified.

U.S. Government-Sponsored Mortgage-Backed Securities

The unrealized losses on the Corporation's investment in U.S. Government-sponsored mortgage-backed securities were a result of changes in interest rates. The Corporation expects to recover the amortized cost basis over the term of the securities as the decline in market value is attributable to changes in interest rates and not credit quality. The Corporation does not intend to sell the investment and it is not more likely than not that the Corporation will be required to sell the investment before recovery of its new, lower amortized cost basis, which may be maturity. The Corporation does not consider the investment securities to be other-than-temporarily impaired at September 30, 2012.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Table dollars in thousands)
(Unaudited)

NOTE 3. Investment Securities continued

State and Municipal

The unrealized losses on the Corporation's investments in securities of state and political subdivisions were caused by changes in interest rates. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. The Corporation does not intend to sell the investment and it is not more likely than not that the Corporation will be required to sell the investment before recovery of its new, lower amortized cost basis, which may be maturity. The Corporation does not consider the investment securities to be other-than-temporarily impaired at September 30, 2012.

Corporate Obligations

The Corporation's unrealized losses on Corporate Obligations were due to the decline in value related to the pooled trust preferred securities, and is attributable to temporary illiquidity and the financial crisis affecting these markets, coupled with the potential credit loss resulting from the adverse change in expected cash flows. Due to the illiquidity in the market, it is unlikely that the Corporation would be able to recover its investment in these securities if the Corporation sold the securities at this time. Management has analyzed the cash flow characteristics of the securities and this analysis included utilizing the most recent trustee reports and any other relevant market information, including announcements of deferrals or defaults of trust preferred securities. The Corporation compared expected discounted cash flows, based on performance indicators of the underlying assets in the security, to the carrying value of the investment to determine if OTTI existed. The Corporation does not consider the remainder of the investment securities, which are classified as Level 3 inputs in the fair value hierarchy, to be other-than-temporarily impaired at September 30, 2012. The Corporation does not intend to sell the investment, and it is not more likely than not that the Corporation will be required to sell the investment before recovery of its new, lower amortized cost basis, which may be maturity.

Credit Losses Recognized on Investments

Certain debt securities have experienced fair value deterioration due to credit losses and other market factors. The following table provides information about debt securities for which only a credit loss was recognized in income and other losses were recorded in other comprehensive income.

	Accumulated Credit Losses in 2012	Accumulated Credit Losses in 2011
Credit losses on debt securities held:		
Balance, January 1	$ 11,355	$ 10,955
Additions related to other-than-temporary losses not previously recognized		400
Balance, September 30	$ 11,355	$ 11,355

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Table dollars in thousands)
(Unaudited)

NOTE 4. Loans and Allowance

The Corporation's primary lending focus is small business and middle market commercial, residential real estate, auto and small consumer lending, which results in portfolio diversification. The following tables show the composition in the loan portfolio, loan grades and the allowance for loan losses excluding loans held for sale. Residential real estate loans held for sale at September 30, 2012, and December 31, 2011, were $27,711,000 and $17,864,000, respectively.

Effective February 10, 2012, the Bank assumed $113.0 million in loans as part of the Purchase and Assumption Agreement discussed in NOTE 2. PURCHASE AND ASSUMPTION included in the Notes to Consolidated Condensed Financial Statements of this Form 10-Q. This loan portfolio was acquired at a fair value discount of $19.2 million.

The following table shows the composition of the Corporation's loan portfolio by loan class for the periods indicated:

	September 30, 2012	December 31, 2011
Loans:		
Commercial and industrial loans	$ 592,517	$ 532,523
Agricultural production financing and other loans to farmers	107,166	104,526
Real estate loans:		
Construction	93,610	81,780
Commercial and farm land	1,241,054	1,194,230
Residential	475,272	481,493
Home Equity	204,888	191,631
Individual's loans for household and other personal expenditures	77,171	84,172
Lease financing receivables, net of unearned income	2,970	3,555
Other loans	41,676	39,505
	2,836,324	2,713,415
Allowance for loan losses	(69,493)	(70,898)
Total Loans	$ 2,766,831	$ 2,642,517

The Corporation maintains an allowance for loan losses to cover probable credit losses identified during its loan review process. The allowance is increased by the provision for loan losses and decreased by charge offs less recoveries. All charge offs are approved by the Bank's senior loan officers or loan committees, depending on the amount of the charge off. The Bank charges off loans when a determination is made that all or a portion of a loan is uncollectible. The allowance for loan losses is maintained through the provision for loan losses, which is a charge against earnings.

The amount provided for loan losses in a given period may be greater than or less than net loan losses, and is based on management's judgment as to the appropriate level of the allowance for loan losses. The determination of the provision amount in a given period is based on management's continuing review and evaluation of the loan portfolio, including an internally administered loan "watch" list and an independent loan review. The evaluation takes into consideration identified credit problems, the possibility of losses inherent in the loan portfolio that are not specifically identified and management’s judgment as to the impact of current economic conditions on the portfolio.

Management believes that the allowance for loan losses is adequate to cover probable incurred losses inherent in the loan portfolio at September 30, 2012. The process for determining the adequacy of the allowance for loan losses is critical to the Corporation’s financial results. It requires management to make difficult, subjective and complex judgments, to estimate the effect of uncertain matters. The allowance for loan losses considers current factors, including economic conditions and ongoing internal and external examination processes, and will increase or decrease as deemed necessary to ensure the allowance for loan losses remains adequate. In addition, the allowance as a percentage of charge offs and nonperforming loans will change at different points in time based on credit performance, loan mix and collateral values.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Table dollars in thousands)
(Unaudited)

NOTE 4. Loans and Allowance continued

The historical loss allocation for loans not deemed impaired according to ASC 310 is the product of the volume of loans within the non-impaired criticized and non-criticized risk grade classifications, each segmented by call code, and the historical loss factor for each respective classification and call code segment. The historical loss factors are based upon actual loss experience within each risk and call code classification. The historical look back period for non-criticized loans looks to the most recent rolling-four-quarter average and aligns with the look back period for non-impaired criticized loans. Each of the rolling four quarter periods used to obtain the average, include all charge offs for the previous twelve-month period, therefore the historical look back period includes seven quarters. The resulting allocation is reflective of current conditions. Criticized loans are grouped based on the risk grade assigned to the loan. Loans with a special mention grade are assigned a loss factor, and loans with a classified grade but not impaired are assigned a separate loss factor. The loss factor computation for this allocation includes a segmented historical loss migration analysis of criticized risk grades to charge off.

In addition to the specific reserves and historical loss components of the allowance, consideration is given to various environmental factors to help ensure that losses inherent in the portfolio are reflected in the allowance for loan losses. The environmental component adjusts the historical loss allocations for commercial and consumer loans to reflect relevant current conditions that, in management's opinion, have an impact on loss recognition. Environmental factors that management reviews in the analysis include: national and local economic trends and conditions; trends in growth in the loan portfolio and growth in higher risk areas; levels of, and trends in, delinquencies and non-accruals; experience and depth of lending management and staff; adequacy of, and adherence to, lending policies and procedures including those for underwriting; industry concentrations of credit; and adequacy of risk identification systems and controls through the internal loan review and internal audit processes.

The risk characteristics of the Corporation's material portfolio segments are as follows:

Commercial

Commercial loans are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial real estate

These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. Management monitors and evaluates commercial real estate loans based on collateral and risk grade criteria. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans.

Residential and Consumer

With respect to residential loans that are secured by 1-4 family residences and are generally owner occupied, the Corporation generally establishes a maximum loan-to-value ratio and requires private mortgage insurance if that ratio is exceeded. Home equity loans are typically secured by a subordinate interest in 1-4 family residences, and consumer loans are secured by consumer assets such as automobiles or recreational vehicles. Some consumer loans are unsecured such as small installment loans and certain lines of credit. Repayment of these loans is primarily dependent on the personal income and credit rating of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Repayment can also be impacted by changes in property values on residential properties. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Table dollars in thousands)
(Unaudited)

NOTE 4. Loans and Allowance continued

The following tables summarize changes in the allowance for loan losses by loan segment for the three and nine months ended September 30, 2012, and September 30, 2011:

Three Months Ended September 30, 2012	Commercial	Real Estate Commercial	Consumer	Residential	Finance Leases	Total
Allowance for loan losses:						
Balances, July 1	$ 17,791	$ 35,133	$ 2,431	$ 14,788		$ 70,143
Provision for losses	5,431	(879)	147	(90)		4,609
Recoveries on loans	526	1,598	219	174		2,517
Loans charged off	(1,424)	(4,439)	(168)	(1,745)		(7,776)
Balances, September 30, 2012	$ 22,324	$ 31,413	$ 2,629	$ 13,127		$ 69,493

Nine Months Ended September 30, 2012	Commercial	Real Estate Commercial	Consumer	Residential	Finance Leases	Total
Allowance for loan losses:						
Balances, January 1	$ 17,731	$ 37,919	$ 2,902	$ 12,343	$ 3	$ 70,898
Provision for losses	10,333	149	(14)	3,565	(4)	14,029
Recoveries on loans	1,193	3,462	595	968	1	6,219
Loans charged off	(6,933)	(10,117)	(854)	(3,749)		(21,653)
Balances, September 30, 2012	$ 22,324	$ 31,413	$ 2,629	$ 13,127		$ 69,493

Three Months Ended September 30, 2011	Commercial	Real Estate Commercial	Consumer	Residential	Finance Leases	Total
Allowance for loan losses:						
Balances, April 1	$ 23,715	$ 38,668	$ 2,859	$ 11,877	$ 14	$ 77,133
Provision for losses	(903)	3,042	281	3,142	(6)	5,556
Recoveries on loans	1,176	378	163	237	1	1,955
Loans charged off	(4,344)	(5,003)	(266)	(1,957)		(11,570)
Balances, September 30, 2011	$ 19,644	$ 37,085	$ 3,037	$ 13,299	$ 9	$ 73,074

Nine Months Ended September 30, 2011	Commercial	Real Estate Commercial	Consumer	Residential	Finance Leases	Total
Allowance for loan losses:						

Balances, January 1	$	32,508	$	36,341	$	3,622	$	10,408	$	98	$	82,977
Provision for losses		(14,778)		24,232		(187)		7,601		(93)		16,775
Recoveries on loans		8,174		1,244		781		934		4		11,137
Loans charged off		(6,260)		(24,732)		(1,179)		(5,644)				(37,815)
Balances, September 30, 2011	$	19,644	$	37,085	$	3,037	$	13,299	$	9	$	73,074

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Table dollars in thousands)
(Unaudited)

NOTE 4. Loans and Allowance continued

The following table shows the Corporation's allowance for credit losses and loan portfolio by loan segment for the periods indicated:

	September 30, 2012					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance Balances:						
Individually evaluated for impairment	$ 1,775	$ 4,157		$ 319		$ 6,251
Collectively evaluated for impairment	20,549	27,256	$ 2,629	12,808		63,242
Total Allowance for Loan Losses	$ 22,324	$ 31,413	$ 2,629	$ 13,127		$ 69,493
Loan Balances:						
Individually evaluated for impairment	$ 16,286	$ 54,773		$ 8,906		$ 79,965
Collectively evaluated for impairment	725,073	1,279,891	$ 77,171	671,254	$ 2,970	2,756,359
Total Loans	$ 741,359	$ 1,334,664	$ 77,171	$ 680,160	$ 2,970	$ 2,836,324

	December 31, 2011					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance Balances:						
Individually evaluated for impairment	$ 4,701	$ 2,504		$ 733		$ 7,938
Collectively evaluated for impairment	13,030	35,415	$ 2,902	11,610	$ 3	62,960
Total Allowance for Loan Losses	$ 17,731	$ 37,919	$ 2,902	$ 12,343	$ 3	$ 70,898
Loan Balances:						
Individually evaluated for impairment	$ 18,793	$ 51,980		$ 12,546		$ 83,319
Collectively evaluated for impairment	657,760	1,224,031	$ 84,172	660,578	$ 3,555	2,630,096
Total Loans	$ 676,553	$ 1,276,011	$ 84,172	$ 673,124	$ 3,555	$ 2,713,415

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. Payments subsequently received on nonaccrual loans are applied to principal. A loan is returned to accrual status when principal and interest are no longer past due and collectability is probable, typically after a minimum of six consecutive months of performance. Payments received on impaired accruing or delinquent loans are applied to interest income as accrued.

The following table summarizes the Corporation's non-accrual loans by loan class for the periods indicated:

	September 30, 2012	December 31, 2011
Commercial and Industrial	$ 12,507	$ 12,246
Real Estate Loans:		
Construction	5,440	8,990
Commercial and farm land	24,501	31,093
Residential	12,444	14,805
Home Equity	1,761	1,896
Individuals loans for household and other personal expenditures	3	1
Lease financing receivables, net of unearned income	337	
Other Loans	6	561
Total	$ 56,999	$ 69,592

Commercial impaired loans include all non-accrual loans, loans accounted for under SOP-03-3 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. A loan is deemed impaired 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.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Table dollars in thousands)
(Unaudited)

NOTE 4. Loans and Allowance continued

Impaired loans are measured by the present value of expected future cash flows or the fair value of the collateral of the loans, if collateral dependent. The fair value for impaired loans is measured based on the value of the collateral securing those loans and is determined using several methods. 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 valued by using financial information such as financial statements and aging reports provided by the borrower and is discounted as considered appropriate.

The following table shows the composition of the Corporation's commercial impaired loans by loan class as of September 30, 2012:

	September 30, 2012			Three Months Ended September 30, 2012		Nine Months Ended September 30, 2012	
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Impaired loans with no related allowance:							
Commercial and industrial	$ 27,363	$ 10,743		$ 9,994	$ 26	$ 11,615	$ 68
Agriculture production financing and other loans to farmers	300	300		300		300	
Real Estate Loans:							
Construction	10,743	6,378		6,658	17	7,665	47
Commercial and farm land	52,953	35,606		31,081	250	33,459	706
Residential	9,307	6,716		6,936	20	7,342	54
Home equity	3,901	711		713	3	727	10
Other loans	87	16		17		18	1
Total	$ 104,654	$ 60,470		$ 55,699	$ 316	$ 61,126	$ 886
Impaired loans with related allowance:							
Commercial and industrial	$ 5,570	$ 5,227	$ 1,775				