

GERMAN AMERICAN BANCORP, INC.
Form 10-Q
November 09, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarterly Period Ended September 30, 2006

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 0-11244

German American Bancorp, Inc
(Exact name of registrant as specified in its charter)

Indiana
(State or other jurisdiction of
incorporation or organization)

35-1547518
(I.R.S. Employer
Identification No.)

711 Main Street, Jasper, Indiana 47546
(Address of Principal Executive Offices and Zip Code)

Registrant's telephone number, including area code: (812) 482-1314

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 NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer:

Large Accelerated filer

Accelerated filer

Non-accelerated filer

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

YES NO

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class | Outstanding at November 1, 2006 |
|----------------------------|---------------------------------|
| Common Stock, no par value | 11,009,187 |

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CAUTION REGARDING FORWARD-LOOKING STATEMENTS AND ASSOCIATED RISKS

Information included in or incorporated by reference in this Quarterly Report on Form 10-Q, our other filings with the Securities and Exchange Commission (the “SEC”) and our press releases or other public statements, contains or may contain “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Please refer to a discussion of our forward-looking statements and associated risks in Item 2 of Part I of this Report (“Management’s Discussion and Analysis of Financial Condition and Results of Operations”) at the conclusion of that Item 2 under the heading “Forward-Looking Statements and Associated Risks.”

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PART I. FINANCIAL INFORMATION**Item 1. Financial Statements**

GERMAN AMERICAN BANCORP, INC.
CONSOLIDATED BALANCE SHEETS
(unaudited, dollars in thousands except per share data)

| | September 30, 2006 | December 31, 2005 |
|--|-----------------------|----------------------|
| ASSETS | | |
| Cash and Due from Banks | \$ 27,889 | \$ 27,644 |
| Federal Funds Sold and Other Short-term Investments | 5,188 | 5,287 |
| Cash and Cash Equivalents | 33,077 | 32,931 |
| Interest-bearing Time Deposits with Banks | 200 | --- |
| Securities Available-for-Sale, at Fair Value | 204,185 | 181,150 |
| Securities Held-to-Maturity, at Cost (Fair value of \$6,207 and \$8,811 on September 30, 2006 and December 31, 2005, respectively) | 6,135 | 8,684 |
| Loans Held-for-Sale | 2,800 | 1,901 |
| Total Loans | 740,787 | 653,074 |
| Less: Unearned Income | (1,864) | (1,118) |
| Allowance for Loan Losses | (9,111) | (9,265) |
| Loans, Net | 729,812 | 642,691 |
| Stock in FHLB of Indianapolis and Other Restricted Stock, at Cost | 11,942 | 14,095 |
| Premises, Furniture and Equipment, Net | 23,207 | 20,233 |
| Other Real Estate | 1,082 | 506 |
| Goodwill | 9,372 | 3,813 |
| Intangible Assets | 3,184 | 2,388 |
| Company Owned Life Insurance | 21,374 | 19,067 |
| Accrued Interest Receivable and Other Assets | 14,351 | 19,008 |
| TOTAL ASSETS | \$ 1,060,721 | \$ 946,467 |
| LIABILITIES | | |
| Non-interest-bearing Demand Deposits | \$ 129,536 | \$ 130,383 |
| Interest-bearing Demand, Savings, and Money Market Accounts | 301,257 | 307,664 |
| Time Deposits | 393,524 | 308,774 |
| Total Deposits | 824,317 | 746,821 |
| FHLB Advances and Other Borrowings | 132,464 | 105,394 |
| Accrued Interest Payable and Other Liabilities | 12,931 | 11,997 |
| TOTAL LIABILITIES | 969,712 | 864,212 |
| SHAREHOLDERS' EQUITY | | |
| Preferred Stock, \$10 par value; 500,000 shares authorized, no shares issued | --- | --- |
| Common Stock, no par value, \$1 stated value; | | |

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| | | |
|---|--------------|------------|
| 20,000,000 shares authorized | 11,009 | 10,643 |
| Additional Paid-in Capital | 68,165 | 63,784 |
| Retained Earnings | 12,553 | 9,391 |
| Accumulated Other Comprehensive Loss | (718) | (1,563) |
| TOTAL SHAREHOLDERS' EQUITY | 91,009 | 82,255 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$ 1,060,721 | \$ 946,467 |
| End of period shares issued and outstanding | 11,009,187 | 10,643,514 |

See accompanying notes to consolidated financial statements.

GERMAN AMERICAN BANCORP, INC.
CONSOLIDATED STATEMENTS OF INCOME
AND COMPREHENSIVE INCOME
(unaudited, dollars in thousands except per share data)

| | Three Months Ended | |
|---|---------------------------|-----------------|
| | September 30, | |
| | 2006 | 2005 |
| INTEREST INCOME | | |
| Interest and Fees on Loans | \$ 13,799 | \$ 10,514 |
| Interest on Federal Funds Sold and Other Short-term Investments | 105 | 55 |
| Interest and Dividends on Securities: | | |
| Taxable | 1,998 | 1,484 |
| Non-taxable | 472 | 523 |
| TOTAL INTEREST INCOME | 16,374 | 12,576 |
| INTEREST EXPENSE | | |
| Interest on Deposits | 5,586 | 3,427 |
| Interest on FHLB Advances and Other Borrowings | 1,679 | 1,168 |
| TOTAL INTEREST EXPENSE | 7,265 | 4,595 |
| NET INTEREST INCOME | 9,109 | 7,981 |
| Provision for Loan Losses | 290 | 552 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 8,819 | 7,429 |
| NON-INTEREST INCOME | | |
| Trust and Investment Product Fees | 564 | 514 |
| Service Charges on Deposit Accounts | 1,101 | 1,009 |
| Insurance Revenues | 1,116 | 1,096 |
| Other Operating Income | 523 | 635 |
| Gain on Sales of Loans and Related Assets | 83 | 234 |
| Gain / (Loss) on Sales of Securities | 951 | --- |
| TOTAL NON-INTEREST INCOME | 4,338 | 3,488 |
| NON-INTEREST EXPENSE | | |
| Salaries and Employee Benefits | 5,403 | 4,465 |
| Occupancy Expense | 700 | 589 |
| Furniture and Equipment Expense | 581 | 474 |
| Data Processing Fees | 451 | 309 |
| Professional Fees | 541 | 335 |
| Advertising and Promotions | 201 | 171 |
| Supplies | 162 | 129 |
| Other Operating Expenses | 1,192 | 1,053 |
| TOTAL NON-INTEREST EXPENSE | 9,231 | 7,525 |
| Income before Income Taxes | 3,926 | 3,392 |
| Income Tax Expense | 1,194 | 921 |
| NET INCOME | \$ 2,732 | \$ 2,471 |

| | | | | |
|---|----|-------|----|-------|
| COMPREHENSIVE INCOME | \$ | 3,850 | \$ | 2,289 |
| Earnings Per Share and Diluted Earnings Per Share | \$ | 0.25 | \$ | 0.23 |
| Dividends Per Share | \$ | 0.14 | \$ | 0.14 |

See accompanying notes to consolidated financial statements.

GERMAN AMERICAN BANCORP, INC.
CONSOLIDATED STATEMENTS OF INCOME
AND COMPREHENSIVE INCOME
(unaudited, dollars in thousands except per share data)

| | Nine Months Ended September 30, | |
|---|------------------------------------|---------------|
| | 2006 | 2005 |
| INTEREST INCOME | | |
| Interest and Fees on Loans | \$ 38,994 | \$ 30,502 |
| Interest on Federal Funds Sold and Other Short-term Investments | 367 | 194 |
| Interest and Dividends on Securities: | | |
| Taxable | 5,668 | 4,389 |
| Non-taxable | 1,470 | 1,667 |
| TOTAL INTEREST INCOME | 46,499 | 36,752 |
| INTEREST EXPENSE | | |
| Interest on Deposits | 15,136 | 9,398 |
| Interest on FHLB Advances and Other Borrowings | 4,480 | 3,399 |
| TOTAL INTEREST EXPENSE | 19,616 | 12,797 |
| NET INTEREST INCOME | 26,883 | 23,955 |
| Provision for Loan Losses | 634 | 1,725 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 26,249 | 22,230 |
| NON-INTEREST INCOME | | |
| Trust and Investment Product Fees | 1,690 | 1,586 |
| Service Charges on Deposit Accounts | 2,976 | 2,776 |
| Insurance Revenues | 3,646 | 3,562 |
| Other Operating Income | 1,747 | 2,063 |
| Gain on Sales of Loans and Related Assets | 750 | 699 |
| Gain / (Loss) on Sales of Securities | 951 | --- |
| TOTAL NON-INTEREST INCOME | 11,760 | 10,686 |
| NON-INTEREST EXPENSE | | |
| Salaries and Employee Benefits | 15,954 | 13,592 |
| Occupancy Expense | 2,034 | 1,798 |
| Furniture and Equipment Expense | 1,667 | 1,489 |
| Data Processing Fees | 1,269 | 946 |
| Professional Fees | 1,423 | 1,246 |
| Advertising and Promotions | 612 | 492 |
| Supplies | 428 | 360 |
| Other Operating Expenses | 3,661 | 3,248 |
| TOTAL NON-INTEREST EXPENSE | 27,048 | 23,171 |
| Income before Income Taxes | 10,961 | 9,745 |
| Income Tax Expense | 3,178 | 2,455 |

| | | | | |
|---|----|-------|----|-------|
| NET INCOME | \$ | 7,783 | \$ | 7,290 |
| COMPREHENSIVE INCOME | \$ | 8,628 | \$ | 6,575 |
| Earnings Per Share and Diluted Earnings Per Share | \$ | 0.71 | \$ | 0.67 |
| Dividends Per Share | \$ | 0.42 | \$ | 0.42 |

See accompanying notes to consolidated financial statements.

GERMAN AMERICAN BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, dollars in thousands)

| | Nine Months Ended | |
|--|--------------------------|--------------|
| | September 30, | |
| | 2006 | 2005 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net Income | \$ 7,783 | \$ 7,290 |
| Adjustments to Reconcile Net Income to Net Cash from Operating Activities: | | |
| Net Amortization on Securities | (82) | 458 |
| Depreciation and Amortization | 2,043 | 1,889 |
| Amortization and Impairment of Mortgage Servicing Rights | 271 | 193 |
| Loans Originated for Sale | (43,203) | (47,503) |
| Proceeds from Sales of Loans Held-for-Sale | 42,542 | 48,009 |
| Loss on Investment in Limited Partnership | 164 | 52 |
| Provision for Loan Losses | 634 | 1,725 |
| Gain on Sale of Loans and Mortgage Servicing Rights, Net | (749) | (676) |
| (Gain) on Securities, Net | (951) | --- |
| Loss / (Gain) on Sale of Other Real Estate and Repossessed Assets | 1 | (23) |
| (Gain) on Disposition and Impairment of Premises and Equipment | (13) | (311) |
| FHLB Stock Dividends | --- | (287) |
| Increase in Cash Surrender Value of Company Owned Life Insurance | (529) | (369) |
| Equity Based Compensation | 233 | --- |
| Change in Assets and Liabilities: | | |
| Interest Receivable and Other Assets | 1,271 | (1,572) |
| Interest Payable and Other Liabilities | 16 | (1,896) |
| Net Cash from Operating Activities | 9,431 | 6,979 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Proceeds from Maturities of Securities Available-for-Sale | 34,327 | 40,241 |
| Proceeds from Sales of Securities Available-for-Sale | 13,001 | --- |
| Purchase of Securities Available-for-Sale | (62,006) | (40,231) |
| Proceeds from Maturities of Securities Held-to-Maturity | 2,558 | 4,012 |
| Proceeds from Redemption of Federal Home Loan Bank Stock | 2,541 | --- |
| Purchase of Loans | (16,474) | (7,309) |
| Proceeds from Sales of Loans | 16,535 | 8,896 |
| Loans Made to Customers, Net of Payments Received | (41,901) | 782 |
| Proceeds from Sales of Mortgage Servicing Rights | 3,554 | --- |
| Proceeds from Sales of Other Real Estate | 689 | 520 |
| Property and Equipment Expenditures | (2,834) | (1,359) |
| Proceeds from the Sale of Property and Equipment | 291 | 445 |
| Acquire Banking Entities | (4,111) | --- |
| Net Cash from Investing Activities | (53,830) | 5,997 |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Change in Deposits | 30,053 | (38,735) |
| Change in Short-term Borrowings | 18,896 | 19,125 |

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| | | |
|--|---------------|-----------------|
| Advances of Long-term Debt | 6,500 | 17,500 |
| Repayments of Long-term Debt | (6,196) | (20,956) |
| Issuance of Common Stock | 18 | 47 |
| Purchase / Retire Common Stock | --- | (1,261) |
| Employee Stock Purchase Plan | (105) | (63) |
| Dividends Paid | (4,621) | (4,556) |
| Net Cash from Financing Activities | 44,545 | (28,899) |
| Net Change in Cash and Cash Equivalents | 146 | (15,923) |
| Cash and Cash Equivalents at Beginning of Year | 32,931 | 47,666 |
| Cash and Cash Equivalents at End of Period | \$ 33,077 | \$ 31,743 |

See accompanying notes to consolidated financial statements.

GERMAN AMERICAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2006
(unaudited, dollars in thousands except per share data)

Note 1 - Basis of Presentation

German American Bancorp, Inc. operates primarily in the banking industry. The accounting and reporting policies of German American Bancorp, Inc. and its subsidiaries conform to U.S. generally accepted accounting principles. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. All adjustments which are, in the opinion of management, necessary for a fair presentation of the results for the periods reported have been included in the accompanying unaudited consolidated financial statements, and all such adjustments are of a normal recurring nature. It is suggested that these consolidated financial statements and notes be read in conjunction with the financial statements and notes thereto in the German American Bancorp, Inc. December 31, 2005 Annual Report on Form 10-K.

Note 2 - Per Share Data

The computations of Earnings per Share and Diluted Earnings per Share are as follows:

| | Three Months Ended | |
|---|---------------------------|-------------|
| | September 30, | |
| Earnings per Share: | 2006 | 2005 |
| Net Income | \$ 2,732 | \$ 2,471 |
| Weighted Average Shares Outstanding | 10,994,686 | 10,826,729 |
| Earnings per Share: | \$ 0.25 | \$ 0.23 |
| Diluted Earnings per Share: | | |
| Net Income | \$ 2,732 | \$ 2,471 |
| Weighted Average Shares Outstanding | 10,994,686 | 10,826,729 |
| Potentially Dilutive Shares, Net | 13,416 | 5,957 |
| Diluted Weighted Average Shares Outstanding | 11,008,102 | 10,832,686 |
| Diluted Earnings per Share | \$ 0.25 | \$ 0.23 |

Stock options for 332,142 and 352,793 shares of common stock were not considered in computing diluted earnings per share for the three months ended September 30, 2006 and 2005, respectively because they were anti-dilutive.

The computations of Earnings per Share and Diluted Earnings per Share are as follows:

| | Nine Months Ended | |
|-------------------------------------|--------------------------|-------------|
| | September 30, | |
| Earnings per Share: | 2006 | 2005 |
| Net Income | \$ 7,783 | \$ 7,290 |
| Weighted Average Shares Outstanding | 10,993,944 | 10,851,022 |

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| | | | | |
|---|----|------------|----|------------|
| Earnings per Share: | \$ | 0.71 | \$ | 0.67 |
| Diluted Earnings per Share: | | | | |
| Net Income | \$ | 7,783 | \$ | 7,290 |
| Weighted Average Shares Outstanding | | 10,993,944 | | 10,851,022 |
| Potentially Dilutive Shares, Net | | 8,735 | | 6,869 |
| Diluted Weighted Average Shares Outstanding | | 11,002,679 | | 10,857,891 |
| Diluted Earnings per Share | \$ | 0.71 | \$ | 0.67 |

Stock options for 343,142 and 338,755 shares of common stock were not considered in computing diluted earnings per share for the nine months ended September 30, 2006 and 2005, respectively because they were anti-dilutive.

GERMAN AMERICAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2006
(unaudited, dollars in thousands except per share data)

Note 3 - Securities

The fair values of Securities Available-for-Sale are as follows:

| | September 30, 2006 | December 31, 2005 |
|---|-------------------------------|------------------------------|
| U.S. Treasury Securities and Obligations of U.S. Government Corporations and Agencies | \$ 43,153 | \$ 13,492 |
| Obligations of State and Political Subdivisions | 21,826 | 23,527 |
| Asset-/Mortgage-backed Securities | 131,904 | 125,844 |
| Corporate Securities | --- | 500 |
| Equity Securities | 7,302 | 17,787 |
| Total | \$ 204,185 | \$ 181,150 |

As of September 30, 2006, net unrealized losses on the total securities available-for-sale portfolio totaled approximately \$735. As of December 31, 2005, net unrealized losses on the total securities available-for-sale portfolio totaled approximately \$2,008.

Securities are written down to fair value when a decline in fair value is not considered temporary. In estimating other-than-temporary losses, management considers the length of time and extent that fair value has been less than cost, the financial condition and near term prospects of the issuer, and the Company's ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in fair value. The Company had the intent and ability to hold these securities for the foreseeable future, and the decline in fair value was largely due to changes in market interest rates, therefore, the Company does not consider these securities to be other-than-temporarily impaired.

The total carrying values and fair values of Securities Held-to-Maturity are as follows:

| | Carrying Value | Fair Value |
|---|---------------------------|-----------------------|
| September 30, 2006: | | |
| Obligations of State and Political Subdivisions | \$ 6,135 | \$ 6,207 |
| December 31, 2005: | | |
| Obligations of State and Political Subdivisions | \$ 8,684 | \$ 8,811 |

Note 4 - Loans

Total loans, as presented on the balance sheet, are comprised of the following classifications:

September 30, December 31,

| | 2006 | 2005 |
|---------------------------------|-------------|-------------|
| Commercial and Industrial Loans | \$ 388,556 | \$ 319,241 |
| Residential Mortgage Loans | 114,463 | 102,891 |
| Consumer Loans | 132,932 | 129,587 |
| Agricultural Loans | 104,836 | 101,355 |
| Total Loans | \$ 740,787 | \$ 653,074 |
| Less: Unearned Income | (1,864) | (1,118) |
| Allowance for Loan Losses | (9,111) | (9,265) |
| Loans, Net | \$ 729,812 | \$ 642,691 |

GERMAN AMERICAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2006
(unaudited, dollars in thousands except per share data)

Note 5 - Allowance for Loan Losses

A summary of the activity in the allowance for loan losses follows:

| | September 30, 2006 | September 30, 2005 |
|--------------------------------------|-----------------------|-----------------------|
| Balance at January 1 | \$ 9,265 | \$ 8,801 |
| Allowance of Acquired Affiliate | 484 | --- |
| Provision for Loan Losses | 634 | 1,725 |
| Recoveries of Prior Loan Losses | 284 | 311 |
| Loan Losses Charged to the Allowance | (1,556) | (1,467) |
| Balance at September 30 | \$ 9,111 | \$ 9,370 |

Note 6 - Segment Information

The Company's operations include three primary segments: core banking, trust and investment advisory services, and insurance operations. The core banking segment involves attracting deposits from the general public and using such funds to originate consumer, commercial, commercial real estate, and residential mortgage loans, primarily in the Company's local markets. The core banking segment also involves the sale of residential mortgage loans in the secondary market and the operation of a title insurance company. During the second quarter of 2006, the Company sold its mortgage loan servicing rights portfolio and commenced selling all secondary market residential mortgage loans on a servicing released basis. The trust and investment advisory services segment involves providing trust, investment advisory, and brokerage services to customers. The insurance segment offers a full range of personal and corporate property and casualty insurance products, primarily in the affiliate banks' local markets.

The core banking segment is comprised by the Company's banking subsidiary, German American Bancorp, which operates through six community banking affiliates with 29 retail banking offices. Net interest income from loans and investments funded by deposits and borrowings is the primary revenue for the core-banking segment. The trust and investment advisory services segment's revenues are comprised primarily of fees generated by German American Financial Advisors & Trust Company ("GAFA"). These fees are derived by providing trust, investment advisory, and brokerage services to its customers. The insurance segment consists of German American Insurance, Inc., which provides a full line of personal and corporate insurance products as agent under five distinctive insurance agency names from five offices; and German American Reinsurance Company, Ltd. ("GARC"), which reinsures credit insurance products sold by the Company's affiliate banks. Commissions derived from the sale of insurance products are the primary source of revenue for the insurance segment.

The following segment financial information has been derived from the internal financial statements of German American Bancorp, Inc., which are used by management to monitor and manage the financial performance of the Company. The accounting policies of the three segments are the same as those of the Company. The evaluation process for segments does not include holding company income and expense. Holding company amounts are the primary differences between segment amounts and consolidated totals, and are reflected in the Holding Company and

Other column below, along with amounts to eliminate transactions between segments.

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GERMAN AMERICAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2006
(unaudited, dollars in thousands except per share data)

Note 6 - Segment Information (continued)**Three Months Ended
September 30, 2006**

| | Core Banking | Trust and Investment Advisory Services | Insurance | Holding Company and Other | Consolidated Totals |
|--|-------------------------|---|------------------|--|--------------------------------|
| Net Interest Income | \$ 9,411 | \$ 26 | \$ 31 | \$ (359) | \$ 9,109 |
| Gain on Sales of Loans and Related Assets | 83 | --- | --- | --- | 83 |
| Net Gain / (Loss) on Securities | 951 | --- | --- | --- | 951 |
| Trust and Investment Product Fees | 1 | 585 | --- | (22) | 564 |
| Insurance Revenues | 52 | 3 | 1,076 | (15) | 1,116 |
| Noncash Items: | | | | | |
| Provision for Loan Losses | 290 | --- | --- | --- | 290 |
| Provision for Income Taxes | 2,002 | 37 | 84 | (929) | 1,194 |
| Segment Profit / (Loss) | 4,062 | 51 | 89 | (1,470) | 2,732 |
| Segment Assets | 1,048,015 | 2,193 | 9,186 | 1,327 | 1,060,721 |

**Three Months Ended
September 30, 2005**

| | Core Banking | Trust and Investment Advisory Services | Insurance | Holding Company and Other | Consolidated Totals |
|--|-------------------------|---|------------------|--|--------------------------------|
| Net Interest Income | \$ 8,198 | \$ 11 | \$ 11 | \$ (239) | \$ 7,981 |
| Gain on Sales of Loans and Related Assets | 234 | --- | --- | --- | 234 |
| Net Gain / (Loss) on Securities | --- | --- | --- | --- | --- |
| Trust and Investment Product Fees | 1 | 534 | --- | (21) | 514 |
| Insurance Revenues | 46 | 21 | 1,055 | (26) | 1,096 |
| Noncash Items: | | | | | |
| Provision for Loan Losses | (548) | --- | --- | 1,100 | 552 |
| Provision for Income Taxes | 1,968 | 56 | 51 | (1,154) | 921 |
| Segment Profit / (Loss) | 3,992 | 86 | 97 | (1,704) | 2,471 |
| Segment Assets | 900,584 | 2,238 | 7,123 | 7,930 | 917,875 |

**Nine Months Ended
September 30, 2006**

| | Core Banking | Trust and Investment Advisory Services | Insurance | Holding Company and Other | Consolidated Totals |
|--|-------------------------|---|------------------|--|--------------------------------|
|--|-------------------------|---|------------------|--|--------------------------------|

| | | | | | | | | | | |
|--|----|-----------|----|-------|----|-------|----|---------|----|-----------|
| Net Interest Income | \$ | 27,877 | \$ | 54 | \$ | 81 | \$ | (1,129) | \$ | 26,883 |
| Gain on Sales of Loans and Related Assets | | 750 | | --- | | --- | | --- | | 750 |
| Net Gain / (Loss) on Securities | | 951 | | --- | | --- | | --- | | 951 |
| Trust and Investment Product Fees | | 3 | | 1,753 | | --- | | (66) | | 1,690 |
| Insurance Revenues | | 151 | | 9 | | 3,544 | | (58) | | 3,646 |
| Noncash Items: | | | | | | | | | | |
| Provision for Loan Losses | | 1,091 | | --- | | --- | | (457) | | 634 |
| Provision for Income Taxes | | 5,310 | | 105 | | 348 | | (2,585) | | 3,178 |
| Segment Profit / (Loss) | | 11,361 | | 151 | | 540 | | (4,269) | | 7,783 |
| Segment Assets | | 1,048,015 | | 2,193 | | 9,186 | | 1,327 | | 1,060,721 |

GERMAN AMERICAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2006
(unaudited, dollars in thousands except per share data)

Note 6 - Segment Information (continued)**Nine Months Ended
September 30, 2005**

| | Core Banking | Trust and Investment Advisory Services | Insurance | Holding Company and Other | Consolidated Totals |
|--|-------------------------|---|------------------|--|--------------------------------|
| Net Interest Income | \$ 24,370 | \$ 28 | \$ 22 | \$ (465) | \$ 23,955 |
| Gain on Sales of Loans and Related Assets | 699 | --- | --- | --- | 699 |
| Net Gain / (Loss) on Securities | --- | --- | --- | --- | --- |
| Trust and Investment Product Fees | 4 | 1,645 | --- | (63) | 1,586 |
| Insurance Revenues | 167 | 28 | 3,423 | (56) | 3,562 |
| Noncash Items: | | | | | |
| Provision for Loan Losses | 625 | --- | --- | 1,100 | 1,725 |
| Provision for Income Taxes | 4,669 | 101 | 245 | (2,560) | 2,455 |
| Segment Profit / (Loss) | 10,469 | 153 | 385 | (3,717) | 7,290 |
| Segment Assets | 900,584 | 2,238 | 7,123 | 7,930 | 917,875 |

Note 7 - Stock Repurchase Plan

On April 26, 2001 the Company announced that its Board of Directors approved a stock repurchase program for up to 607,754 (as adjusted for subsequent stock dividends) of the outstanding Common Shares of the Company. Shares may be purchased from time to time in the open market and in large block privately negotiated transactions. The Company is not obligated to purchase any shares under the program, and the program may be discontinued at any time before the maximum number of shares specified by the program are purchased. As of September 30, 2006, the Company had purchased 334,965 (as adjusted for subsequent stock dividends) shares under the program. No shares were purchased under the plan during the nine months ended September 30, 2006.

Note 8 - Equity Plans and Equity Based Compensation

The Company maintains two equity incentive plans under which stock options, restricted stock, and other equity incentive awards can be granted. At September 30, 2006, the Company has reserved 620,144 shares of Common Stock (as adjusted for subsequent stock dividends and subject to further customary anti-dilution adjustments) for the purpose of issuance pursuant to outstanding and future grants of options, restricted stock, and other equity awards to officers, directors and other employees of the Company.

Options may be designated as "incentive stock options" under the Internal Revenue Code of 1986, or as nonqualified options. While the date after which options are first exercisable is determined by the Long-Term Incentive Award Committee (formerly known as the Stock Option Committee) of the Company or, in the case of options granted to directors, by the Board of Directors, no stock option may be exercised after ten years from the date of grant (twenty years in the case of nonqualified stock options). The exercise price of stock options granted pursuant to the Plans must

be no less than the fair market value of the Common Stock on the date of the grant.

The Plans authorize an optionee to pay the exercise price of options in cash or in common shares of the Company or in some combination of cash and common shares. An optionee may tender already-owned common shares to the Company in exercise of an option. The Company typically issues authorized but unissued common shares upon the exercise of options.

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards (“SFAS”) No. 123R, “Share Based Payment.” The Company elected to utilize the modified prospective transition method, therefore, prior period results have not been restated. Prior to the adoption of SFAS 123R, stock-based compensation expense related to stock options was not recognized in the results of operations if the exercise price was at least equal to the market value of the common stock on the grant date, in accordance with Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees.”

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Note 8 - Equity Plans and Equity Based Compensation (continued)

SFAS 123R requires all share-based payments to employees, including grants of employee stock options and grants of restricted shares, to be recognized as compensation expense over the service period (generally the vesting period) in the consolidated financial statements based on their fair values. For options with graded vesting, the Company values the stock option grants and recognizes compensation expense as if each vesting portion of the award was a single award. Under the modified prospective method, unvested awards, awards that are granted, modified, or settled on or after January 1, 2006 are measured and accounted for in accordance with SFAS 123R. The impact of forfeitures that may occur prior to vesting is also estimated and considered in the amount recognized.

Stock Options

On December 29, 2005, the Long-Term Incentive Award Committee of the Company approved the accelerated vesting of all currently outstanding unvested stock options awarded to recipients under its 1999 Long Term Equity Incentive Plan effective December 29, 2005. The decision to accelerate the vesting was made primarily to reduce non-cash compensation expense that the Company would have recorded in its income statement in future periods upon the adoption of SFAS 123R in January 2006. The Long-Term Incentive Award Committee believed it was in the best interest of the Company's shareholders to accelerate the vesting of these Options to eliminate compensation expense in future periods. This future expense was estimated to be \$143. As a result of the acceleration action, options to purchase up to 161,601 shares of common stock became exercisable immediately. Without the acceleration, the options would have vested on dates ranging from December 31, 2005 to August 29, 2010.

In conjunction with the acceleration of all vesting periods, the Long-Term Incentive Award Committee also took action to amend all outstanding options to eliminate any obligation to grant new options in replacement of shares tendered in payment of the exercise price of options, effective January 1, 2006. All other terms and conditions applicable to options, including the exercise prices and exercise periods, remain unchanged.

The following table summarizes stock option activity:

| | Nine Months Ended September 30, 2006 | |
|------------------------------------|---|---|
| | Number Of Options | Weighted Average Price Per Share |
| Outstanding at beginning of period | 405,019 | \$ 16.37 |
| Granted | 11,000 | 13.25 |
| Exercised | 12,663 | 12.58 |
| Forfeited | --- | --- |
| Expired | 21,109 | \$ 16.53 |
| Outstanding at end of period | 382,247 | \$ 16.40 |

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Note 8 - Equity Plans and Equity Based Compensation (continued)

The following table details stock options outstanding :

| | September 30, 2006 | December 31, 2005 |
|--|-------------------------------|------------------------------|
| Stock Options vested and currently exercisable: | | |
| Number of Options | 382,247 | 405,019 |
| Weighted average exercise price | \$ 16.40 | \$ 16.37 |
| Weighted average remaining life (in years) | 4.88 | 5.04 |
| Aggregate intrinsic value | \$ 57 | \$ 22 |

The intrinsic value for stock options is calculated based on the exercise price of the underlying awards and the market price of common stock as of the reporting date. The intrinsic value of options exercised was approximately \$5 for the nine months ended September 30, 2006. There were no options exercised during the third quarter 2006.

The Company recorded \$19 in stock compensation expense, net of an income tax benefit of \$10, during the nine months ended September 30, 2006 related to the granting of 11,000 options granted in the second quarter of 2006. To calculate the fair value of this option grant, the following assumptions were used as of the grant date: risk free interest rate 5.11%, expected option life 10.0 years, expected stock price volatility of 22.4%, and dividend yield of 4.20%. The resulting weighted average fair value of the options granted in the second quarter of 2006 was \$2.68 for each option granted. The Company recorded no other stock compensation expense applicable to options during the three and nine months ended September 30, 2006 because all outstanding options as of January 1, 2006 were fully vested prior to 2006.

The fair value of each stock option granted will be estimated on the date of grant using the Black-Scholes based stock option valuation model. This model requires the input of subjective assumptions that may have a significant impact on the fair value estimate. Expected volatility will be based on historical volatility of the Company's stock, and other factors. Expected dividends will be based on dividend trends and the market price of the Company's stock price at the time of the grant. The Company will use historical data to estimate option exercises and employee terminations within the valuation model. The risk-free rate for periods within the contractual life of the option will be based on the U.S. Treasury yield curve in effect at the time of the grant.

SFAS 123R requires the recognition of stock based compensation for the number of awards that are ultimately expected to vest. The Company did not reduce its compensation expense for estimated forfeitures prior to vesting because all grants made during the third quarter of 2006 were immediately vested. Estimated forfeitures will continue to be reassessed in future periods and may change based on new facts and circumstances.

As of September 30, 2006, there was no unrecognized option expense as all outstanding options were fully vested.

Restricted Stock

Effective February 15, 2006, the Long-Term Incentive Award Committee awarded a new type of long-term incentive award under one of its existing plans. In prior years, awards of long-term incentives were granted in the form of incentive stock options. The Long-Term Incentive Award Committee effective February 15, 2006 determined that future awards of long-term incentives under the plan should generally be made in the form of restricted stock, granted in tandem with cash credit entitlements. The incentive awards will typically be in the form of 50% restricted stock grants and 50% cash credit entitlements. The restricted stock grants and tandem cash credit entitlements are subject to forfeiture in the event that the recipient of the grant does not continue employment with the Company through December 15 of the year of grant, at which time they generally vest 100 percent. For measuring compensation costs, restricted stock awards are valued based upon the market value of the common shares on the date of grant.

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Note 8 - Equity Plans and Equity Based Compensation (continued)

The expense recorded for the restricted stock grants totaled \$35, net of an income tax benefit of \$23, and \$89, net of an income tax benefit of \$58, during the three and nine months ended September 30, 2006. Unrecognized expense associated with the restricted stock grants totaled \$41 as of September 30, 2006.

The following table presents information on restricted stock grants outstanding for the period shown:

| | Nine Months Ended September 30, 2006 | |
|------------------------------------|---|---|
| | Restricted Shares | Weighted Average Market Price at Grant |
| Outstanding at Beginning of Period | --- | --- |
| Granted | 14,501 | \$ 12.98 |
| Released | --- | --- |
| Forfeited | --- | --- |
| Outstanding at End of Period | 14,501 | \$ 12.98 |

Employee Stock Purchase Plan

The Company maintains an Employee Stock Purchase Plan whereby eligible employees have the option to purchase the Company's common stock at a discount. The purchase price of the shares under this plan is determined annually and shall be in the range from 85% to 100% of the fair market value of such stock at either the beginning or end of the plan year. The plan provides for the purchase of up to 542,420 shares of common stock, which the Company may obtain by purchases on the open market or from private sources, or by issuing authorized but unissued common shares. Funding for the purchase of common stock is from employee and Company contributions. The plan was considered non-compensatory under APB No. 25, and as a result no compensation expense was recorded in periods prior to 2006 and Company contributions were a reduction to additional paid-in capital.

As a result of the adoption of SFAS 123R on January 1, 2006, the Company was required to record compensation expense for plan participation beginning January 1, 2006. The plan year for the Employee Stock Purchase Plan runs from August 17 through August 16 of the subsequent year. As of the beginning of the plan year, participants were granted the option to purchase Company stock at 85% of the lesser of the market value at the beginning or end of the plan year. The fair value of options granted as a part of plan was estimated on the date of grant similarly to those stock options granted under the Company's equity incentive plans utilizing a Black-Scholes stock option valuation model. The inputs for expected volatility, expected dividends, and risk-free rate are the same as previously discussed. The fair value of options granted was also affected by the estimate of employee participation in the plan, which is based upon historical experience. The grant date fair value of options granted for the plan year ending August 16, 2006 was estimated to be \$3.08. The grant date fair value of options granted for the plan year ending August 16, 2007 was estimated to be \$2.50. The expense recorded for the employee stock purchase plan totaled \$19 and \$58 during the three and nine months ended September 30, 2006. Unrecognized compensation expense as of September 30, 2006 totaled \$65 for the Employee Stock Purchase Plan.

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Note 8 - Equity Plans and Equity Based Compensation (continued)

The following table reflects the effect on net income and net income per share if the fair value based method had been applied to all outstanding and unvested stock options in 2005:

| | | Three Months Ended September 30, 2005 |
|---|----|--|
| Net Income as Reported | \$ | 2,471 |
| Compensation Expense Under Fair Value Method, Net of Tax | | 37 |
| Pro forma Net Income | \$ | 2,434 |
| Pro forma Earnings per Share and Diluted Earnings per Share | \$ | 0.22 |
| Earnings per Share and Diluted Earnings per Share as Reported | \$ | 0.23 |

| | | Nine Months Ended September 30, 2005 |
|------------------------|----|---|
| Net Income as Reported | \$ | |