GERMAN AMERICAN BANCORP, INC.
Form 10-K
March 01, 2019

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018

Commission File Number 001-15877

GERMAN AMERICAN BANCORP, INC.
(Exact name of registrant as specified in its charter)

INDIANA	35-1547518
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

711 Main Street, Box 810, Jasper, Indiana	47546
(Address of Principal Executive Offices)	(Zip Code)

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

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

Title of Each Class	Name of each exchange on which registered
Common Shares, no par value	The NASDAQ Stock Market LLC

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.	þ Yes o No
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.	o Yes þ No
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.	þ Yes o No
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files).	þ Yes o No
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 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:	o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

The aggregate market value of the registrant's common shares held by non-affiliates as of June 30, 2018 was approximately $759,917,505. This calculation does not reflect a determination that persons are (or are not) affiliates for any other purpose.

As of February 20, 2019, there were outstanding 24,967,458 common shares, no par value, of the registrant.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement of German American Bancorp, Inc., for the Annual Meeting of its Shareholders to be held May 16, 2019, to the extent stated herein, are incorporated by reference into Part III (Items 10 through 14).

GERMAN AMERICAN BANCORP, INC.
ANNUAL REPORT ON FORM 10-K
For Fiscal Year Ended December 31, 2018

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Information included in or incorporated by reference in this Annual Report on Form 10-K, our other filings with the Securities and Exchange Commission and our press releases or other public statements, contain 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 1, “Business - Forward-Looking Statements and Associated Risks” and our discussion of risk factors in Item 1A, “Risk Factors” in this Annual Report on Form 10-K.

PART I

Item 1. Business.

General

German American Bancorp, Inc., is a NASDAQ-traded (symbol: GABC) bank holding company based in Jasper, Indiana. German American, through its banking subsidiary German American Bank, operates 65 banking offices in 20 contiguous southern Indiana counties and four Kentucky counties. The Company also owns an investment brokerage subsidiary (German American Investment Services, Inc.) and a full line property and casualty insurance agency (German American Insurance, Inc.).

Throughout this Report, when we use the term “Company”, we will usually be referring to the business and affairs (financial and otherwise) of German American Bancorp, Inc. and its consolidated subsidiaries as a whole. Occasionally, we will refer to the term “parent company” or “holding company” when we mean to refer to only German American Bancorp, Inc. and the term “Bank” when we mean to refer only to the Company’s bank subsidiary.

The Company’s lines of business include retail and commercial banking, comprehensive financial planning, full service brokerage and trust administration, and a full range of personal and corporate insurance products. Financial and other information by segment is included in Note 16 (Segment Information) of the Notes to the Consolidated Financial Statements included in Item 8 of this Report and is incorporated into this Item 1 by reference. Substantially all of the Company’s revenues are derived from customers located in, and substantially all of its assets are located in, the United States.

Subsidiaries

The Company’s principal operating subsidiaries are described in the following table:

Name	Type of Business	Principal Office Location
German American Bank	Commercial Bank	Jasper, IN
German American Insurance, Inc.	Multi-Line Insurance Agency	Jasper, IN
German American Investment Services, Inc.	Retail Brokerage	Jasper, IN

Effective April 1, 2018, the legal name of German American Bank was changed from German American Bancorp to its current name. The new name corresponds with the trade name already being used by the banking subsidiary and promotes further distinction in nomenclature between the banking subsidiary and the bank holding company, German American Bancorp, Inc.

Business Developments

On February 21, 2019, the Company entered into an Agreement and Plan of Reorganization with Citizens First Corporation (“Citizens First”), pursuant to which Citizens First agreed to merge with and into the Company. The merger agreement also provides that Citizens First’s wholly-owned banking subsidiary, Citizens First Bank, Inc. will be merged with and into the Company’s subsidiary bank, German American Bank, immediately following the holding company merger. Based on the number of Citizens First common shares expected to be outstanding at closing, the

Company would issue approximately 1.7 million shares of its common stock, and pay approximately $16 million cash, for all of the issued and outstanding common shares of Citizens First. Citizens First is a bank holding company headquartered in Bowling Green, Kentucky. It operates, through Citizens First Bank, Inc., branch offices in Barren, Hart, Simpson and Warren Counties in Kentucky, and a loan production office in Williamson County, Tennessee. At December 31, 2018, Citizens First reported total assets of approximately $476 million, total loans of approximately $372 million, and total deposits of approximately $389 million. Completion of the mergers is subject to approval by regulatory authorities and Citizens First’s shareholders, as well as certain other closing conditions. The transaction is expected to be completed in the third quarter of 2019.

On October 15, 2018, the Company completed the acquisition of First Security, Inc. ("First Security") through the merger of First Security with and into the Company. Immediately following completion of the First Security holding company merger, First Security’s subsidiary bank, First Security Bank, Inc., was merged with and into the Company’s subsidiary bank, German American Bank. First Security, based in Owensboro, Kentucky, operated 11 retail banking offices, through First Security Bank, Inc., in Owensboro, Bowling Green, Franklin and Lexington, Kentucky and in Evansville and Newburgh, Indiana. As of the closing of the transaction, First Security had total assets of approximately $553.2 million, total loans of approximately $390.1 million, and total deposits of approximately $424.4 million. The Company issued approximately 2.0 million shares of its common stock, and paid approximately $31.2 million in cash, in exchange for all of the issued and outstanding shares of common stock of First Security and in cancellation of all outstanding options to acquire First Security common stock.

On May 18, 2018, German American Bank completed the acquisition of five branch locations of First Financial Bancorp (formerly branch locations of Mainsource Financial Group, Inc. prior to its merger with First Financial Bancorp on April 1, 2018) and certain related assets, and the assumption by German American Bank of certain related liabilities. Four of the branches are located in Columbus, Indiana, and one in Greensburg, Indiana. German American Bank acquired approximately $175.7 million in deposits and approximately $116.3 million in loans associated with the five bank branches. The premium paid on deposits by German American Bank was approximately $7.4 million. The premium was subject to adjustment to reflect increases or decreases in the deposit balances during the six month period following the closing date. In January 2019, an adjustment of approximately $0.1 million in additional premium was paid by German American Bank as a result of the change in deposits during the six month measurement period. German American Bank also had the ability, under certain circumstances, to put loans back to First Financial Bancorp's bank subsidiary during such six month period. During the fourth quarter of 2018, approximately $1.3 million of loans were put back by German American Bank.

On March 1, 2016, the Company acquired by merger River Valley Bancorp ("River Valley") and its subsidiary, River Valley Financial Bank. River Valley Financial Bank, headquartered in Madison, Indiana, provided a full range of commercial and consumer banking services from 15 banking offices predominantly located in southeast Indiana. At the time of acquisition, River Valley reported on its balance sheet consolidated assets and equity (unaudited) as of February 29, 2016 that totaled $516.3 million and $56.6 million, respectively.

For further information regarding these merger and acquisition transactions, see Note 18 (Business Combinations) and Note 21 (Subsequent Events) in the Notes to the Consolidated Financial Statements included in Item 8 of this Report, which Note 18 and Note 21 are incorporated into this Item 1 by reference.

The Company expects to continue to evaluate opportunities to expand its business through opening of new banking, insurance or trust, brokerage and financial planning offices, and through acquisitions of other banks, bank branches, portfolios of loans or other assets, and other financial-service-related businesses and assets in the future.

Office Locations

The map below illustrates the locations of the Company's 66 retail and commercial banking, insurance and investment offices as of February 20, 2019.

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Competition

The industries in which the Company operates are highly competitive. The Bank competes for commercial and retail banking business within its core banking segment not only with financial institutions that have offices in the same counties but also with financial institutions that compete from other locations in Southern Indiana, Kentucky and elsewhere. Further, the Bank competes for loans and deposits not only with commercial banks but also with savings and loan associations, savings banks, credit unions, production credit associations, federal land banks, finance companies, credit card companies, personal loan companies, investment brokerage firms, insurance agencies, insurance companies, lease finance companies, money market funds, mortgage companies, and other non-depository financial intermediaries. There are numerous alternative providers (including national providers that advertise extensively and provide their services via e-mail, direct mail, telephone and the Internet) for the insurance products and services offered by German American Insurance, Inc., trust and financial planning services offered by the Bank and the brokerage products and financial planning services offered by German American Investment Services, Inc. Many of these competitors have substantially greater resources than the Company.

Employees

At February 20, 2019 the Company and its subsidiaries employed approximately 738 full-time equivalent employees. There are no collective bargaining agreements, and employee relations are considered to be good.

Regulation and Supervision
Overview

The Company is subject to regulation and supervision by the Board of Governors of the Federal Reserve System ("FRB") under the Bank Holding Company Act of 1956, as amended ("BHC Act"), and is required to file with the FRB annual reports and such additional information as the FRB may require. The FRB may also make examinations or inspections of the Company. The Bank is under the supervision of and subject to examination by the Indiana Department of Financial Institutions ("DFI"), and the Federal Deposit Insurance Corporation ("FDIC"). Regulation and examination by banking regulatory agencies are primarily for the benefit of depositors rather than shareholders.
Under FRB policy and the Dodd-Frank Wall Street Reform and Consumer Protection Act, a complex and wide-ranging statute that was enacted by Congress and signed into law during July 2010 (the "Dodd-Frank Act"), the Company is required to act as a source of financial and managerial strength to the Bank, and to commit resources to support the Bank, even in circumstances where the Company might not do so absent such a requirement. Under current federal law, the FRB may require a bank holding company to make capital injections into a troubled subsidiary bank. It may charge the bank holding company with engaging in unsafe and unsound practices if the bank holding company fails to commit resources to such a subsidiary bank or if it undertakes actions that the FRB believes might jeopardize the bank holding company's ability to commit resources to such subsidiary bank.
With certain exceptions, the BHC Act prohibits a bank holding company from engaging in (or acquiring direct or indirect control of more than 5 percent of the voting shares of any company engaged in) nonbanking activities. One of the principal exceptions to this prohibition is for activities deemed by the FRB to be "closely related to banking." Under current regulations, bank holding companies and their subsidiaries are permitted to engage in such banking-related business ventures as consumer finance; equipment leasing; credit life insurance; computer service bureau and software operations; mortgage banking; and securities brokerage.
Under the BHC Act, certain well-managed and well-capitalized bank holding companies may elect to be treated as a "financial holding company" and, as a result, be permitted to engage in a broader range of activities that are "financial in nature" and in activities that are determined to be incidental or complementary to activities that are financial in nature. These activities include underwriting and dealing in and making a market in securities (subject to certain limits and compliance procedures required by the so-called Volcker Rule provisions added by the Dodd-Frank Act, described below under "Other Aspects of the Dodd-Frank Act"); insurance underwriting, and merchant banking. Banks may also engage through financial subsidiaries in certain of the activities permitted for financial holding companies, subject to

certain conditions. The Company has not elected to become a financial holding company and its subsidiary bank has not elected to form financial subsidiaries.

The Bank and the subsidiaries of the Bank may generally engage in activities that are permissible activities for state chartered banks under Indiana banking law, without regard to the limitations that might apply to such activities under the BHC Act if the Company were to engage directly in such activities at the parent company level or through parent company subsidiaries that were not also bank subsidiaries.

Indiana law and the BHC Act restrict certain types of expansion by the Company and its bank subsidiary. The Company and its subsidiaries may be required to apply for prior approval from (or give prior notice and an opportunity for review to) the FRB, the DFI, the FDIC, and/or other bank regulatory or other regulatory agencies, as a condition to the acquisition or establishment of new offices, or the acquisition (by merger or consolidation, purchase or otherwise) of the stock, business or properties of other banks or other companies.

The earnings of commercial banks and their holding companies are affected not only by general economic conditions but also by the policies of various governmental regulatory authorities. In particular, the FRB regulates money and credit conditions and interest rates in order to influence general economic conditions, primarily through open-market operations in U.S. Government securities, varying the discount rate on bank borrowings, and setting reserve requirements against bank deposits. These policies have a significant influence on overall growth and distribution of bank loans, investments and deposits, and affect interest rates charged on loans and earned on investments or paid for time and savings deposits. FRB monetary policies have had a significant effect on the operating results of commercial banks in the past and this is expected to continue in the future. The general effect, if any, of such policies upon the future business and earnings of the Company cannot accurately be predicted.

Capital Requirements

We are subject to various regulatory capital requirements both at the parent company and at the Bank level administered by the FRB and by the FDIC and DFI, respectively. Failure to meet minimum capital requirements could result in certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have an adverse material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for “Prompt Corrective Action” (described below), we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting policies. Our capital amounts and classification are also subject to judgments by the regulators regarding qualitative components, risk weightings, and other factors. We have consistently maintained regulatory capital ratios at or above the well-capitalized standards.

Generally, for purposes of satisfying these capital requirements, we must maintain capital sufficient to meet both risk-based asset ratio tests and a leverage ratio test on a consolidated basis. The risk-based ratios are determined by allocating assets and specified off-balance sheet commitments into various weighted categories, with higher weighting assigned to categories perceived as representing greater risk. A risk-based ratio represents the applicable measure of capital divided by total risk-weighted assets. The leverage ratio is a measure of our core capital divided by our total assets adjusted as specified in the guidelines.

Effective January 1, 2015 (subject to certain phase-in provisions), we became subject to new federal banking agency rules implementing certain regulatory capital reforms agreed to by the Basel Committee on Banking Supervision (known as “Basel III”) and to certain changes required by the Dodd-Frank Act. Generally, under these new rules (which were subject to certain phase-in provisions), (a) minimum requirements were increased for both the quality and quantity of capital held by banking organizations, (b) stricter criteria are applied in determining the eligibility for inclusion in regulatory capital of capital instruments (other than common equity), and (c) the methodology for calculating risk-weighted assets was changed. The rules include, among other requirements:

- a new minimum ratio of “Common Equity Tier 1 Capital” to risk-weighted assets of 4.5%;
- a new conservation buffer on Common Equity Tier 1 Capital equal to an additional 0.625% of risk-weighted assets during 2016 and increasing each year by another 0.625% until reaching 2.5% when fully phased-in effective as of January 1, 2019 (bringing the Common Equity Tier 1 Capital to risk-weighted assets ratio to a total of 7.0% when fully implemented);
- a minimum ratio of Tier 1 Capital to risk-weighted assets of 6% plus the conservation buffer (which, when fully phased-in effective as January 1, 2019, results in a minimum required total Tier 1 Capital to risk-weighted assets ratio of 8.5%);
- a minimum ratio of Total Capital (that is, Tier 1 Capital plus instruments includable in a tier called Tier 2 Capital) to risk-weighted assets of at least 8.0% plus the conservation buffer (which, when fully phased-in effective as of January 1, 2019, results in a minimum Total Capital to risk-weighted assets ratio of 10.5%); and
- a minimum leverage ratio of 4% (calculated as the ratio of Tier 1 Capital to adjusted average consolidated assets).

The new capital measure “Common Equity Tier 1” (“CET1”) Capital consists of common stock instruments that meet the eligibility criteria in the new rules, retained earnings, accumulated other comprehensive income (“AOCI”) and common

equity Tier 1 minority interest.
Tier 1 Capital under the new rules consists of CET1 (subject to certain adjustments) and "additional Tier 1 capital" instruments meeting specified requirements, plus, in the case of smaller holding companies like ours, trust preferred securities in accordance with prior requirements for their inclusion in Tier I Capital.
Under the Basel III rules, we and our bank subsidiary elected, in our March 31, 2015 financial report filed with banking agencies, to opt-out of the requirement to include AOCI in our CET1. As a result, most AOCI items will be treated, for regulatory capital purposes, in the same manner in which they were prior to Basel III.

Although banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer will technically comply with minimum capital requirements under the new rules, such institutions will face limitations on the payment of dividends, common stock repurchases and discretionary cash payments to executive officers based on the amount of the shortfall.

Prompt Corrective Action Classifications

The Federal Deposit Insurance Corporation Improvements Act (enacted in 1991) (FDICIA) requires federal banking regulatory authorities to take regulatory enforcement actions known as Prompt Corrective Action with respect to depository institutions that do not meet minimum capital requirements. For these purposes, FDICIA establishes five capital tiers: well-capitalized, adequately-capitalized, under-capitalized, significantly under-capitalized, and critically under-capitalized.

Under FDICIA, a depository institution that is not well-capitalized is generally prohibited from accepting brokered deposits and offering interest rates on deposits higher than the prevailing rate in its market. Since the Bank throughout 2018 was well-capitalized, the FDICIA brokered deposit rule did not adversely affect its ability to accept brokered deposits. The Bank had $91.6 million of such brokered deposits at December 31, 2018. Further, a depository institution or its holding company that is not well-capitalized will generally not be successful in seeking regulatory approvals that may be necessary in connection with any plan or agreement to expand its business, such as through the acquisition (by merger or consolidation, purchase or otherwise) of the stock, business or properties of other banks or other companies.

Under the Prompt Corrective Action regulations, the applicable agency can treat an institution as if it were in the next lower category if the agency determines (after notice and an opportunity for hearing) that the institution is in an unsafe or unsound condition or is engaging in an unsafe or unsound practice. The degree of regulatory scrutiny of a financial institution will increase, and the permissible activities of the institution will decrease, as it moves downward through the capital categories. Institutions that fall into one of the three "undercapitalized" categories (as such term is used in the FDICIA) may be required to (i) submit a capital restoration plan; (ii) raise additional capital; (iii) restrict their growth, deposit interest rates, and other activities; (iv) improve their management; (v) eliminate management fees and dividends; or (vi) divest themselves of all or a part of their operations. Bank holding companies can be called upon to boost the capital of the financial institutions that they control, and to partially guarantee the institutions' performance under their capital restoration plans. Critically under-capitalized institutions are subject to appointment of a receiver or conservator within 90 days of becoming so classified.

The minimum ratios defined by the Prompt Corrective Action regulations from time to time are merely guidelines and the bank regulators possess the discretionary authority to require higher capital ratios. Further, the risk-based capital standards of the FRB and the FDIC specify that evaluations by the banking agencies of a bank's capital adequacy will include an assessment of the exposure to declines in the economic value of a bank's capital due to changes in interest rates. These banking agencies issued a joint policy statement on interest rate risk describing prudent methods for monitoring such risk that rely principally on internal measures of exposure and active oversight of risk management activities by senior management.

To qualify as a "well-capitalized" institution, a depository institution under the Prompt Corrective Action requirements must have a leverage ratio of no less than 5%, a Tier I Capital ratio of no less than 8%, a CET1 ratio of no less than 6.5%, and a total risk-based capital ratio of no less than 10%, and the bank must not have been under any order or directive from the appropriate regulatory agency to meet and maintain a specific capital level. As of December 31, 2018, the Bank exceeded the requirements contained in the applicable regulations, policies and directives pertaining to capital adequacy to be classified as "well-capitalized", and is unaware of any material violation or alleged violation of these regulations, policies or directives. For a tabular presentation of our regulatory capital ratios and those of the Bank as of December 31, 2018, see Note 8 (Shareholders' Equity) of the Notes to the Consolidated Financial Statements included in Item 8 of this Report, which Note 8 is incorporated herein by reference.

Future rulemaking and regulatory changes on capital requirements may impact the Company as it continues to grow and evaluate potential mergers and acquisitions.

Restrictions on Bank Dividends or Loans to, or other Transactions with, the Parent Company, and on Parent Company Dividends

German American Bancorp, Inc., which is the publicly-held parent of the Bank (German American Bancorp), is a corporation that is separate and distinct from the Bank and its other subsidiaries. Most of the parent company's revenues historically have been comprised of dividends, fees, and interest paid to it by the Bank, and this is expected to continue in the future. There are, however, statutory limits under Indiana law on the amount of dividends that the Bank can pay to its parent company without regulatory approval. The Bank may not, without the approval of the DFI, pay a dividend in an amount greater than its undivided profits. In addition, the prior approval of the DFI is required for the payment of a dividend by an Indiana state-chartered bank if the total of all dividends declared in a calendar year would exceed the total of its net income for the year combined with its retained net income for the two preceding years, unless such a payment qualifies under certain exemptive criteria that exempt certain dividend payments by certain qualified banks from the prior approval requirement. At December 31, 2018, the Bank was eligible for payment of dividends under the exemptive criteria established by DFI policy for this purpose, and could have declared and paid to the holding company $76 million of its undivided profits without approval by the DFI in accordance with such criteria. See Note 8 (Shareholders' Equity) of the Notes to Consolidated Financial Statements included in Item 8 of this Report for further discussion.

Insured depository institutions such as the Bank are also prohibited under the FDICIA from making capital distributions, including the payment of dividends, if, after making such distribution, the institution would become undercapitalized.

In addition, the FRB and other bank regulatory agencies have issued policy statements or advisories that provide that insured banks and bank holding companies should generally only pay dividends out of current operating earnings.

In addition to these statutory restrictions, if, in the opinion of the applicable regulatory authority, a bank under its jurisdiction is engaged in, or is about to engage in, an unsafe or unsound practice, such authority may require, after notice and hearing, that such bank cease and desist from such practice. Accordingly, if the Bank were to experience financial difficulties, it is possible that the applicable regulatory authority could determine that the Bank would be engaged in an unsafe or unsound practice if the Bank were to pay dividends and could prohibit the Bank from doing so, even if availability existed for dividends under the statutory formula.

Further, the Bank is subject to affiliate transaction restrictions under federal laws, which limit certain transactions generally involving the transfer of funds by a subsidiary bank or its subsidiaries to its parent corporation or any nonbank subsidiary of its parent corporation, whether in the form of loans, extensions of credit, investments, or asset purchases, or otherwise undertaking certain obligations on behalf of such affiliates. Furthermore, covered transactions that are loans and extensions of credit must be secured within specified amounts. In addition, all covered transactions and other affiliate transactions must be conducted on terms and under circumstances that are substantially the same as such transactions with unaffiliated entities.

Other Aspects of the Dodd-Frank Act

The Dodd-Frank Act (in addition to the regulatory changes discussed elsewhere in this "Regulation and Supervision" discussion and below under "Federal Deposit Insurance Premiums and Assessments") made a variety of changes that affect the business and affairs of the Company and the Bank in other ways. For instance, the Dodd-Frank Act (or agency regulations adopted and implemented (or to be adopted and implemented) under the Dodd-Frank Act) altered the authority and duties of the federal banking and securities regulatory agencies, implemented certain corporate governance requirements for all public companies including financial institutions with regard to executive compensation, proxy access by shareholders, and certain whistleblower provisions; restricted certain proprietary trading and hedge fund and private equity activities of banks and their affiliates; eliminated the former statutory prohibition against the payment of interest on business checking accounts; limited interchange fees on debit card transactions by certain large processors; and established the Consumer Financial Protection Bureau ("CFPB").

The CFPB was granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, the Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act and certain other statutes. The CFPB has examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets. Smaller institutions are subject to rules promulgated by the CFPB but continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB has authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. The Dodd-Frank Act authorized the CFPB to establish certain minimum standards for the origination of residential mortgages including a determination of the borrower's ability to repay. In addition, Dodd-Frank allows borrowers to raise certain defenses to foreclosure if they receive any loan other than a "qualified mortgage" as defined by the CFPB. The Dodd-Frank Act permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

The CFPB issued a rule, effective as of January 14, 2014, designed to clarify for lenders how they can avoid monetary damages under the Dodd-Frank Act, which would hold lenders accountable for ensuring a borrower's ability to repay a mortgage. Loans that satisfy this "qualified mortgage" safe-harbor will be presumed to have complied with the new ability-to-repay standard. Under the CFPB's rule, a "qualified mortgage" loan must not contain certain specified features, and the borrower's total monthly debt-to-income ratio may not exceed a specified percentage. Lenders must also verify and document the income and financial resources relied upon to qualify the borrower for the loan and underwrite the loan based on a fully amortizing payment schedule and maximum interest rate during the first five years, taking into account all applicable taxes, insurance and assessments.

On December 10, 2013, five financial regulatory agencies, including the FRB and FDIC, adopted final rules implementing the so-called Volcker Rule added to banking law by Section 619 of the Dodd-Frank Act. These final rules prohibit banking entities from, among other things, (1) engaging in short-term proprietary trading for their own accounts, and (2) having certain ownership interests in and relationships with hedge funds or private equity funds ("covered funds"). Community banks like the Bank have been afforded some relief under these final rules from onerous compliance obligations created by the rules; if banks are engaged only in exempted proprietary trading, such as trading in U.S. government, agency, state and municipal obligations, they are exempt entirely from compliance program requirements. Moreover, even if a community bank engages in proprietary trading or covered fund activities under the rule, they need only incorporate references to the Volcker Rule into their existing policies and procedures. The Final Rules were effective April 1, 2014, but the conformance period was extended from its statutory end date of July 21, 2014 until July 21, 2015. In addition, the FRB granted extensions until July 21, 2017 of the conformance period for banking entities to conform investments in and relationships with covered funds that were in place prior to December 31, 2013 and, in December 2016, provided guidance allowing for additional extensions to the conformance period for certain illiquid funds. We do not expect that the Volcker Rule will have any material financial implications on us or our investments or activities.

Certain Other Laws and Regulations

The Community Reinvestment Act of 1977 (the "CRA") requires depository institutions to assist in meeting the credit needs of their market areas consistent with safe and sound banking practice. Under the CRA, each depository institution is required to help meet the credit needs of its market areas by, among other things, providing credit to low- and moderate-income individuals and communities. These factors are also considered in evaluating mergers, acquisitions and applications to open a branch or facility. The applicable federal regulators regularly conduct CRA examinations to assess the performance of financial institutions and assign one of four ratings to the institution's records of meeting the credit needs of its community. During its last examination, a rating of "satisfactory" was received by the Bank.

In accordance with the Gramm-Leach-Bliley Financial Modernization Act of 1999 (the "GLB Act"), federal banking regulators adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about consumers to nonaffiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a nonaffiliated third party. The privacy provisions of the GLB Act affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors.

A major focus of governmental policy on financial institutions is combating money laundering and terrorist financing. The Bank Secrecy Act (the "BSA") requires financial institutions to develop policies, procedures, and practices to prevent and deter money laundering, and mandates that every bank have a written, board-approved program that is reasonably designed to assure and monitor compliance with the BSA. In addition, banks are required to adopt a customer identification program as part of its BSA compliance program, and are required to file Suspicious Activity Reports when they detect certain known or suspected violations of federal law or suspicious transactions related to a money laundering activity or a violation of the BSA. Effective as of May 11, 2018, following implementation of recent amendments to the BSA regulations, covered institutions such as the Bank are also required to (1) identify and verify, subject to certain exceptions, the identity of the beneficial owners of all legal entity customers at the time a new account is opened, and (2) include, in its anti-money laundering program, risk-based procedures for conducting ongoing customer due diligence, which must include procedures that: (a) assist in understanding the nature and purpose of customer relationships for the purpose of developing a customer risk profile, and (b) require the covered institutions to conduct ongoing monitoring to identify and report suspicious transactions and, on a risk basis, to maintain and update customer information.

The USA PATRIOT Act of 2001, or the USA Patriot Act, substantially broadened the scope of United States anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations, creating new crimes and penalties and expanding the extra-territorial jurisdiction of the United States. The U.S. Treasury Department has issued a number of regulations that apply various requirements of the USA Patriot Act to financial institutions such as the Bank. These regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing and to verify the identity of their customers. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal and reputational consequences for the institution.

The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others. These are typically known as the "OFAC" rules based on their administration by the U.S. Treasury Department Office of Foreign Assets Control ("OFAC"). The OFAC-administered sanctions targeting countries take many different forms. Generally, however, they contain one or more of the following elements: (i) restrictions on trade with or investment in a sanctioned country, including prohibitions against direct or indirect imports from and exports to a sanctioned country and prohibitions on "U.S. persons" engaging in financial transactions relating to making investments in, or providing investment-related advice or assistance to, a sanctioned country; and (ii) a blocking of assets in which the government or specially designated nationals of the sanctioned country have an interest, by prohibiting transfers of property subject to U.S. jurisdiction (including property in the possession or control of U.S. persons). Blocked assets (e.g., property and bank deposits) cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC. Failure to comply with these sanctions could have serious legal and reputational consequences.

The Bank is subject to a wide variety of other laws with respect to the operation of its businesses, and regulations adopted under those laws, including but not limited to the Truth in Lending Act, Truth in Savings Act, Equal Credit Opportunity Act, Electronic Funds Transfer Act, Fair Housing Act, Home Mortgage Disclosure Act, Fair Debt Collection Practices Act, Fair Credit Reporting

Act, Expedited Funds Availability (Regulation CC), Reserve Requirements (Regulation D), Insider Transactions (Regulation O), Privacy of Consumer Information (Regulation P), Margin Stock Loans (Regulation U), Right To Financial Privacy Act, Flood Disaster Protection Act, Homeowners Protection Act, Servicemembers Civil Relief Act, Real Estate Settlement Procedures Act, TILA-RESPA Integrated Disclosure Rule, Telephone Consumer Protection Act, CAN-SPAM Act, Children's Online Privacy Protection Act, the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act) and the John Warner National Defense Authorization Act. The laws and regulations to which we are subject are constantly under review by Congress, the federal regulatory agencies, and the state authorities.

Federal Deposit Insurance Premiums and Assessments

The Bank's deposit accounts are currently insured by the Deposit Insurance Fund (the "DIF") of the FDIC. The insurance benefit generally covers up to a maximum of $250,000 per separately insured depositor. As an FDIC-insured bank, our bank subsidiary is subject to deposit insurance premiums and assessments to maintain the DIF. The Bank's deposit insurance premium assessment rate depends on the asset and supervisory categories to which it is assigned. The FDIC has authority to raise or lower assessment rates on insured banks in order to achieve statutorily required reserve ratios in the DIF and to impose special additional assessments.

Under the current system, deposit insurance assessments are based on average total assets minus average tangible equity. The FDIC assigns a banking institution to one of two categories based on asset size. As an institution with under $10 billion in assets, the Bank falls into the "Established Small Institution" category. This category has three sub-categories based on supervisory ratings designed to measure risk (the FDIC's "CAMELS Composite" ratings). The assessment rate, which ranges from 1.5 to 30.0 basis points (such basis points representing a per annum rate) for Established Small Institutions, is determined based upon each applicable institution's most recent supervisory and capital evaluations.

In addition, each FDIC insured institution is required to pay to the FDIC an assessment on the institution's total assets less tangible capital in order to fund interest payments on bonds issued by the Financing Corporation, an agency of the federal government established to recapitalize the predecessor to the Savings Association Insurance Fund. The Federal Housing Finance Agency, the agency authorized to prescribe regulations relating to the Financing Corporation, has projected that the last payment will be collected with the March 2019 assessment. For the Bank's December 2018 payment, the bond assessment was equal to a per annum rate of 0.14 basis points.

Internet Address; Internet Availability of SEC Reports

The Company's Internet address is www.germanamerican.com.

The Company makes available, free of charge through the Investor Relations - Financial Information section of its Internet website, the Company's annual report on Form 10-K, its quarterly reports on Form 10-Q, its current reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after those reports are filed with or furnished to the SEC.

Forward-Looking Statements and Associated Risks

The Company from time to time in its oral and written communications makes statements relating to its expectations regarding the future. These types of statements are considered "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements can include statements about the Company's net interest income or net interest margin; adequacy of the Company's capital under regulatory requirements and of its allowance for loan losses, and the quality of the Company's loans, investment securities and other assets; simulations of changes in interest rates; litigation results; dividend policy; acquisitions or mergers; estimated cost savings, plans and objectives for future operations; and expectations about the Company's financial and business performance and other business matters as well as economic and market conditions and trends. All statements other than statements of historical fact included in this Report, including statements regarding our financial position, business strategy and the plans and objectives of our management for future operations, are forward-looking

statements. When used in this Report, words such as “anticipate”, “believe”, “estimate”, “expect”, “plan”, “intend”, “should”, “
“could”, “can”, “may”, “will”, “might” and similar expressions, as they relate to us or our management, identify forward-lookin
statements.
Such forward-looking statements are based on the beliefs of our management, as well as assumptions made by and information currently available to our management, and are subject to risks, uncertainties, and other factors.
Actual results may differ materially and adversely from the expectations of the Company that are expressed or implied by any forward-looking statement. The discussions in Item 1A, “Risk Factors,” and in Item 7 of this Form 10-K, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” list some of the factors that could cause the Company’s actual results to vary materially from those expressed or implied by any forward-looking statements. Other risks, uncertainties, and factors

that could cause the Company's actual results to vary materially from those expressed or implied by any forward-looking statement include but not limited to:

- the unknown future direction of interest rates and the timing and magnitude of any changes in interest rates;
- changes in competitive conditions;
- the introduction, withdrawal, success and timing of asset/liability management strategies or of mergers and acquisitions and other business initiatives and strategies;
- changes in customer borrowing, repayment, investment and deposit practices;
- changes in fiscal, monetary and tax policies;
- changes in financial and capital markets;
- potential deterioration in general economic conditions, either nationally or locally, resulting in, among other things, credit quality deterioration;
- capital management activities, including possible future sales of new securities, or possible repurchases or redemptions by the Company of outstanding debt or equity securities;
- risks of expansion through acquisitions and mergers, such as unexpected credit quality problems of the acquired loans or other assets, unexpected attrition of the customer base or employee base of the acquired institution or branches, and difficulties in integration of the acquired operations;
- factors driving impairment charges on investments;
- the impact, extent and timing of technological changes;
- potential cyber-attacks, information security breaches and other criminal activities;
- litigation liabilities, including related costs, expenses, settlements and judgments, or the outcome of matters before regulatory agencies, whether pending or commencing in the future;
- actions of the FRB;
- changes in accounting principles and interpretations;
- potential increases of federal deposit insurance premium expense, and possible future special assessments of FDIC premiums, either industry wide or specific to the Company's banking subsidiary;
- actions of the regulatory authorities under the Dodd-Frank Act and the Federal Deposit Insurance Act and other possible legislative and regulatory actions and reforms;
- impacts resulting from possible amendments or revisions to the Dodd-Frank Act and the regulations promulgated thereunder, or to CFPB rules and regulations; and
- the continued availability of earnings and excess capital sufficient for the lawful and prudent declaration and payment of cash dividends.

Such statements reflect our views with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to the operations, results of operations, growth strategy and liquidity of the Company. Readers are cautioned not to place undue reliance on these forward-looking statements. It is intended that these forward-looking statements speak only as of the date they are made. We do not undertake any obligation to release publicly any revisions to these forward-looking statements to reflect future events or circumstances or to reflect the occurrence of unanticipated events.

Item 1A. Risk Factors.

The following describes some of the principal risks and uncertainties to which our industry in general, and our securities, assets and businesses specifically, are subject; other risks are briefly identified in our cautionary statement that is included under the heading "Forward-Looking Statements and Associated Risks" in Part I, Item 1, "Business." Although we seek ways to manage these risks and uncertainties and to develop programs to control those that we can, we ultimately cannot predict the future. Future results may differ materially from past results, and from our expectations and plans.

Risks Related to the Financial Services Industry

We operate in a highly regulated environment and changes in laws and regulations to which we are subject may adversely affect our results of operations.

The banking industry in which we operate is subject to extensive regulation and supervision under federal and state laws and regulations. The restrictions imposed by such laws and regulations limit the manner in which we conduct our business, undertake new investments and activities and obtain financing. These regulations are designed primarily for the protection of the deposit insurance funds and consumers and not to benefit our shareholders. Financial institution regulation has been the subject of significant legislation in recent years and may be the subject of further significant legislation, none of which is in our control. Significant new laws or changes in, or repeals of, existing laws (including changes in federal or state laws affecting corporate taxpayers generally or financial institutions specifically) could have a material adverse effect on our business, financial condition, results of operations or liquidity. Further, federal monetary policy, particularly as implemented through the Federal Reserve System, significantly affects credit conditions, and any unfavorable change in these conditions could have a material adverse effect on our business, financial condition, results of operations or liquidity.

The Dodd-Frank Act and regulations adopted under that law could materially and adversely affect us by increasing compliance costs and heightening our risk of noncompliance with applicable regulations.

The Dodd-Frank Act (discussed in Item 1 - Business - Regulation and Supervision) has resulted in sweeping changes in the regulation of financial institutions. The Dodd-Frank Act contains numerous provisions that affect all banks and bank holding companies. Many of these provisions remain subject to regulatory rule-making and implementation, the effects of which are not yet known. Accordingly, we cannot predict the specific impact and long-term effects that the Dodd-Frank Act and the regulations promulgated thereunder will have on us and our prospects, our target markets and the financial industry more generally. However, the Dodd-Frank Act and the regulations promulgated thereunder have imposed additional administrative and regulatory burdens that obligate us to incur additional expenses (which adversely affect our margins and profitability) and increase the risk that we might not comply in all respects with the new requirements. Further, the CFPB's rule on qualified mortgages could limit our ability or desire to make certain types of loans or loans to certain borrowers, or could make it more expensive and/or time consuming to make these loans, which could adversely impact our growth or profitability.

The banking industry may be subject to new legislation, regulation, and government policy including possible amendments or revisions to the Dodd-Frank Act and the regulations promulgated thereunder, and to CFPB rules and regulations. Future legislation, regulation, and government policy could affect the banking industry as a whole, including our business and results of operations, in ways that cannot accurately be predicted. In addition, our financial condition and results of operations also could be adversely affected by changes in the way in which existing statutes and regulations are interpreted or applied by courts and government agencies.

Compliance with the Basel III Capital Rules may have an adverse effect on us.

We are subject to certain capital rules adopted by the federal banking agencies that are based on the international Basel III guidelines, which became effective January 1, 2015. See Item 1- Business - Regulation and Supervision. Some of these capital rules, which are being phased in over a three-year period that began in 2016, require us to satisfy additional, more stringent capital adequacy standards than we had in the past. These requirements could have a negative impact on our ability to lend, grow deposit balances, make acquisitions or make capital distributions in the form of dividends. Higher capital levels could also lower our return on equity.

Our FDIC insurance premiums may increase, and special assessments could be made, which might negatively impact our results of operations.

High levels of insured institution failures, as a result of the recent recession, significantly increased losses to the Deposit Insurance Fund of the FDIC. Further, the Dodd-Frank Act mandated the FDIC to increase the level of its reserves for future losses in its Deposit Insurance Fund. Since the Deposit Insurance Fund is funded by premiums and assessments paid by insured banks, our FDIC insurance premium could increase in future years depending upon the FDIC's actual loss experience, changes in our Bank's financial condition or capital strength, and future conditions in the banking industry.

Risks Related to Our Business and Financial Strategies

Economic weakness in our geographic markets could negatively affect us.

We conduct business from offices that are located in 20 contiguous southern Indiana counties and four counties in Kentucky, from which substantially all of our customer base is drawn. Because of the geographic concentration of our operations and customer base, our results depend largely upon economic conditions in this area. Any material deterioration in the economic conditions in these markets could have direct or indirect material adverse impacts on us, or on our customers or on the financial institutions with whom we deal as counterparties to financial transactions. Such deterioration could negatively impact customers' ability to obtain new loans or to repay existing loans, diminish the values of any collateral securing such loans and could cause increases in the number of the Company's customers experiencing financial distress and in the levels of the Company's delinquencies, non-performing loans and other problem assets, charge-offs and provision for credit losses, all of which could materially adversely affect our financial condition and results of operations. The underwriting and credit monitoring policies and procedures that we have adopted cannot eliminate the risk that we might incur losses on account of factors relating to the economy like those identified above, and those losses could have a material adverse effect on our business, financial condition, results of operations and cash flows.

If our actual loan losses exceed our estimates, our earnings and financial condition will be impacted.

A significant source of risk for any bank or other enterprise that lends money arises from the possibility that losses will be sustained because borrowers, guarantors and related parties may fail (because of financial difficulties or other reasons) to perform in accordance with the terms of their loan agreements. In our case, we originate many loans that are secured, but some loans are unsecured depending on the nature of the loan. With respect to secured loans, the collateral securing the repayment of these loans includes a wide variety of real and personal property that may be insufficient to cover the obligations owed under such loans, due to adverse changes in collateral values caused by changes in prevailing economic, environmental and other conditions, including declines in the value of real estate and other external events.

We could be adversely affected by changes in interest rates.

Our earnings and cash flows are largely dependent upon our net interest income. Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions, demand for loans, securities and deposits, and policies of various governmental and regulatory agencies and, in particular, the monetary policies of the FRB. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, our net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings. We maintain an investment portfolio consisting of various high quality liquid fixed-income securities. The nature of fixed-income securities is such that increases in prevailing market interest rates negatively impact the value of these securities, while decreases in prevailing market interest rates positively impact the value of these securities. Any substantial, prolonged change in market interest rates could have a material adverse effect on our financial condition, results of operations, and cash flows.

The banking and financial services business in our markets is highly competitive.

We compete with much larger regional, national, and international competitors, including competitors that have no (or only a limited number of) offices physically located within our markets, many of which compete with us via Internet and other electronic product and service offerings. In addition, banking and other financial services competitors (including newly organized companies) that are not currently represented by physical locations within our geographic markets could establish office facilities within our markets, including through their acquisition of existing competitors. In December 2016, the OCC announced its intent to make special purpose national bank charters available to financial technology companies. While the agency issued a draft supplement to its licensing manual in March 2017, providing more details on how companies applying for such charters would be evaluated, the OCC has not given any definitive indication as to whether or not it intends to move forward in making such special purpose charters available to financial technology companies. In any event, developments increasing the nature or level of our competition, or decreasing the effectiveness by which we compete, could have a material adverse effect on our business, financial condition, results of operations or liquidity. See also Part I, Item 1, of this Report, “Business - Competition,” and “Business - Regulation and Supervision.”

The manner in which we report our financial condition and results of operations may be affected by accounting changes.

Our financial condition and results of operations that are presented in our consolidated financial statements, accompanying notes to the consolidated financial statements, and selected financial data appearing in this Report, are, to a large degree, dependent upon our accounting policies. The selection of and application of these policies involve estimates, judgments and uncertainties that are subject to change, and the effect of any change in estimates or judgments that might be caused by future developments or resolution of uncertainties could be materially adverse to our reported financial condition and results of operations. In addition, authorities that prescribe accounting principles and standards for public companies from time to time change those principles or standards or adopt formal or informal interpretations of existing principles or standards. Such changes or interpretations (to the extent applicable to us) could result in changes that would be materially adverse to our reported financial condition and results of operations.

Future impacts of the Tax Cuts and Jobs Act (the "Tax Act") on us and our customers are unknown at present, creating uncertainty and risk related to demand for credit and our future results.

Increased economic activity resulting from the Tax Act's lower tax rates on businesses, generally, could encourage additional borrowing. However, some customers may use the additional cash flow from lower taxes to fund existing levels of activity and, as a result, decreasing their borrowing needs. The elimination of the federal income tax deductibility of business interest expense for a significant number of our customers effectively increases the cost of borrowing and makes equity or hybrid funding relatively more attractive. This could have a long-term negative impact on business customer borrowing. While our 2018 net income was positively impacted by the Tax Act, there is no guarantee that our future results will benefit similarly. Some or all of the benefits realized in 2018 could be lost to the extent that the banks and financial services companies we compete with elect to lower interest rates and fees and we must do the same in order to remain competitive. Additionally, the benefits from the Tax Act could be repealed as a result of future regulatory actions. As a result of these uncertainties, there is no assurance that we will realize the anticipated continued benefits of the Tax Act in the future.

Liquidity risk could impair our ability to fund operations and jeopardize our financial condition.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale of securities or loans and other sources could have a substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities or the terms of which are acceptable to us could be impaired by factors that affect us specifically or the financial services industry or economy in general. Although we have historically been able to replace maturing deposits and borrowings as necessary, we might not be able to replace such funds in the future if, among other things, our results of operations or financial condition or the results of operations or financial condition of our lenders or market conditions were to change.

The value of securities in our investment securities portfolio may be negatively affected by disruptions in securities markets.

Prices and volumes of transactions in the nation’s securities markets can be affected suddenly by economic crises, or by other national or international crises, such as national disasters, acts of war or terrorism, changes in commodities markets, or instability in foreign governments. Disruptions in securities markets may detrimentally affect the value of securities that we hold in our investment portfolio, such as through reduced valuations due to the perception of heightened credit and liquidity risks. There can be no assurance that declines in market value associated with these disruptions will not result in other than temporary impairments of these assets, which would lead to accounting charges that could have a material adverse effect on our net income and capital levels.

The soundness of other financial institutions could adversely affect us.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services companies are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds, and other institutional clients. As a result, defaults by, or even rumors or questions about, one or more financial services companies, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. Many of these transactions expose us to credit risk in the event of default of our counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by us cannot be realized or is liquidated at prices not sufficient to recover the full amount due us.

We are dependent on key personnel and the loss of one or more of those key personnel could harm our business.

Competition for qualified employees and personnel in the financial services industry (including banking personnel, trust and investments personnel, and insurance personnel) is intense and there are a limited number of qualified persons with knowledge of and experience in our local Southern Indiana markets. Our success depends to a significant degree upon our ability to attract and retain qualified loan origination executives, sales executives for our trust and investment products and services, and sales executives for our insurance products and services. We also depend upon the continued contributions of our management personnel, and in particular upon the abilities of our senior executive management, and the loss of the services of one or more of them could harm our business.

Our controls and procedures may fail or be circumvented.

Management regularly reviews and updates our internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of our controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, results of operations, cash flows and financial condition.

Our methods of reducing risk exposure may not be effective.

The Company maintains a comprehensive risk management program designed to identify, quantify, manage, mitigate, monitor, aggregate, and report risks. However, instruments, systems and strategies used to hedge or otherwise manage exposure to various types of credit, market, liquidity, operational, compliance, financial reporting and strategic risks could be less effective than anticipated. As a result, the Company may not be able to effectively mitigate its risk exposures in particular market environments or against particular types of risk, which could have a material adverse effect on our business, results of operations, cash flows and financial condition. For more information regarding risk management, please see “RISK MANAGEMENT” under Item 7 of this Report (“Management’s Discussion and Analysis of Financial Condition and Results of Operations”).

We are exposed to risk of environmental liabilities with respect to properties to which we take title.

In the course of our business, we may own or foreclose and take title to real estate, and could be subject to environmental liabilities with respect to these properties (including liabilities for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination), or may be required to investigate or clean up hazardous or toxic substances, or chemical releases at a property.

Risks Related to Our Operations

We face significant operational risks due to the high volume and the high dollar value nature of transactions we process.

We operate in many different businesses in diverse markets and rely on the ability of our employees and systems to process transactions. Operational risk is the risk of loss resulting from our operations, including but not limited to, the risk of fraud by employees or persons outside our company, the execution of unauthorized transactions, errors relating to transaction processing and technology, breaches of our internal control systems or failures of those of our suppliers or counterparties, compliance failures, cyber-attacks or unforeseen problems encountered while implementing new computer systems or upgrades to existing systems, business continuation and disaster recovery issues, and other external events. Insurance coverage may not be available for such losses, or where available, such losses may exceed insurance limits. This risk of loss also includes the potential legal actions that could arise as a result of an operational deficiency or as a result of noncompliance with applicable regulatory standards, adverse business decisions or their implementation, and customer attrition due to potential negative publicity. The occurrence of any of these events could cause us to suffer financial loss, face regulatory action and suffer damage to our reputation.

Unauthorized disclosure of sensitive or confidential client or customer information, whether through a cyber-attack, other breach of our computer systems or otherwise, could harm our business.

In the normal course of our business, we collect, process and retain sensitive and confidential client and customer information on our behalf and on behalf of other third parties. Despite the security measures we have in place, our facilities and systems may be vulnerable to cyber-attacks, security breaches, acts of vandalism, computer viruses, misplaced or lost data, programming and / or human errors, or other similar events.

Information security risks for financial institutions like us have increased recently in part because of new technologies, the use of the Internet and telecommunications technologies (including mobile devices) to conduct financial and other business transactions and the increased sophistication and activities of organized crime, perpetrators of fraud, hackers, terrorists and others. In addition to cyber-attacks or other security breaches involving the theft of sensitive and confidential information, hackers recently have engaged in attacks against large financial institutions, particularly denial of service attacks, designed to disrupt key business services such as customer-facing web sites. We may not be able to anticipate or implement effective preventive measures against all security breaches of these types. Although we employ detection and response mechanisms designed to contain and mitigate security incidents, early detection may be thwarted by sophisticated attacks and malware designed to avoid detection.

We also face risks related to cyber-attacks and other security breaches in connection with credit card transactions that typically involve the transmission of sensitive information regarding our customers through various third parties. Some of these parties have in the past been the target of security breaches and cyber-attacks, and because the transactions involve third parties and environments that we do not control or secure, future security breaches or cyber-attacks affecting any of these third parties could impact us through no fault of our own, and in some cases we may have exposure and suffer losses for breaches or attacks relating to them. We also rely on numerous other third party service providers to conduct other aspects of our business operations and face similar risks relating to them. We cannot be sure that their information security protocols are sufficient to withstand a cyber-attack or other security breach.

Any cyber-attack or other security breach involving the misappropriation, loss or other unauthorized disclosure of confidential customer information could severely damage our reputation, erode confidence in the security of our systems, products and services, expose us to the risk of litigation and liability, disrupt our operations and have a material adverse effect on our business.

Our information systems may experience an interruption or breach in security.

We rely heavily on communications and information systems to conduct our business. Any failure, interruption, or breach in security or operational integrity of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan, and other systems. While we have policies and procedures designed to prevent or limit the effect of the failure, interruption, or security breach of our information systems, we cannot completely ensure that any such failures, interruptions, or security breaches will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions, or security breaches of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

We are dependent upon third parties for certain information system, data management and processing services and to provide key components of our business infrastructure.

We outsource certain information system and data management and processing functions to third party providers. These third party service providers are sources of operational and informational security risk to us, including risks associated with operational errors, information system interruptions or breaches, and unauthorized disclosures of sensitive or confidential client or customer information. If third party service providers encounter any of these issues, or if we have difficulty communicating with them, we could be exposed to disruption of operations, loss of service or connectivity to customers, reputational damage, and litigation risk that could have a material adverse effect on our results of operations or our business.

Third party vendors provide key components of our business infrastructure such as internet connections, network access and core application processing.

While we have selected these third party vendors carefully, we do not control their actions. Any problems caused by these third parties, including as a result of their not providing us their services for any reason or their performing their services poorly, could adversely affect our ability to deliver products and services to our customers and otherwise to conduct our business. Replacing these third party vendors could also entail significant delay and expense.

Risks Relating to Expansion of Our Businesses by Acquisition

Any acquisitions of banks, bank branches, or loans or other financial service assets pose risks to us.

We may acquire other banks, bank branches and other financial-service-related businesses and assets in the future. Acquiring other banks, businesses, or branches involves various risks commonly associated with acquisitions, including, among other things:

- potential exposure to unknown or contingent liabilities of the acquired assets, operations or company;
- exposure to potential asset quality issues of the acquired assets, operations or company;
- environmental liability with acquired real estate collateral or other real estate;
- difficulty and expense of integrating the operations, systems and personnel of the acquired assets, operations or company;
- potential disruption to our ongoing business, including diversion of our management's time and attention;
- the possible loss of key employees and customers of the acquired operations or company;
- difficulty in estimating the value of the acquired assets, operations or company; and
- potential changes in banking or tax laws or regulations that may affect the acquired assets, operations or company.

We may not be successful in overcoming these risks or any other problems encountered in connection with mergers or acquisitions.

Acquisitions typically involve the payment of a premium over book and market values, and, therefore, some dilution of the Company's tangible book value per common share or net income per common share (or both) may occur in connection with any future transaction.

We may incur substantial costs to expand by acquisition, and such acquisitions may not result in the levels of profits we seek.

Integration efforts for any future acquisitions may not be successful and following any future acquisition, after giving it effect, we may not achieve financial results comparable to or better than our historical experience.

We may participate in FDIC-assisted acquisitions, which could present additional risks to our financial condition.

We may make opportunistic whole or partial acquisitions of troubled financial institutions in transactions facilitated by the FDIC. In addition to the risks frequently associated with acquisitions, an acquisition of a troubled financial institution may involve a greater risk that the acquired assets underperform compared to our expectations. Because these acquisitions are structured in a manner that would not allow us the time normally associated with preparing for and evaluating an acquisition, including preparing for integration of an acquired institution, we may face additional risks including, among other things, the loss of customers, strain on management resources related to collection and management of problem loans and problems related to integration of personnel and operating systems. Additionally, while the FDIC may agree to assume certain losses in transactions that it facilitates, there can be no assurances that we would not be required to raise additional capital as a condition to, or as a result of, participation in an FDIC-assisted transaction. Any such transactions and related issuances of stock may have dilutive effect on earnings per share and share ownership.

Risks Related to Our Common Stock

Our common stock price may fluctuate significantly, and this may make it difficult for you to resell our common stock at times or at prices acceptable to you.

Our common stock price constantly changes in response to a variety of factors (some of which are beyond our control), and we expect that our stock price will continue to fluctuate in the future. Factors impacting the price of our common stock include, among others:

- actual or anticipated variations in our quarterly results of operations;
- recommendations or research reports about us or the financial services industry in general published by securities analysts;
- the failure of securities analysts to cover, or continue to cover, us;
- operating and stock price performance of other companies that investors believe are comparable to us;
- news reports relating to trends, concerns and other issues in the financial services industry;
- perceptions in the marketplace regarding us, or our reputation, competitors or other financial institutions;
- actual or anticipated sales of our equity or equity-related securities;
- our past and future dividend practice;
- departure of our management team or other key personnel;
- new technology used, or services offered, by competitors;
- significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving us or our competitors;
- failure to integrate acquisitions or realize anticipated benefits from acquisitions;
- existing or increased regulatory and compliance requirements, changes or proposed changes in laws or regulations, or differing interpretations thereof affecting our business, or enforcement of these laws and regulations; and
- litigation and governmental investigations.

General market fluctuations, industry factors and general economic and political conditions and events (such as economic slowdowns or recessions, interest rate changes or credit loss trends) could also cause our stock price to decrease regardless of operating results.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

The Company’s executive offices are located in the main office building of the Bank at 711 Main Street, Jasper, Indiana. The main office building, which is owned by the Bank and also serves as the main office of the Company’s other subsidiaries, contains approximately 23,600 square feet of office space. The Bank and the Company’s other subsidiaries also conduct their operations from 60 other locations in Southern Indiana and eight in Northern Kentucky of which 54 are owned by the Company and 15 are leased from third parties.

Item 3. Legal Proceedings.

There are no material pending legal proceedings, other than routine litigation incidental to the business of the Company’s subsidiaries, to which the Company or any of its subsidiaries is a party or of which any of their property is the subject.

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Market for Common Stock

German American Bancorp, Inc.’s stock is traded on NASDAQ’s Global Select Market under the symbol GABC.

The Common Stock was held of record by approximately 3,684 shareholders at February 20, 2019.

Transfer Agent:	Computershare Priority Processing 250 Royall St Canton, MA 02021 Contact: Shareholder Relations (800) 884-4225	Shareholder Information and Corporate Office:	Terri A. Eckerle German American Bancorp, Inc. P.O. Box 810 Jasper, Indiana 47547-0810 (812) 482-1314 (800) 482-1314

Stock Performance Graph

The following graph compares the Company’s five-year cumulative total returns with those of the Russell 2000 Stock Index, Russell Microcap Stock Index, and the Indiana Bank Peer Group. The Indiana Bank Peer Group (which is a custom peer group identified by Company management) includes all Indiana-based commercial bank holding companies (excluding companies owning thrift institutions that are not regulated as bank holding companies) that have been in existence as commercial bank holding companies throughout the five-year period ended December 31, 2018, the stocks of which have been traded on an established securities market (NYSE, NYSE American or NASDAQ) throughout that five-year period. The companies comprising the Indiana Bank Peer Group for purposes of the December 2018 comparison were: 1st Source Corp., First Financial Corp., First Merchants Corp., Lakeland Financial Corp., Old National Bancorp, Horizon Bancorp, MutualFirst Financial, Inc., and First Internet Bancorp. First Internet Bancorp was added to the Indiana Bank Peer Group for the first time in this Annual Report on Form 10-K as a result of being approved for listing on the NASDAQ Capital Market effective February 22, 2013, and otherwise meeting the above criteria. The returns of each company in the Indiana Bank Peer Group have been weighted to reflect the company’s market capitalization. The Russell 2000 Stock Index, which is designed to measure the performance of the small-cap segment of the U.S. equity universe, is a subset of the Russell 3000 Index (which measures the performance of the largest 3,000 U.S. companies) that includes approximately 2,000 of the smallest securities in that index based on a combination of their market cap and current index membership, and is annually reconstituted at the end of each June. The Russell Microcap Stock Index is an index representing the smallest 1,000 securities in the small-cap Russell 2000 Index plus the next 1,000 securities, which is also annually reconstituted at the end of each June. The Company’s stock is currently included in the Russell 2000 Index and Russell Microcap Index.

Stock Repurchase Program Information

The following table sets forth information regarding the Company's purchases of its common shares during each of the three months ended December 31, 2018.

Period	Total Number of Shares (or Units) Purchased	Average Price Paid Per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs [1]
October 2018	—	—	—	409,184
November 2018	—	—	—	409,184
December 2018	—	—	—	409,184

[1] On April 26, 2001, the Company announced that its Board of Directors had approved a stock repurchase program for up to 911,631 of its outstanding common shares, of which the Company had purchased 502,447 common shares through December 31, 2018 (both such numbers adjusted for subsequent stock dividends). The Board of Directors established no expiration date for this program. The Company purchased no shares under this program during the quarter ended December 31, 2018.

Equity Compensation Plan Information

The Company maintains four plans under which it has authorized the issuance of its Common Shares to employees and non-employee directors as compensation: its 1992 Stock Option Plan (under which no new grants may be made), its 1999 Long-Term Equity Incentive Plan (under which no new grants may be made), its 2009 Long-Term Equity Incentive Plan, and its 2009 Employee Stock Purchase Plan. Each of these four plans was approved by the requisite vote of the Company's common shareholders in the year of adoption by the Board of Directors. The Company is not a party to any individual compensation arrangement involving the authorization for issuance of its equity securities to any single person, other than option agreements and restricted stock award agreements that have been granted under the terms of one of the four plans identified above. The following table sets forth information regarding these plans as of December 31, 2018:

Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants or Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans (Excluding Securities Reflected in First Column)

Equity compensation plans approved by security holders	— (a)	$ —	845,697	(b)
Equity compensation plans not approved by security holders	—	—	—	
Total	—	$ —	845,697	

(a) Any shares that employees may have the right to purchase under the Employee Stock Purchase Plan in August 2019 in respect of employee payroll deductions of participating employees that had accumulated as of December 31, 2018 during the plan year that commenced in August 2018 have been excluded. Although these employees have the right under this Plan to have their accumulated payroll deductions applied to the purchase of Common Shares at a discounted price in August 2019, the price at which such shares may be purchased and the number of shares that may be purchased under that Plan at that time is not presently determinable.

(b) Represents 539,293 shares that the Company may in the future issue to employees under the Employee Stock Purchase Plan (although the Company typically purchases the shares needed for sale to participating employees on the open market rather than issuing new issue shares to such employees) and 306,404 shares that were available for grant or issuance at December 31, 2018 under the 2009 Long-Term Equity Incentive Plan. Under the Long-Term Equity Incentive Plan, the aggregate number of Common Shares available for the grant of awards (subject to customary anti-dilution adjustment provisions) cumulatively following the adoption of the Plan in 2009 through the expiration of the Plan in 2019 may not exceed the sum of the following: (a) 500,000 shares, plus (b) any shares exchanged by a participant as full or partial payment to the Company of the exercise price of an option granted to the participant under the Plan; plus (c) at the beginning of each calendar year, an additional number of shares (if any) equal to the number of shares that would result in the number of shares available for awards as of such date being equal to one percent (1%) of the total number of the Company's shares outstanding as of the immediately preceding December 31, on a fully-diluted basis.

For additional information regarding the Company's equity incentive plans and employee stock purchase plan, see Note 8 (Shareholders' Equity) of the Notes to the Consolidated Financial Statements included in Item 8 of this Report.

Item 6. Selected Financial Data.

The following selected data should be read in conjunction with the consolidated financial statements and related notes that are included in Item 8 of this Report, and “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” which is included in Item 7 of this Report (dollars in thousands, except per share data). Year-to-year financial information comparability is affected by the acquisition accounting treatment for mergers and acquisitions, including but not limited to the Company's acquisition of River Valley Bancorp, effective March 1, 2016, the acquisition of five branches from First Financial Bancorp effective May 18, 2018, and the acquisition of First Security, Inc effective October 15, 2018.

	2018		2017		2016		2015		2014	
Summary of Operations:										
Interest Income	$133,749		$111,030		$103,365		$81,620		$80,386	
Interest Expense	19,139		11,121		8,461		6,068		6,047	
Net Interest Income	114,610		99,909		94,904		75,552		74,339	
Provision for Loan Losses	2,070		1,750		1,200		—		150	
Net Interest Income after Provision For Loan Losses	112,540		98,159		93,704		75,552		74,189	
Non-interest Income	37,070		31,854		32,013		27,444		23,937	
Non-interest Expense	93,553		77,803		76,587		61,326		57,713	
Income before Income Taxes	56,057		52,210		49,130		41,670		40,413	
Income Tax Expense	9,528		11,534		13,946		11,606		12,069	
Net Income	$46,529		$40,676		$35,184		$30,064		$28,344	
Year-end Balances:										
Total Assets	$3,929,090		$3,144,360		$2,955,994		$2,373,701		$2,237,099	
Total Loans, Net of Unearned Income	2,728,059		2,141,638		1,989,955		1,564,347		1,447,982	
Total Deposits	3,072,632		2,484,052		2,349,551		1,826,376		1,779,761	
Total Long-term Debt	126,635		141,717		120,560		95,606		64,591	
Total Shareholders’ Equity	458,640		364,571		330,267		252,348		228,824	
Average Balances:										
Total Assets	$3,380,409		$3,002,695		$2,841,096		$2,267,555		$2,170,761	
Total Loans, Net of Unearned Income	2,339,089		2,036,717		1,904,779		1,483,752		1,406,000	
Total Deposits	2,716,712		2,395,146		2,249,892		1,825,913		1,783,348	
Total Shareholders’ Equity	385,476		350,913		321,520		241,018		214,496	
Per Share Data:										
Net Income (1)	$1.99		$1.77		$1.57		$1.51		$1.43	
Cash Dividends	0.60		0.52		0.48		0.45		0.43	
Book Value at Year-end	18.37		15.90		14.42		12.67		11.54	
Tangible Book Value Per Share (2)	13.81		13.45		11.94		11.57		10.40	
Other Data at Year-end:										
Number of Shareholders	3,705		3,459		3,513		3,343		3,398	
Number of Employees	747		621		605		479		473	
Weighted Average Number of Shares (1)	23,381,616		22,924,726		22,391,115		19,888,374		19,834,766	
Selected Performance Ratios:										
Return on Assets	1.38	%	1.35	%	1.24	%	1.33	%	1.31	%

Return on Equity	12.07 %	11.59 %	10.94 %	12.47 %	13.21 %
Equity to Assets	11.67 %	11.59 %	11.17 %	10.63 %	10.23 %
Dividend Payout	30.25 %	29.11 %	30.21 %	29.97 %	29.81 %
Net Charge-offs (Recoveries) to Average Loans	0.08 %	0.04 %	0.04 %	0.03 %	(0.01)%
Allowance for Loan Losses to Loans	0.58 %	0.73 %	0.74 %	0.92 %	1.03 %
Net Interest Margin	3.75 %	3.76 %	3.75 %	3.70 %	3.76 %

(1) Share and Per Share Data includes the dilutive effect of stock options.

(2) Tangible Book Value per Share is defined as Total Shareholders' Equity less Goodwill and Other Intangible Assets divided by End of Period Shares Outstanding.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

INTRODUCTION

German American Bancorp, Inc., is a NASDAQ-traded (symbol: GABC) bank holding company based in Jasper, Indiana. German American, through its banking subsidiary German American Bank, operates 65 banking offices in 20 contiguous southern Indiana counties and four Kentucky counties. The Company also owns an investment brokerage subsidiary (German American Investment Services, Inc.) and a full line property and casualty insurance agency (German American Insurance, Inc.).

Throughout this Management's Discussion and Analysis, as elsewhere in this Report, when we use the term "Company", we will usually be referring to the business and affairs (financial and otherwise) of the Company and its subsidiaries and affiliates as a whole. Occasionally, we will refer to the term "parent company" or "holding company" when we mean to refer to only German American Bancorp, Inc., and the term "Bank" when we mean to refer to only the Company's bank subsidiary.

This Management's Discussion and Analysis includes an analysis of the major components of the Company's operations for the years 2016 through 2018 and its financial condition as of December 31, 2017 and 2018. This information should be read in conjunction with the accompanying consolidated financial statements and footnotes contained elsewhere in this Report and with the description of business included in Item 1 of this Report (including the cautionary disclosure regarding "Forward Looking Statements and Associated Risks"). Financial and other information by segment is included in Note 16 (Segment Information) of the Notes to the Consolidated Financial Statements included in Item 8 of this Report and is incorporated into this Item 7 by reference.

The statements of management's expectations and goals concerning the Company's future operations and performance that are set forth in the following Management Overview and in other sections of this Item 7 are forward-looking statements, and readers are cautioned that these forward-looking statements are based on assumptions and are subject to risks, uncertainties, and other factors. Actual results may differ materially from the expectations of the Company that is expressed or implied by any forward-looking statement. This Item 7, as well as the discussions in Item 1 ("Business") entitled "Forward-Looking Statements and Associated Risks" and in Item 1A ("Risk Factors") (which discussions are incorporated in this Item 7 by reference) list some of the factors that could cause the Company's actual results to vary materially from those expressed or implied by any such forward-looking statements.

Any statements of management's expectations and goals concerning the Company's future operations and performance, and future financial condition, liquidity and capital resources that are set forth in the following Management Overview and in other sections of this Item 7 are forward-looking statements, and readers are cautioned that these forward-looking statements are based on assumptions and are subject to risks, uncertainties, and other factors. Actual results may differ materially from the expectations of the Company that is expressed or implied by any forward-looking statement. This Item 7, as well as the discussions in Item 1 ("Business") entitled "Forward-Looking Statements and Associated Risks" and in Item 1A ("Risk Factors") (which discussions are incorporated in this Item 7 by reference) list some of the factors that could cause the Company's actual results to vary materially from those expressed or implied by any such forward-looking statements.

MANAGEMENT OVERVIEW

Net income for the year ended December 31, 2018 totaled $46,529,000 or $1.99 per share, an increase of $5,853,000, or approximately 12% on a per share basis, from the year ended December 31, 2017 net income of $40,676,000 or $1.77 per share.

Net income for 2018 was positively impacted by lower federal income tax rates that became effective January 1, 2018, as a result of the Tax Cuts and Jobs Act of 2017 (the "Tax Act"). The lower federal income tax rates had a positive impact of approximately $0.26 per share for the year ended December 31, 2018.

Net income for 2018 was also impacted by merger and acquisition activity during the year. The year ended December 31, 2018 included acquisition-related expenses of approximately $4,592,000 (approximately $3,526,000 or $0.15 per share, on an after tax basis).

During the fourth quarter of 2017, as a result of the enactment of the Tax Act, the Company revalued its deferred tax assets and deferred tax liabilities. The revaluation resulted in a net tax benefit of $2,284,000, or approximately $0.10 per share during 2017.

On May 18, 2018, German American Bank completed the acquisition of five branch locations of First Financial Bancorp (formerly branch locations of Mainsource Financial Group, Inc. prior to its merger with First Financial Bancorp on April 1, 2018) and certain related assets, and the assumption by German American Bank of certain related liabilities. Four of the branches are located in

Columbus, Indiana, and one in Greensburg, Indiana. German American Bank acquired approximately $175.7 million in deposits and approximately $116.3 million in loans associated with the five bank branches. The premium paid on deposits by German American Bank was approximately $7.4 million. The premium was subject to adjustment to reflect increases or decreases in the deposit balances during the six month period following the closing date. In January 2019, an adjustment of approximately $0.1 million in additional premium was paid by German American Bank as a result of the change in deposits during the six month measurement period. German American Bank also had the ability, under certain circumstances, to put loans back to First Financial Bancorp's bank subsidiary during such six month period. During the fourth quarter of 2018, approximately $1.3 million of loans were put back by German American Bank.

On October 15, 2018, the Company completed the acquisition of First Security, Inc. ("First Security") through the merger of First Security with and into the Company. Immediately following completion of the First Security holding company merger, First Security's subsidiary bank, First Security Bank, Inc., was merged with and into the Company's subsidiary bank, German American Bank. First Security, based in Owensboro, Kentucky, operated 11 retail banking offices, through First Security Bank, Inc., in Owensboro, Bowling Green, Franklin and Lexington, Kentucky and in Evansville and Newburgh, Indiana. As of the closing of the transaction, First Security had total assets of approximately $553.2 million, total loans of approximately $390.1 million, and total deposits of approximately $424.4 million. The Company issued approximately 2.0 million shares of its common stock, and paid approximately $31.2 million in cash, in exchange for all of the issued and outstanding shares of common stock of First Security and in cancellation of all outstanding options to acquire First Security common stock.

On February 21, 2019, the Company entered into an Agreement and Plan of Reorganization with Citizens First Corporation ("Citizens First"), pursuant to which Citizens First agreed to merge with and into the Company. The merger agreement also provides that Citizens First's wholly-owned banking subsidiary, Citizens First Bank, Inc. will be merged with and into the Company's subsidiary bank, German American Bank, immediately following the holding company merger. Based on the number of Citizens First common shares expected to be outstanding at closing, the Company would issue approximately 1.7 million shares of its common stock, and pay approximately $16 million cash, for all of the issued and outstanding common shares of Citizens First. Citizens First is a bank holding company headquartered in Bowling Green, Kentucky. It operates, through Citizens First Bank, Inc., branch offices in Barren, Hart, Simpson and Warren Counties in Kentucky, and a loan production office in Williamson County, Tennessee. At December 31, 2018, Citizens First reported total assets of approximately $476 million, total loans of approximately $372 million, and total deposits of approximately $389 million. Completion of the mergers is subject to approval by regulatory authorities and Citizens First's shareholders, as well as certain other closing conditions. The transaction is expected to be completed in the third quarter of 2019.

For further information regarding this pending acquisition, see Note 21 (Subsequent Events) in the Notes to the Consolidated Financial Statements included in Item 8 of this Report.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The financial condition and results of operations for the Company presented in the Consolidated Financial Statements, accompanying Notes to the Consolidated Financial Statements, and selected financial data appearing elsewhere within this Report, are, to a large degree, dependent upon the Company's accounting policies. The selection of and application of these policies involve estimates, judgments, and uncertainties that are subject to change. The critical accounting policies and estimates that the Company has determined to be the most susceptible to change in the near term relate to the determination of the allowance for loan losses, the valuation of securities available for sale, income tax expense, and the valuation of goodwill and other intangible assets.

Allowance for Loan Losses

The Company maintains an allowance for loan losses to cover probable incurred credit losses at the balance sheet date. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off. A provision for loan losses is charged to operations based on management's periodic evaluation of the necessary allowance balance. Evaluations are conducted at least quarterly and more often if deemed necessary. The ultimate recovery of all loans is susceptible to future market factors beyond the Company's control.

The Company has an established process to determine the adequacy of the allowance for loan losses. The determination of the allowance is inherently subjective, as it requires significant estimates, including the amounts and timing of expected future cash flows on impaired loans, estimated losses on other classified loans and pools of homogeneous loans, and consideration of past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors, all of which may be susceptible to significant change. The allowance consists of two components of allocations, specific and general. These two components represent the total allowance for loan losses deemed adequate to cover losses inherent in the loan portfolio.

Commercial and agricultural loans are subject to a standardized grading process administered by an internal loan review function. The need for specific reserves is considered for credits identified as impaired when: (a) the customer's cash flow or net worth appears insufficient to repay the loan; (b) the loan has been criticized in a regulatory examination; (c) the loan is on non-accrual; or (d) other reasons where the ultimate collectability of the loan is in question, or the loan characteristics require special monitoring. Specific allowances are established in cases where management has identified significant conditions or circumstances related to an individual credit that we believe indicates the loan is impaired.

Specific allocations on impaired loans are determined by comparing the loan balance to the present value of expected cash flows or expected collateral proceeds. Allocations are also applied to categories of loans not considered individually impaired but for which the rate of loss is expected to be greater than historical averages, including non-performing consumer or residential real estate loans. Such allocations are based on past loss experience and information about specific borrower situations and estimated collateral values.

General allocations are made for commercial and agricultural loans that are graded as substandard based on migration analysis techniques to determine historical average losses for similar types of loans. General allocations are also made for other pools of loans, including non-classified loans, homogeneous portfolios of consumer and residential real estate loans, and loans within certain industry categories believed to present unique risk of loss. General allocations of the allowance are primarily made based on historical averages for loan losses for these portfolios, judgmentally adjusted for economic, external and internal factors and portfolio trends. Economic factors include evaluating changes in international, national, regional and local economic and business conditions that affect the collectability of the loan portfolio. Internal factors include evaluating changes in lending policies and procedures; changes in the nature and volume of the loan portfolio; and changes in experience, ability and depth of lending management and staff. In setting our external and internal factors we also consider the overall level of the allowance for loan losses to total loans; our allowance coverage as compared to similar size bank holding companies; and regulatory requirements.

Due to the imprecise nature of estimating the allowance for loan losses, the Company's allowance for loan losses includes a minor unallocated component. The unallocated component of the allowance for loan losses incorporates the Company's judgmental determination of inherent losses that may not be fully reflected in other allocations, including factors such as economic uncertainties, lending staff quality, industry trends impacting specific portfolio segments, and broad portfolio quality trends. Therefore, the ratio of allocated to unallocated components within the total allowance may fluctuate from period to period.

Securities Valuation

Securities available-for-sale are carried at fair value, with unrealized holding gains and losses reported separately in accumulated other comprehensive income (loss), net of tax. The Company obtains market values from a third party on a monthly basis in order to adjust the securities to fair value. Equity securities that do not have readily determinable fair values are carried at cost. Additionally, when securities are deemed to be other than temporarily impaired, a charge will be recorded through earnings; therefore, future changes in the fair value of securities could have a significant impact on the Company's operating results. In determining whether a market value decline is other than temporary, management considers the reason for the decline, the extent of the decline, the duration of the decline and whether the Company intends to sell or believes it will be required to sell the securities prior to recovery. As of December 31, 2018, gross unrealized gains on the securities available-for-sale portfolio totaled approximately $5,436,000 and gross unrealized losses totaled approximately $14,079,000.

Income Tax Expense

Income tax expense involves estimates related to the valuation allowance on deferred tax assets and loss contingencies related to exposure from tax examinations presumed to occur.

A valuation allowance reduces deferred tax assets to the amount management believes is more likely than not to be realized. In evaluating the realization of deferred tax assets, management considers the likelihood that sufficient taxable income of appropriate character will be generated within carry-back and carry-forward periods, including consideration of available tax planning strategies. Tax-related loss contingencies, including assessments arising from tax examinations and tax strategies, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. In considering the likelihood of loss, management considers the nature of the contingency, the progress of any examination or related protest or appeal, the views of legal counsel and other advisors, experience of the Company or other enterprises in similar matters, if any, and management's intended response to any assessment.

Goodwill and Other Intangible Assets

Goodwill resulting from business combinations represents the excess of the purchase price over the fair value of the net assets of businesses acquired. Goodwill resulting from business combinations is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually. The Company has selected December 31 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on the Company's balance sheet.

Other intangible assets consist of core deposit and acquired customer relationship intangible assets. They are initially measured at fair value and then are amortized over their estimated useful lives, which range from 6 to 10 years.

RESULTS OF OPERATIONS

NET INCOME

Net income for the year ended December 31, 2018 totaled $46,529,000 or $1.99 per share, an increase of $5,853,000, or approximately 12% on a per share basis, from the year ended December 31, 2017 net income of $40,676,000 or $1.77 per share.
Net income for 2018 was positively impacted by lower federal income tax rates that became effective January 1, 2018, as a result of the Tax Cuts and Jobs Act of 2017 (the "Tax Act"). The lower federal income tax rates had a positive impact of approximately $0.26 per share for the year ended December 31, 2018.

Net income for 2018 was also impacted by the five-branch acquisition completed in May 2018 and the First Security acquisition completed in October 2018. The year ended December 31, 2018 included acquisition-related expenses of approximately $4,592,000 (approximately $3,526,000 or $0.15 per share, on an after tax basis) for the aforementioned acquisitions.

Net income for the year ended December 31, 2017 totaled $40,676,000 or $1.77 per share, an increase of $5,492,000, or approximately 13% on a per share basis, from the year ended December 31, 2016 net income of $35,184,000 or $1.57 per share. The 2017 results of operations were positively impacted by the revaluation of the Company's deferred tax assets and deferred tax liabilities related to the Tax Act. The revaluation resulted in a net tax benefit of $2,284,000, or approximately $0.10 per share during 2017.

NET INTEREST INCOME

Net interest income is the Company's single largest source of earnings, and represents the difference between interest and fees realized on earning assets, less interest paid on deposits and borrowed funds. Several factors contribute to the determination of net interest income and net interest margin, including the volume and mix of earning assets, interest rates, and income taxes. Many factors affecting net interest income are subject to control by management policies and actions. Factors beyond the control of management include the general level of credit and deposit demand, Federal Reserve Board monetary policy, and changes in tax laws.

Net interest income increased $14,701,000, or 15%, for the year ended December 31, 2018 compared with 2017. The increased level of net interest income during 2018 compared with 2017 was driven primarily by a higher level of earning assets resulting from organic loan growth and merger and acquisition activity completed during 2018.

The net interest margin represents tax-equivalent net interest income expressed as a percentage of average earning assets. The tax equivalent net interest margin for the year ended December 31, 2018 was 3.75% compared to 3.76% in 2017. The tax equivalent yield on earning assets totaled 4.36% during 2018 compared to 4.16% in 2017, while the cost of funds (expressed as a percentage of average earning assets) totaled 0.61% during 2018 compared to 0.40% in 2017. The increased yield on earning assets and the increase in the cost of funds during 2018 were both impacted by increased short-term market interest rates.

Accretion of loan discounts on acquired loans contributed approximately 8 basis points to the net interest margin during 2018 compared with 9 basis points in 2017. The lower federal income tax rates during 2018 had an approximately 9 basis point negative impact on the Company's net interest margin and earning asset yield.

Net interest income increased $5,005,000, or 5%, for the year ended December 31, 2017 compared with 2016. The increased level of net interest income during 2017 compared with 2016 was driven primarily by a higher level of earning assets resulting from organic loan growth and the acquisition of River Valley Bancorp effective March 1, 2016.

The tax equivalent net interest margin was 3.76% during 2017 compared to 3.75% during 2016. The tax equivalent yield on earning assets totaled 4.16% during 2017 compared to 4.07% in 2016, while the cost of funds totaled 0.40% during 2017 compared to 0.32% in 2016.

The modest increase in the net interest margin during 2017 compared with the prior year was primarily attributable to an improved yield on the Company's securities portfolio combined with a larger loan portfolio, partially offset by a higher cost of funds and a lower level of accretion of loan discounts on acquired loans. Accretion of loan discounts on acquired loans contributed approximately 9 basis points to the net interest margin during 2017 and 13 basis points in 2016. The Company's cost of funds increased approximately 8 basis points during 2017 compared with 2016. The higher cost of funds was largely attributable to an increase in short-term market interest rates.

The following table summarizes net interest income (on a tax-equivalent basis) for each of the past three years. For tax-equivalent adjustments, an effective tax rate of 21% was used for 2018 and an effective tax rate of 35% was used for 2017 and 2016 [1].

Average Balance Sheet
(Tax-equivalent basis, dollars in thousands)

	Twelve Months Ended December 31, 2018			Twelve Months Ended December 31, 2017			Twelve Months Ended December 31, 2016		
	Principal Balance	Income / Expense	Yield / Rate	Principal Balance	Income / Expense	Yield / Rate	Principal Balance	Income / Expense	Yield / Rate
ASSETS									
Federal Funds Sold and Other Short-term Investments	$18,587	$308	1.65%	$12,405	$134	1.09%	$22,180	$74	0.33%
Securities:									
Taxable	488,291	12,398	2.54%	482,331	10,898	2.26%	484,744	9,638	1.99%
Non-taxable	280,070	11,341	4.05%	262,654	12,697	4.83%	238,300	11,464	4.81%
Total Loans and Leases (2)	2,339,089	112,437	4.81%	2,036,717	92,449	4.54%	1,904,779	86,755	4.55%
TOTAL INTEREST EARNING ASSETS	3,126,037	136,484	4.36%	2,794,107	116,178	4.16%	2,650,003	107,931	4.07%
Other Assets	270,022			223,939			206,213		
Less: Allowance for Loan Losses	(15,650)			(15,351)			(15,120)		
TOTAL ASSETS	$3,380,409			$3,002,695			$2,841,096		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Interest-bearing Demand Deposits	$969,922	$5,755	0.59%	$836,262	$2,893	0.35%	$755,775	$1,745	0.23%

Savings Deposits and Money Market Accounts	646,636	1,954	0.30%	606,212	1,078	0.18%	566,818	770	0.14%
Time Deposits	459,289	5,916	1.29%	380,316	3,123	0.82%	414,100	2,672	0.65%
FHLB Advances and Other Borrowings	257,737	5,514	2.14%	233,315	4,027	1.73%	242,483	3,274	1.35%
TOTAL INTEREST-BEARING LIABILITIES	2,333,584	19,139	0.82%	2,056,105	11,121	0.54%	1,979,176	8,461	0.43%
Demand Deposit Accounts	640,865			572,356			513,199		
Other Liabilities	20,484			23,321			27,201		
TOTAL LIABILITIES	2,994,933			2,651,782			2,519,576		
Shareholders’ Equity	385,476			350,913			321,520		
TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY	$3,380,409			$3,002,695			$2,841,096		
COST OF FUNDS			0.61%			0.40%			0.32%
NET INTEREST INCOME		$117,345			$105,057			$99,470	
NET INTEREST MARGIN			3.75%			3.76%			3.75%

(1) Effective tax rates were determined as though interest earned on the Company's investments in municipal bonds and loans was fully taxable.

(2) Loans held-for-sale and non-accruing loans have been included in average loans. Interest income on loans includes loan fees of $3,151, $3,216, and $4,283 for 2018, 2017 and 2016, respectively.

The following table sets forth for the periods indicated a summary of the changes in interest income and interest expense resulting from changes in volume and changes in rates:

Net Interest Income – Rate / Volume Analysis
(Tax-Equivalent basis, dollars in thousands)

	2018 compared to 2017 Increase / (Decrease) Due to [1]			2017 compared to 2016 Increase / (Decrease) Due to [1]		
	Volume	Rate	Net	Volume	Rate	Net
Interest Income:						
Federal Funds Sold and Other Short-term Investments	$86	$88	$174	$(45)	$105	$60
Taxable Securities	136	1,365	1,501	(48)	1,308	1,260
Non-taxable Securities	802	(2,159)	(1,357)	1,177	56	1,233
Loans and Leases	14,304	5,684	19,988	5,990	(296)	5,694
Total Interest Income	15,328	4,978	20,306	7,074	1,173	8,247
Interest Expense:						
Savings and Interest-bearing Demand	529	3,209	3,738	245	1,211	1,456
Time Deposits	747	2,046	2,793	(231)	682	451
FHLB Advances and Other Borrowings	452	1,035	1,487	(128)	881	753
Total Interest Expense	1,728	6,290	8,018	(114)	2,774	2,660
Net Interest Income	$13,600	$(1,312)	$12,288	$7,188	$(1,601)	$5,587

(1) The change in interest due to both rate and volume has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

See the Company's Average Balance Sheet and the discussions headed USES OF FUNDS, SOURCES OF FUNDS, and "RISK MANAGEMENT – Liquidity and Interest Rate Risk Management" for further information on the Company's net interest income, net interest margin, and interest rate sensitivity position.

PROVISION FOR LOAN LOSSES

The Company provides for loan losses through regular provisions to the allowance for loan losses. The provision is affected by net charge-offs on loans and changes in specific and general allocations required on the allowance for loan losses. Provisions for loan losses totaled $2,070,000, $1,750,000, and $1,200,000 in 2018, 2017, and 2016, respectively.

During 2018, the provision for loan loss represented approximately 9 basis points of average loans on an annualized basis. The increased level of provision during 2018 was largely related to an increased level of net charge-offs during 2018 compared with 2017. The Company realized net charge-offs of $1,941,000 or 8 basis points of average loans outstanding during 2018. The increase in net charge-offs during 2018 was primarily attributable to a partial charge-off on a single commercial lending relationship in the first quarter of 2018 that was downgraded and largely reserved for during the fourth quarter of 2017.

During 2017, the provision for loan loss represented approximately 9 basis points of average loans on an annualized basis. The increased level of provision during 2017 was largely related to an increased level of allowance for loan loss that has been allocated to the Company's commercial and industrial loan portfolio. The Company realized net charge-offs of $864,000 or 4 basis points of average loans outstanding during 2017.

The Company's allowance for loan losses represented 0.58% of total loans at year-end 2018 compared with 0.73% of total loans at year-end 2017. Under acquisition accounting, loans are recorded at fair value which includes a credit risk component, and therefore the allowance on loans acquired is not carried over from the seller. The Company's allowance for loan losses represented 0.77% of total non-acquired loans at year-end 2018 compared with 0.83% of total non-acquired loans at year-end 2017.

Provisions for loan losses in all periods were made at levels deemed necessary by management to absorb estimated, probable incurred losses in the loan portfolio. A detailed evaluation of the adequacy of the allowance for loan losses is completed quarterly by management, the results of which are used to determine provisions for loan losses. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other qualitative factors. Refer also to the sections entitled CRITICAL

ACCOUNTING POLICIES AND ESTIMATES and "RISK MANAGEMENT - Lending and Loan Administration" for further discussion of the provision and allowance for loan losses.

NON-INTEREST INCOME

During the year ended December 31, 2018, non-interest income increased $5,216,000, or 16%, from the year ended December 31, 2017. During the year ended December 31, 2017, non-interest income declined less than 1% from the year ended December 31, 2016.

Non-interest Income (dollars in thousands)	Years Ended December 31,			% Change From Prior Year	
	2018	2017	2016	2018	2017
Trust and Investment Product Fees	$6,680	$5,272	$4,644	27 %	14 %
Service Charges on Deposit Accounts	7,044	6,178	5,973	14	3
Insurance Revenues	8,330	7,979	7,741	4	3
Company Owned Life Insurance	1,243	1,341	987	(7)	36
Interchange Fee Income	7,278	4,567	3,627	59	26
Other Operating Income	2,785	2,641	3,703	5	(29)
Subtotal	33,360	27,978	26,675	19	5
Net Gains on Sales of Loans	3,004	3,280	3,359	(8)	(2)
Net Gains on Securities	706	596	1,979	18	(70)
TOTAL NON-INTEREST INCOME	$37,070	$31,854	$32,013	16	n/m [1]

[1] n/m = not meaningful

Trust and investment product fees increased $1,408,000, or 27%, during 2018 compared with 2017. Trust and investment product fees increased $628,000, or 14%, during 2017 compared with 2016. The increase in both years was primarily attributable to fees generated from increased assets under management in the Company's wealth management group.

Service charges on deposit accounts increased $866,000, or 14%, during 2018 compared with 2017. The increase during 2018 compared with 2017 was positively impacted by the acquisition activity completed during 2018. Service charges on deposit accounts increased $205,000, or 3%, during 2017 compared with 2016.

Insurance revenues increased $351,000, or 4%, during 2018 compared with 2017. The increase during 2018 was primarily due to increased contingency revenue. Insurance revenues increased $238,000, or 3%, during 2017 as compared to 2016 as a result of increased commercial insurance revenue and personal insurance revenue partially offset by a decline in contingency revenue. Contingency revenue totaled $1,218,000 in 2018 compared with $992,000 in 2017 and $1,114,000 in 2016. Contingency revenue is reflective of claims and loss experience with insurance carriers that the Company represents through its property and casualty insurance agency.

Interchange fees increased $2,711,000, or 59%, during 2018 compared to 2017. The increase during 2018 was largely attributable to increased card utilization by customers, the acquisition activity completed during 2018 and to the adoption of the new revenue recognition standard effective January 1, 2018. While the adoption of the standard did not have a significant impact on the Company's financial results, the recording of revenue gross versus net of certain expenses, in accordance with the standard, did result in the reclassification of some expenses associated with the interchange fee revenue during 2018. The reclassification of this expense for 2018 totaled $1,244,000. Interchange fee income increased $940,000, or 26%, during 2017 compared with 2016. The increase was attributable to increased card utilization by customers and a full year of operations from the River Vally Bancorp acquisition that closed during the first quarter of 2016.

Other operating income increased $144,000, or 5% during 2018 compared with 2017. Other operating income declined $1,062,000, or 29%, during 2017 compared with 2016. The decline was largely attributable to decreased fees and fair value adjustments associated with swap transactions with loan customers.

Net gains on sales of loans declined $276,000, or 8%, during 2018 compared with 2017. The decline in the net gain on sales of loans during 2018 compared with 2017 was largely attributable to lower pricing levels on loans sold. Net gains on sales of loans declined $79,000, or 2%, during 2017 compared with 2016. Loan sales for 2018, 2017, and 2016 totaled $135.3 million, $130.3 million, and $133.6 million, respectively.

During 2018, the Company realized net gains on the sale of securities of $706,000 related to the sale of approximately $90.3 million of securities. During 2017, the Company realized net gains on the sale of securities of $596,000 related to the sale of approximately $48.3 million of securities. During 2016, the Company realized net gains on the sale of securities of $1,979,000 related to the sale of approximately $163.1 million of securities.

NON-INTEREST EXPENSE

During 2018, non-interest expense increased of $15,750,000, or 20%, compared with 2017. 2018 included operating expenses related to the branch acquisition completed during the second quarter of 2018 as well as operating expenses related to the bank acquisition completed early in the fourth quarter of 2018. 2018 also included acquisition-related expenses of a non-recurring nature of approximately $4,592,000 related to the aforementioned merger and acquisition activity. During 2017, non-interest expense increased $1,216,000, or 2%, compared with 2016.

Non-interest Expense (dollars in thousands)	Years Ended December 31,			% Change From Prior Year	
	2018	2017	2016	2018	2017
Salaries and Employee Benefits	$51,306	$46,642	$43,961	10 %	6 %
Occupancy, Furniture and Equipment Expense	10,877	9,230	8,558	18	8
FDIC Premiums	1,033	954	1,151	8	(17)
Data Processing Fees	6,942	4,276	5,686	62	(25)
Professional Fees	5,362	2,817	3,672	90	(23)
Advertising and Promotion	3,492	3,543	2,657	(1)	33
Intangible Amortization	1,752	942	1,062	86	(11)
Other Operating Expenses	12,789	9,399	9,840	36	(4)
TOTAL NON-INTEREST EXPENSE	$93,553	$77,803	$76,587	20	2

Salaries and benefits increased $4,664,000, or 10%, during 2018 compared with 2017. The increase during 2018 compared with 2017 was primarily attributable to an increased number of full-time equivalent employees due in part to the acquisition transactions during 2018. Salaries and benefits increased $2,681,000, or 6%, during 2017 compared with the 2016. The increase in 2017 compared with 2016 was primarily attributable to acquisition activity during 2016 combined with an increased number of full-time equivalent employees and higher levels of employee benefit costs including health insurance costs.

Occupancy, furniture and equipment expense increased $1,647,000, or 18%, during 2018 compared with 2017. The increase during 2018 compared to 2017 was primarily due to operating costs related to the acquisition activity during 2018 as well as other facilities the Company has placed into service over the past several quarters. Occupancy, furniture and equipment expense increased $672,000, or 8%, in 2017 compared with 2016. This increase was largely related to capital investments into the Company's branch network and to the acquisition activity during 2016.

Data processing fees increased $2,666,000, or 62%, during 2018 compared to 2017. The increase was largely related to costs associated with merger and acquisition activities which totaled approximately $2,002,000 during 2018. Data processing fees declined $1,410,000, or 25%, in 2017 compared with 2016. The decline during 2017 compared with 2016 was primarily due to expenses totaling $1,288,000 related to the consolidation of various data processing and information systems that were incurred for the acquisition completed during 2016.

Professional fees increased $2,545,000, or 90%, during 2018 compared with 2017. The increase was primarily due to professional fees related to merger and acquisition activities which totaled $1,738,000 during 2018. Professional fees during 2018 also included approximately $930,000 in fees related to certain contract negotiations not related to the acquisition activity. Professional fees declined $855,000, or 23%, in 2017 compared with 2016. The decline during 2017 compared with 2016 was attributable to expenses totaling $770,000 associated with the acquisition completed during 2016.

Advertising and promotion declined $51,000, or 1%, in 2018 compared with 2017. Advertising and promotion increased $886,000, or 33%, in 2017 compared with 2016. The primary driver of the increase in advertising and promotion during 2017 was a contribution expense of $773,000 related to the donation of a former branch facility to a municipality in one of the Company's market areas.

Intangible amortization increased $810,000, or 86%, during 2018 compared with 2017. The increase in intangible amortization was attributable to the previously discussed acquisition transactions completed during 2018. Intangible amortization decreased $120,000, or 11%, during 2017 compared with 2016.

Other operating expenses increased $3,390,000, or 36%, during 2018 compared with 2017. The increase during 2018 was largely attributable to the operating costs related to the acquisitions completed in 2018 and to the adoption of the revenue recognition standard effective January 1, 2018 and the reclassification of expenses as previously discussed. The reclassification of this expense for 2018 totaled $1,244,000. Other operating expenses declined $441,000, or 4%, during 2017 compared with 2016.

PROVISION FOR INCOME TAXES

The Company records a provision for current income taxes payable, along with a provision for deferred taxes payable in the future. Deferred taxes arise from temporary differences, which are items recorded for financial statement purposes in a different period than for income tax returns. The Company’s effective tax rate was 17.0%, 22.1%, and 28.4%, respectively, in 2018, 2017, and 2016. The effective tax rate in all periods is lower than the blended statutory rate. The lower effective rate in all periods primarily resulted from the Company’s tax-exempt investment income on securities, loans, and company owned life insurance, income tax credits generated by investments in affordable housing projects, and income generated by subsidiaries domiciled in a state with no state or local income tax.

The Company's effective tax rate and provision for income tax was positively impacted during 2018 by the reduction of federal income tax rates from a statutory rate of 35% to 21% effective January 1, 2018 related to the enactment of the Tax Act during the fourth quarter of 2017. As a result of the enactment of the Tax Act, the Company revalued its its deferred tax assets and deferred tax liabilities during the fourth quarter of 2017 which resulted in a net tax benefit of $2,284,000 and consequently impacted the effective tax rate for 2017 as well.

See Note 10 to the Company’s consolidated financial statements included in Item 8 of this Report for additional details relative to the Company’s income tax provision.

CAPITAL RESOURCES

As of December 31, 2018, shareholders’ equity increased by $94.1 million to $458.6 million compared with $364.5 million at year-end 2017. The increase in shareholders' equity was largely attributable to the issuance of the Company's common shares in
the acquisition of First Security. Approximately 1,988,000 shares were issued to First Security shareholders resulting in an increase to shareholders' equity of $64.7 million. The increase in shareholders' equity was also attributable to an increase of $32.5 million in retained earnings. Shareholders’ equity represented 11.7% of total assets at December 31, 2018 and 11.6% of total assets at December 31, 2017. Shareholders’ equity included $113.6 million of goodwill and other intangible assets at December 31, 2018 compared to $56.2 million of goodwill and other intangible assets at December 31, 2017.

Federal banking regulations provide guidelines for determining the capital adequacy of bank holding companies and banks. These guidelines provide for a more narrow definition of core capital and assign a measure of risk to the various categories of assets. The Company is required to maintain minimum levels of capital in proportion to total risk-weighted assets and off-balance sheet exposures.

As of January 1, 2015, the Company and its subsidiary bank adopted the new Basel III regulatory capital framework. The adoption of this new framework modified the regulatory capital calculations, minimum capital levels and well-capitalized thresholds and added the new Common Equity Tier 1 capital ratio. Additionally, under the new rules, in order to avoid limitations on capital distributions, including dividend payments, the Company is required to maintain a capital conservation buffer above the adequately capitalized regulatory capital ratios. The capital conservation buffer was phased in from 0.00% in 2015 to 2.50% effective January 1, 2019. For December 31, 2018, the capital conservation buffer was 1.875%. At December 31, 2018, the capital levels for the Company and its subsidiary bank remained well in excess of of the minimum amounts needed for capital adequacy purposes and the

Bank's capital levels met the necessary requirements to be considered well-capitalized.

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The table below presents the Company’s consolidated and the subsidiary bank's capital ratios under regulatory guidelines:

	12/31/2018 Ratio		12/31/2017 Ratio		Minimum for Capital Adequacy Purposes (1)		Well-Capitalized Guidelines	
Total Capital (to Risk Weighted Assets)								
Consolidated	12.36	%	13.62	%	8.00	%	N/A	
Bank	12.37		12.29		8.00		10.00	%
Tier 1 (Core) Capital (to Risk Weighted Assets)								
Consolidated	11.85	%	12.99	%	6.00	%	N/A	
Bank	11.86		11.66		6.00		8.00	%
Common Equity Tier 1 (CET 1) Capital Ratio (to Risk Weighted Assets)								
Consolidated	11.48	%	12.55	%	4.50	%	N/A	
Bank	11.86		11.66		4.50		6.50	%
Tier 1 Capital (to Average Assets)								
Consolidated	9.75	%	10.71	%	4.00	%	N/A	
Bank	9.78		9.63		4.00		5.00	%

(1) Excludes capital conservation buffer.

Under the the final rules provided for by Basel III, accumulated other comprehensive income ("AOCI") was to be included in a banking organization's Common Equity Tier 1 capital. The final rules allowed community banks to make a one-time election not to include the additional components of AOCI in regulatory capital and instead use the existing treatment under the general risk-based capital rules that excludes most AOCI components from regulatory capital. The Company elected, in its March 31, 2015 regulatory filings (Call Report and FR Y-9), to opt-out and continue the existing treatment of AOCI for regulatory capital purposes.

USES OF FUNDS

LOANS

December 31, 2018 total loans increased $586.7 million compared with year-end 2017. As of December 31, 2018, outstanding loans from the First Security transaction, which closed in October 2018, totaled $374.5 million. At December 31, 2018, the loans acquired as a part of the branch acquisition, which closed in May 2018, totaled $106.0 million.

Total loans from the Company's existing branch network, excluding the acquired First Security loans and the loans acquired in the branch acquisition, grew by approximately $106.2 million, or 5%, at year-end 2018 compared with year-end 2017 total loans. Included in this 2018 loan growth, excluding First Security and the branch acquisition, was an increase of approximately $16.1 million, or 3%, in commercial and industrial loans, an increase of $56.8 million, or 6%, in commercial real estate loans, an increase of $22.0 million, or 7%, in agricultural loans, and an increase of $11.3 million, or 3%, in retail loans. The level of organic loan growth in the last half of 2018 from the Company’s existing branch network was impacted by an increased level of large balance pay-offs (approximately $52.0 million), which were largely driven by borrowers' sales of individual properties and businesses.

December 31, 2017 loans outstanding increased $151.6 million, or 8%, from year-end 2016. The increase in loans during 2017 was from virtually all categories with the exception of residential mortgage loans which experienced a modest decline. This growth came from across the Company's entire Southern Indiana market area. Commercial and industrial loans increased $29.3 million, or 6%, commercial real estate loans increased $70.6 million, or 8%, agricultural loans increased $30.1 million, or 10%, consumer loans increased $26.2 million, or 14%, and residential mortgage loans decreased $4.6 million, or 2%.

The composition of the loan portfolio has remained relatively stable and diversified over the past several years, including 2018. The portfolio is most heavily concentrated in commercial real estate loans at 44% of the portfolio. The Company's exposure to non-owner occupied commercial real estate, including multi-family housing, was limited to 31% of the total loan portfolio at year-end 2018. The Company's commercial lending is extended to various industries, including multi-family housing and hotel, agribusiness and manufacturing, as well as health care, wholesale, and retail services. The Company also continues to have only limited exposure in construction and development lending with this segment representing approximately 5% of the total loan portfolio.

Loan Portfolio	December 31,				
(dollars in thousands)	2018	2017	2016	2015	2014
Commercial and Industrial Loans and Leases	$543,761	$486,668	$457,372	$418,154	$380,079
Commercial Real Estate Loans	1,208,646	926,729	856,094	618,788	583,086
Agricultural Loans	365,208	333,227	303,128	246,886	216,774
Home Equity and Consumer Loans	285,534	219,662	193,520	147,931	134,847
Residential Mortgage Loans	328,592	178,733	183,290	136,316	137,204
Total Loans	2,731,741	2,145,019	1,993,404	1,568,075	1,451,990
Less: Unearned Income	(3,682)	(3,381)	(3,449)	(3,728)	(4,008)
Subtotal	2,728,059	2,141,638	1,989,955	1,564,347	1,447,982
Less: Allowance for Loan Losses	(15,823)	(15,694)	(14,808)	(14,438)	(14,929)
Loans, Net	$2,712,236	$2,125,944	$1,975,147	$1,549,909	$1,433,053
Ratio of Loans to Total Loans					
Commercial and Industrial Loans and Leases	20%	23%	23%	27%	26%
Commercial Real Estate Loans	44%	43%	43%	39%	40%
Agricultural Loans	13%	16%	15%	16%	15%
Home Equity and Consumer Loans	11%	10%	10%	9%	9%
Residential Mortgage Loans	12%	8%	9%	9%	10%
Total Loans	100%	100%	100%	100%	100%

The Company's policy is generally to extend credit to consumer and commercial borrowers in its primary geographic market area in southern Indiana and central and western Kentucky. Commercial extensions of credit outside this market area are generally concentrated in real estate loans within a 120 mile radius of the Company's primary market and are granted on a selective basis.

The following table indicates the amounts of loans (excluding residential mortgages on 1-4 family residences and consumer loans) outstanding as of December 31, 2018, which, based on remaining scheduled repayments of principal, are due in the periods indicated (dollars in thousands).

	Within One Year	One to Five Years	After Five Years	Total
Commercial and Agricultural	$695,122	$1,000,572	$421,921	$2,117,615

	Interest Sensitivity	
	Fixed Rate	Variable Rate
Loans Maturing After One Year	$271,522	$1,150,971

INVESTMENTS

The investment portfolio is a principal source for funding the Company's loan growth and other liquidity needs of its subsidiaries. The Company's securities portfolio primarily consists of money market securities, uncollateralized federal agency securities, municipal obligations of state and political subdivisions, and mortgage-backed securities and collateralized mortgage obligations (MBS/CMO - Residential) issued by U.S. government agencies. Money market securities include federal funds sold, interest-bearing balances with banks, and other short-term investments. The composition of the year-end balances in the investment portfolio is presented in Note 2 (Securities) of the Notes to the Consolidated Financial Statements included in Item 8 of this Report and in the table below:

Investment Portfolio, at Amortized Cost	December 31,								
(dollars in thousands)	2018	%		2017	%		2016	%	
Federal Funds Sold and Other Short-term Investments	$32,001	4	%	$23,093	3	%	$16,349	2	%
Obligations of State and Political Subdivisions	291,449	34		267,437	35		247,350	34	
MBS/CMO - Residential	529,805	62		476,205	62		471,852	64	
Equity Securities	353	n/m [1]		353	n/m [1]		353	n/m [1]	
Total Securities Portfolio	$853,608	100	%	$767,088	100	%	$735,904	100	%

[1] n/m = not meaningful

The amortized cost of investment securities, including federal funds sold and short-term investments, increased $86.5 million, or 11%, at year-end 2018 compared with year-end 2017 and increased $31.2 million, or 4%, at year-end 2017 compared with year-end 2016. The increase during 2018 was largely attributable to the First Security acquisition. The largest component in the investment portfolio continues to be in mortgage related securities, which totaled $529.8 million and represents 62% of the total securities portfolio at December 31, 2018. The Company's level of obligations of state and political subdivisions increased to $291.4 million or 34% of the portfolio at December 31, 2018.

Investment Securities, at Carrying Value
(dollars in thousands)

	December 31,		
Securities Available-for-Sale	2018	2017	2016
Obligations of State and Political Subdivisions	$294,533	$273,309	$247,519
MBS/CMO - Residential	518,078	467,332	461,914
Total Securities	$812,611	$740,641	$709,433

The Company's $812.6 million available-for-sale investment portfolio provides an additional funding source for the liquidity needs of the Company's subsidiaries and for asset/liability management requirements. Although management has the ability to sell these securities if the need arises, their designation as available-for-sale should not necessarily be interpreted as an indication that management anticipates such sales.

The amortized cost of available-for-sale debt securities at December 31, 2018 is shown in the following table by contractual maturity. MBS/CMO - Residential securities are based on estimated average lives. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations. Equity securities do not have contractual maturities, and are excluded from the table below.

Maturities and Average Yields of Securities at December 31, 2018
(dollars in thousands)

	Within One Year	After One But Within Five Years	After Five But Within Ten Years	After Ten Years

	Amount	Yield		Amount	Yield		Amount	Yield		Amount	Yield	
Obligations of State and Political Subdivisions	$2,195	4.06	%	$16,401	4.29	%	$82,449	4.14	%	$190,404	4.09	%
MBS/CMO - Residential	—	—	%	4	4.00	%	36,843	2.02	%	492,958	2.59	%
Total Securities	$2,195	4.06	%	$16,405	4.29	%	$119,292	3.49	%	$683,362	3.01	%

A tax-equivalent adjustment using a tax rate of 21 percent was used in the above table.

In addition to the other uses of funds discussed previously, the Company had certain long-term contractual obligations as of December 31, 2018. These contractual obligations primarily consisted of long-term borrowings with the Federal Home Loan Bank ("FHLB") and junior subordinated debentures, time deposits, and lease commitments for certain office facilities. Scheduled principal payments on long-term borrowings, time deposits, and future minimum lease payments are outlined in the table below.

Contractual Obligations	Payments Due By Period				
(dollars in thousands)	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Long-term Borrowings	$123,113	$31,075	$55,551	$—	$36,487
Time Deposits	588,483	383,827	176,312	28,262	82
Capital Lease Obligations	6,585	519	1,038	1,038	3,990
Operating Lease Commitments	7,731	1,406	1,918	1,500	2,907
Total Contractual Obligations	$725,912	$416,827	$234,819	$30,800	$43,466

SOURCES OF FUNDS

The Company's primary source of funding is its base of core customer deposits. Core deposits consist of demand deposits, savings, interest-bearing checking, money market accounts, and certificates of deposit of less than $100,000. Other sources of funds are certificates of deposit of $100,000 or more, brokered deposits, overnight borrowings from other financial institutions and securities sold under agreement to repurchase. The membership of the Company's affiliate bank in the Federal Home Loan Bank System provides a significant additional source for both long and short-term collateralized borrowings. In addition, the Company, as a separate and distinct corporation from its bank and other subsidiaries, also has the ability to borrow funds from other financial institutions and to raise debt or equity capital from the capital markets and other sources. The following pages contain a discussion of changes in these areas.

The table below illustrates changes between years in the average balances of all funding sources:

Funding Sources - Average Balances (dollars in thousands)	December 31,			% Change From Prior Year	
	2018	2017	2016	2018	2017
Demand Deposits					
Non-interest-bearing	$640,865	$572,356	$513,199	12%	12 %
Interest-bearing	969,922	836,262	755,775	16	11
Savings Deposits	254,581	233,056	215,032	9	8
Money Market Accounts	392,055	373,156	351,786	5	6
Other Time Deposits	206,864	204,371	219,408	1	(7)
Total Core Deposits	2,464,287	2,219,201	2,055,200	11	8
Certificates of Deposits of $100,000 or more and Brokered Deposits	252,425	175,945	194,692	43	(10)
FHLB Advances and Other Borrowings	257,737	233,315	242,483	10	(4)
Total Funding Sources	$2,974,449	$2,628,461	$2,492,375	13	5

Maturities of certificates of deposit of $100,000 or more and brokered deposits are summarized as follows:
(dollars in thousands)

	3 Months	3 Thru	6 Thru	Over	Total

	Or Less	6 Months	12 Months	12 Months	
December 31, 2018	$71,380	$34,866	$56,928	$176,001	$339,175

CORE DEPOSITS

The Company’s overall level of average core deposits increased approximately $245.1 million, or 11%, during 2017 following a $164.0 million, or 8%, increase during 2017. During 2018, average demand deposits (non-interest bearing and interest bearing) increased $202.2 million, average savings deposits increased $21.5 million, average money market demand deposits increased $18.9 million and average time deposits under $100,000 increased $2.5 million. The acquisition activity which occurred during the second quarter of 2018 and fourth quarter of 2018 was a significant contributor to the increased level of average core deposits during 2018 compared with 2017.

The Company's ability to attract core deposits continues to be influenced by competition and the interest rate environment, as well as the availability of alternative investment products. Core deposits continue to represent a significant funding source for the Company's operations and represented 83% of average total funding sources during 2018 compared with 84% during 2017 and 82% during 2016.

Demand, savings, and money market deposits have provided a growing source of funding for the Company in each of the periods reported. Average demand, savings, and money market deposits increased 12% during 2018 following 10% growth during 2017. Average demand, savings, and money market deposits totaled $2.257 billion or 92% of core deposits (76% of total funding sources) in 2018 compared with $2.015 billion or 91% of core deposits (77% of total funding sources) in 2017 and $1.836 billion or 89% of core deposits (74% of total funding sources) in 2016.

Other time deposits consist of certificates of deposits in denominations of less than $100,000. These average deposits increased by 1% during 2018 following a decline of 7% during 2017. Other time deposits comprised 8% of core deposits in 2018, 9% in 2017 and 11% in 2016.

OTHER FUNDING SOURCES

Federal Home Loan Bank advances and other borrowings represent the Company's most significant source of other funding. Average borrowed funds increased $24.4 million, or 10%, during 2018 following a decline of $9.2 million, or 4%, during 2017. Borrowings comprised approximately 9% of average total funding sources during 2018 compared with 9% in 2017 and 10% in 2016.

Certificates of deposits in denominations of $100,000 or more and brokered deposits are an additional source of other funding for the Company's bank subsidiary. Large denomination certificates and brokered deposits increased $76.5 million, or 43%, during 2018 following a decline of $18.7 million, or 10% during 2017. Large certificates and brokered deposits comprised approximately 8% of average total funding sources in 2018 compared with 7% in 2017 and 8% in 2016. This type of funding is used as both long-term and short-term funding sources.

The bank subsidiary of the Company also utilizes short-term funding sources from time to time. These sources consist of overnight federal funds purchased from other financial institutions, secured repurchase agreements that generally mature within one day of the transaction date, and secured overnight variable rate borrowings from the FHLB. These borrowings represent an important source of short-term liquidity for the Company's bank subsidiary. Long-term debt at the Company's bank subsidiary is in the form of FHLB advances, which are secured by the pledge of certain investment securities, residential and housing-related mortgage loans, and certain other commercial real estate loans. See Note 7 (FHLB Advances and Other Borrowings) of the Notes to the Consolidated Financial Statements included in Item 8 of this Report for further information regarding borrowed funds.

PARENT COMPANY FUNDING SOURCES

The parent company is a corporation separate and distinct from its bank and other subsidiaries. For information regarding the financial condition, result of operations, and cash flows of the Company, presented on a parent-company-only basis, see Note 17 (Parent Company Financial Statements) of the Notes to the Consolidated Financial Statements included in Item 8 of this Report.

The Company uses funds at the parent company level to pay dividends to its shareholders, to acquire or make other investments in other businesses or their securities or assets, to repurchase its stock from time to time, and for other general corporate purposes. The parent company does not have access to the deposits and certain other sources of funds that are available to its bank subsidiary to support its operations. Instead, the parent company has historically derived most of its revenues from dividends paid to the parent company by its bank subsidiary. The Company's banking subsidiary is subject to statutory restrictions on its ability to pay dividends to the parent company. See Note 8 (Shareholders' Equity) of the Notes to the Consolidated Financial Statements included in Item 8 of this Report, which is incorporated herein by reference. The parent company has in recent years supplemented the dividends received from its subsidiaries with borrowings, which are discussed in detail below.

On October 11, 2018, the Company entered into a Loan Agreement with U.S. Bank National Association, providing the Company with a term loan in the principal amount of $25,000,000 (the "Term Loan"), and with a revolving credit loan in the principal amount of up to $15,000,000 (the "Revolving Credit Loan" and, collectively with the Term Loan, the "Loans"). The Term Loan was advanced in its entirety on October 11, 2018, for purposes of funding a portion of the cash payment required to be paid by the Company in connection with the First Security acquisition, which closed effective October 15, 2018. The Revolving Credit Loan will be used for general corporate needs, operating expenditures and capital injections incurred in the ordinary course of business.

The Term Loan, as evidenced by a term loan promissory note (the "Term Note"), bears interest at an annual rate of 5.24%. The Revolving Credit Loan, as evidenced by a revolving credit promissory note (the "Revolving Credit Note"), bears interest at an annual rate equal to 1.75% plus the greater of (a) zero percent (0.00%) or (b) the one month LIBOR rate in effect two New York banking days prior to the beginning of each calendar month, adjusted for any reserve requirement and any subsequent costs arising from a change in government regulation, as reset each month.

The Company will pay quarterly payments of accrued interest on the Loans which began on December 31, 2018. The balance of all outstanding principal and accrued interest under the Term Note will become due and payable on September 30, 2021. The balance of all outstanding principal and accrued interest under the Revolving Credit Note will become due and payable on September 30, 2019. As of the date hereof, there have been no borrowings under the Revolving Credit Note.

Effective January 1, 2011, and as a result of the acquisition of American Community Bancorp, Inc., the Company assumed long-term debt obligations of American Community in the form of two junior subordinated debentures issued by American Community in the aggregate unpaid principal amount of approximately $8.3 million. Effective March 1, 2016, and as a result of the acquisition of River Valley Bancorp, the Company assumed long-term debt obligations of River Valley in the form of a junior subordinated debenture issued by River Valley in the aggregate unpaid principal amount of approximately $7.2 million.

The junior subordinated debentures were issued to certain statutory trusts established by American Community and River Valley (in support of related issuances of trust preferred securities issued by those trusts) and mature in installments of principal payable in 2035 and 2033, respectively, and bear interest payable on a quarterly basis at a floating rate, adjustable quarterly based on the 90-day LIBOR plus a specified percentage. These debentures are of a type that are eligible (under current regulatory capital requirements) to qualify as Tier 1 capital (with certain limitations) for regulatory purposes and as of December 31, 2018 approximately $11.3 million of the junior subordinated debentures were treated as Tier 1 capital for regulatory capital purposes.

See Note 17 (Parent Company Financial Statements) of the Notes to the Consolidated Financial Statements included in Item 8 of this Report for further information regarding the parent company borrowed funds and other indebtedness.

RISK MANAGEMENT

The Company is exposed to various types of business risk on an on-going basis. These risks include credit risk, liquidity risk and interest rate risk. Various procedures are employed at the Company’s subsidiary bank to monitor and mitigate risk in the loan and investment portfolios, as well as risks associated with changes in interest rates. Following is a discussion of the Company’s philosophies and procedures to address these risks.

LENDING AND LOAN ADMINISTRATION

Primary responsibility and accountability for day-to-day lending activities rests with the Company’s subsidiary bank. Loan personnel at the subsidiary bank have the authority to extend credit under guidelines approved by the bank’s board of directors. The executive loan committee serves as a vehicle for communication and for the pooling of knowledge, judgment and experience of its members. The committee provides valuable input to lending personnel, acts as an approval body, and monitors the overall quality of the bank’s loan portfolio. The Corporate Credit Risk Management Committee comprised of members of the Company’s and its subsidiary bank’s executive officers and board of directors, strives to ensure a consistent application of the Company’s lending policies. The Company also maintains a comprehensive risk-grading and loan review program, which includes quarterly reviews of problem loans, delinquencies and charge-offs. The purpose of this program is to evaluate loan administration, credit quality, loan documentation and the adequacy of the allowance for loan losses.

The Company maintains an allowance for loan losses to cover probable, incurred credit losses identified during its loan review process. Management estimates the required level of allowance for loan losses using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed.

The allowance for loan losses is comprised of: (a) specific reserves on individual credits; (b) general reserves for certain loan categories and industries, and overall historical loss experience; and (c) unallocated reserves based on performance trends in the loan portfolios, current economic conditions, and other factors that influence the level of estimated probable losses. The need for specific reserves are considered for credits when: (a) the customer's cash flow or net worth appears insufficient to repay the loan; (b) the loan has been criticized in a regulatory examination; (c) the loan is on non-accrual; or, (d) other reasons where the ultimate collectability of the loan is in question, or the loan characteristics require special monitoring.

Allowance for Loan Losses (dollars in thousands)	Years Ended December 31,				
	2018	2017	2016	2015	2014
Balance of Allowance for Possible Losses at Beginning of Period	$15,694	$14,808	$14,438	$14,929	$14,584
Loans Charged-off:					
Commercial and Industrial Loans and Leases	1,500	151	66	36	199
Commercial Real Estate Loans	49	220	54	350	329
Agricultural Loans	—	49	22	—	—
Home Equity and Consumer Loans	922	765	612	345	370
Residential Mortgage Loans	75	93	346	233	117
Total Loans Charged-off	2,546	1,278	1,100	964	1,015
Recoveries of Previously Charged-off Loans:					
Commercial and Industrial Loans and Leases	141	14	32	102	111
Commercial Real Estate Loans	20	48	10	107	863
Agricultural Loans	20	9	1	—	—
Home Equity and Consumer Loans	387	280	211	246	215
Residential Mortgage Loans	37	63	16	18	21
Total Recoveries	605	414	270	473	1,210
Net Loans Recovered (Charged-off)	(1,941)	(864)	(830)	(491)	195
Additions to Allowance Charged to Expense	2,070	1,750	1,200	—	150
Balance at End of Period	$15,823	$15,694	$14,808	$14,438	$14,929
Net Charge-offs (Recoveries) to Average Loans Outstanding	0.08%	0.04%	0.04%	0.03%	(0.01)%
Provision for Loan Losses to Average Loans Outstanding	0.09%	0.09%	0.06%	0.00%	0.01%
Allowance for Loan Losses to Total Loans at Year-end	0.58%	0.73%	0.74%	0.92%	1.03%

The following table indicates the breakdown of the allowance for loan losses for the periods indicated (dollars in thousands):

	Years Ended December 31,				
	2018	2017	2016	2015	2014
Commercial and Industrial Loans and Leases	$2,953	$4,735	$3,725	$4,242	$4,627
Commercial Real Estate Loans	5,291	4,591	5,452	6,342	7,273
Agricultural Loans	5,776	4,894	4,094	2,115	1,123
Home Equity and Consumer Loans	649	628	518	613	600
Residential Mortgage Loans	472	343	329	414	622
Unallocated	682	503	690	712	684
Total Allowance for Loan Losses	$15,823	$15,694	$14,808	$14,438	$14,929

The Company’s allowance for loan losses totaled $15.8 million at December 31, 2018 representing an increase of $129,000, or 1%, compared with year-end 2017. During 2018, the allowance for commercial and industrial loans decreased primarily as a result of a partial charge-off taken on a single commercial borrowing relationships that was moved to impaired and non-performing status during 2017. The allowance for loan losses was increased for agricultural loans primarily due to an increased level of criticized and classified agricultural loans during 2018 when compared to year-end 2017.

The Company's allowance for loan losses totaled $15.7 million at December 31, 2017 representing an increase of $886,000, or 6%, compared with year-end 2016. During 2017, the allowance for commercial and industrial loans increased primarily as a result of specific allocations on two commercial borrowing relationships that were moved to impaired and non-performing status during 2017. The allowance for loan losses was increased for agricultural loans primarily due to an increased level of criticized and classified agricultural loans during 2017 when compared to year-end 2016.

The allowance for loan losses represented 0.58% of period-end loans at December 31, 2018 compared with 0.73% of period-end loans at December 31, 2017 and 0.74% at December 31, 2016. The decline in the allowance for loan loss as a percent of total loans during 2018 was the result of the acquisition activity by the Company during 2018. Under acquisition accounting treatment, loans acquired are recorded at fair value which includes a credit risk component, and therefore the allowance on loans acquired is not carried over from the seller. The Company held a discount on acquired loans of $19.5 million as of December 31, 2018, $7.6 million at December 31, 2017 and $10.0 million at December 31, 2016. The Company's allowance for loan losses represented

0.77% of total non-acquired loans at year-end 2018 compared with 0.83% of total non-acquired loans at year-end 2017 and 0.89% at year-end 2016.

The Company realized net charge-offs of $1,941,000, or 0.08% of average loans outstanding during 2018 compared with net charge-offs of $864,000, or 0.04% of average loans outstanding during 2017 and $830,000, or 0.04% of average loans during 2016.

Please see “RESULTS OF OPERATIONS - Provision for Loan Losses” and “CRITICAL ACCOUNTING POLICIES AND ESTIMATES - Allowance for Loan Losses” for additional information regarding the allowance.

NON-PERFORMING ASSETS

Non-performing assets consist of: (a) non-accrual loans; (b) loans which have been renegotiated to provide for a reduction or deferral of interest or principal because of deterioration in the financial condition of the borrower; (c) loans past due 90 days or more as to principal or interest; and, (d) other real estate owned. Loans are placed on non-accrual status when scheduled principal or interest payments are past due for 90 days or more or when the borrower’s ability to repay becomes doubtful. Uncollected accrued interest is reversed against income at the time a loan is placed on non-accrual. Loans are typically charged-off at 180 days past due, or earlier if deemed uncollectible. Exceptions to the non-accrual and charge-off policies are made when the loan is well secured and in the process of collection. The following table presents an analysis of the Company’s non-performing assets.

Non-performing Assets (dollars in thousands)	December 31, 2018	2017	2016	2015	2014
Non-accrual Loans	$12,579	$11,091	$3,793	$3,143	$5,970
Past Due Loans (90 days or more)	633	719	2	143	140
Total Non-performing Loans	13,212	11,810	3,795	3,286	6,110
Other Real Estate	286	54	242	169	356
Total Non-performing Assets	$13,498	$11,864	$4,037	$3,455	$6,466
Restructured Loans	$121	$149	$28	$2,203	$2,726
Non-performing Loans to Total Loans	0.48 %	0.55 %	0.19 %	0.21 %	0.42 %
Allowance for Loan Losses to Non-performing Loans	119.76 %	132.89 %	390.20 %	439.38 %	244.34 %

Non-performing assets totaled $13.5 million, or 0.34% of total assets at December 31, 2018 compared to $11.9 million, or 0.38% of total assets at December 31, 2017 and compared to $4.0 million, or 0.14% of total assets at December 31, 2016. Non-performing loans totaled $13.2 million, or 0.48% of total loans at December 31, 2018 compared with $11.8 million, or 0.55% of total loans at December 31, 2017 and $3.8 million, or 0.19% of total loans at December 31, 2016. The increase in non-performing assets and non-performing loans at year-end 2018 was primarily attributable to the merger transaction with First Security which included $4.6 million of non-accrual loans at December 31, 2018. The increase in non-performing assets during the year-ended December 31, 2017 was primarily related to two commercial lending relationships that were moved into impaired and non-performing status during 2017.

The following tables present an analysis of the Company's non-accrual loans and loans past due 90 days or more and still accruing.

Non-Accrual Loans (dollars in thousands)	December 31, 2018	2017	2016	2015	2014

Commercial and Industrial Loans and Leases	$2,430	$4,753	$86	$134	$161
Commercial Real Estate Loans	6,833	4,618	1,408	2,047	3,460
Agricultural Loans	1,449	748	792	—	—
Home Equity Loans	88	199	73	204	268
Consumer Loans	162	286	85	90	196
Residential Mortgage Loans	1,617	487	1,349	668	1,885
Total	$12,579	$11,091	$3,793	$3,143	$5,970

Loans Past Due 90 Days or More & Still Accruing	December 31,				
(dollars in thousands)	2018	2017	2016	2015	2014
Commercial and Industrial Loans and Leases	$—	$—	$ 2	$96	$68
Commercial Real Estate Loans	364	471	—	47	—
Agricultural Loans	269	248	—	—	72
Home Equity Loans	—	—	—	—	—
Consumer Loans	—	—	—	—	—
Residential Mortgage Loans	—	—	—	—	—
Total	$633	$719	$ 2	$143	$140

The Company purchases individual loans and groups of loans. Purchased loans that show evidence of credit deterioration since origination are recorded at the amount paid (or allocated fair value in a purchase business combination), such that there is no carryover of the seller's allowance for loan losses. After acquisition, incurred losses are recognized by an increase in the allowance for loan losses.

Purchased loans that indicated evidence of credit deterioration since origination at the time of acquisition by the Company did not have a material adverse impact on the Company's key credit metrics during 2018 or 2017. The key credit metrics the Company measures generally include non-performing loans, past due loans, and adversely classified loans.

Loan impairment is reported when full repayment under the terms of the loan is not expected. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate, or at the fair value of collateral if repayment is expected solely from the collateral. Commercial and industrial loans, commercial real estate loans, and agricultural loans are evaluated individually for impairment. Smaller balance homogeneous loans are evaluated for impairment in total. Such loans include real estate loans secured by one-to-four family residences and loans to individuals for household, family and other personal expenditures. Individually evaluated loans on non-accrual are generally considered impaired. Impaired loans, or portions thereof, are charged off when deemed uncollectible. The amount of loans individually evaluated for impairment, including purchase credit impaired loans, totaled $13.6 million and $12.6 million at December 31, 2018 and 2017, respectively. For additional detail on impaired loans, see Note 4 to the Company's consolidated financial statements included in Item 8 of this Report.

Interest income recognized on non-performing loans for 2018 was $77,000. The gross interest income that would have been recognized in 2018 on non-performing loans if the loans had been current in accordance with their original terms was $799,000. Loans are typically placed on non-accrual status when scheduled principal or interest payments are past due for 90 days or more, unless the loan is well secured and in the process of collection.

LIQUIDITY AND INTEREST RATE RISK MANAGEMENT

Liquidity is a measure of the ability of the Company's subsidiary bank to fund new loan demand, existing loan commitments and deposit withdrawals. The purpose of liquidity management is to match sources of funds with anticipated customer borrowings and withdrawals and other obligations to ensure a dependable funding base, without unduly penalizing earnings. Failure to properly manage liquidity requirements can result in the need to satisfy customer withdrawals and other obligations on less than desirable terms. The liquidity of the parent company is dependent upon the receipt of dividends from its bank subsidiary, which are subject to certain regulatory limitations explained in Note 8 (Shareholders' Equity) of the Notes to the Consolidated Financial Statements included in Item 8 of this Report. The subsidiary bank's source of funding is predominately core deposits, time deposits in excess of $100,000 and brokered certificates of deposit, maturities of securities, repayments of loan principal and interest, federal funds purchased, securities sold under agreements to repurchase and borrowings from the Federal Home Loan Bank and Federal Reserve Bank.

Interest rate risk is the exposure of the Company's financial condition to adverse changes in market interest rates. In an effort to estimate the impact of sustained interest rate movements to the Company's earnings, the Company monitors interest rate risk through computer-assisted simulation modeling of its net interest income. The Company's simulation modeling monitors the potential impact to net interest income under various interest rate scenarios. The Company's objective is to actively manage its asset/liability position within a one-year interval and to limit the risk in any of the interest rate scenarios to a reasonable level of tax-equivalent net interest income within that interval. The Company's Asset/Liability Committee monitors compliance within established guidelines of the Funds Management Policy. See Item 7A. Quantitative and Qualitative Disclosures About Market Risk section for further discussion regarding interest rate risk.

OFF-BALANCE SHEET ARRANGEMENTS

The Company has no off-balance sheet arrangements other than stand-by letters of credit as disclosed in Note 14 (Commitments and Off-balance Sheet Items) of the Notes to the Consolidated Financial Statements included in Item 8 of this Report.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

The Company's exposure to market risk is reviewed on a regular basis by the Asset/Liability Committee and Boards of Directors of the parent company and its subsidiary bank. Primary market risks which impact the Company's operations are liquidity risk and interest rate risk.

The liquidity of the parent company is dependent upon the receipt of dividends from its subsidiary bank, which is subject to certain regulatory limitations. The Bank's source of funding is predominately core deposits, maturities of securities, repayments of loan principal and interest, federal funds purchased, securities sold under agreements to repurchase and borrowings from the Federal Home Loan Bank.

The Company monitors interest rate risk by the use of computer simulation modeling to estimate the potential impact on its net interest income under various interest rate scenarios, and by estimating its static interest rate sensitivity position. Another method by which the Company's interest rate risk position can be estimated is by computing estimated changes in its net portfolio value ("NPV"). This method estimates interest rate risk exposure from movements in interest rates by using interest rate sensitivity analysis to determine the change in the NPV of discounted cash flows from assets and liabilities. NPV represents the market value of portfolio equity and is equal to the estimated market value of assets minus the estimated market value of liabilities.

Computations for measuring both net interest income and NPV are based on a number of assumptions, including the relative levels of market interest rates and prepayments in mortgage loans and certain types of investments. These computations do not contemplate any actions management may undertake in response to changes in interest rates, and should not be relied upon as indicative of actual results. In addition, certain shortcomings are inherent in the method of computing both net interest income and NPV. Should interest rates remain or decrease below current levels, the proportion of adjustable rate loans could decrease in future periods due to refinancing activity. In the event of an interest rate change, prepayment levels would likely be different from those assumed in the modeling. Lastly, the ability of many borrowers to repay their adjustable rate debt may decline during a rising interest rate environment.

The Company from time to time utilizes derivatives to manage interest rate risk. Management continuously evaluates the merits of such interest rate risk products but does not anticipate the use of such products to become a major part of the Company's risk management strategy.

The table below provides an assessment of the risk to net interest income over the next 12 months in the event of a sudden and sustained 1% and 2% increase and decrease in prevailing interest rates (dollars in thousands).

Interest Rate Sensitivity as of December 31, 2018 - Net Interest Income

	Net Interest Income	
Changes in Rates	Amount	% Change
+2%	$129,924	(3.43)%
+1%	132,337	(1.63)
Base	134,535	—
-1%	133,890	(0.48)
-2%	125,825	(6.47)

The above table is a measurement of the Company's net interest income at risk, assuming a static balance sheet as of December 31, 2018 and instantaneous parallel changes in interest rates. The Company also monitors interest rate risk under other scenarios including a more gradual movement in market interest rates. This type of scenario can at times produce different modeling results in measuring interest rate risk sensitivity.

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The table below provides an assessment of the risk to NPV in the event of a sudden and sustained 1% and 2% increase and decrease in prevailing interest rates (dollars in thousands).

Interest Rate Sensitivity as of December 31, 2018 - Net Portfolio Value

	Net Portfolio Value		Net Portfolio Value as a % of Present Value of Assets	
Changes in Rates	Amount	% Change	NPV Ratio	Change
+2%	$452,304	(9.15)%	12.58%	(60) b.p.
+1%	476,969	(4.20)	12.94	(24) b.p.
Base	497,884	—	13.18	—
-1%	497,569	(0.06)	12.92	(26) b.p.
-2%	454,308	(8.75)	11.60	(158) b.p.

The above discussion, and the portions of MANAGEMENT'S DISCUSSION AND ANALYSIS in Item 7 of this Report that are referenced in the above discussion contain statements relating to future results of the Company that are considered "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to, among other things, simulation of the impact on net interest income from changes in interest rates. Actual results may differ materially from those expressed or implied therein as a result of certain risks and uncertainties, including those risks and uncertainties expressed above, those that are described in MANAGEMENT'S DISCUSSION AND ANALYSIS in Item 7 of this Report, and those that are described in Item 1 of this Report, "Business," under the caption "Forward-Looking Statements and Associated Risks," which discussions are incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data.

Report of Independent Registered Public Accounting Firm

Shareholders and the Board of Directors of
German American Bancorp, Inc.
Jasper, Indiana

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of German American Bancorp, Inc. (the "Company") as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2018, and the related notes (collectively referred to as the "financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework: (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2018 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework: (2013) issued by COSO.

Basis for Opinions

The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. As permitted, the Company has excluded the operations of First Security, Inc. acquired during 2018, which is described in Note 18 of the consolidated financial statements, from the scope of management's report on internal control over financial reporting. As such, it has also been excluded from the scope of our audit of internal control over financial reporting. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance

Report of Independent Registered Public Accounting Firm

regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Crowe LLP
Crowe LLP

We have served as the Company's auditor since 1977.

Indianapolis, Indiana
March 1, 2019

Consolidated Balance Sheets
Dollars in thousands, except per share data

	December 31,	
	2018	2017
ASSETS		
Cash and Due from Banks	$64,549	$47,266
Federal Funds Sold and Other Short-term Investments	32,001	23,093
Cash and Cash Equivalents	96,550	70,359
Interest-bearing Time Deposits with Banks	250	—
Securities Available-for-Sale, at Fair Value	812,611	740,641
Other Investments	353	353
Loans Held-for-Sale, at Fair Value	4,263	6,719
Loans	2,731,741	2,145,019
Less: Unearned Income	(3,682)	(3,381)
Allowance for Loan Losses	(15,823)	(15,694)
Loans, Net	2,712,236	2,125,944
Stock in FHLB of Indianapolis and Other Restricted Stock, at Cost	13,048	13,048
Premises, Furniture and Equipment, Net	80,627	54,246
Other Real Estate	286	54
Goodwill	103,681	54,058
Intangible Assets	9,964	2,102
Company Owned Life Insurance	59,896	46,385
Accrued Interest Receivable and Other Assets	35,325	30,451
TOTAL ASSETS	$3,929,090	$3,144,360
LIABILITIES		
Non-interest-bearing Demand Deposits	$715,972	$606,134
Interest-bearing Demand, Savings, and Money Market Accounts	1,768,177	1,490,033
Time Deposits	588,483	387,885
Total Deposits	3,072,632	2,484,052
FHLB Advances and Other Borrowings	376,409	275,216
Accrued Interest Payable and Other Liabilities	21,409	20,521
TOTAL LIABILITIES	3,470,450	2,779,789
Commitments and Contingencies (Note 13)		
SHAREHOLDERS' EQUITY		
Preferred Stock, no par value; 500,000 shares authorized, no shares issued	—	—
Common Stock, no par value, $1 stated value; 45,000,000 shares authorized	24,967	22,934
Additional Paid-in Capital	229,347	165,288

Retained Earnings	211,424	178,969
Accumulated Other Comprehensive Loss	(7,098)	(2,620)
TOTAL SHAREHOLDERS' EQUITY	458,640	364,571
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$3,929,090	$3,144,360
End of period shares issued and outstanding	24,967,458	22,934,403

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Income
Dollars in thousands, except per share data

	Years Ended December 31,		
	2018	2017	2016
INTEREST INCOME			
Interest and Fees on Loans	$112,084	$91,745	$86,202
Interest on Federal Funds Sold and Other Short-term Investments	308	134	74
Interest and Dividends on Securities:			
Taxable	12,398	10,898	9,638
Non-taxable	8,959	8,253	7,451
TOTAL INTEREST INCOME	133,749	111,030	103,365
INTEREST EXPENSE			
Interest on Deposits	13,625	7,094	5,187
Interest on FHLB Advances and Other Borrowings	5,514	4,027	3,274
TOTAL INTEREST EXPENSE	19,139	11,121	8,461
NET INTEREST INCOME	114,610	99,909	94,904
Provision for Loan Losses	2,070	1,750	1,200
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	112,540	98,159	93,704
NON-INTEREST INCOME			
Trust and Investment Product Fees	6,680	5,272	4,644
Service Charges on Deposit Accounts	7,044	6,178	5,973
Insurance Revenues	8,330	7,979	7,741
Company Owned Life Insurance	1,243	1,341	987
Interchange Fee Income	7,278	4,567	3,627
Other Operating Income	2,785	2,641	3,703
Net Gains on Sales of Loans	3,004	3,280	3,359
Net Gains on Securities	706	596	1,979
TOTAL NON-INTEREST INCOME	37,070	31,854	32,013
NON-INTEREST EXPENSE			
Salaries and Employee Benefits	51,306	46,642	43,961
Occupancy Expense	7,735	6,609	6,297
Furniture and Equipment Expense	3,142	2,621	2,261
FDIC Premiums	1,033	954	1,151
Data Processing Fees	6,942	4,276	5,686
Professional Fees	5,362	2,817	3,672

Advertising and Promotion	3,492	3,543	2,657
Intangible Amortization	1,752	942	1,062
Other Operating Expenses	12,789	9,399	9,840
TOTAL NON-INTEREST EXPENSE	93,553	77,803	76,587
Income before Income Taxes	56,057	52,210	49,130
Income Tax Expense	9,528	11,534	13,946
NET INCOME	$46,529	$40,676	$35,184
Basic Earnings per Share	$1.99	$1.77	$1.57
Diluted Earnings per Share	$1.99	$1.77	$1.57
Dividends per Share	$0.60	$0.52	$0.48

See accompanying notes to the consolidated financial statements

Consolidated Statements of Comprehensive Income
Dollars in thousands, except per share data

	Years Ended December 31,		
	2018	2017	2016
NET INCOME	$46,529	$40,676	$35,184
Other Comprehensive Income (Loss):			
Unrealized Gains (Losses) on Securities:			
Unrealized Holding Gain (Loss) Arising During the Period	(4,936)	7,364	(13,830)
Reclassification Adjustment for Gains Included in Net Income	(706)	(596)	(1,979)
Tax Effect	1,218	(2,377)	5,607
Net of Tax	(4,424)	4,391	(10,202)
Postretirement Benefit Obligation:			
Net (Loss) Arising During the Period	(73)	(226)	(24)
Reclassification Adjustment for Amortization of Prior Service Cost and Net Loss Included in Net Periodic Pension Cost	32	8	6
Tax Effect	(13)	80	4
Net of Tax	(54)	(138)	(14)
Total Other Comprehensive Income (Loss)	(4,478)	4,253	(10,216)
COMPREHENSIVE INCOME	$42,051	$44,929	$24,968

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Changes in Shareholders' Equity
Dollars in thousands, except per share data

	Common Stock					
	Shares	Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances, January 1, 2016	13,278,824	$13,279	$110,145	$125,112	$ 3,812	$ 252,348
Net Income				35,184		35,184
Other Comprehensive Income (Loss)					(10,216)	(10,216)
Cash Dividends ($0.48 per share)				(10,630)		(10,630)
Issuance of Common Stock for:						
Exercise of Stock Options	4,166	4	51			55
Acquisition of River Valley Bancorp	1,942,429	1,942	59,977			61,919
Restricted Share Grants	36,012	36	1,371			1,407
Income Tax Benefit From Restricted Share Vesting			200			200
Balances, December 31, 2016	15,261,431	15,261	171,744	149,666	(6,404)	330,267
Net Income				40,676		40,676
Other Comprehensive Income (Loss)					4,253	4,253
Reclass Upon Adoption of ASU 2018-02 (See Note 1 - Summary of Significant Accounting Policies)				469	(469)	—
Cash Dividends ($0.52 per share)				(11,842)		(11,842)
Issuance of Common Stock for:						
3-for-2 Stock Split	7,642,726	7,643	(7,672)			(29)
Restricted Share Grants	30,246	30	1,216			1,246
Income Tax Benefit From Restricted Share Vesting			—			—
Balances, December 31, 2017	22,934,403	22,934	165,288	178,969	(2,620)	364,571
Net Income				46,529		46,529
Other Comprehensive Income (Loss)					(4,478)	(4,478)
Cash Dividends ($0.60 per share)				(14,074)		(14,074)
Issuance of Common Stock for:						
Acquisition of First Security Bank	1,987,698	1,988	62,749			64,737
Restricted Share Grants	45,357	45	1,310			1,355
Income Tax Benefit From Restricted Share Vesting			—			—
Balances, December 31, 2018	24,967,458	$24,967	$229,347	$211,424	$ (7,098)	$ 458,640

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Cash Flows
Dollars in thousands

	Years Ended December 31,		
CASH FLOWS FROM OPERATING ACTIVITIES	2018	2017	2016
Net Income	$ 46,529	$ 40,676	$ 35,184
Adjustments to Reconcile Net Income to Net Cash from Operating Activities:			
Net Amortization on Securities	3,550	3,543	3,675
Depreciation and Amortization	6,184	4,687	4,315
Loans Originated for Sale	(131,916)	(122,518)	(138,192)
Proceeds from Sales of Loans Held-for-Sale	137,417	134,316	137,307
Provision for Loan Losses	2,070	1,750	1,200
Gain on Sale of Loans, net	(3,004)	(3,280)	(3,359)
Gain on Securities, net	(706)	(596)	(1,979)
Gain on Sales of Other Real Estate and Repossessed Assets	(41)	(17)	(55)
Loss (Gain) on Disposition and Donation of Premises and Equipment	(36)	870	5
Loss on Disposition of Land	44	—	—
Post Retirement Medical Benefit	(55)	(34)	7
Increase in Cash Surrender Value of Company Owned Life Insurance	(1,141)	(1,370)	(1,068)
Equity Based Compensation	1,355	1,246	1,407
Excess Tax Benefit from Restricted Share Grant	32	240	200
Change in Assets and Liabilities:			
Interest Receivable and Other Assets	2,211	(4,528)	5,813
	(162)	(110)	(2,547)

Interest Payable and Other Liabilities			
Net Cash from Operating Activities	62,331	54,875	41,913
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of Other Short-term Investments	—	—	(1,000)
Proceeds from Maturity of Other Short-term Investments	—	—	1,992
Proceeds from Maturities of Securities Available-for-Sale	78,714	79,955	103,301
Proceeds from Sales of Securities Available-for-Sale	91,013	49,459	165,102
Purchase of Securities Available-for-Sale	(140,604)	(156,802)	(225,456)
Proceeds from Maturities of Securities Held-to-Maturity	—	—	95
Purchase of Federal Home Loan Bank Stock	—	—	(1,350)
Proceeds from Redemption of Federal Home Loan Bank Stock	2,607	—	—
Purchase of Loans	(1,209)	(5,547)	(5,383)
Proceeds from Sales of Loans	6,000	1,106	2,029
Loans Made to Customers, net of Payments Received	(87,127)	(149,336)	(106,198)
Proceeds from Sales of Other Real Estate	662	1,435	1,429
Property and Equipment Expenditures	(15,186)	(11,183)	(5,234)
Proceeds from Sales of Property and Equipment	40	6	—
Proceeds from Sale of Land	393	—	—
Proceeds from Life Insurance	765	1,627	—
Acquisition of River Valley Bancorp	—	—	(1,016)
Cash from Acquisition of Bank Branches	42,700	—	—

Acquisition of First Security, Inc.	(17,566)	—	—
Net Cash from Investing Activities	(38,798)	(189,280)	(71,689)
CASH FLOWS FROM FINANCING ACTIVITIES			
Change in Deposits	(11,112)	134,737	118,231
Change in Short-term Borrowings	42,999	(4,054)	(40,163)
Advances in Long-term Debt	25,000	75,000	—
Repayments of Long-term Debt	(40,155)	(53,864)	(24,910)
Issuance (Retirement) of Common Stock	—	(29)	55
Dividends Paid	(14,074)	(11,842)	(10,630)
Net Cash from Financing Activities	2,658	139,948	42,583
Net Change in Cash and Cash Equivalents	26,191	5,543	12,807
Cash and Cash Equivalents at Beginning of Year	70,359	64,816	52,009
Cash and Cash Equivalents at End of Year	$ 96,550	$ 70,359	$ 64,816
Cash Paid During the Year for			
Interest	$ 18,239	$ 10,852	$ 8,348
Income Taxes	5,920	12,462	9,254
Supplemental Non Cash Disclosures (See Note 18 for Business Combinations)			
Loans Transferred to Other Real Estate	$ 398	$ 1,230	$ 565
Reclassification of Land and Buildings to Other Assets	850	330	664

See accompanying notes to the consolidated financial statements.

Notes to the Consolidated Financial Statements
Dollars in thousands, except per share data

NOTE 1 – Summary of Significant Accounting Policies

Description of Business and Basis of Presentation
German American Bancorp, Inc's. operations are primarily comprised of three business segments: core banking, trust and investment advisory services, and insurance operations. The accounting and reporting policies of German American Bancorp, Inc. and its subsidiaries conform to U.S. generally accepted accounting principles. The more significant policies are described below. The consolidated financial statements include the accounts of the Company and its subsidiaries after elimination of all material intercompany accounts and transactions. Certain prior year amounts have been reclassified to conform with current classifications. Reclassifications had no impact on shareholders' equity or net income. To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and actual results could differ.

Securities
Debt securities classified as available-for-sale are securities that the Company intends to hold for an indefinite period of time, but not necessarily until maturity. These include securities that management may use as part of its asset/liability strategy, or that may be sold in response to changes in interest rates, changes in prepayment risk, or similar reasons. Securities classified as available-for-sale are reported at fair value with unrealized gains or losses included as a separate component of equity, net of tax. Securities classified as held-to-maturity are securities that the Company has both the ability and positive intent to hold to maturity. Securities held-to-maturity are carried at amortized cost.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage backed securities where prepayments are anticipated. Gains and losses on sales are recorded on trade date and determined using the specific identification method.

On January 1, 2018, the Company adopted the new accounting for Financial Instruments, which requires equity investments with readily determinable values (except those accounted for under equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. Equity securities that do not have readily determinable fair values are carried at historical cost and evaluated for impairment on a periodic basis. The adoption of this guidance impacted one security and resulted in no adjustment to beginning retained earnings and no impact to beginning other comprehensive income. Upon adoption of the guidance, this equity security is no longer classified as available for sale. For additional information on this security, see Note 2 - Securities.

Management evaluates debt securities for other-than-temporary impairment (“OTTI”) on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

Loans Held for Sale
Mortgage loans originated and intended for sale in the secondary market are carried at fair value. Fair value is determined based on collateral value and prevailing market prices for loans with similar characteristics. Net unrealized gains or losses are recorded through earnings.

Mortgage loans held for sale are generally sold on a servicing released basis. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

Loans
Loans that management originates and has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at the principal balance outstanding, net of unearned interest, deferred loan fees and costs, and an allowance for loan losses. Interest income is accrued on unpaid principal balance and includes amortization of net deferred loan fees and costs over the loan term without anticipating prepayments.

Notes to the Consolidated Financial Statements
Dollars in thousands, except per share data

NOTE 1 – Summary of Significant Accounting Policies (continued)

All classes of loans are generally placed on non-accrual status when scheduled principal or interest payments are past due for 90 days or more or when the borrower's ability to repay becomes doubtful. Uncollected accrued interest for each class of loans is reversed against income at the time a loan is placed on non-accrual. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. All classes of loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Loans are typically charged-off at 180 days past due, or earlier if deemed uncollectible. Exceptions to the non-accrual and charge-off policies are made when the loan is well secured and in the process of collection.

Certain Purchased Loans
The Company purchases individual loans and groups of loans. Purchased loans that show evidence of credit deterioration since origination are recorded at the amount paid (or allocated fair value in a purchase business combination), such that there is no carryover of the seller's allowance for loan losses. After acquisition, incurred losses are recognized by an increase in the allowance for loan losses. Such purchased loans are accounted for individually. The Company estimates the amount and timing of expected cash flows for each purchased loan and the expected cash flows in excess of amount paid is recorded as interest income over the remaining life of the loan (accretable yield). The excess of the loan's contractual principal and interest over expected cash flows is not recorded (nonaccretable difference).

Over the life of the loan, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

Allowance for Loan Losses
The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off. The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or special mention. The general component covers non-classified loans and is based on historical loss experience adjusted for current factors.

Loan impairment is reported when full repayment under the terms of the loan is not expected. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate, or at the fair value of collateral if repayment is expected solely from the collateral. Commercial and industrial loans, commercial real estate loans, and agricultural loans are evaluated individually for impairment. Smaller balance homogeneous loans are evaluated for impairment in total. Such loans include real estate loans secured by one-to-four family residences and loans to individuals for household, family and other personal expenditures. Individually evaluated loans on non-accrual are generally considered impaired. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported at the fair value of the collateral net of disposition costs. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The general component of the allowance for loan losses covers non-impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and risk classifications and is based on the actual loss history experienced by the Company over a 20 quarter average. The Company separately assigns allocations for substandard and special mention commercial and agricultural credits as well as other categories of loans based on migration analysis techniques. This actual loss experience is supplemented with other external and internal factors based on the risks present for each portfolio segment. These factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. The following portfolio segments have been identified: Commercial Loans and Retail Loans. Commercial Loans have been classified according to the following risk characteristics: Commercial and Industrial Loans and Leases,

Notes to the Consolidated Financial Statements
Dollars in thousands, except per share data

NOTE 1 – Summary of Significant Accounting Policies (continued)

Commercial Real Estate, and Agricultural Loans. Commercial and Industrial loans are primarily based on the cash flows of the business operations and secured by assets being financed and other assets such as accounts receivable and inventory. Commercial Real Estate Loans and Agricultural Loans are primarily based on cash flow of the borrower and their business and further secured by real estate. All types of commercial and agricultural (real estate secured and non-real estate) may also come with personal guarantees of the borrowers and business owners. Retail Loans have been classified according to the following risk characteristics: Home Equity Loans, Consumer Loans and Residential Mortgage Loans. Retail loans are generally dependent on personal income of the customer, and repayment is dependent on borrower's personal cash flow and employment status which can be affected by general economic conditions. Additionally, collateral values may fluctuate based on the impact of economic conditions on residential real estate values and other consumer type assets such as automobiles.

Loans or portions of loans shall be charged off when there is a distinct probability of loss identified. A distinct probability of loss exists when it has been determined that any remaining sources of repayment are insufficient to cover all outstanding principal. The probable loss is immediately calculated based on the value of the remaining sources of repayment and charged to the allowance for loan loss.

Servicing Rights
When mortgage loans are sold with servicing retained, servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on market prices for comparable mortgage servicing contracts when available or, alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans. Through the acquisition of River Valley Bancorp in 2016, German American acquired a portfolio of servicing rights on mortgage loans. German American also acquired a portfolio of servicing rights on mortgage loans through the acquisition of five branch locations of First Financial Bancorp (formerly branch locations of Mainsource Financial Group, Inc. prior to its merger with First Financial Bancorp on April 1, 2018). The fair value of mortgage servicing rights were $995 and $547 at December 31, 2018 and 2017, respectively.

On a quarterly basis, loan servicing rights are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. The valuation model utilizes interest rate, prepayment speed, and default rate assumptions that market participants would use in estimating future net servicing income and that can be validated against available market data.

Servicing fee income is reported on the income statement as other operating income. The fees are based on a contractual percentage of the outstanding principal and are recorded as income when earned. The amortization of mortgage servicing right is netted against loan servicing fee income.

Federal Home Loan Bank (FHLB) Stock
The Bank is a member of the FHLB of Indianapolis. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Premises, Furniture and Equipment

Land is carried at cost. Premises, furniture, and equipment are stated at cost less accumulated depreciation. Buildings and related components are depreciated using the straight-line method with useful lives ranging generally from 10 to 40 years. Furniture, fixtures, and equipment are depreciated using the straight-line method with useful lives ranging generally from 3 to 10 years.

Other Real Estate

Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

Goodwill and Other Intangible Assets

Goodwill resulting from business combinations prior to January 1, 2009 represents the excess of the purchase price over the fair value of the net assets of businesses acquired. Goodwill resulting from business combinations after January 1, 2009, is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible

Notes to the Consolidated Financial Statements
Dollars in thousands, except per share data

NOTE 1 – Summary of Significant Accounting Policies (continued)

assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually. The Company has selected December 31 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on the Company's balance sheet.

Other intangible assets consist of core deposit and acquired customer relationship intangible assets. They are initially measured at fair value and then are amortized over their estimated useful lives, which range from 6 to 10 years.

Company Owned Life Insurance
The Company has purchased life insurance policies on certain directors and executives. This life insurance is recorded at its cash surrender value or the amount that can be realized, which considers any adjustments or changes that are probable at settlement.

Loss Contingencies
Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe currently that there are any such matters that will have a material impact on the financial statements.

Loan Commitments and Related Financial Instruments
Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Restrictions on Cash
At December 31, 2018 and 2017, respectively, the Company was required to have $15,170 and $10,967 on deposit with the Federal Reserve, or as cash on hand.

Long-term Assets
Premises and equipment, core deposit and other intangible assets, and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Stock Based Compensation
Compensation cost is recognized for stock options and restricted stock awards issued to employees and directors, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Corporation's common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period.

Comprehensive Income
Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale and changes in unrecognized amounts in pension and other postretirement benefits, which are also recognized as a separate component of equity.

Income Taxes

Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

Notes to the Consolidated Financial Statements
Dollars in thousands, except per share data

NOTE 1 – Summary of Significant Accounting Policies (continued)

Retirement Plans
Pension expense under the suspended defined benefit plan is the net of interest cost, return on plan assets and amortization of gains and losses not immediately recognized. Employee 401(k) and profit sharing plan expense is the amount of matching contributions. Deferred compensation and supplemental retirement plan expense allocates the benefits over years of service.

Earnings Per Share
Earnings per share are based on net income divided by the weighted average number of shares outstanding during the period. Diluted earnings per share show the potential dilutive effect of additional common shares issuable under the Company’s stock based compensation plans. Earnings per share are retroactively restated for stock splits and stock dividends.

Cash Flow Reporting
The Company reports net cash flows for customer loan transactions, deposit transactions, deposits made with other financial institutions and short-term borrowings. Cash and cash equivalents are defined to include cash on hand, demand deposits in other institutions and Federal Funds Sold.

Fair Values of Financial Instruments
Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 15. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

New Accounting Pronouncements
In February 2016, the FASB amended existing guidance (ASU No. 2016-02, Leases (Topic 842)) that requires lessees recognize the following for all leases (with the exception of short-term leases) at the commencement date (1) A lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The new guidance also requires enhanced disclosure about an entity's leasing arrangements. The Company will adopt Topic 842 in the first quarter of 2019, as required for public business entities.

An entity may adopt the new guidance by either restating prior periods and recording a cumulative effect adjustment at the beginning of the earliest comparative period presented or by recording a cumulative effect adjustment at the beginning of the period of adoption. The Company plans to record a cumulative effect adjustment at the beginning of the earliest comparative period.

Based on our leases outstanding as of December 31, 2018, the Company does not expect this new guidance to have a material impact on the consolidated results of operation or financial condition. However as a result of this new guidance, the Company anticipates an estimated increase in total assets and total liabilities on the Consolidated Balance Sheet of approximately $9,300.

In June 2016, the FASB issued guidance (ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326)) to replace the incurred loss model with an expected loss model, which is referred to as the current expected credit loss

(CECL) model. The CECL model is applicable to the measurement of credit losses on financial assets measured at amortized cost, including loan receivables, held-to-maturity debt securities, and reinsurance receivables. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investments in leases recognized by a lessor. This standard will be effective for public business entities for fiscal years beginning after December 15, 2019, including interim periods within that reporting period.

The transition to the new standard will be applied as follows:

- For debt securities with other-than-temporary impairment (OTTI), the guidance will be applied prospectively.
- Existing purchased credit impaired (PCI) assets will be grandfathered and classified as purchased credit deteriorated (PCD) assets at the date of adoption. The asset will be grossed up for the allowance for expected credit losses for all PCD assets at the date of adoption and will continue to recognize the noncredit discount in interest income based on the yield of such assets as of the adoption date. Subsequent changes in expected credit losses will be recorded through the allowance.
- For all other assets within the scope of CECL, a cumulative-effect adjustment will be recognized in retained earnings as of the beginning of the first reporting period in which the guidance is effective.

Notes to the Consolidated Financial Statements
Dollars in thousands, except per share data

NOTE 1 – Summary of Significant Accounting Policies (continued)

The Company has formed a cross-functional committee that has assessed data and system needs, selected a vendor to provide modeling needs, and implemented new software with the plan to run parallel processing of our existing allowance for loan loss model with the CECL model in the first quarter of 2019. The Company expects to recognize a one-time cumulative adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective, but cannot estimate the amount at this time.

In March 2017, the FASB amended existing guidance (ASU No. 2017-08, Receivables-Nonrefundable Fees and Other Costs (Subtopic 310-20)) to amend the amortization period for certain purchased callable debt securities held at a premium. The amortization period has been shortened to the earliest call date. Under current generally accepted accounting principles, entities generally amortize the premium as an adjustment of yield over the contractual life of the instrument. These amendments are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company early adopted this guidance in 2017 and it did not have a material impact on the Company's operating results or financial condition.

In February 2018, the FASB issued new guidance (ASU No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220)) to allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The amendments eliminate the stranded tax effects resulting from the Tax Cuts and Jobs Act and will improve the usefulness of information reported to financial statement users. This amendment is effective for public business entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The Company early adopted this guidance in 2017 and it did not have a material impact on the Company's operating results or financial condition.

NOTE 2 - Securities

The amortized cost, unrealized gross gains and losses recognized in accumulated other comprehensive income (loss), and fair value of Securities Available-for-Sale were as follows:

Securities Available-for-Sale:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2018				
Obligations of State and Political Subdivisions	$291,449	$ 4,407	$(1,323)	$294,533
MBS/CMO – Residential	529,805	1,029	(12,756)	518,078
Total	$821,254	$ 5,436	$(14,079)	$812,611
2017				
Obligations of State and Political Subdivisions	$267,437	$ 6,733	$(861)	$273,309
MBS/CMO - Residential	476,205	416	(9,289)	467,332
Total	$743,642	$ 7,149	$(10,150)	$740,641

All mortgage-backed securities in the above table (identified above and throughout this Note 2 as "MBS/CMO - Residential") are residential mortgage-backed securities and guaranteed by government sponsored entities.

The amortized cost and fair value of Securities at December 31, 2018 by contractual maturity are shown below. Expected maturities may differ from contractual maturities because some issuers have the right to call or prepay certain obligations with or without call or prepayment penalties. Mortgage-backed Securities are not due at a single maturity date and are shown separately.

	Amortized Cost	Fair Value
Securities Available-for-Sale:		
Due in one year or less	$ 2,195	$ 2,202
Due after one year through five years	16,401	16,689
Due after five years through ten years	82,449	84,085
Due after ten years	190,404	191,557
MBS/CMO - Residential	529,805	518,078
Total	$ 821,254	$ 812,611

Notes to the Consolidated Financial Statements
Dollars in thousands, except per share data

NOTE 2 – Securities (continued)

Proceeds from the Sales of Securities are summarized below:	2018 Available-for-Sale	2017 Available-for-Sale	2016 Available-for-Sale
Proceeds from Sales	$ 91,013	$ 49,459	$ 165,102
Gross Gains on Sales	706	596	1,979
Income Taxes on Gross Gains	148	209	693

The carrying value of securities pledged to secure repurchase agreements, public and trust deposits, and for other purposes as required by law was $211,239 and $165,404 as of December 31, 2018 and 2017, respectively.

Below is a summary of securities with unrealized losses as of year-end 2018 and 2017, presented by length of time the securities have been in a continuous unrealized loss position:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
December 31, 2018						
Obligations of State and Political Subdivisions	$37,936	$ (286)	$49,071	$(1,037)	$87,007	$(1,323)
MBS/CMO - Residential	56,386	(601)	356,218	(12,155)	412,604	(12,756)
Total	$94,322	$ (887)	$405,289	$(13,192)	$499,611	$(14,079)

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
December 31, 2017						
Obligations of State and Political Subdivisions	$33,230	$ (237)	$24,161	$ (624)	$57,391	$(861)
MBS/CMO - Residential	172,354	(2,048)	250,520	(7,241)	422,874	(9,289)
Total	$205,584	$ (2,285)	$274,681	$ (7,865)	$480,265	$(10,150)

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 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 Company 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 Company doesn't intend to sell or expect to be required to sell these securities, and the decline in fair value is largely due to changes in market interest rates; therefore, the Company does not consider these securities to be other-than-temporarily impaired. All mortgage-backed securities and collateralized mortgages obligations (MBS/CMO - Residential) in the Company's portfolio are guaranteed by government sponsored entities, are investment grade, and are performing as expected.

The Company's equity securities are listed as Other Investments on the Consolidated Balance Sheets and consist of one non-controlling investment in a single banking organization at December 31, 2018 and 2017. The original investment totaled $1,350 and other-than-temporary impairment was previously recorded totaling $997. The Company's equity securities are considered not to have readily determinable fair value and are carried at cost and evaluated for impairment. During 2018, there was no additional impairment recognized through earnings.

NOTE 3 – Derivatives

The Company executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. The notional amounts of these interest rate swaps and the offsetting counterparty derivative instruments were $85.6 million and $87.8 million at December 31, 2018 and 2017, respectively. These interest rate swaps are simultaneously hedged by offsetting interest rate swaps that the Company executes with a third party, such that the Company minimizes its net risk exposure resulting from such transactions with approved, reputable, independent counterparties with substantially matching terms. The agreements are considered stand alone derivatives and changes in the fair value of derivatives are reported in earnings as non-interest income.

Notes to the Consolidated Financial Statements
Dollars in thousands, except per share data

NOTE 3 – Derivatives (continued)

Credit risk arises from the possible inability of counterparties to meet the terms of their contracts. The Company's exposure is limited to the replacement value of the contracts rather than the notional, principal or contract amounts. There are provisions in the agreements with the counterparties that allow for certain unsecured credit exposure up to an agreed threshold. Exposures in excess of the agreed thresholds are collateralized. In addition, the Company minimizes credit risk through credit approvals, limits, and monitoring procedures.

The following table reflects the fair value hedges included in the Consolidated Balance Sheets as of:

	December 31, 2018		December 31, 2017	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Included in Other Assets:				
Interest Rate Swaps	$85,587	$1,713	$87,788	$1,564
Included in Other Liabilities:				
Interest Rate Swaps	$85,587	$1,734	$87,788	$1,633

The following table presents the effect of derivative instruments on the Consolidated Statements of Income for the years ended December 31, 2018, 2017 and 2016 is as follows:

	2018	2017	2016
Interest Rate Swaps:			
Included in Other Income	$ 48	$478	$1,207

NOTE 4 – Loans

Loans were comprised of the following classifications at December 31:

	2018	2017
Commercial:		
Commercial and Industrial Loans and Leases	$543,761	$486,668
Commercial Real Estate Loans	1,208,646	926,729
Agricultural Loans	365,208	333,227
Retail:		
Home Equity Loans	207,987	152,187
Consumer Loans	77,547	67,475
Residential Mortgage Loans	328,592	178,733
Subtotal	2,731,741	2,145,019
Less: Unearned Income	(3,682)	(3,381)
Allowance for Loan Losses	(15,823)	(15,694)
Loans, net	$2,712,236	$2,125,944

As further described in Note 18, during 2018 the Company acquired loans at fair value from two separate acquisitions. The table below summarizes the loans acquired in the current year.

	Acquired Loan Balance	Fair Value Discounts	Fair Value

Branch Acquisition	$119,176	$ (2,871)	$116,305
Bank Acquisition	402,234	(12,128)	390,106

Notes to the Consolidated Financial Statements
Dollars in thousands, except per share data

NOTE 4 – Loans (continued)

The table below summarizes the remaining carrying amount of acquired loans included in the December 31, 2018 table above.

	Loan Balance at December 31, 2018	Fair Value Discount at December 31, 2018
Branch Acquisition	$ 108,505	$ (2,491)
Bank Acquisition	385,557	(11,063)

The following tables present the activity in the allowance for loan losses by portfolio class for the years ended December 31, 2018, 2017, and 2016:

	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated	Total
December 31, 2018								
Beginning Balance	$ 4,735	$ 4,591	$ 4,894	$ 330	$ 298	$ 343	$ 503	$ 15,694
Provision for Loan Losses	(423)	729	862	(52)	608	167	179	2,070
Recoveries	141	20	20	12	375	37	—	605
Loans Charged-off	(1,500)	(49)	—	(61)	(861)	(75)	—	(2,546)
Ending Balance	$ 2,953	$ 5,291	$ 5,776	$ 229	$ 420	$ 472	$ 682	$ 15,823

	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated	Total
December 31, 2017								
Beginning Balance	$ 3,725	$ 5,452	$ 4,094	$ 283	$ 235	$ 329	$ 690	$ 14,808
Provision for Loan Losses	1,147	(689)	840	78	517	44	(187)	1,750
Recoveries	14	48	9	8	272	63	—	414
Loans Charged-off	(151)	(220)	(49)	(39)	(726)	(93)	—	(1,278)
Ending Balance	$ 4,735	$ 4,591	$ 4,894	$ 330	$ 298	$ 343	$ 503	$ 15,694

	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated	Total
December 31, 2016								
Beginning Balance	$ 4,242	$ 6,342	$ 2,115	$ 383	$ 230	$ 414	$ 712	$ 14,438

Provision for Loan Losses	(483)	(846)	2,000	33	273	245	(22)	1,200
Recoveries	32	10	1	3	208	16	—	270
Loans Charged-off	(66)	(54)	(22)	(136)	(476)	(346)	—	(1,100)
Ending Balance	$ 3,725	$ 5,452	$ 4,094	$283	$ 235	$ 329	$ 690	$14,808

In determining the adequacy of the allowance for loan loss, general allocations are made for pools of loans, including non-classified loans, homogeneous portfolios of consumer and residential real estate loans, and loans within certain industry categories believed to present unique risk of loss. General allocations of the allowance are primarily made based on historical averages for loan losses for these portfolios, judgmentally adjusted for current economic factors and portfolio trends.

Notes to the Consolidated Financial Statements
Dollars in thousands, except per share data

NOTE 4 – Loans (continued)

Loan impairment is reported when full repayment under the terms of the loan is not expected. This methodology is used for all loans, including loans acquired with deteriorated credit quality if such loans perform worse than what was expected at the time of acquisition. For purchased loans, the assessment is made at the time of acquisition as well as over the life of loan. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate, or at the fair value of collateral if repayment is expected solely from the collateral. Commercial and industrial loans, commercial real estate loans, and agricultural loans are evaluated individually for impairment. Smaller balance homogeneous loans are evaluated for impairment in total. Such loans include real estate loans secured by one-to-four family residences and loans to individuals for household, family and other personal expenditures. Individually evaluated loans on non-accrual are generally considered impaired. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

Specific allocations on impaired loans are determined by comparing the loan balance to the present value of expected cash flows or expected collateral proceeds. Allocations are also applied to categories of loans not considered individually impaired but for which the rate of loss is expected to be greater than historical averages, including non-performing consumer or residential real estate loans. Such allocations are based on past loss experience and information about specific borrower situations and estimated collateral values.

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio class and based on impairment method as of December 31, 2018 and 2017:

December 31, 2018	Total	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated
Allowance for Loan Losses:								
Ending Allowance Balance Attributable to Loans:								
Individually Evaluated for Impairment	$1,823	$ 143	$ 1,680	$ —	$ —	$ —	$ —	$ —
Collectively Evaluated for Impairment	13,992	2,810	3,608	5,776	229	420	467	682
Acquired with Deteriorated Credit Quality	8	—	3	—	—	—	5	—
Total Ending Allowance Balance	$15,823	$ 2,953	$ 5,291	$ 5,776	$ 229			