

FIRST FINANCIAL BANCORP /OH/  
Form 10-Q  
August 06, 2013  
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FORM 10-Q  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington D.C. 20549

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2013

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-12379

FIRST FINANCIAL BANCORP.  
(Exact name of registrant as specified in its charter)

|   |   |
|---|---|
| Ohio  | 31-1042001                              |
| (State or other jurisdiction of<br>incorporation or organization) | (I.R.S. Employer<br>Identification No.) |

|  |            |
|--|------------|
| 255 East Fifth Street, Suite 700         | 45202      |
| Cincinnati, Ohio                         | (Zip Code) |
| (Address of principal executive offices) |            |

Registrant's telephone number, including area code (877) 322-9530

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

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

| Class                      | Outstanding at August 5, 2013 |
|----------------------------|-------------------------------|
| Common stock, No par value | 57,707,718                    |

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PART I - FINANCIAL INFORMATION  
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 FIRST FINANCIAL BANCORP. AND SUBSIDIARIES  
 CONSOLIDATED BALANCE SHEETS  
 (Dollars in thousands)

|  | June 30,<br>2013<br>(Unaudited) | December 31,<br>2012 |
|--|---------------------------------|----------------------|
| Assets   |                                 |                      |
| Cash and due from banks  | \$114,745                       | \$134,502            |
| Interest-bearing deposits with other banks   | 2,671                           | 24,341               |
| Investment securities available-for-sale, at market value (cost \$900,068 at June 30, 2013 and \$1,017,104 at December 31, 2012) | 884,694                         | 1,032,096            |
| Investment securities held-to-maturity (market value \$664,398 at June 30, 2013 and \$778,474 at December 31, 2012)              | 670,246                         | 770,755              |
| Other investments  | 75,645                          | 71,492               |
| Loans held for sale  | 18,650                          | 16,256               |
| Loans  |                                 |                      |
| Commercial   | 940,420                         | 861,033              |
| Real estate-construction   | 97,246                          | 73,517               |
| Real estate-commercial   | 1,477,226                       | 1,417,008            |
| Real estate-residential  | 343,016                         | 318,210              |
| Installment  | 50,781                          | 56,810               |
| Home equity  | 370,206                         | 367,500              |
| Credit card  | 33,222                          | 34,198               |
| Lease financing  | 70,011                          | 50,788               |
| Total loans - excluding covered loans  | 3,382,128                       | 3,179,064            |
| Less: Allowance for loan and lease losses - uncovered  | 47,047                          | 47,777               |
| Net loans - excluding covered loans  | 3,335,081                       | 3,131,287            |
| Covered loans  | 622,265                         | 748,116              |
| Less: Allowance for loan and lease losses - covered  | 32,961                          | 45,190               |
| Net loans – covered  | 589,304                         | 702,926              |
| Net loans  | 3,924,385                       | 3,834,213            |
| Premises and equipment   | 142,675                         | 146,716              |
| Goodwill   | 95,050                          | 95,050               |
| Other intangibles  | 6,620                           | 7,648                |
| FDIC indemnification asset   | 88,966                          | 119,607              |
| Accrued interest and other assets  | 250,228                         | 244,372              |
| Total assets   | \$6,274,575                     | \$6,497,048          |
| Liabilities  |                                 |                      |
| Deposits   |                                 |                      |
| Interest-bearing   | \$1,131,466                     | \$1,160,815          |
| Savings  | 1,601,122                       | 1,623,614            |
| Time   | 978,680                         | 1,068,637            |
| Total interest-bearing deposits  | 3,711,268                       | 3,853,066            |
| Noninterest-bearing  | 1,059,368                       | 1,102,774            |
| Total deposits   | 4,770,636                       | 4,955,840            |

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|  |             |              |
|--|-------------|--------------|
| Federal funds purchased and securities sold under agreements to repurchase       | 114,030     | 122,570      |
| Federal Home Loan Bank short-term borrowings                                     | 505,900     | 502,000      |
| Total short-term borrowings  | 619,930     | 624,570      |
| Long-term debt   | 73,957      | 75,202       |
| Total borrowed funds   | 693,887     | 699,772      |
| Accrued interest and other liabilities   | 114,600     | 131,011      |
| Total liabilities  | 5,579,123   | 5,786,623    |
| Shareholders' equity   |             |              |
| Common stock - no par value  |             |              |
| Authorized - 160,000,000 shares; Issued - 68,730,731 shares in 2013 and 2012     | 576,641     | 579,293      |
| Retained earnings  | 329,633     | 330,004      |
| Accumulated other comprehensive loss   | (25,645     | ) (18,677 )  |
| Treasury stock, at cost, 11,032,387 shares in 2013 and 10,684,496 shares in 2012 | (185,177    | ) (180,195 ) |
| Total shareholders' equity   | 695,452     | 710,425      |
| Total liabilities and shareholders' equity                                       | \$6,274,575 | \$6,497,048  |

See Notes to Consolidated Financial Statements.

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## FIRST FINANCIAL BANCORP. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands, except per share data)

(Unaudited)

|   | Three months ended |           | Six months ended |           |
|---|--------------------|-----------|------------------|-----------|
|   | June 30,           |           | June 30,         |           |
|   | 2013               | 2012      | 2013             | 2012      |
| Interest income   |                    |           |                  |           |
| Loans, including fees   | \$55,022           | \$63,390  | \$111,047        | \$129,826 |
| Investment securities   |                    |           |                  |           |
| Taxable   | 8,295              | 10,379    | 16,671           | 20,896    |
| Tax-exempt  | 560                | 121       | 1,140            | 255       |
| Total interest on investment securities                       | 8,855              | 10,500    | 17,811           | 21,151    |
| Other earning assets  | (1,556)            | ) (1,967) | ) (3,028)        | ) (3,957) |
| Total interest income   | 62,321             | 71,923    | 125,830          | 147,020   |
| Interest expense  |                    |           |                  |           |
| Deposits  | 3,284              | 6,381     | 7,144            | 14,097    |
| Short-term borrowings   | 305                | 37        | 634              | 49        |
| Long-term borrowings  | 654                | 675       | 1,308            | 1,355     |
| Total interest expense  | 4,243              | 7,093     | 9,086            | 15,501    |
| Net interest income   | 58,078             | 64,830    | 116,744          | 131,519   |
| Provision for loan and lease losses - uncovered               | 2,409              | 8,364     | 5,450            | 11,622    |
| Provision for loan and lease losses - covered                 | (8,283)            | ) 6,047   | 759              | 18,998    |
| Net interest income after provision for loan and lease losses | 63,952             | 50,419    | 110,535          | 100,899   |
| Noninterest income  |                    |           |                  |           |
| Service charges on deposit accounts                           | 5,205              | 5,376     | 9,922            | 10,285    |
| Trust and wealth management fees                              | 3,497              | 3,377     | 7,447            | 7,168     |
| Bankcard income   | 3,145              | 2,579     | 5,578            | 5,115     |
| Net gains from sales of loans                                 | 1,089              | 1,132     | 1,795            | 2,072     |
| Gains on sales of investment securities                       | 188                | 0         | 1,724            | 0         |
| FDIC loss sharing income                                      | (7,384)            | ) 8,280   | 1,550            | 21,096    |
| Accelerated discount on covered loans                         | 1,935              | 3,764     | 3,870            | 7,409     |
| Other   | 3,940              | 9,037     | 6,427            | 12,325    |
| Total noninterest income                                      | 11,615             | 33,545    | 38,313           | 65,470    |
| Noninterest expenses  |                    |           |                  |           |
| Salaries and employee benefits                                | 26,216             | 29,048    | 53,545           | 57,909    |
| Pension settlement charges                                    | 4,316              | 0         | 4,316            | 0         |
| Net occupancy   | 5,384              | 5,025     | 11,549           | 10,407    |
| Furniture and equipment                                       | 2,250              | 2,323     | 4,621            | 4,567     |
| Data processing   | 2,559              | 2,076     | 5,028            | 3,977     |
| Marketing   | 1,182              | 1,238     | 2,079            | 2,392     |
| Communication   | 781                | 913       | 1,614            | 1,807     |
| Professional services   | 1,764              | 2,151     | 3,567            | 4,298     |
| State intangible tax  | 1,004              | 970       | 2,018            | 1,996     |
| FDIC assessments  | 1,148              | 1,270     | 2,273            | 2,433     |

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|   |            |            |            |            |
|---|------------|------------|------------|------------|
| Loss (gain) - other real estate owned         | 216        | 313        | 718        | 1,309      |
| Loss (gain) - covered other real estate owned | (2,212     | ) 1,233    | (2,369     | ) 2,525    |
| Loss sharing expense                          | 1,578      | 3,085      | 3,864      | 4,836      |
| Other   | 7,097      | 7,814      | 13,566     | 14,781     |
| Total noninterest expenses                    | 53,283     | 57,459     | 106,389    | 113,237    |
| Income before income taxes                    | 22,284     | 26,505     | 42,459     | 53,132     |
| Income tax expense                            | 6,455      | 8,703      | 12,806     | 18,336     |
| Net income                                    | \$15,829   | \$17,802   | \$29,653   | \$34,796   |
| Net earnings per common share - basic         | \$0.28     | \$0.31     | \$0.52     | \$0.60     |
| Net earnings per common share - diluted       | \$0.27     | \$0.30     | \$0.51     | \$0.59     |
| Cash dividends declared per share             | \$0.24     | \$0.29     | \$0.52     | \$0.60     |
| Average common shares outstanding - basic     | 57,291,994 | 57,933,281 | 57,365,105 | 57,864,269 |
| Average common shares outstanding - diluted   | 58,128,349 | 58,958,279 | 58,206,503 | 58,921,689 |

See Notes to Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in thousands)

(Unaudited)

|  | Three months ended |          | Six months ended |          |
|--|--------------------|----------|------------------|----------|
|  | June 30,           |          | June 30,         |          |
|  | 2013               | 2012     | 2013             | 2012     |
| Net income   | \$15,829           | \$17,802 | \$29,653         | \$34,796 |
| Other comprehensive (loss) income, net of tax:                               |                    |          |                  |          |
| Unrealized (losses) gains on investment securities arising during the period | (15,210            | ) 157    | (18,567          | ) 2,596  |
| Change in retirement obligation  | 10,365             | 355      | 10,810           | 710      |
| Unrealized gain (loss) on derivatives  | 690                | 0        | 816              | 0        |
| Unrealized (loss) gain on foreign currency exchange                          | (15                | ) 3      | (27              | ) 12     |
| Other comprehensive (loss) income  | (4,170             | ) 515    | (6,968           | ) 3,318  |
| Comprehensive income   | \$11,659           | \$18,317 | \$22,685         | \$38,114 |

See Notes to Consolidated Financial Statements.



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FIRST FINANCIAL BANCORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY  
(Dollars in thousands except per share data)  
(Unaudited)

|  | Common<br>Stock | Common<br>Stock | Retained  | Accumulated<br>other<br>comprehensive | Treasury stock |              | Total     |
|--|-----------------|-----------------|-----------|---------------------------------------|----------------|--------------|-----------|
|  | Shares          | Amount          | Earnings  | income (loss)                         | Shares         | Amount       |           |
| Balance at January 1, 2012                         | 68,730,731      | \$579,871       | \$331,351 | \$ (21,490 )                          | (10,463,677)   | \$(177,511 ) | \$712,221 |
| Net income   |                 |                 | 34,796    |                                       |                |              | 34,796    |
| Other comprehensive income                         |                 |                 |           | 3,318                                 |                |              | 3,318     |
| Cash dividends declared:                           |                 |                 |           |                                       |                |              |           |
| Common stock at \$0.60 per share                   |                 |                 | (34,832 ) |                                       |                |              | (34,832 ) |
| Excess tax benefit on share-based compensation     |                 | 348             |           |                                       |                |              | 348       |
| Exercise of stock options, net of shares purchased |                 | (914 )          |           |                                       | 57,604         | 977          | 63        |
| Restricted stock awards, net of forfeitures        |                 | (4,318 )        |           |                                       | 188,735        | 3,250        | (1,068 )  |
| Share-based compensation expense                   |                 | 1,942           |           |                                       |                |              | 1,942     |
| Balance at June 30, 2012                           | 68,730,731      | \$576,929       | \$331,315 | \$ (18,172 )                          | (10,217,338)   | \$(173,284 ) | \$716,788 |
| Balance at January 1, 2013                         | 68,730,731      | \$579,293       | \$330,004 | \$ (18,677 )                          | (10,684,496)   | \$(180,195 ) | \$710,425 |
| Net income   |                 |                 | 29,653    |                                       |                |              | 29,653    |
| Other comprehensive loss                           |                 |                 |           | (6,968 )                              |                |              | (6,968 )  |
| Cash dividends declared:                           |                 |                 |           |                                       |                |              |           |
| Common stock at \$0.52 per share                   |                 |                 | (30,024 ) |                                       |                |              | (30,024 ) |
| Purchase of common stock                           |                 |                 |           |                                       | (540,400 )     | (8,339 )     | (8,339 )  |
| Excess tax benefit on share-based compensation     |                 | 30              |           |                                       |                |              | 30        |
| Exercise of stock options, net of shares purchased |                 | (503 )          |           |                                       | 21,526         | 362          | (141 )    |
|  |                 | (4,316 )        |           |                                       | 170,983        | 2,995        | (1,321 )  |

Restricted stock awards,  
net of forfeitures

|                                     |            |           |           |              |              |             |           |
|-------------------------------------|------------|-----------|-----------|--------------|--------------|-------------|-----------|
| Share-based<br>compensation expense |            | 2,137     |           |              |              | 2,137       |           |
| Balance at June 30,<br>2013         | 68,730,731 | \$576,641 | \$329,633 | \$ (25,645 ) | (11,032,387) | \$(185,177) | \$695,452 |

See Notes to Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

|   | Six months ended |             |
|---|------------------|-------------|
|   | June 30,         |             |
|   | 2013             | 2012        |
| Operating activities  |                  |             |
| Net income  | \$29,653         | \$34,796    |
| Adjustments to reconcile net income to net cash provided by operating activities: |                  |             |
| Provision for loan and lease losses   | 6,209            | 30,620      |
| Depreciation and amortization   | 7,630            | 7,669       |
| Stock-based compensation expense  | 2,137            | 1,942       |
| Pension expense (income)  | 4,185            | (285)       |
| Net amortization of premiums/accretion of discounts on investment securities      | 8,856            | 4,902       |
| Gains on sales of investment securities   | (1,724)          | ) 0         |
| Originations of loans held for sale   | (93,248)         | ) (102,950) |
| Net gains from sales of loans held for sale                                       | (1,795)          | ) (2,072)   |
| Proceeds from sales of loans held for sale  | 91,340           | 106,803     |
| Deferred income taxes   | (4,454)          | ) (2,670)   |
| (Increase) decrease in interest receivable  | (570)            | ) 3,341     |
| (Increase) decrease in cash surrender value of life insurance                     | (333)            | ) 2,039     |
| (Increase) decrease in prepaid expenses   | (3,178)          | ) 1,109     |
| Decrease in indemnification asset   | 30,641           | 26,244      |
| Decrease in accrued expenses  | (4,199)          | ) (2,932)   |
| Decrease in interest payable  | (267)            | ) (993)     |
| Other   | 8,848            | 4,928       |
| Net cash provided by operating activities   | 79,731           | 112,491     |
| Investing activities  |                  |             |
| Proceeds from sales of securities available-for-sale                              | 92,684           | 0           |
| Proceeds from calls, paydowns and maturities of securities available-for-sale     | 128,606          | 126,901     |
| Purchases of securities available-for-sale  | (109,767)        | ) (331,300) |
| Proceeds from calls, paydowns and maturities of securities held-to-maturity       | 95,020           | 50,122      |
| Net decrease in interest-bearing deposits with other banks                        | 21,670           | 366,211     |
| Net increase in loans and leases - excluding covered loans                        | (210,630)        | ) (62,600)  |
| Net decrease in covered assets  | 99,995           | 128,100     |
| Proceeds from disposal of other real estate owned                                 | 19,995           | 22,537      |
| Purchases of premises and equipment   | (5,440)          | ) (10,779)  |
| Net cash provided by investing activities   | 132,133          | 289,192     |
| Financing activities  |                  |             |
| Net decrease in total deposits  | (185,204)        | ) (541,091) |
| Net (decrease) increase in short-term borrowings                                  | (4,640)          | ) 150,488   |
| Payments on long-term borrowings  | (1,231)          | ) (1,410)   |
| Cash dividends paid on common stock   | (32,237)         | ) (33,571)  |
| Treasury stock purchase   | (8,339)          | ) 0         |
| Proceeds from exercise of stock options   | 0                | 292         |
| Excess tax benefit on share-based compensation                                    | 30               | 348         |

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|  |           |            |   |
|--|-----------|------------|---|
| Net cash used in financing activities          | (231,621  | ) (424,944 | ) |
| Cash and due from banks:                       |           |            |   |
| Net decrease in cash and due from banks        | (19,757   | ) (23,261  | ) |
| Cash and due from banks at beginning of period | 134,502   | 149,653    |   |
| Cash and due from banks at end of period       | \$114,745 | \$126,392  |   |

See Notes to Consolidated Financial Statements.

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FIRST FINANCIAL BANCORP. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2013  
(Unaudited)

The consolidated financial statements for interim periods are unaudited; however, in the opinion of the management of First Financial Bancorp. (First Financial or the Company), all material adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation have been included.

NOTE 1: BASIS OF PRESENTATION

The Consolidated Financial Statements of First Financial, a bank holding company principally serving Ohio, Indiana and Kentucky, include the accounts and operations of First Financial and its wholly-owned subsidiary – First Financial Bank, N.A. (First Financial Bank or the Bank). All significant intercompany transactions and accounts have been eliminated in consolidation. Certain reclassifications of prior periods' amounts have been made to conform to the current period's presentation and had no effect on net earnings.

The preparation of financial statements in conformity with U.S. Generally Accepted Accounting Principles (GAAP) requires management to make estimates, assumptions and judgments that affect the amounts reported in the Consolidated Financial Statements and accompanying Notes. Actual realized amounts could differ materially from those estimates.

These interim financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and serve to update the First Financial Bancorp. Annual Report on Form 10-K (Form 10-K) for the year ended December 31, 2012. These interim financial statements may not include all information and notes necessary to constitute a complete set of financial statements under GAAP applicable to annual periods and accordingly should be read in conjunction with the financial information contained in the Form 10-K. Management believes these unaudited consolidated financial statements reflect all adjustments of a normal recurring nature which are necessary for a fair presentation of the results for the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year or any other interim period. The Consolidated Balance Sheet as of December 31, 2012, has been derived from the audited financial statements in the Company's 2012 Form 10-K.

NOTE 2: RECENTLY ADOPTED AND ISSUED ACCOUNTING STANDARDS

In December 2011, the FASB issued an update (ASU 2011-11, Disclosures About Offsetting Assets and Liabilities) which creates new disclosure requirements about the nature of an entity's rights of offset and related arrangements associated with its financial instruments and derivative instruments. These disclosure requirements are required for recognized financial and derivative instruments that are offset in accordance with the guidance in FASB ASC Topic 210-20-45, Balance Sheet - Offsetting - Other Presentation Matters, FASB ASC Topic 815-10-45, Derivatives and Hedging - Other Presentation Matters, or are subject to an enforceable master netting arrangement or similar agreement. Subsequently, the FASB issued ASU 2013-01, Scope Clarification of Disclosures about Offsetting Assets and Liabilities, which limits the scope of ASU 2011-11 to derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and lending transactions. Companies are required to disclose information to enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on its financial position, including the effect or potential effect of rights of set-off associated with certain financial instruments and derivative instruments. The provisions of ASU 2011-11 became effective for the interim reporting period ended March 31, 2013 and resulted in additional disclosures related to the Company's derivatives programs. For further detail, see Note 6 - Derivatives.

In July 2012, the FASB issued an update (ASU 2012-02, Intangibles—Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment) which allows an entity testing an indefinite-lived intangible asset for impairment the option of performing a qualitative assessment before calculating the fair value of the asset. This update also addresses circumstances that a company should consider in interim periods, but does not remove the requirement for testing of indefinite-lived intangible assets for impairment annually and between annual tests if there is a change in events and circumstances. The provisions of ASU 2012-02 became effective for the interim reporting period ended March 31, 2013 and did not have a material impact on the Company's Consolidated Financial Statements.

In October 2012, the FASB issued an update (ASU 2012-06, Business Combinations (Topic 805): Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution) which clarifies the applicable guidance for subsequently measuring an indemnification asset recognized as a result of a government-assisted acquisition of a financial institution. When a company recognizes an indemnification asset as a result

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of a government-assisted acquisition of a financial institution and subsequently a change in the cash flows expected to be collected on the indemnification asset occurs (as a result of a change in cash flows expected to be collected on the assets subject to indemnification), the company should subsequently account for the change in the measurement of the indemnification asset on the same basis as the change in the assets subject to indemnification. Any amortization of changes in value should be limited to the contractual term of the indemnification agreement (that is, the lesser of the term of the indemnification agreement and the remaining life of the indemnified assets). The provisions of ASU 2012-06 became effective for the interim reporting period ended March 31, 2013 and did not have a material impact on the Company's Consolidated Financial Statements.

On February 5, 2013, the FASB issued an update (ASU 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (AOCI)) which requires preparers to report in one place information about reclassifications out of AOCI. The ASU also requires companies to report changes in AOCI balances and expands the disclosure requirements in FASB ASC Topic 220, Comprehensive Income (ASC 220), for presentation of changes in AOCI. This ASU requires companies to disaggregate the total change of each component of other comprehensive income and separately present (1) reclassification adjustments and (2) current-period OCI. ASU 2013-02 also requires companies to present information about significant items reclassified out of AOCI by component either (1) on the face of the statement where net income is presented or (2) as a separate disclosure in the notes to the financial statements. The provisions of ASU 2013-02 became effective for the interim reporting period ended March 31, 2013 and resulted in additional disclosures related to reclassifications from AOCI. For further detail, see Note 14 - Accumulated Other Comprehensive Income (Loss).

**NOTE 3: GOODWILL AND OTHER INTANGIBLE ASSETS**

Goodwill. Assets and liabilities of acquired entities are recorded at their estimated fair values as of the acquisition date. The excess cost of the acquisition over the fair value of net assets acquired is recorded as goodwill. Goodwill is not amortized, but is measured for impairment on an annual basis as of October 1 of each year or whenever events or changes in circumstances indicate that the fair value of a reporting unit may be below its carrying value. First Financial performed its most recent annual impairment test as of October 1, 2012 and no impairment was indicated. As of June 30, 2013, no events or changes in circumstances indicated that the fair value of a reporting unit was below its carrying value. First Financial had goodwill of \$95.1 million as of June 30, 2013 and December 31, 2012.

Other intangible assets. Other intangible assets consist primarily of core deposit intangibles. Core deposit intangibles are recorded at their estimated fair value as of the acquisition date and are then amortized on an accelerated basis over their estimated useful lives. Core deposit intangibles were \$6.6 million and \$7.4 million as of June 30, 2013 and December 31, 2012, respectively. First Financial's core deposit intangibles have an estimated weighted average remaining life of 7.3 years. Amortization expense for the three months ended June 30, 2013 and 2012 was \$0.4 million and \$0.8 million, respectively.

Amortization expense recognized on intangible assets for the six months ended June 30, 2013 and 2012, was \$0.8 million and \$1.3 million, respectively.

**NOTE 4: COMMITMENTS AND CONTINGENCIES**

In the normal course of business, First Financial offers a variety of financial instruments with off-balance-sheet risk to its clients to assist them in meeting their requirements for liquidity and credit enhancement. These financial instruments include standby letters of credit and outstanding commitments to extend credit. GAAP does not require these financial instruments to be recorded in the Consolidated Financial Statements.

First Financial's exposure to credit loss, in the event of nonperformance by the other party to the financial instrument for standby letters of credit, and outstanding commitments to extend credit, is represented by the contractual amounts of those instruments. First Financial uses the same credit policies in issuing commitments and conditional obligations as it does for credit instruments recorded on the Consolidated Balance Sheets.

Letters of credit. Letters of credit are conditional commitments issued by First Financial to guarantee the performance of a client to a third party. First Financial's portfolio of standby letters of credit consists primarily of performance assurances made on behalf of clients who have a contractual commitment to produce or deliver goods or services. The risk to First Financial arises from its obligation to make payment in the event of the client's contractual default to produce the contracted good or service to a third party. First Financial has issued letters of credit (including standby letters of credit) aggregating \$14.6 million and \$14.8 million at June 30, 2013, and December 31, 2012, respectively. Management conducts regular reviews of these instruments on an individual client basis.



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Loan commitments. Loan commitments are agreements to extend credit to a client as long as there is no violation of any condition established in the commitment agreement. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by First Financial upon extension of credit, is based on management's credit evaluation of the client. The collateral held varies, but may include securities, real estate, inventory, plant or equipment. First Financial had commitments outstanding to extend credit totaling \$1.3 billion at June 30, 2013, and \$1.2 billion at December 31, 2012.

First Financial utilizes the allowance for loan and lease losses methodology to maintain a reserve that it considers sufficient to absorb probable losses inherent in standby letters of credit and outstanding loan commitments and records the reserve within Accrued interest and other liabilities on the Consolidated Balance Sheets.

Contingencies/Litigation. First Financial and its subsidiaries are engaged in various matters of litigation, other assertions of improper or fraudulent loan practices or lending violations and other matters from time to time, and have a number of unresolved claims pending. Additionally, as part of the ordinary course of business, First Financial and its subsidiaries are parties to litigation involving claims to the ownership of funds in particular accounts, the collection of delinquent accounts, challenges to security interests in collateral and foreclosure interests, that is incidental to our regular business activities. While the ultimate liability with respect to these other litigation matters and claims cannot be determined at this time, First Financial believes that damages, if any, and other amounts relating to pending matters are not probable or cannot be reasonably estimated as of June 30, 2013. Reserves are established for these various matters of litigation, when appropriate under FASB ASC Topic 450, Contingencies, based in part upon the advice of legal counsel.

## NOTE 5: INVESTMENTS

The following is a summary of held-to-maturity and available-for-sale investment securities as of June 30, 2013:

| (Dollars in thousands)                                  | Held-to-Maturity |                 |                 |              | Available-for-Sale |                 |                 |              |
|---|------------------|-----------------|-----------------|--------------|--------------------|-----------------|-----------------|--------------|
|   | Amortized Cost   | Unrealized Gain | Unrealized Loss | Market Value | Amortized Cost     | Unrealized Gain | Unrealized Loss | Market Value |
| U.S. Treasuries   | \$0              | \$0             | \$0             | \$0          | \$97               | \$0             | \$(3 )          | \$94         |
| Securities of U.S. government agencies and corporations | 19,854           | 0               | (276 )          | 19,578       | 10,272             | 0               | (125 )          | 10,147       |
| Mortgage-backed securities                              | 641,491          | 694             | (5,835 )        | 636,350      | 681,529            | 6,777           | (17,974 )       | 670,332      |
| Obligations of state and other political subdivisions   | 8,901            | 166             | (597 )          | 8,470        | 34,693             | 52              | (1,608 )        | 33,137       |
| Asset-backed securities                                 | 0                | 0               | 0               | 0            | 60,873             | 0               | (388 )          | 60,485       |
| Other securities  | 0                | 0               | 0               | 0            | 112,604            | 193             | (2,298 )        | 110,499      |
| Total   | \$670,246        | \$860           | \$(6,708 )      | \$664,398    | \$900,068          | \$7,022         | \$(22,396 )     | \$884,694    |

The following is a summary of held-to-maturity and available-for-sale investment securities as of December 31, 2012:

| (Dollars in thousands) | Held-to-Maturity |                 |                 |              | Available-for-Sale |                 |                 |              |
|------------------------|------------------|-----------------|-----------------|--------------|--------------------|-----------------|-----------------|--------------|
|                        | Amortized Cost   | Unrealized Gain | Unrealized Loss | Market Value | Amortized Cost     | Unrealized Gain | Unrealized Loss | Market Value |
|                        | \$20,512         | \$679           | \$0             | \$21,191     | \$15,562           | \$333           | \$0             | \$15,895     |

|   |           |         |            |           |             |          |            |             |
|---|-----------|---------|------------|-----------|-------------|----------|------------|-------------|
| Securities of U.S.<br>government agencies<br>and corporations |           |         |            |           |             |          |            |             |
| Mortgage-backed<br>securities                                 | 740,891   | 8,077   | (1,290 )   | 747,678   | 854,150     | 14,564   | (1,485 )   | 867,229     |
| Obligations of state<br>and other political<br>subdivisions   | 9,352     | 265     | (12 )      | 9,605     | 35,913      | 169      | (84 )      | 35,998      |
| Asset-backed<br>securities                                    | 0         | 0       | 0          | 0         | 57,000      | 90       | (1 )       | 57,089      |
| Other securities  | 0         | 0       | 0          | 0         | 54,479      | 1,569    | (163 )     | 55,885      |
| Total   | \$770,755 | \$9,021 | \$(1,302 ) | \$778,474 | \$1,017,104 | \$16,725 | \$(1,733 ) | \$1,032,096 |

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The following is a summary of investment securities by estimated maturity as of June 30, 2013:

| (Dollars in thousands)                 | Held-to-Maturity |              | Available-for-Sale |              |
|--|------------------|--------------|--------------------|--------------|
|  | Amortized Cost   | Market Value | Amortized Cost     | Market Value |
| Due in one year or less                | \$215            | \$218        | \$14,244           | \$14,779     |
| Due after one year through five years  | 553,586          | 550,083      | 356,449            | 355,526      |
| Due after five years through ten years | 107,195          | 104,818      | 219,699            | 214,398      |
| Due after ten years                    | 9,250            | 9,279        | 309,676            | 299,991      |
| Total                                  | \$670,246        | \$664,398    | \$900,068          | \$884,694    |

The following tables present the age of gross unrealized losses and associated fair value by investment category:

| (Dollars in thousands)                                  | June 30, 2013       |                 |                   |                 |             |                 |
|---|---------------------|-----------------|-------------------|-----------------|-------------|-----------------|
|   | Less than 12 Months |                 | 12 Months or More |                 | Total       |                 |
|   | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value  | Unrealized Loss |
| Securities of U.S. government agencies and corporations | \$19,625            | \$(225)         | \$0               | \$0             | \$19,625    | \$(225)         |
| Mortgage-backed securities                              | 865,450             | (21,140)        | 23,867            | (231)           | 889,317     | (21,371)        |
| Obligations of state and other political subdivisions   | 68,190              | (2,648)         | 0                 | 0               | 68,190      | (2,648)         |
| Asset-backed securities                                 | 60,486              | (388)           | 0                 | 0               | 60,486      | (388)           |
| Other securities  | 66,453              | (1,737)         | 1,252             | (119)           | 67,705      | (1,856)         |
| Total   | \$1,080,204         | \$(26,138)      | \$25,119          | \$(350)         | \$1,105,323 | \$(26,488)      |

| (Dollars in thousands)                                | December 31, 2012   |                 |                   |                 |            |                 |
|---|---------------------|-----------------|-------------------|-----------------|------------|-----------------|
|   | Less than 12 Months |                 | 12 Months or More |                 | Total      |                 |
|   | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| Mortgage-backed securities                            | \$240,641           | \$(1,635)       | \$25,513          | \$(405)         | \$266,154  | \$(2,040)       |
| Obligations of state and other political subdivisions | 21,341              | (96)            | 0                 | 0               | 21,341     | (96)            |
| Asset-backed securities                               | 9,999               | (1)             | 0                 | 0               | 9,999      | (1)             |
| Other securities                                      | 8,454               | (163)           | 0                 | 0               | 8,454      | (163)           |
| Total   | \$280,435           | \$(1,895)       | \$25,513          | \$(405)         | \$305,948  | \$(2,300)       |

Gains and losses on debt securities are generally due to higher current market yields relative to the yields of the debt securities at their amortized cost. All securities with unrealized losses are reviewed quarterly to determine if any impairment is considered other than temporary, requiring a write-down to fair market value. First Financial considers the percentage loss on a security, duration of the loss, average life or duration of the security, credit rating of the security and payment performance, as well as the Company's intent and ability to hold the security to maturity when determining whether any impairment is other than temporary. At this time First Financial does not intend to sell, and it is not more likely than not that the Company will be required to sell debt securities temporarily impaired prior to maturity or recovery of the recorded value. First Financial had no other than temporary impairment related to its investment securities portfolio as of June 30, 2013 or December 31, 2012.

For further detail on the fair value of investment securities, see Note 13 – Fair Value Disclosures.

## NOTE 6: DERIVATIVES

First Financial uses derivative instruments, including interest rate caps, floors and swaps, to meet the needs of its clients while managing the interest rate risk associated with certain transactions. First Financial does not use derivatives for speculative purposes.

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While authorized to use a variety of derivative products, First Financial primarily utilizes interest rate swaps as a means to offer borrowers credit-based products that meet their needs and may from time to time utilize interest rate swaps to manage the interest rate risk profile of the Company. The interest rate swap agreements establish the basis on which interest rate payments are exchanged with counterparties referred to as the notional amount.

The following table summarizes the notional values of derivative financial instruments utilized by First Financial by the nature of the underlying asset or liability:

| (Dollars in thousands)            | June 30, 2013 | December 31, 2012 |
|-----------------------------------|---------------|-------------------|
| Fair value hedges                 |               |                   |
| Instruments associated with loans | \$910,175     | \$935,493         |

As only interest rate payments are exchanged, the cash requirements and credit risk associated with interest rate swaps are significantly less than the notional amount and the Company's credit risk exposure is limited to the market value of the instruments. First Financial manages the market value credit risk associated with counterparties through counterparty credit policies. These policies require the Company to maintain a total derivative notional position of less than 35% of assets, total credit exposure of less than 3% of capital and no single counterparty credit risk exposure greater than \$20.0 million. The Company is currently well below all single counterparty and portfolio limits. At June 30, 2013, the Company had a total counterparty notional amount outstanding of approximately \$495.4 million, spread among eight counterparties, with an outstanding liability from these contracts of \$12.6 million. At December 31, 2012, the Company had a total counterparty notional amount outstanding of approximately \$509.1 million, spread among eight counterparties, with an outstanding liability from these contracts of \$26.0 million.

First Financial's exposure to credit loss, in the event of nonperformance by a borrower, is limited to the market value of the derivative instrument associated with that borrower. First Financial monitors its derivative credit exposure to borrowers through the normal credit review processes the Company performs on all borrowers. Additionally, the Company monitors derivative credit risk exposure related to problem loans through the Company's allowance for loan and lease losses committee. First Financial considers the market value of a derivative instrument to be part of the carrying value of the related loan for these purposes as the borrower is contractually obligated to pay First Financial this amount in the event the derivative contract is terminated.

The following table summarizes the derivative financial instruments utilized by First Financial and their balances:

| (Dollars in thousands)                          | Balance Sheet Classification           | June 30, 2013   |                      |             | December 31, 2012 |                      |             |
|---|--|-----------------|----------------------|-------------|-------------------|----------------------|-------------|
|   |  | Notional amount | Estimated fair value |             | Notional amount   | Estimated fair value |             |
|   |  |                 | Gain                 | Loss        |                   | Gain                 | Loss        |
| Fair value hedges                               |  |                 |                      |             |                   |                      |             |
| Pay fixed interest rate swaps with counterparty | Accrued interest and other liabilities | \$10,675        | \$0                  | \$(1,082 )  | \$12,739          | \$0                  | \$(1,445 )  |
| Matched interest rate swaps with borrower       | Accrued interest and other assets      | 449,750         | 14,328               | (1,169 )    | 461,377           | 24,135               | 0           |
| Matched interest rate swaps with counterparty   | Accrued interest and other liabilities | 449,750         | 1,169                | (14,418 )   | 461,377           | 0                    | (24,978 )   |
| Total   |  | \$910,175       | \$15,497             | \$(16,669 ) | \$935,493         | \$24,135             | \$(26,423 ) |

In connection with its use of derivative instruments, from time to time First Financial and its counterparties are required to post cash collateral to offset the market position of the derivative instruments. First Financial maintains the

right to offset these derivative positions with the collateral posted against them by or with the relevant counterparties. First Financial classifies the derivative cash collateral outstanding with its counterparties as an adjustment to the fair value of the derivative contracts within Accrued interest and other assets or Accrued interest and other liabilities in the Consolidated Balance Sheets.

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The following table discloses the gross and net amounts of liabilities recognized in the Consolidated Balance Sheets:

| (Dollars in thousands)                          | June 30, 2013                           |   |   | December 31, 2012                       |   |   |
|---|---|---|---|---|---|---|
|   | Gross amounts of recognized liabilities | Gross amounts offset in the Consolidated Balance Sheets | Net amounts of liabilities presented in the Consolidated Balance Sheets | Gross amounts of recognized liabilities | Gross amounts offset in the Consolidated Balance Sheets | Net amounts of liabilities presented in the Consolidated Balance Sheets |
| Fair value hedges                               |   |   |   |   |   |   |
| Pay fixed interest rate swaps with counterparty | \$1,082                                 | \$ (444 )   | \$ 638  | \$1,445                                 | \$ (669 )   | \$ 776  |
| Matched interest rate swaps with counterparty   | 15,587                                  | (13,552 )   | 2,035   | 24,978                                  | (23,057 )   | 1,921   |
| Total   | \$16,669                                | \$ (13,996 )  | \$ 2,673  | \$26,423                                | \$ (23,726 )  | \$ 2,697  |

The following table details the derivative financial instruments, the average remaining maturities and the weighted-average interest rates being paid and received by First Financial at June 30, 2013:

| (Dollars in thousands)                                   | Notional amount | Average maturity (years) | Fair value | Weighted-average rate |        |   |
|--|-----------------|--------------------------|------------|-----------------------|--------|---|
|  |                 |                          |            | Receive               | Pay    |   |
| Asset conversion swaps                                   |                 |                          |            |                       |        |   |
| Pay fixed interest rate swaps with counterparty          | \$10,675        | 3.3                      | \$(1,082 ) | 2.21                  | % 6.85 | % |
| Receive fixed, matched interest rate swaps with borrower | 449,750         | 4.2                      | 13,159     | 4.94                  | % 2.93 | % |
| Pay fixed, matched interest rate swaps with counterparty | 449,750         | 4.2                      | (13,249 )  | 2.93                  | % 4.94 | % |
| Total asset conversion swaps                             | \$910,175       | 4.2                      | \$(1,172 ) | 3.91                  | % 3.97 | % |

The accounting for changes in the fair value of derivatives depends on the intended use of the derivative instrument and the resulting designation. Derivatives used to hedge the exposure to changes in the fair value of an asset, liability or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives used to hedge the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges.

**Fair Value Hedges.** First Financial utilizes interest rate swaps designated as fair value hedges as a means to offer commercial borrowers products that meet their needs, but are also designed to achieve First Financial's desired interest rate risk profile. First Financial accomplishes this by entering into swap agreements with commercial borrowers and simultaneously entering into offsetting swap agreements, with substantially matching terms, with institutional counterparties. These interest rate swap agreements generally involve the receipt by First Financial of floating rate amounts from counterparties in exchange for payments to these counterparties by First Financial of fixed rate amounts received from commercial borrowers over the life of the agreements. These interest rate swap agreements do not involve an exchange of the underlying principal or notional amount. This results in First Financial's loan customers receiving fixed rate funding, while providing First Financial with a floating rate asset. First Financial's matched interest rate swaps economically hedge offsetting "receive fixed" and "pay fixed" exposures, but do not qualify for hedge accounting.

The net interest receivable or payable on matched interest rate swaps is accrued and recognized as an adjustment to the interest income of the hedged item. The fair value of matched interest rate swaps is included within Accrued interest and other assets and Accrued interest and other liabilities on the Consolidated Balance Sheets.

For the unmatched, pay fixed interest rate swaps, which qualify for hedge accounting, the corresponding fair-value adjustment is included on the Consolidated Balance Sheets in the carrying value of the hedged item. The net interest receivable or payable on unmatched interest rate swaps is accrued and recognized as an adjustment to the interest income of the hedged item. Gains and losses from derivatives not considered effective in hedging the change in fair value of the hedged item, if any, are recognized in income immediately.



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The following table details the location and amounts recognized for fair value hedges:

| (Dollars in thousands)                          | Location of change in fair value | Decrease to Interest income |          |                  |          |
|---|----------------------------------|-----------------------------|----------|------------------|----------|
|   |                                  | Three months ended          |          | Six months ended |          |
| Derivatives in fair value hedging relationships |                                  | June 30,                    |          | June 30,         |          |
|   |                                  | 2013                        | 2012     | 2013             | 2012     |
| Interest rate contracts                         |                                  |                             |          |                  |          |
| Loans   | Interest income - loans          | \$(129 )                    | \$(192 ) | \$(271 )         | \$(388 ) |
| Total   |                                  | \$(129 )                    | \$(192 ) | \$(271 )         | \$(388 ) |

Cash Flow Hedges. First Financial utilizes interest rate swaps designated as cash flow hedges to manage the variability of cash flows, primarily net interest income, attributable to changes in interest rates. The net interest receivable or payable on an interest rate swap designated as a cash flow hedge is accrued and recognized as an adjustment to interest income or interest expense. The fair value of interest rate swaps is included within accrued interest and other liabilities on the Consolidated Balance Sheets. Changes in the fair value of interest rate swaps are included in accumulated other comprehensive income (loss). Gains and losses from derivatives not considered effective in hedging the cash flows related to the hedged items, if any, are recognized in income immediately.

In 2012, First Financial executed a cash flow hedge utilizing an interest rate swap to hedge against interest rate volatility on \$35.0 million of floating rate interest-bearing deposits indexed to the U.S. Federal Funds Target Rate. This interest rate swap involves the receipt by First Financial of variable-rate interest amounts in exchange for fixed-rate interest payments by First Financial for a period of 7 years and does qualify for hedge accounting. Accrued interest and other assets included \$1.1 million at June 30, 2013 and accrued interest and other liabilities included \$0.2 million at December 31, 2012 reflecting the fair value of this cash flow hedge.

**NOTE 7: BORROWINGS**

Short-term borrowings on the Consolidated Balance Sheets include repurchase agreements utilized for corporate sweep accounts with cash management account agreements in place as well as overnight advances from the Federal Loan Home Bank (FHLB). All repurchase agreements are subject to terms and conditions of repurchase/security agreements between First Financial Bank and the client. To secure the Bank's liability to the client, First Financial Bank is authorized to sell or repurchase U. S. Treasury, government agency and mortgage-backed securities.

First Financial had \$505.9 million in short-term borrowings with the FHLB at June 30, 2013 and \$502.0 million as of December 31, 2012. These short-term borrowings are used to manage the Company's normal liquidity needs and support the Company's asset and liability management strategies.

Long-term debt primarily consists of FHLB long-term advances and repurchase agreements utilizing investment securities pledged as collateral. These instruments are primarily utilized to reduce overnight liquidity risk and to mitigate interest rate sensitivity on the Consolidated Balance Sheets. First Financial has \$65.0 million in repurchase agreements which have remaining maturities of less than 3 years and a weighted average rate of 3.50%. Securities pledged as collateral in conjunction with the repurchase agreements are included within Investment securities available-for-sale on the Consolidated Balance Sheets.

The following is a summary of long-term debt:

| (Dollars in thousands)               | June 30, 2013 |              | December 31, 2012 |              |   |
|--------------------------------------|---------------|--------------|-------------------|--------------|---|
|                                      | Amount        | Average Rate | Amount            | Average Rate |   |
| Federal Home Loan Bank               | \$8,182       | 3.77         | % \$9,427         | 3.74         | % |
| National Market Repurchase Agreement | 65,000        | 3.50         | % 65,000          | 3.50         | % |

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|                                |          |      |            |      |   |
|--------------------------------|----------|------|------------|------|---|
| Capital loan with municipality | 775      | 0.00 | % 775      | 0.00 | % |
| Total long-term debt           | \$73,957 | 3.50 | % \$75,202 | 3.49 | % |

Under Federal Reserve Board guidelines, a company can issue qualifying debentures up to 25% of qualifying Tier I capital. First Financial has the capacity to issue approximately \$159.4 million in additional qualifying debentures under these guidelines.

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NOTE 8: LOANS - EXCLUDING COVERED LOANS

First Financial offers clients a variety of commercial and consumer loan and lease products with various interest rates and payment terms. Lending activities are primarily concentrated in Ohio, Indiana and Kentucky, where the Bank currently operates banking centers. Additionally, First Financial provides equipment and leasehold improvement financing for franchisees in the quick service and casual dining restaurant sector throughout the United States.

**Credit Quality.** To facilitate the monitoring of credit quality for commercial loans, and for purposes of determining an appropriate allowance for loan and lease losses, First Financial utilizes the following categories of credit grades:

**Pass** - Higher quality loans that do not fit any of the other categories described below.

**Special Mention** - First Financial assigns a Special Mention rating to loans and leases with potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or lease or in First Financial's credit position at some future date.

**Substandard** - First Financial assigns a substandard rating to loans or leases that are inadequately protected by the current sound financial worth and paying capacity of the borrower or of the collateral pledged, if any. Substandard loans and leases have well-defined weaknesses that jeopardize repayment of the debt. Substandard loans and leases are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not addressed.

**Doubtful** - First Financial assigns a doubtful rating to loans and leases with all the attributes of a substandard rating with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors that may work to the advantage and strengthening of the credit quality of the loan or lease, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition or liquidation procedures, capital injection, perfecting liens on additional collateral and refinancing plans.

The credit grades described above, which are derived from standard regulatory rating definitions, are assigned upon initial approval of credit to borrowers and updated periodically thereafter.

First Financial considers repayment performance as the best indicator of credit quality for consumer loans. Consumer loans that have principal and interest payments that are past due by ninety days or more are generally classified as nonperforming. Additionally, consumer loans that have been modified in a troubled debt restructuring (TDR) are classified as nonperforming unless such loans have a sustained period of repayment performance of six months or greater and are reasonably assured of repayment in accordance with the restructured terms.

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Commercial and consumer credit exposure by risk attribute was as follows:

As of June 30, 2013

| (Dollars in thousands) | Commercial | Real Estate<br>Construction | Commercial  | Total       |
|------------------------|------------|-----------------------------|-------------|-------------|
| Pass                   | \$887,396  | \$91,897                    | \$1,373,521 | \$2,352,814 |
| Special Mention        | 28,523     | 65                          | 31,091      | 59,679      |
| Substandard            | 24,501     | 5,284                       | 72,614      | 102,399     |
| Doubtful               | 0          | 0                           | 0           | 0           |
| Total                  | \$940,420  | \$97,246                    | \$1,477,226 | \$2,514,892 |

| (Dollars in thousands) | Real Estate<br>Residential | Installment | Home Equity | Other     | Total     |
|------------------------|----------------------------|-------------|-------------|-----------|-----------|
| Performing             | \$333,647                  | \$50,532    | \$367,392   | \$102,737 | \$854,308 |
| Nonperforming          | 9,369                      | 249         | 2,814       | 496       | 12,928    |
| Total                  | \$343,016                  | \$50,781    | \$370,206   | \$103,233 | \$867,236 |

As of December 31, 2012

| (Dollars in thousands) | Commercial | Real Estate<br>Construction | Commercial  | Total       |
|------------------------|------------|-----------------------------|-------------|-------------|
| Pass                   | \$803,351  | \$64,866                    | \$1,307,370 | \$2,175,587 |
| Special Mention        | 29,663     | 65                          | 38,516      | 68,244      |
| Substandard            | 28,019     | 8,586                       | 71,122      | 107,727     |
| Doubtful               | 0          | 0                           | 0           | 0           |
| Total                  | \$861,033  | \$73,517                    | \$1,417,008 | \$2,351,558 |

| (Dollars in thousands) | Real Estate<br>Residential | Installment | Home Equity | Other    | Total     |
|------------------------|----------------------------|-------------|-------------|----------|-----------|
| Performing             | \$310,341                  | \$56,358    | \$364,248   | \$84,490 | \$815,437 |
| Nonperforming          | 7,869                      | 452         | 3,252       | 496      | 12,069    |
| Total                  | \$318,210                  | \$56,810    | \$367,500   | \$84,986 | \$827,506 |

Delinquency. Loans are considered past due or delinquent when the contractual principal or interest due in accordance with the terms of the loan agreement or any portion thereof remains unpaid after the date of the scheduled payment.

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Loan delinquency, including nonaccrual loans, was as follows:

| As of June 30, 2013        |                       |                       |                    |                |             |             |                                 |
|----------------------------|-----------------------|-----------------------|--------------------|----------------|-------------|-------------|---------------------------------|
| (Dollars in thousands)     | 30 – 59 days past due | 60 – 89 days past due | > 90 days past due | Total past due | Current     | Total       | > 90 days past due and accruing |
| Loans                      |                       |                       |                    |                |             |             |                                 |
| Commercial                 | \$723                 | \$3                   | \$10,551           | \$11,277       | \$929,143   | \$940,420   | \$0                             |
| Real estate - construction | 0                     | 0                     | 1,104              | 1,104          | 96,142      | 97,246      | 0                               |
| Real estate - commercial   | 7,397                 | 2,504                 | 28,314             | 38,215         | 1,439,011   | 1,477,226   | 0                               |
| Real estate - residential  | 4,618                 | 0                     | 6,460              | 11,078         | 331,938     | 343,016     | 0                               |
| Installment                | 414                   | 131                   | 197                | 742            | 50,039      | 50,781      | 0                               |
| Home equity                | 1,247                 | 524                   | 1,520              | 3,291          | 366,915     | 370,206     | 0                               |
| Other                      | 261                   | 160                   | 654                | 1,075          | 102,158     | 103,233     | 158                             |
| Total                      | \$14,660              | \$3,322               | \$48,800           | \$66,782       | \$3,315,346 | \$3,382,128 | \$158                           |

| As of December 31, 2012    |                       |                       |                    |                |             |             |                                 |
|----------------------------|-----------------------|-----------------------|--------------------|----------------|-------------|-------------|---------------------------------|
| (Dollars in thousands)     | 30 - 59 days past due | 60 - 89 days past due | > 90 days past due | Total past due | Current     | Total       | > 90 days past due and accruing |
| Loans                      |                       |                       |                    |                |             |             |                                 |
| Commercial                 | \$1,770               | \$832                 | \$4,197            | \$6,799        | \$854,234   | \$861,033   | \$0                             |
| Real estate - construction | 0                     | 0                     | 892                | 892            | 72,625      | 73,517      | 0                               |
| Real estate - commercial   | 2,549                 | 1,931                 | 27,966             | 32,446         | 1,384,562   | 1,417,008   | 0                               |
| Real estate - residential  | 6,071                 | 1,463                 | 6,113              | 13,647         | 304,563     | 318,210     | 0                               |
| Installment                | 280                   | 148                   | 344                | 772            | 56,038      | 56,810      | 0                               |
| Home equity                | 1,311                 | 869                   | 1,440              | 3,620          | 363,880     | 367,500     | 0                               |
| Other                      | 386                   | 168                   | 708                | 1,262          | 83,724      | 84,986      | 212                             |
| Total                      | \$12,367              | \$5,411               | \$41,660           | \$59,438       | \$3,119,626 | \$3,179,064 | \$212                           |

Nonaccrual. Loans are classified as nonaccrual when, in the opinion of management, collection of principal or interest is doubtful or when principal or interest payments are ninety days or more past due. Generally, loans are placed on nonaccrual status due to the continued failure to adhere to contractual payment terms by the borrower coupled with other pertinent factors such as insufficient collateral value. The accrual of interest income is discontinued and previously accrued, but unpaid interest is reversed when a loan is placed on nonaccrual status. Any payments received while a loan is on nonaccrual status are applied as a reduction to the carrying value of the loan. A loan may be placed back on accrual status if all contractual payments have been received and collection of future principal and interest payments is no longer doubtful.

Troubled Debt Restructurings. A loan modification is considered a TDR when two conditions are met: 1) the borrower is experiencing financial difficulty and 2) concessions are made by the Company that would not otherwise be considered for a borrower with similar credit characteristics. The most common types of modifications include interest

rate reductions, maturity extensions and modifications to principal amortization, including interest only structures. Modified terms are dependent upon the financial position and needs of the individual borrower. If the modification agreement is violated, the loan is managed by the Company's credit administration group for resolution, which may result in foreclosure in the case of real estate.

TDRs are generally classified as nonaccrual for a minimum period of six months and may qualify for return to accrual status once they have demonstrated performance with the terms of the loan modification.

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First Financial had 207 TDRs totaling \$32.9 million at June 30, 2013, including \$12.9 million on accrual status and \$19.9 million classified as nonaccrual. First Financial had \$2.6 million of commitments outstanding to lend additional funds to borrowers whose loan terms have been modified through TDRs. At June 30, 2013, the allowance for loan and lease losses included reserves of \$2.9 million related to TDRs. For the three and six months ended June 30, 2013, First Financial charged off \$0.3 million and \$1.2 million, respectively, for the portion of TDRs determined to be uncollectible. Additionally, at June 30, 2013, approximately \$5.7 million of the accruing TDRs have been performing in accordance with the restructured terms for more than one year.

First Financial had 145 TDRs totaling \$25.0 million at December 31, 2012, including \$10.9 million of loans on accrual status and \$14.1 million classified as nonaccrual. First Financial had \$3.5 million of commitments outstanding to lend additional funds to borrowers whose loan terms have been modified through TDRs. At December 31, 2012, the allowance for loan and lease losses included reserves of \$3.0 million related to TDRs. For the year ended December 31, 2012, First Financial charged off \$7.2 million for the portion of TDRs determined to be uncollectible. At December 31, 2012, approximately \$2.7 million of the accruing TDRs had been performing in accordance with the restructured terms for more than one year.

The following tables provide information on loan modifications classified as TDRs during the three and six months ended June 30, 2013 and 2012.

| (Dollars in thousands)     | Three months ended<br>June 30, 2013 |                                  |                       | June 30, 2012      |                                  |                       |
|----------------------------|-------------------------------------|----------------------------------|-----------------------|--------------------|----------------------------------|-----------------------|
|                            | Number of<br>loans                  | Pre-modification<br>loan balance | Period end<br>balance | Number of<br>loans | Pre-modification<br>loan balance | Period end<br>balance |
| Commercial                 | 4                                   | \$ 171                           | \$171                 | 2                  | \$ 66                            | \$66                  |
| Real estate - construction | 0                                   | 0                                | 0                     | 0                  | 0                                | 0                     |
| Real estate - commercial   | 3                                   | 659                              | 657                   | 8                  | 909                              | 901                   |
| Real estate - residential  | 9                                   | 596                              | 594                   | 2                  | 164                              | 166                   |
| Installment                | 3                                   | 17                               | 16                    | 0                  | 0                                | 0                     |
| Home equity                | 6                                   | 82                               | 81                    | 0                  | 0                                | 0                     |
| Total                      | 25                                  | \$ 1,525                         | \$1,519               | 12                 | \$ 1,139                         | \$ 1,133              |

| (Dollars in thousands)     | Six months ended<br>June 30, 2013 |                                  |                       | June 30, 2012      |                                  |                       |
|----------------------------|-----------------------------------|----------------------------------|-----------------------|--------------------|----------------------------------|-----------------------|
|                            | Number of<br>loans                | Pre-modification<br>loan balance | Period end<br>balance | Number of<br>loans | Pre-modification<br>loan balance | Period end<br>balance |
| Commercial                 | 10                                | \$ 7,738                         | \$7,047               | 10                 | \$ 4,571                         | \$4,562               |
| Real estate - construction | 0                                 | 0                                | 0                     | 0                  | 0                                | 0                     |
| Real estate - commercial   | 7                                 | 2,251                            | 2,242                 | 14                 | 4,749                            | 4,718                 |
| Real estate - residential  | 30                                | 1,969                            | 1,850                 | 2                  | 164                              | 166                   |
| Installment                | 11                                | 154                              | 97                    | 0                  | 0                                | 0                     |
| Home equity                | 30                                | 883                              | 763                   | 0                  | 0                                | 0                     |
| Total                      | 88                                | \$ 12,995                        | \$11,999              | 26                 | \$ 9,484                         | \$9,446               |

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The following table provides information on how TDRs were modified during the three and six months ended June 30, 2013 and 2012.

| (Dollars in thousands)                   | Three months ended      |         | Six months ended        |         |
|--|-------------------------|---------|-------------------------|---------|
|  | June 30, <sup>(2)</sup> |         | June 30, <sup>(2)</sup> |         |
|  | 2013                    | 2012    | 2013                    | 2012    |
| Extended maturities                      | \$268                   | \$406   | \$8,068                 | \$7,260 |
| Adjusted interest rates                  | 0                       | 166     | 562                     | 166     |
| Combination of rate and maturity changes | 135                     | 468     | 236                     | 563     |
| Forbearance                              | 0                       | 93      | 0                       | 1,236   |
| Other <sup>(1)</sup>                     | 1,116                   | 0       | 3,133                   | 221     |
| Total                                    | \$1,519                 | \$1,133 | \$11,999                | \$9,446 |

(1) Includes covenant modifications and other concessions, or combination of concessions, that do not consist of interest rate adjustments, forbearance and maturity extensions

(2) Balances are as of period end

First Financial considers repayment performance as an indication of the effectiveness of the Company's loan modifications. A borrower that is ninety days or more past due on any principal or interest payments for a TDR, or who prematurely terminates a restructured loan agreement without satisfying the contractual principal balance (for example, in a deed-in-lieu arrangement), is considered to be in payment default of the terms of the TDR agreement.

The following table provides information on TDRs for which there was a payment default during the period that occurred within twelve months of the loan modification:

| (Dollars in thousands)     | June 30,  |            | 2012      |            |
|----------------------------|-----------|------------|-----------|------------|
|                            | 2013      |            |           |            |
|                            | Number of | Period End | Number of | Period End |
|                            | Loans     | Balance    | Loans     | Balance    |
| Commercial                 | 3         | \$6,238    | 1         | \$984      |
| Real estate - construction | 0         | 0          | 0         | 0          |
| Real estate - commercial   | 1         | 72         | 0         | 0          |
| Real estate - residential  | 3         | 185        | 0         | 0          |
| Installment                | 3         | 14         | 0         | 0          |
| Home equity                | 3         | 17         | 0         | 0          |
| Total                      | 13        | \$6,526    | 1         | \$984      |



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Impaired Loans. Loans placed on nonaccrual status and TDRs are considered impaired. The following table provides information on nonaccrual, TDRs and total impaired loans.

| (Dollars in thousands)             | June 30, 2013 | December 31, 2012 |
|------------------------------------|---------------|-------------------|
| Impaired loans                     |               |                   |
| Nonaccrual loans                   |               |                   |
| Commercial                         | \$2,904       | \$10,562          |
| Real estate-construction           | 808           | 950               |
| Real estate-commercial             | 30,977        | 31,002            |
| Real estate-residential            | 5,149         | 5,045             |
| Installment                        | 153           | 376               |
| Home equity                        | 1,576         | 2,499             |
| Other                              | 496           | 496               |
| Nonaccrual loans                   | 42,063        | 50,930            |
| Troubled debt restructurings       |               |                   |
| Accruing                           | 12,924        | 10,856            |
| Nonaccrual                         | 19,948        | 14,111            |
| Total troubled debt restructurings | 32,872        | 24,967            |
| Total impaired loans               | \$74,935      | \$75,897          |

| (Dollars in thousands)  | Three months ended |         | Six months ended |         |
|---|--------------------|---------|------------------|---------|
|   | June 30,<br>2013   | 2012    | June 30,<br>2013 | 2012    |
| Interest income effect on impaired loans                                    |                    |         |                  |         |
| Gross amount of interest that would have been recorded under original terms | \$1,135            | \$1,259 | \$2,257          | \$2,589 |
| Interest included in income   |                    |         |                  |         |
| Nonaccrual loans  | 70                 | 140     | 142              | 349     |
| Troubled debt restructurings  | 158                | 148     | 401              | 231     |
| Total interest included in income   | 228                | 288     | 543              | 580     |
| Net impact on interest income   | \$907              | \$971   | \$1,714          | \$2,009 |
| Commitments outstanding to borrowers with nonaccrual loans                  |                    |         | \$2,351          | \$288   |

First Financial individually reviews all impaired commercial loan relationships greater than \$250,000, as well as consumer loan TDRs greater than \$100,000, to determine if a specific allowance based on the borrower's overall financial condition, resources and payment record, support from guarantors and the realizable value of any collateral is necessary. Specific allowances are based on expected cash flows, discounted using the loan's initial effective interest rate or the fair value of the collateral for certain collateral dependent loans.

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First Financial's investment in impaired loans was as follows:

As of June 30, 2013

| (Dollars in thousands)                   | Current<br>Balance | Contractual<br>Principal<br>Balance | Related<br>Allowance | Average<br>Current<br>Balance | YTD<br>Interest<br>Income<br>Recognized | Quarterly<br>Interest<br>Income<br>Recognized |
|--|--------------------|-------------------------------------|----------------------|-------------------------------|---|---|
| Loans with no related allowance recorded |                    |                                     |                      |                               |   |   |
| Commercial                               | \$13,909           | \$16,034                            | \$0                  | \$13,976                      | \$124                                   | \$51  |
| Real estate - construction               | 750                | 1,052                               | 0                    | 557                           | 0                                       | 0   |
| Real estate - commercial                 | 20,473             | 27,322                              | 0                    | 17,958                        | 209                                     | 97  |
| Real estate - residential                | 10,818             | 12,650                              | 0                    | 9,931                         | 72                                      | 37  |
| Installment                              | 319                | 357                                 | 0                    | 394                           | 3                                       | 1   |
| Home equity                              | 2,920              | 3,687                               | 0                    | 3,138                         | 21                                      | 10  |
| Other                                    | 0                  | 0                                   | 0                    | 217                           | 0                                       | 0   |
| Loans with an allowance recorded         |                    |                                     |                      |                               |   |   |
| Commercial                               | 2,194              | 2,716                               | 1,076                | 4,030                         | 50                                      | 5   |
| Real estate - construction               | 354                | 624                                 | 35                   | 1,210                         | 7                                       | 0   |
| Real estate - commercial                 | 20,565             | 23,614                              | 6,158                | 22,243                        | 39                                      | 18  |
| Real estate - residential                | 2,037              | 2,092                               | 348                  | 1,980                         | 18                                      | 9   |
| Installment                              | 0                  | 0                                   | 0                    | 0                             | 0                                       | 0   |
| Home equity                              | 100                | 100                                 | 2                    | 101                           | 0                                       | 0   |
| Other                                    | 496                | 496                                 | 378                  | 279                           | 0                                       | 0   |
| Total                                    |                    |                                     |                      |                               |   |   |
| Commercial                               | 16,103             | 18,750                              | 1,076                | 18,006                        | 174                                     | 56  |
| Real estate - construction               | 1,104              | 1,676                               | 35                   | 1,767                         | 7                                       | 0   |
| Real estate - commercial                 | 41,038             | 50,936                              | 6,158                | 40,201                        | 248                                     | 115   |
| Real estate - residential                | 12,855             | 14,742                              | 348                  | 11,911                        | 90                                      | 46  |
| Installment                              | 319                | 357                                 | 0                    | 394                           | 3                                       | 1   |
| Home equity                              | 3,020              | 3,787                               | 2                    | 3,239                         | 21                                      | 10  |
| Other                                    | 496                | 496                                 | 378                  | 496                           | 0                                       | 0   |
| Total                                    | \$74,935           | \$90,744                            | \$7,997              | \$76,014                      | \$543                                   | \$228   |

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| (Dollars in thousands)                   | As of December 31, 2012 |                               |                   |                         |                            |
|--|-------------------------|-------------------------------|-------------------|-------------------------|----------------------------|
|  | Current Balance         | Contractual Principal Balance | Related Allowance | Average Current Balance | Interest Income Recognized |
| Loans with no related allowance recorded |                         |                               |                   |                         |                            |
| Commercial                               | \$14,961                | \$17,269                      | \$0               | \$9,337                 | \$215                      |
| Real estate - construction               | 462                     | 672                           | 0                 | 3,857                   | 15                         |
| Real estate - commercial                 | 15,782                  | 21,578                        | 0                 | 15,554                  | 277                        |
| Real estate - residential                | 9,222                   | 10,817                        | 0                 | 8,463                   | 81                         |
| Installment                              | 452                     | 556                           | 0                 | 452                     | 2                          |
| Home equity                              | 3,251                   | 4,132                         | 0                 | 2,423                   | 19                         |
| Other                                    | 326                     | 326                           | 0                 | 65                      | 0                          |
| Loans with an allowance recorded         |                         |                               |                   |                         |                            |
| Commercial                               | 3,560                   | 4,252                         | 1,151             | 5,350                   | 161                        |
| Real estate - construction               | 1,640                   | 2,168                         | 838               | 5,033                   | 81                         |
| Real estate - commercial                 | 24,014                  | 25,684                        | 7,155             | 25,499                  | 235                        |
| Real estate - residential                | 1,956                   | 2,003                         | 290               | 2,278                   | 38                         |
| Installment                              | 0                       | 0                             | 0                 | 0                       | 0                          |
| Home equity                              | 101                     | 101                           | 2                 | 81                      | 1                          |
| Other                                    | 170                     | 170                           | 92                | 34                      | 0                          |
| Total                                    |                         |                               |                   |                         |                            |
| Commercial                               | 18,521                  | 21,521                        | 1,151             | 14,687                  | 376                        |
| Real estate - construction               | 2,102                   | 2,840                         | 838               | 8,890                   | 96                         |
| Real estate - commercial                 | 39,796                  | 47,262                        | 7,155             | 41,053                  | 512                        |
| Real estate - residential                | 11,178                  | 12,820                        | 290               | 10,741                  | 119                        |
| Installment                              | 452                     | 556                           | 0                 | 452                     | 2                          |
| Home equity                              | 3,352                   | 4,233                         | 2                 | 2,504                   | 20                         |
| Other                                    | 496                     | 496                           | 92                | 99                      | 0                          |
| Total                                    | \$75,897                | \$89,728                      | \$9,528           | \$78,426                | \$1,125                    |

OREO. Other real estate owned (OREO) is comprised of properties acquired by the Company through the loan foreclosure or repossession process, or other resolution activity that results in partial or total satisfaction of problem loans. The acquired properties are recorded at the lower of cost or fair value less estimated costs of disposal (net realizable value) upon acquisition. Losses arising at the time of acquisition of such properties are charged against the allowance for loan and lease losses. Subsequent write-downs in the carrying value of OREO properties are expensed as incurred. Improvements to the properties may be capitalized if the improvements contribute to the overall value of the property, but may not be capitalized in excess of the net realizable value of the property.

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Changes in OREO were as follows:

| (Dollars in thousands)         | Three months ended |          | Six months ended |          |
|--------------------------------|--------------------|----------|------------------|----------|
|                                | June 30,<br>2013   | 2012     | June 30,<br>2013 | 2012     |
| Balance at beginning of period | \$11,993           | \$15,036 | \$12,526         | \$11,317 |
| Additions                      |                    |          |                  |          |
| Commercial                     | 1,759              | 808      | 2,316            | 5,349    |
| Residential                    | 233                | 992      | 380              | 1,914    |
| Total additions                | 1,992              | 1,800    | 2,696            | 7,263    |
| Disposals                      |                    |          |                  |          |
| Commercial                     | 1,641              | 550      | 1,882            | 1,012    |
| Residential                    | 357                | 313      | 651              | 612      |
| Total disposals                | 1,998              | 863      | 2,533            | 1,624    |
| Write-downs                    |                    |          |                  |          |
| Commercial                     | 156                | 182      | 561              | 1,140    |
| Residential                    | 33                 | 103      | 330              | 128      |
| Total write-downs              | 189                | 285      | 891              | 1,268    |
| Balance at end of period       | \$11,798           | \$15,688 | \$11,798         | \$15,688 |

## NOTE 9: COVERED LOANS

Loans acquired in Federal Deposit Insurance Corporation (FDIC)-assisted transactions initially covered under loss sharing agreements whereby the FDIC will reimburse First Financial for the majority of any losses incurred are referred to as covered loans. Pursuant to the terms of each loss sharing agreement, covered loans are subject to a stated loss threshold whereby the FDIC will reimburse First Financial for 80% of losses up to the stated loss threshold and 95% of losses in excess of the threshold. First Financial will reimburse the FDIC for its pro rata share of recoveries with respect to losses for which the FDIC paid First Financial a reimbursement under the loss sharing agreement. The FDIC's obligation to reimburse First Financial for losses with respect to covered loans began with the first dollar of loss incurred.

First Financial accounts for the majority of covered loans under FASB ASC Topic 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality, except loans with revolving privileges, which are outside the scope of this guidance, and loans for which cash flows could not be estimated, which are accounted for under the cost recovery method. Loans accounted for under FASB ASC Topic 310-30 are referred to as purchased impaired loans.

Purchased impaired loans are not classified as nonperforming assets as the loans are considered to be performing under FASB ASC Topic 310-30. Therefore, interest income, through accretion of the difference between the carrying value of the loans and the expected cash flows (accretable difference) is recognized on all covered purchased impaired loans.

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The following table reflects the carrying value of all covered purchased impaired and nonimpaired covered loans:

| (Dollars in thousands)     | June 30, 2013                             |                                     |           | December 31, 2012                         |                                     |           |
|----------------------------|---|-------------------------------------|-----------|---|-------------------------------------|-----------|
|                            | Loans                                     | Loans                               | Total     | Loans                                     | Loans                               | Total     |
|                            | accounted for under FASB ASC Topic 310-30 | excluded from FASB ASC Topic 310-30 |           | accounted for under FASB ASC Topic 310-30 | excluded from FASB ASC Topic 310-30 |           |
| Commercial                 | \$67,718                                  | \$1,844                             | \$69,562  | \$94,775                                  | \$7,351                             | \$102,126 |
| Real estate - construction | 9,647                                     | 0                                   | 9,647     | 10,631                                    | 0                                   | 10,631    |
| Real estate - commercial   | 382,547                                   | 6,735                               | 389,282   | 458,066                                   | 7,489                               | 465,555   |
| Real estate - residential  | 90,707                                    | 0                                   | 90,707    | 100,694                                   | 0                                   | 100,694   |
| Installment                | 6,409                                     | 648                                 | 7,057     | 7,911                                     | 763                                 | 8,674     |
| Home equity                | 1,372                                     | 51,842                              | 53,214    | 2,080                                     | 55,378                              | 57,458    |
| Other covered loans        | 0   | 2,796                               | 2,796     | 0   | 2,978                               | 2,978     |
| Total covered loans        | \$558,400                                 | \$63,865                            | \$622,265 | \$674,157                                 | \$73,959                            | \$748,116 |

The balance of all loans accounted for under FASB ASC Topic 310-30, including all contractual principal, interest, fees and penalties, was \$0.9 billion and \$1.1 billion as of June 30, 2013 and December 31, 2012, respectively. These balances include \$187.1 million and \$220.4 million of contractual interest not yet accrued as of June 30, 2013 and December 31, 2012, respectively.

Changes in the carrying amount of accretable difference for covered purchased impaired loans were as follows:

| (Dollars in thousands)                              | Three Months Ended |               | Six months ended |               |
|---|--------------------|---------------|------------------|---------------|
|   | June 30, 2013      | June 30, 2012 | June 30, 2013    | June 30, 2012 |
| Balance at beginning of period                      | \$208,670          | \$313,669     | \$224,694        | \$344,410     |
| Reclassification (to)/from nonaccretable difference | (8,459 )           | 9,058         | (708 )           | 23,442        |
| Accretion   | (15,252 )          | (24,025 )     | (33,199 )        | (49,944 )     |
| Other net activity <sup>(1)</sup>                   | (11,039 )          | (15,406 )     | (16,867 )        | (34,612 )     |
| Balance at end of period                            | \$173,920          | \$283,296     | \$173,920        | \$283,296     |

(1) Includes the impact of loan repayments and charge-offs

First Financial regularly reviews its forecast of expected cash flows for covered purchased impaired loans. During the second quarter, the Company implemented certain enhancements to its valuation methodology and the estimation of impairment to place greater emphasis on changes in total expected cash flows and less emphasis on changes in the net present value of expected cash flows. These enhancements contributed to a net reclassification from accretable difference to nonaccretable difference of \$8.5 million and resulted in lower yields on certain loan pools during the quarter. Conversely, First Financial recognized a \$9.1 million reclassification from nonaccretable difference to accretable difference and higher yields on certain loan pools during the second quarter of 2012 related to improvement in the cash flow expectations for certain loan pools. For the six months ended June 30, 2013, the Company recognized a net reclassification of \$0.7 million from accretable difference to nonaccretable difference as a result of the enhancements made during the second quarter. For the six months ended June 30, 2012, the Company recognized a net reclassification of \$23.4 million from nonaccretable difference to accretable difference. For further detail on impairment and provision expense related to covered purchased impaired loans, see "Covered Loans" in Note 10 - Allowance for Loan and Lease Losses.



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Credit Quality. For further discussion of First Financial's monitoring of credit quality for commercial and consumer loans, including discussion of the risk attributes noted below, please see Note 8 - Loans, excluding covered loans.

Covered commercial and consumer credit exposure by risk attribute was as follows:

As of June 30, 2013

| (Dollars in thousands) | Real Estate |              | Commercial | Total     |
|------------------------|-------------|--------------|------------|-----------|
|                        | Commercial  | Construction |            |           |
| Pass                   | \$33,317    | \$1,714      | \$200,641  | \$235,672 |
| Special Mention        | 9,716       | 0            | 45,491     | 55,207    |
| Substandard            | 25,679      | 7,933        | 143,150    | 176,762   |
| Doubtful               | 850         | 0            | 0          | 850       |
| Total                  | \$69,562    | \$9,647      | \$389,282  | \$468,491 |

| (Dollars in thousands) | Real estate residential | Installment | Home equity | Other   | Total     |
|------------------------|-------------------------|-------------|-------------|---------|-----------|
| Performing             | \$90,707                | \$7,054     | \$50,640    | \$2,787 | \$151,188 |
| Nonperforming          | 0                       | 3           | 2,574       | 9       | 2,586     |
| Total                  | \$90,707                | \$7,057     | \$53,214    | \$2,796 | \$153,774 |

As of December 31, 2012

| (Dollars in thousands) | Real Estate |              | Commercial | Total     |
|------------------------|-------------|--------------|------------|-----------|
|                        | Commercial  | Construction |            |           |
| Pass                   | \$48,213    | \$2,304      | \$213,143  | \$263,660 |
| Special Mention        | 16,293      | 7            | 70,894     | 87,194    |
| Substandard            | 35,596      | 8,320        | 181,345    | 225,261   |
| Doubtful               | 2,024       | 0            | 173        | 2,197     |
| Total                  | \$102,126   | \$10,631     | \$465,555  | \$578,312 |

| (Dollars in thousands) | Real estate residential | Installment | Home equity | Other   | Total     |
|------------------------|-------------------------|-------------|-------------|---------|-----------|
| Performing             | \$100,694               | \$8,674     | \$53,231    | \$2,967 | \$165,566 |
| Nonperforming          | 0                       | 0           | 4,227       | 11      | 4,238     |
| Total                  | \$100,694               | \$8,674     | \$57,458    | \$2,978 | \$169,804 |

Delinquency. Covered loans are considered past due or delinquent when the contractual principal or interest due in accordance with the terms of the loan agreement or any portion thereof remains unpaid after the due date of the scheduled payment.

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Covered loan delinquency, excluding loans accounted for under FASB ASC Topic 310-30, was as follows:

| (Dollars in thousands)      | As of June 30, 2013         |                             |                       | Total<br>past<br>due | Current   | Total     | > 90 days<br>past due and<br>accruing |
|-----------------------------|-----------------------------|-----------------------------|-----------------------|----------------------|-----------|-----------|---------------------------------------|
|                             | 30 - 59<br>days<br>past due | 60 - 89<br>days<br>past due | > 90 days<br>past due |                      |           |           |                                       |
| Loans                       |                             |                             |                       |                      |           |           |                                       |
| Commercial                  | \$ 136                      | \$ 0                        | \$ 469                | \$ 605               | \$ 1,239  | \$ 1,844  | \$ 0                                  |
| Real estate -<br>commercial | 506                         | 0                           | 1,331                 | 1,837                | 4,898     | 6,735     | 0                                     |
| Installment                 | 0                           | 0                           | 6                     | 6                    | 642       | 648       | 0                                     |
| Home equity                 | 826                         | 0                           | 2,062                 | 2,888                | 48,954    | 51,842    | 0                                     |
| All other                   | 61                          | 0                           | 33                    | 94                   | 2,702     | 2,796     | 24                                    |
| Total                       | \$ 1,529                    | \$ 0                        | \$ 3,901              | \$ 5,430             | \$ 58,435 | \$ 63,865 | \$ 24                                 |

| (Dollars in thousands)      | As of December 31, 2012     |                             |                       | Total<br>past<br>due | Current   | Total     | > 90 days<br>past due and<br>accruing |
|-----------------------------|-----------------------------|-----------------------------|-----------------------|----------------------|-----------|-----------|---------------------------------------|
|                             | 30 - 59<br>days<br>past due | 60 - 89<br>days<br>past due | > 90 days<br>past due |                      |           |           |                                       |
| Loans                       |                             |                             |                       |                      |           |           |                                       |
| Commercial                  | \$ 351                      | \$ 148                      | \$ 3,781              | \$ 4,280             | \$ 3,071  | \$ 7,351  | \$ 0                                  |
| Real estate -<br>commercial | 138                         | 1,149                       | 2,201                 | 3,488                | 4,001     | 7,489     | 0                                     |
| Installment                 | 0                           | 0                           | 0                     | 0                    | 763       | 763       | 0                                     |
| Home equity                 | 286                         | 296                         | 3,697                 | 4,279                | 51,099    | 55,378    | 0                                     |
| All other                   | 19                          | 26                          | 42                    | 87                   | 2,891     | 2,978     | 31                                    |
| Total                       | \$ 794                      | \$ 1,619                    | \$ 9,721              | \$ 12,134            | \$ 61,825 | \$ 73,959 | \$ 31                                 |

Nonaccrual. Covered purchased impaired loans are classified as performing, even though they may be contractually past due, as any nonpayment of contractual principal or interest is considered in the periodic re-estimation of expected cash flows and is included in the resulting recognition of current period covered loan loss provision or prospective yield adjustments.

Similar to uncovered loans, covered loans accounted for outside FASB ASC Topic 310-30 are classified as nonaccrual when, in the opinion of management, collection of principal or interest is doubtful or when principal or interest payments are ninety days or more past due. Generally, these loans are placed on nonaccrual status due to the continued failure to adhere to contractual payment terms by the borrower coupled with other pertinent factors, such as insufficient collateral value. The accrual of interest income is discontinued and previously accrued, but unpaid interest is reversed when a loan is placed in nonaccrual status. Any payments received while a loan is in nonaccrual status are applied as a reduction to the carrying value of the loan. A loan may be returned to accrual status if all contractual payments have been received and collection of future principal and interest payments is no longer doubtful.



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Information on covered nonaccrual loans was as follows:

| (Dollars in thousands)             | June 30, 2013 | December 31, 2012 |
|------------------------------------|---------------|-------------------|
| Impaired loans                     |               |                   |
| Nonaccrual loans                   |               |                   |
| Commercial                         | \$449         | \$4,498           |
| Real estate-commercial             | 1,413         | 2,986             |
| Installment                        | 3             | 0                 |
| Home equity                        | 2,574         | 4,227             |
| All other                          | 9             | 11                |
| Nonaccrual loans                   | 4,448         | 11,722            |
| Troubled debt restructurings       |               |                   |
| Accruing                           | 365           | 0                 |
| Nonaccrual                         | 323           | 0                 |
| Total troubled debt restructurings | 688           | 0                 |
| Total impaired loans               | \$5,136       | \$11,722          |

| (Dollars in thousands)  | Three months ended |       | Six months ended |       |
|---|--------------------|-------|------------------|-------|
|   | June 30, 2013      | 2012  | June 30, 2013    | 2012  |
| Interest income effect on impaired loans                                    |                    |       |                  |       |
| Gross amount of interest that would have been recorded under original terms | \$115              | \$150 | \$253            | \$358 |
| Interest included in income   |                    |       |                  |       |
| Nonaccrual loans  | 6                  | 13    | 13               | 61    |
| Troubled debt restructurings  | 4                  | 0     | 4                | 0     |
| Total interest included in income   | 10                 | 13    | 17               | 61    |
| Net impact on interest income   | \$105              | \$137 | \$236            | \$297 |

Impaired Loans. Covered loans placed in nonaccrual status, excluding loans accounted for under FASB ASC Topic 310-30, are considered impaired. First Financial's investment in covered impaired loans, excluding loans accounted for under FASB ASC Topic 310-30, was as follows:

| (Dollars in thousands)                   | As of June 30, 2013 |                          |                   |                             |                                |                                      |
|--|---------------------|--------------------------|-------------------|-----------------------------|--------------------------------|--------------------------------------|
|  | Current Balance     | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | YTD Interest Income Recognized | Quarterly Interest Income Recognized |
| Loans with no related allowance recorded |                     |                          |                   |                             |                                |                                      |
| Commercial                               | \$449               | \$2,468                  | \$0               | \$2,348                     | \$5                            | \$2                                  |
| Real estate - commercial                 | 1,413               | 2,827                    | 0                 | 1,894                       | 2                              | 1                                    |
| Installment                              | 3                   | 3                        | 0                 | 1                           | 0                              | 0                                    |
| Home equity                              | 2,574               | 3,784                    | 0                 | 2,972                       | 6                              | 3                                    |
| All other                                | 9                   | 9                        | 0                 | 11                          | 0                              | 0                                    |
| Total                                    | \$4,448             | \$9,091                  | \$0               | \$7,226                     | \$13                           | \$6                                  |

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| (Dollars in thousands)                   | As of December 31, 2012 |                          |                   |                             |                            |
|--|-------------------------|--------------------------|-------------------|-----------------------------|----------------------------|
|  | Current Balance         | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
| Loans with no related allowance recorded |                         |                          |                   |                             |                            |
| Commercial                               | \$4,498                 | \$4,660                  | \$0               | \$4,526                     | \$62                       |
| Real estate - commercial                 | 2,986                   | 3,216                    | 0                 | 2,153                       | 18                         |
| Home equity                              | 4,227                   | 5,260                    | 0                 | 2,006                       | 5                          |
| All other                                | 11                      | 11                       | 0                 | 13                          | 0                          |
| Total                                    | \$11,722                | \$13,147                 | \$0               | \$8,698                     | \$85                       |

Covered OREO. Covered OREO is comprised of properties acquired by the Company through the loan foreclosure or repossession process, or other resolution activities that result in partial or total satisfaction of problem covered loans. These properties remain subject to loss sharing agreements whereby the FDIC reimburses First Financial for the majority of any losses incurred. The acquired properties are recorded at the lower of cost or fair value upon acquisition. Losses arising at the time of acquisition of such properties are charged against the allowance for loan and lease losses. Subsequent write-downs in the carrying value of covered OREO properties are expensed as incurred. Estimated reimbursements due from the FDIC under loss sharing agreements related to any losses upon acquisition or subsequent write-downs in the carrying value of covered OREO are recorded as noninterest income and an increase to the FDIC indemnification asset in the same period. Improvements to the properties may be capitalized if the improvements contribute to the overall value of the property, but may not be capitalized in excess of the net realizable value of the property.

Changes in covered OREO were as follows:

| (Dollars in thousands)         | Three months ended |          | Six months ended |          |
|--------------------------------|--------------------|----------|------------------|----------|
|                                | June 30, 2013      | 2012     | June 30, 2013    | 2012     |
| Balance at beginning of period | \$29,345           | \$41,489 | \$28,862         | \$44,818 |
| Additions                      |                    |          |                  |          |
| Commercial                     | 6,029              | 2,349    | 12,491           | 5,099    |
| Residential                    | 161                | 62       | 377              | 2,686    |
| Total additions                | 6,190              | 2,411    | 12,868           | 7,785    |
| Disposals                      |                    |          |                  |          |
| Commercial                     | 12,027             | 13,554   | 16,648           | 18,559   |
| Residential                    | 470                | 1,811    | 814              | 2,354    |
| Total disposals                | 12,497             | 15,365   | 17,462           | 20,913   |
| Write-downs                    |                    |          |                  |          |
| Commercial                     | 557                | 2,332    | 1,682            | 5,416    |
| Residential                    | 6                  | 795      | 111              | 866      |
| Total write-downs              | 563                | 3,127    | 1,793            | 6,282    |
| Balance at end of period       | \$22,475           | \$25,408 | \$22,475         | \$25,408 |

## NOTE 10: ALLOWANCE FOR LOAN AND LEASE LOSSES

Loans - excluding covered loans. For each reporting period, management maintains the allowance for loan and lease losses at a level that it considers sufficient to absorb probable loan and lease losses inherent in the portfolio. Management determines the adequacy of the allowance based on historical loss experience as well as other significant factors such as composition of the portfolio, economic conditions, geographic footprint, the results of periodic internal

and external evaluations of delinquent, nonaccrual and classified loans and any other adverse situations that may affect a specific borrower's ability to repay (including the timing of future payments). This evaluation is inherently subjective as it requires utilizing material estimates that may be susceptible to significant change.

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In the commercial portfolio, which includes commercial loans, construction and commercial real estate loans and lease financing, impaired loan relationships greater than \$250,000 are evaluated to determine the need for a specific allowance based on the borrower's overall financial condition, resources and payment record, support from guarantors and the realizable value of any collateral. Loans are considered impaired when, in the judgment of management, based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected.

The allowance for non-impaired commercial loans and impaired commercial loan relationships less than \$250,000 includes a process of estimating the probable losses inherent in the portfolio by category, based on First Financial's internal system of credit risk ratings and historical loss data. These estimates may also be adjusted for management's estimate of probable losses on specific loan types dependent upon trends in the values of the underlying collateral, delinquent and nonaccrual loans, prevailing economic conditions, changes in lending strategies and other influencing factors.

With the exception of loans modified as TDRs, consumer loans are evaluated by loan type (i.e. residential real estate, installment, etc.), as these loans exhibit homogeneous characteristics. The allowance for consumer loans, which includes residential real estate, installment, home equity, credit card loans and overdrafts, is established by estimating losses inherent in each particular category of consumer loans. The estimate of losses is primarily based on historical loss rates for each category, as well as trends in delinquent and nonaccrual loans, prevailing economic conditions and other significant influencing factors. Consumer loans modified as TDRs greater than \$100,000 are individually reviewed to determine if a specific allowance is necessary.

There were no material changes to First Financial's accounting policies or methodology related to the allowance for loan and lease losses during the first six months of 2013, however certain modifications were made to the estimation process in the third quarter of 2012 to place greater emphasis on quantitative factors such as historical loan losses and less emphasis on qualitative factors. This resulted in a shift in the allocation of the allowance between certain consumer and commercial loan types but had no significant impact on the total allowance for loan and lease losses at June 30, 2013.

The allowance is increased by provision expense and decreased by actual charge-offs, net of recoveries of amounts previously charged-off. First Financial's policy is to charge-off all or a portion of a loan when, in management's opinion, it is unlikely to collect the principal amount owed in full either through payments from the borrower or from the liquidation of collateral.

Changes in the allowance for loan and lease losses for the previous five quarters are presented in the table that follows:

|   | Three Months Ended |          |          |          | Six months ended |          |           |   |
|---|--------------------|----------|----------|----------|------------------|----------|-----------|---|
|   | 2013               |          | 2012     |          | June 30,         |          | 2012      |   |
| (Dollars in thousands)                                    | June 30,           | Mar. 31, | Dec. 31, | Sep. 30, | June 30,         | 2013     | 2012      |   |
| Balance at beginning of period                            | \$48,306           | \$47,777 | \$49,192 | \$50,952 | \$49,437         | \$47,777 | \$52,576  |   |
| Provision for loan and lease losses                       | 2,409              | 3,041    | 3,882    | 3,613    | 8,364            | 5,450    | 11,622    |   |
| Loans charged off   | (4,194 )           | (3,210 ) | (5,548 ) | (5,804 ) | (7,138 )         | (7,404 ) | (13,960 ) |   |
| Recoveries  | 526                | 698      | 251      | 431      | 289              | 1,224    | 714       |   |
| Balance at end of period                                  | \$47,047           | \$48,306 | \$47,777 | \$49,192 | \$50,952         | \$47,047 | \$50,952  |   |
| Allowance for loan and lease losses to total ending loans | 1.39               | % 1.49   | % 1.50   | % 1.60   | % 1.69           | % 1.39   | % 1.69    | % |



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Year-to-date changes in the allowance for loan and lease losses by loan category were as follows:

Six Months Ended June 30, 2013

Real Estate

| (Dollars in thousands)  | Commercial | Construction | Commercial  | Residential | Installment | Home Equity | Other     | Total       |
|---|------------|--------------|-------------|-------------|-------------|-------------|-----------|-------------|
| Allowance for loan and lease losses:                            |            |              |             |             |             |             |           |             |
| Balance at beginning of period                                  | \$7,926    | \$3,268      | \$24,151    | \$3,599     | \$522       | \$5,173     | \$3,138   | \$47,777    |
| Provision for loan and lease losses                             | 2,144      | (1,655 )     | 2,934       | 613         | (136 )      | 1,013       | 537       | 5,450       |
| Gross charge-offs   | 1,640      | 0            | 3,039       | 549         | 197         | 1,292       | 687       | 7,404       |
| Recoveries  | 386        | 136          | 96          | 9           | 187         | 277         | 133       | 1,224       |
| Total net charge-offs   | 1,254      | (136 )       | 2,943       | 540         | 10          | 1,015       | 554       | 6,180       |
| Ending allowance for loan and lease losses                      | \$8,816    | \$1,749      | \$24,142    | \$3,672     | \$376       | \$5,171     | \$3,121   | \$47,047    |
| Ending allowance on loans individually evaluated for impairment | \$1,076    | \$35         | \$6,158     | \$348       | \$0         | \$2         | \$378     | \$7,997     |
| Ending allowance on loans collectively evaluated for impairment | 7,740      | 1,714        | 17,984      | 3,324       | 376         | 5,169       | 2,743     | 39,050      |
| Ending allowance for loan and lease losses                      | \$8,816    | \$1,749      | \$24,142    | \$3,672     | \$376       | \$5,171     | \$3,121   | \$47,047    |
| Loans - excluding covered loans                                 |            |              |             |             |             |             |           |             |
| Ending balance of loans individually evaluated for impairment   | \$14,450   | \$1,104      | \$35,082    | \$3,652     | \$0         | \$517       | \$496     | \$55,301    |
| Ending balance of loans collectively evaluated for impairment   | 925,970    | 96,142       | 1,442,144   | 339,364     | 50,781      | 369,689     | 102,737   | 3,326,827   |
| Total loans - excluding covered loans                           | \$940,420  | \$97,246     | \$1,477,226 | \$343,016   | \$50,781    | \$370,206   | \$103,233 | \$3,382,128 |

Twelve Months Ended December 31, 2012

Real Estate

| (Dollars in thousands)               | Commercial | Construction | Commercial | Residential | Installment | Home Equity | Other   | Total    |
|--------------------------------------|------------|--------------|------------|-------------|-------------|-------------|---------|----------|
| Allowance for loan and lease losses: |            |              |            |             |             |             |         |          |
|                                      | \$10,289   | \$4,424      | \$18,228   | \$4,994     | \$1,659     | \$10,751    | \$2,231 | \$52,576 |

|   |           |          |             |           |          |           |          |             |
|---|-----------|----------|-------------|-----------|----------|-----------|----------|-------------|
| Balance at beginning of period                                  |           |          |             |           |          |           |          |             |
| Provision for loan and lease losses                             | 1,556     | 1,528    | 16,670      | 346       | (883     | ) (2,032  | ) 1,932  | 19,117      |
| Gross charge-offs   | 4,312     | 2,684    | 11,012      | 1,814     | 577      | 3,661     | 1,252    | 25,312      |
| Recoveries  | 393       | 0        | 265         | 73        | 323      | 115       | 227      | 1,396       |
| Total net charge-offs   | 3,919     | 2,684    | 10,747      | 1,741     | 254      | 3,546     | 1,025    | 23,916      |
| Ending allowance for loan and lease losses                      | \$7,926   | \$3,268  | \$24,151    | \$3,599   | \$522    | \$5,173   | \$3,138  | \$47,777    |
| Ending allowance on loans individually evaluated for impairment | \$1,151   | \$838    | \$7,155     | \$290     | \$0      | \$2       | \$92     | \$9,528     |
| Ending allowance on loans collectively evaluated for impairment | 6,775     | 2,430    | 16,996      | 3,309     | 522      | 5,171     | 3,046    | 38,249      |
| Ending allowance for loan and lease losses                      | \$7,926   | \$3,268  | \$24,151    | \$3,599   | \$522    | \$5,173   | \$3,138  | \$47,777    |
| Loans - excluding covered loans                                 |           |          |             |           |          |           |          |             |
| Ending balance of loans individually evaluated for impairment   | \$16,661  | \$2,076  | \$35,422    | \$2,604   | \$0      | \$101     | \$496    | \$57,360    |
| Ending balance of loans collectively evaluated for impairment   | 844,372   | 71,441   | 1,381,586   | 315,606   | 56,810   | 367,399   | 84,490   | 3,121,704   |
| Total loans - excluding covered loans                           | \$861,033 | \$73,517 | \$1,417,008 | \$318,210 | \$56,810 | \$367,500 | \$84,986 | \$3,179,064 |

Covered Loans. In accordance with the accounting guidance for business combinations, there was no allowance brought forward on covered loans as any credit deterioration evident in the loans at the time of acquisition was included in the determination of the fair value of the loans at the acquisition date.

The majority of covered loans are accounted for under FASB ASC Topic 310-30, whereby First Financial is required to periodically re-estimate the expected cash flows on the loans. For purposes of applying the guidance under FASB ASC Topic 310-30, First Financial grouped acquired loans into pools based on common risk characteristics. Generally, a decline in expected cash flows for a pool of loans is referred to as impairment and recorded as provision expense, and a related allowance for loan and lease losses on covered loans, on a discounted basis during the period. Estimated reimbursements due from the FDIC under loss sharing agreements related to any declines in expected cash flows for a pool of loans are recorded as noninterest income and an increase to the FDIC indemnification asset in the same period. Improvement in expected cash flows

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for a pool of loans, once any previously recorded impairment is recaptured, is recognized prospectively as an adjustment to the yield on the loans in the pool and a related adjustment to the yield on the FDIC indemnification asset.

First Financial performs periodic valuation procedures to re-estimate the expected cash flows on covered loans accounted for under FASB ASC Topic 310-30 and compare the present value of expected cash flows to the carrying value of the loans at the pool level. In order to estimate expected cash flows, First Financial specifically reviews a sample of these covered loans to assist in the determination of appropriate probability of default and loss given default assumptions to be applied to the remainder of the portfolio. The estimate of expected cash flows may also be adjusted for management's estimate of probable losses on specific loan types dependent upon trends in observable market and industry data, such as prepayment speeds and collateral values. These cash flow evaluations are inherently subjective as they require material estimates, all of which may be susceptible to significant change.

During the second quarter, the Company implemented certain enhancements to its valuation methodology and the estimation of impairment to place greater emphasis on changes in total expected cash flows and less emphasis on changes in the net present value of expected cash flows. The Company recognized negative provision expense, or impairment recapture, of \$8.3 million and realized net charge-offs of \$4.3 million during the quarter, resulting in an allowance for covered loan losses of \$33.0 million as of June 30, 2013. First Financial recognized provision expense on covered loans of \$0.8 million and realized net charge-offs of \$13.0 million for the first six months of 2013. For the second quarter of 2012, First Financial recognized provision expense on covered loans of \$6.0 million related to net charge-offs of \$3.9 million during the period. Likewise, for the first six months of 2012, the Company recognized provision expense on covered loans of \$19.0 million and net charge-offs of \$13.5 million.

Additionally, the Company recognized loss sharing expenses of \$1.6 million and \$3.1 million for the second quarter of 2013 and 2012, respectively, primarily related to attorney fees, appraisal costs and delinquent taxes during the periods. The Company also recognized gains on sales of covered OREO of \$2.2 million for the second quarter of 2013 and losses on covered OREO of \$1.2 million for the second quarter of 2012. The payable due to the FDIC under loss sharing agreements, related to covered loan provision expenses, gains/losses on covered OREO and loss sharing expenses, of \$7.4 million was recognized as negative FDIC loss sharing income and a corresponding decrease to the FDIC indemnification asset during the second quarter of 2013. The receivable due from the FDIC under loss sharing agreements of \$8.3 million for the second quarter of 2012, was recognized as FDIC loss sharing income and a corresponding increase to the FDIC indemnification asset. On a year-to-date basis, First Financial recognized loss sharing expenses of \$3.9 million and \$4.8 million for 2013 and 2012 respectively. Similarly, on a year-to-date basis, the Company recognized gains on covered OREO of \$2.4 million for 2013 and losses on covered OREO of \$2.5 million for 2012. The receivable due from the FDIC under loss sharing agreements related to covered loan provision expenses, gains/losses on covered OREO and loss sharing expenses of \$1.6 million for the first six months of 2013 and \$21.1 million for the comparable period in 2012, was recognized as FDIC loss sharing income and a corresponding increase to the FDIC indemnification asset.

The allowance for loan and lease losses on covered loans is presented in the tables below:

|  | June 30, 2013 |                           |             |             |           |
|--|---------------|---------------------------|-------------|-------------|-----------|
| (Dollars in thousands)   | Commercial    | Real Estate<br>Commercial | Residential | Installment | Total     |
| Ending allowance on loans acquired with deteriorated credit quality (ASC 310-30) | \$ 14,259     | \$ 16,195                 | \$ 2,263    | \$ 244      | \$ 32,961 |
| Ending allowance on acquired loans outside the scope of ASC 310-30               | 0             | 0                         | 0           | 0           | 0         |
| Ending allowance on covered loans  | \$ 14,259     | \$ 16,195                 | \$ 2,263    | \$ 244      | \$ 32,961 |



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| (Dollars in thousands)   | December 31, 2012 |                           |             |             | Total     |
|--|-------------------|---------------------------|-------------|-------------|-----------|
|  | Commercial        | Real Estate<br>Commercial | Residential | Installment |           |
| Ending allowance on loans acquired with deteriorated credit quality (ASC 310-30) | \$ 19,136         | \$ 22,918                 | \$ 2,599    | \$ 537      | \$ 45,190 |
| Ending allowance on acquired loans outside the scope of ASC 310-30               | 0                 | 0                         | 0           | 0           | 0         |
| Ending allowance on covered loans  | \$ 19,136         | \$ 22,918                 | \$ 2,599    | \$ 537      | \$ 45,190 |

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Changes in the allowance for loan and lease losses on covered loans for the previous five quarters were as follows:

| (Dollars in thousands)              | Three Months Ended |          |                  |          |          | Six months ended |           |
|-------------------------------------|--------------------|----------|------------------|----------|----------|------------------|-----------|
|                                     | 2013<br>June 30,   | Mar. 31, | 2012<br>Dec. 31, | Sep. 30, | June 30, | 2013<br>June 30, | 2012      |
| Balance at beginning of period      | \$45,496           | \$45,190 | \$48,895         | \$48,327 | \$46,156 | \$45,190         | \$42,835  |
| Provision for loan and lease losses | (8,283 )           | 9,042    | 5,283            | 6,622    | 6,047    | 759              | 18,998    |
| Loans charged-off                   | (4,681 )           | (9,684 ) | (9,568 )         | (9,058 ) | (5,163 ) | (14,365 )        | (15,281 ) |
| Recoveries                          | 429                | 948      | 580              | 3,004    | 1,287    | 1,377            | 1,775     |
| Balance at end of period            | \$32,961           | \$45,496 | \$45,190         | \$48,895 | \$48,327 | \$32,961         | \$48,327  |

## NOTE 11: INCOME TAXES

For the second quarter 2013, income tax expense was \$6.5 million, resulting in an effective tax rate of 29.0%, compared with income tax expense of \$8.7 million and an effective tax rate of 32.8% for the comparable period in 2012. For the first six months of 2013, income tax expense was \$12.8 million, resulting in an effective tax rate of 30.2%, compared with income tax expense of \$18.3 million and an effective tax rate of 34.5% for the comparable period in 2012. The declines in the effective tax rates for the second quarter 2013 and the six months ended June 30, 2013, as compared to the same periods in 2012, were primarily the result of higher income earned on tax-exempt investment securities, favorable tax reversals related to an intercompany tax obligation associated with an unconsolidated former Irwin subsidiary and an adjustment to deferred tax liabilities relating to a favorable change in state tax laws.

At June 30, 2013, and December 31, 2012, First Financial had no FASB ASC Topic 740-10 unrecognized tax benefits recorded. First Financial does not expect the total amount of unrecognized tax benefits to significantly increase within the next twelve months.

First Financial recognizes interest and penalties on income tax assessments or income tax refunds in the Consolidated Financial Statements as a component of noninterest expense.

First Financial regularly reviews its tax positions and establishes reserves for income tax-related uncertainties based on estimates of whether it is more likely than not that the tax uncertainty would be sustained upon challenge by the appropriate tax authorities which would then result in additional taxes, penalties and interest due. These evaluations are inherently subjective as they require material estimates and may be susceptible to significant change. Provision for tax reserves, if any, is included in income tax expense in the Consolidated Financial Statements. Management determined that no reserve for income tax-related uncertainties was necessary as of June 30, 2013 and December 31, 2012.

First Financial and its subsidiaries are subject to U.S. federal income tax as well as state and local income tax in several jurisdictions. Tax years prior to 2010 have been closed and are no longer subject to U.S. federal income tax examinations. Tax years 2010 and 2011 remain open to examination by the federal taxing authority.

First Financial is no longer subject to state and local income tax examinations for years prior to 2009. Tax years 2009 through 2011 remain open to state and local examination in various jurisdictions.

## NOTE 12: EMPLOYEE BENEFIT PLANS

First Financial sponsors a non-contributory defined benefit pension plan covering substantially all employees and uses a December 31 measurement date for its defined benefit pension plan.

First Financial made no cash contributions to fund the pension plan during the six months ended June 30, 2013 and does not expect to make cash contributions to the plan through the remainder of the year. First Financial made no cash contributions to fund the pension plan in 2012.

During the second quarter 2013, First Financial re-measured the Company's pension assets and liabilities, and recognized \$4.3 million of pension settlement charges, as a result of the year-to-date level of lump sum distributions from the Company's pension plan. Consistent with FASB ASC Topic 715, Compensation - Retirement Benefits, pension settlement charges are an acceleration of previously deferred costs that would have been recognized in future periods and are triggered when lump sum

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distributions exceed an annual accounting threshold for the plan. These pension settlement charges were a result of employee-related actions, including staff retirements as well as recent efficiency initiatives, and the resulting lump sum distributions from the plan.

Primarily as a result of the pension plan re-measurement and pension settlement charges during the second quarter, First Financial recorded \$17.4 million of pre-tax adjustments to other comprehensive income related to changes in the values of the Company's pension assets and pension obligations for the six months ended June 30, 2013. As a result of the plan's updated actuarial projections for 2013 as well as the previously mentioned settlement charges, First Financial recorded expenses related to its pension plan of \$4.2 million for the six months ended June 30, 2013, compared to income of \$0.3 million for the same period in 2012. Similarly, First Financial recorded pension plan expenses of \$4.2 million in the second quarter of 2013 compared to pension plan income of \$0.1 million in the second quarter of 2012.

As First Financial has exceeded the annual accounting threshold for lump sum distributions, the Company will recognize a proportionate share of any further lump sum distributions from its pension plan as additional pension settlement charges through the remainder of 2013. The accounting threshold for lump sum distributions will reset at the beginning of 2014.

The following table sets forth information concerning amounts recognized in First Financial's Consolidated Balance Sheets and Consolidated Statements of Income:

|                                    | Three months ended |           | Six months ended |           |
|------------------------------------|--------------------|-----------|------------------|-----------|
|                                    | June 30,           |           | June 30,         |           |
| (Dollars in thousands)             | 2013               | 2012      | 2013             | 2012      |
| Service cost                       | \$898              | \$833     | \$1,873          | \$1,665   |
| Interest cost                      | 567                | 690       | 1,186            | 1,380     |
| Expected return on assets          | (2,230)            | ) (2,235) | ) (4,524)        | ) (4,470) |
| Amortization of prior service cost | (107)              | ) (105)   | ) (212)          | ) (210)   |
| Net actuarial loss                 | 726                | 675       | 1,546            | 1,350     |
| Settlement charge                  | 4,316              | 0         | 4,316            | 0         |
| Net periodic benefit cost (income) | \$4,170            | \$ (142)  | ) \$4,185        | \$ (285)  |

## NOTE 13: FAIR VALUE DISCLOSURES

## Fair Value Measurement

The fair value framework as disclosed in the Fair Value Measurements and Disclosure Topic of FASB ASC Topic 825, Financial Instruments (Fair Value Topic) includes a hierarchy which focuses on prioritizing the inputs used in valuation techniques. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1), a lower priority to observable inputs other than quoted prices in active markets for identical assets and liabilities (Level 2) and the lowest priority to unobservable inputs (Level 3). When determining the fair value measurements for assets and liabilities, First Financial looks to active markets to price identical assets or liabilities whenever possible and classifies such items in Level 1. When identical assets and liabilities are not traded in active markets, First Financial looks to observable market data for similar assets and liabilities and classifies such items as Level 2. Certain assets and liabilities are not actively traded in observable markets and First Financial must use alternative techniques, based on unobservable inputs, to determine the fair value and classifies such items as Level 3. The level within the fair value hierarchy is based on the lowest level of input that is significant in the fair value measurement.

The following methods, assumptions and valuation techniques were used by First Financial to measure different financial assets and liabilities at fair value and in estimating its fair value disclosures for financial instruments.

Cash and short-term investments. The carrying amounts reported in the Consolidated Balance Sheets for cash and short-term investments, such as federal funds sold, approximated the fair value of those instruments. The Company classifies cash and short-term investments in Level 1 of the fair value hierarchy.

Investment securities. Investment securities classified as trading and available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar investment securities. First Financial compiles prices from various sources who may apply such techniques as matrix pricing to determine

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the value of identical or similar investment securities (Level 2). Matrix pricing is a mathematical technique widely used in the banking industry to value investment securities without relying exclusively on quoted prices for the specific investment securities but rather relying on the investment securities' relationship to other benchmark quoted investment securities. Any investment securities not valued based upon the methods above are considered Level 3.

First Financial utilizes information provided by a third-party investment securities administrator in analyzing the investment securities portfolio in accordance with the fair value hierarchy of the Fair Value Topic. The administrator's evaluation of investment security portfolio pricing is performed using a combination of prices and data from other sources, along with internally developed matrix pricing models and assistance from the administrator's internal fixed income analysts and trading desk. The administrator's month-end pricing process includes a series of quality assurance activities where prices are compared to recent market conditions, previous evaluation prices and between the various pricing services. These processes produce a series of quality assurance reports on which price exceptions are identified, reviewed and where appropriate, securities are repriced. In the event of a materially different price, the administrator will report the variance as a "price challenge" and review the pricing methodology in detail. The results of the quality assurance process are incorporated into the selection of pricing providers by the portfolio manager.

First Financial reviews the pricing methodologies utilized by the administrator to ensure the fair value determination is consistent with the applicable accounting guidance and that the investments are properly classified in the fair value hierarchy. Further, the Company periodically validates the fair values for a sample of securities in the portfolio by comparing the fair values provided by the administrator to prices from other independent sources for the same or similar securities. First Financial analyzes unusual or significant variances, conducts additional research with the administrator, if necessary, and takes appropriate action based on its findings.

Loans held for sale. Loans held for sale are carried at the lower of cost or fair value. These loans currently consist of one-to-four family residential real estate loans originated for sale to qualified third parties. Fair value is based on the contractual price to be received from these third parties, which is not materially different than cost due to the short duration between origination and sale (Level 2). As such, First Financial records any fair value adjustments on a nonrecurring basis. Gains and losses on the sale of loans are recorded as net gains from sales of loans within noninterest income in the Consolidated Statements of Income.

Loans - excluding covered loans. The fair value of commercial, commercial real estate, residential real estate and consumer loans were estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities or repricing frequency. The Company classifies the estimated fair value of uncovered loans as Level 3 in the fair value hierarchy.

Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. Impaired loans are valued at the lower of cost or fair value for purposes of determining the appropriate amount of impairment to be allocated to the allowance for loan and lease losses. Fair value is generally measured based on the value of the collateral securing the loans. Collateral may be in the form of real estate or business assets including equipment, inventory and accounts receivable. The vast majority of the collateral is real estate. The value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed third party appraiser (Level 3). The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable borrower financial statements if not considered significant. Likewise, values for inventory and accounts receivable collateral are based on borrower financial statement balances or aging reports on a discounted basis as appropriate (Level 3). Impaired loans allocated to the allowance for loan and lease losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan and lease losses on the Consolidated Statements of Income.

Covered loans. Fair values for covered loans accounted for under FASB ASC Topic 310-30 are based on a discounted cash flow methodology that considers factors including the type of loan and related collateral, classification status, fixed or variable interest rate, term of the loan and whether or not the loan was amortizing and a discount rate reflecting the Company's assessment of risk inherent in the cash flow estimates. These covered loans are grouped together according to similar characteristics and were treated in the aggregate when applying various valuation techniques. First Financial estimated the cash flows expected to be collected on these loans based upon the expected remaining life of the underlying loans, which includes the effects of estimated prepayments. These cash flow evaluations are inherently subjective as they require material estimates, all of which may be susceptible to significant change.

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Fair values for covered loans accounted for outside of FASB ASC Topic 310-30 were estimated by discounting the future cash flows using current interest rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities or repricing frequency. The carrying amount of accrued interest approximates its fair value.

The Company classifies the estimated fair value of covered loans as Level 3 in the fair value hierarchy.

FDIC indemnification asset. The accounting for FDIC indemnification assets is closely related to the accounting for the underlying, indemnified assets. Fair value of the FDIC indemnification asset was estimated using projected cash flows related to the loss sharing agreements based on the expected reimbursements for losses and the applicable loss sharing percentages. First Financial re-estimates the expected indemnification asset cash flows in conjunction with the periodic re-estimation of cash flows on covered loans accounted for under FASB ASC Topic 310-30. Improvements in cash flow expectations on covered loans generally result in a related decline in the expected indemnification cash flows while declines in cash flow expectations on covered loans generally result in an increase in expected indemnification cash flows.

The expected cash flows are discounted to reflect the uncertainty of the timing and receipt of the loss sharing reimbursement from the FDIC. These cash flow evaluations are inherently subjective as they require material estimates, all of which may be susceptible to significant change. The Company classifies the estimated fair value of the indemnification asset as Level 3 in the fair value hierarchy.

Deposit liabilities. The fair value of demand deposits, savings accounts and certain money-market deposits was the amount payable on demand at the reporting date. The carrying amounts for variable-rate certificates of deposit approximated their fair values at the reporting date. The fair value of fixed-rate certificates of deposit was estimated using a discounted cash flow calculation which applies the interest rates currently offered for deposits of similar remaining maturities. The carrying amount of accrued interest approximates its fair value. The Company classifies the estimated fair value of deposit liabilities as Level 2 in the fair value hierarchy.

Borrowings. The carrying amounts of federal funds purchased and securities sold under agreements to repurchase and other short-term borrowings approximate their fair values. The Company classifies the estimated fair value of short-term borrowings as Level 1 of the fair value hierarchy.

The fair value of long-term debt is estimated using a discounted cash flow calculation which utilizes the interest rates currently offered for borrowings of similar remaining maturities. Third-party valuations are used for long-term debt with embedded options, such as call features. The Company classifies the estimated fair value of long-term debt as Level 2 in the fair value hierarchy.

Commitments to extend credit and standby letters of credit. Pricing of these financial instruments is based on the credit quality and relationship, fees, interest rates, probability of funding and compensating balance and other covenants or requirements. Loan commitments generally have fixed expiration dates, are variable rate and contain termination and other clauses which provide for relief from funding in the event that there is a significant deterioration in the credit quality of the client. Many loan commitments are expected to expire without being drawn upon. The rates and terms of the commitments to extend credit and the standby letters of credit are competitive with those in First Financial's market area. The carrying amounts are reasonable estimates of the fair value of these financial instruments. Carrying amounts, which are comprised of the unamortized fee income and, where necessary, reserves for any expected credit losses from these financial instruments, are immaterial.



Derivatives. The fair values of derivative instruments are based primarily on a net present value calculation of the cash flows related to the interest rate swaps at the reporting date, using primarily observable market inputs such as interest rate yield curves. The discounted net present value calculated represents the cost to terminate the swap if First Financial should choose to do so. Additionally, First Financial utilizes a vendor-developed, proprietary model to value the credit risk component of both the derivative assets and liabilities. The credit valuation adjustment is recorded as an adjustment to the fair value of the derivative asset or liability on the reporting date. Derivative instruments are classified as Level 2 in the fair value hierarchy.

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The estimated fair values of First Financial's financial instruments not measured at fair value on a recurring or nonrecurring basis in the consolidated financial statements were as follows:

| (Dollars in thousands)<br>June 30, 2013 | Carrying<br>value | Estimated Fair Value |           |             |           |
|---|-------------------|----------------------|-----------|-------------|-----------|
|   |                   | Total                | Level 1   | Level 2     | Level 3   |
| <b>Financial assets</b>                 |                   |                      |           |             |           |
| Cash and short-term investments         | \$117,416         | \$117,416            | \$117,416 | \$0         | \$0       |
| Investment securities held-to-maturity  | 670,246           | 664,398              | 0         | 664,398     | 0         |
| Other investments                       | 75,645            | 75,645               | 0         | 75,645      | 0         |
| Loans held for sale                     | 18,650            | 18,650               | 0         | 18,650      | 0         |
| Loans - excluding covered loans         | 3,335,081         | 3,341,766            | 0         | 0           | 3,341,766 |
| Covered loans                           | 589,304           | 597,231              | 0         | 0           | 597,231   |
| FDIC indemnification asset              | 88,966            | 79,518               | 0         | 0           | 79,518    |
| <b>Financial liabilities</b>            |                   |                      |           |             |           |
| <b>Deposits</b>                         |                   |                      |           |             |           |
| Noninterest-bearing                     | \$1,059,368       | \$1,059,368          | \$0       | \$1,059,368 | \$0       |
| Interest-bearing demand                 | 1,131,466         | 1,131,466            | 0         | 1,131,466   | 0         |
| Savings                                 | 1,601,122         | 1,601,122            | 0         | 1,601,122   | 0         |
| Time                                    | 978,680           | 976,084              | 0         | 976,084     | 0         |
| Total deposits                          | 4,770,636         | 4,768,040            | 0         | 4,768,040   | 0         |
| Short-term borrowings                   | 619,930           | 619,930              | 619,930   | 0           | 0         |
| Long-term debt                          | 73,957            | 76,491               | 0         | 76,491      | 0         |

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| (Dollars in thousands)                 | Carrying<br>value | Estimated Fair Value |           |             |           |
|--|-------------------|----------------------|-----------|-------------|-----------|
|  |                   | Total                | Level 1   | Level 2     | Level 3   |
| December 31, 2012                      |                   |                      |           |             |           |
| Financial assets                       |                   |                      |           |             |           |
| Cash and short-term investments        | \$158,843         | \$158,843            | \$158,843 | \$0         | \$0       |
| Investment securities held-to-maturity | 770,755           | 778,474              | 0         | 778,474     | 0         |
| Other investments                      | 71,492            | 71,492               | 0         | 71,492      | 0         |
| Loans held for sale                    | 16,256            | 16,256               | 0         | 16,256      | 0         |
| Loans - excluding covered loans        | 3,131,287         | 3,145,120            | 0         | 0           | 3,145,120 |
| Covered loans                          | 702,926           | 713,797              | 0         | 0           | 713,797   |
| FDIC indemnification asset             | 119,607           | 106,380              | 0         | 0           | 106,380   |
| Financial liabilities                  |                   |                      |           |             |           |
| Deposits                               |                   |                      |           |             |           |
| Noninterest-bearing                    | \$1,102,774       | \$1,102,774          | \$0       | \$1,102,774 | \$0       |
| Interest-bearing demand                | 1,160,815         | 1,160,815            | 0         | 1,160,815   | 0         |
| Savings                                | 1,623,614         | 1,623,614            | 0         | 1,623,614   | 0         |
| Time                                   | 1,068,637         | 1,072,201            | 0         | 1,072,201   | 0         |
| Total deposits                         | 4,955,840         | 4,959,404            | 0         | 4,959,404   | 0         |
| Short-term borrowings                  | 624,570           | 624,570              | 624,570   | 0           | 0         |
| Long-term debt                         | 75,202            | 78,941               | 0         | 78,941      | 0         |

The financial assets and liabilities measured at fair value on a recurring basis in the consolidated financial statements were as follows:

| (Dollars in thousands)                   | Fair Value Measurements Using |           |         | Netting<br>Adjustments <sup>(1)</sup> | Assets/Liabilities<br>at Fair Value |
|--|-------------------------------|-----------|---------|---------------------------------------|-------------------------------------|
|  | Level 1                       | Level 2   | Level 3 |                                       |                                     |
| June 30, 2013                            |                               |           |         |                                       |                                     |
| Assets                                   |                               |           |         |                                       |                                     |
| Derivatives                              | \$0                           | \$15,497  | \$0     | \$(15,497)                            | ) \$ 0                              |
| Available-for-sale investment securities | 189                           | 884,505   | 0       | 0                                     | ) 884,694                           |
| Total                                    | \$189                         | \$900,002 | \$0     | \$(15,497)                            | ) \$ 884,694                        |
| Liabilities                              |                               |           |         |                                       |                                     |
| Derivatives                              | \$0                           | \$16,669  | \$0     | \$(15,497)                            | ) \$ 1,172                          |

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| (Dollars in thousands)                   | Fair Value Measurements Using |             |         | Netting<br>Adjustments <sup>(1)</sup> | Assets/Liabilities<br>at Fair Value |
|--|-------------------------------|-------------|---------|---------------------------------------|-------------------------------------|
|  | Level 1                       | Level 2     | Level 3 |                                       |                                     |
| December 31, 2012                        |                               |             |         |                                       |                                     |
| Assets                                   |                               |             |         |                                       |                                     |
| Derivatives                              | \$0                           | \$24,135    | \$0     | \$(24,135)                            | ) \$ 0                              |
| Available-for-sale investment securities | 144                           | 1,031,952   | 0       | 0                                     | ) 1,032,096                         |
| Total                                    | \$144                         | \$1,056,087 | \$0     | \$(24,135)                            | ) \$ 1,032,096                      |
| Liabilities                              |                               |             |         |                                       |                                     |
| Derivatives                              | \$0                           | \$26,652    | \$0     | \$(24,135)                            | ) \$ 2,517                          |

(1) Amounts represent the impact of legally enforceable master netting arrangements that allow First Financial to settle positive and negative positions and also cash collateral held with the same counterparties.

Certain financial assets and liabilities are measured at fair value on a nonrecurring basis. Adjustments to the fair market value of these assets usually result from the application of lower of cost or fair value accounting or write-downs of individual assets. The following table summarizes financial assets and liabilities measured at fair value on a nonrecurring basis.

| (Dollars in thousands)        | Fair Value Measurements Using |         |          |
|-------------------------------|-------------------------------|---------|----------|
|                               | Level 1                       | Level 2 | Level 3  |
| June 30, 2013                 |                               |         |          |
| Assets                        |                               |         |          |
| Impaired loans <sup>(1)</sup> | \$0                           | \$0     | \$14,600 |
| OREO                          | 0                             | 0       | 6,396    |
| Covered OREO                  | 0                             | 0       | 8,706    |

| (Dollars in thousands)        | Fair Value Measurements Using |         |          |
|-------------------------------|-------------------------------|---------|----------|
|                               | Level 1                       | Level 2 | Level 3  |
| December 31, 2012             |                               |         |          |
| Assets                        |                               |         |          |
| Impaired loans <sup>(1)</sup> | \$0                           | \$0     | \$19,564 |
| OREO                          | 0                             | 0       | 5,651    |
| Covered OREO                  | 0                             | 0       | 14,059   |

(1) Amounts represent the fair value of collateral for impaired loans allocated to the allowance for loan and lease losses. Fair values are determined using actual market prices (Level 1), independent third party valuations and borrower records, discounted as appropriate (Level 3).

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## NOTE 14: ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Shareholders' equity is affected by transactions and valuations of asset and liability positions that require adjustments to accumulated other comprehensive income (loss). The related tax effects allocated to other comprehensive income and reclassifications out of accumulated other comprehensive income (loss) are as follows:

June 30, 2013

| (Dollars in thousands)                          | Total other comprehensive income |                       |            |            | Total accumulated other comprehensive income |                   |              |                |
|---|----------------------------------|-----------------------|------------|------------|--|-------------------|--------------|----------------|
|   | Prior to Reclassification        | Reclassification from | Pre-tax    | Tax-effect | Net of tax                                   | Beginning Balance | Net Activity | Ending Balance |
| Unrealized gain (loss) on investment securities | \$(28,256 )                      | \$ 1,724              | \$(29,980) | \$ 11,413  | \$(18,567)                                   | \$ 12,802         | \$(18,567)   | \$(5,765 )     |
| Unrealized gain (loss) on derivatives           | 1,177                            | (134 )                | 1,311      | (495 )     | 816  | (143 )            | 816          | 673            |
| Retirement obligation                           | 11,719                           | (5,650 )              | 17,369     | (6,559 )   | 10,810                                       | (31,338 )         | 10,810       | (20,528 )      |
| Foreign currency translation                    | (27 )                            | 0                     | (27 )      | 0          | (27 )  | 2                 | (27 )        | (25 )          |
| Total   | \$(15,387 )                      | \$(4,060 )            | \$(11,327) | \$ 4,359   | \$(6,968 )                                   | \$(18,677)        | \$(6,968 )   | \$(25,645)     |

June 30, 2012

| (Dollars in thousands)                          | Total other comprehensive income |            |            | Total accumulated other comprehensive income |              |                |
|---|----------------------------------|------------|------------|--|--------------|----------------|
|   | Pre-tax                          | Tax-effect | Net of tax | Beginning Balance                            | Net Activity | Ending Balance |
| Unrealized gain (loss) on investment securities | \$ 4,171                         | \$(1,575 ) | \$ 2,596   | \$ 12,669                                    | \$ 2,596     | \$ 15,265      |
| Retirement obligation                           | 1,140                            | (430 )     | 710        | (34,136 )                                    | 710          | (33,426 )      |
| Foreign currency translation                    | 12                               | 0          | 12         | (23 )  | 12           | (11 )          |
| Total   | \$ 5,323                         | \$(2,005 ) | \$ 3,318   | \$(21,490 )                                  | \$ 3,318     | \$(18,172 )    |

The following table details the activity reclassified from accumulated other comprehensive income into income during the period:

| (Dollars in thousands)                                     | June 30, 2013 |   | Affected Line Item in the Consolidated Statements of Income |
|--|---------------|---|---|
|  | Amount        | Reclassified from Accumulated Other Comprehensive Income <sup>(1)</sup> |   |
| Gains and loss on cash flow hedges                         |               |   |   |
| Interest rate contracts                                    | \$(134 )      |   | Interest expense - deposits                                 |
| Realized gains and losses on securities available-for-sale | 1,724         |   | Gains on sales of investments securities                    |
| Defined benefit pension plan                               |               |   |   |
| Amortization of prior service cost                         | 212           |   | (2)   |
| Recognized net actuarial loss                              | (1,546 )      |   | (2)   |
| Pension settlement charges                                 | (4,316 )      |   | Pension settlement charges                                  |
|  | (5,650 )      |   |   |

Amortization and settlement charges of defined  
benefit pension items

Total reclassifications for the period, before tax        \$(4,060        )

(1) Negative amount are debits to profit/loss.

(2) Included in the computation of net periodic pension cost (see employee benefit footnote for additional details).

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## NOTE 15: EARNINGS PER COMMON SHARE

The following table sets forth the computation of basic and diluted earnings per share:

| (Dollars in thousands, except per share data)                        | Three months ended |            | Six months ended |            |
|--|--------------------|------------|------------------|------------|
|  | June 30,<br>2013   | 2012       | June 30,<br>2013 | 2012       |
| Numerator  |                    |            |                  |            |
| Net income available to common shareholders                          | \$ 15,829          | \$ 17,802  | \$ 29,653        | \$ 34,796  |
| Denominator  |                    |            |                  |            |
| Basic earnings per common share - weighted average shares            | 57,291,994         | 57,933,281 | 57,365,105       | 57,864,269 |
| Effect of dilutive securities —                                      |                    |            |                  |            |
| Employee stock awards  | 735,440            | 915,301    | 739,927          | 936,550    |
| Warrants   | 100,915            | 109,697    | 101,471          | 120,870    |
| Diluted earnings per common share - adjusted weighted average shares | 58,128,349         | 58,958,279 | 58,206,503       | 58,921,689 |
| Earnings per share available to common shareholders                  |                    |            |                  |            |
| Basic  | \$0.28             | \$0.31     | \$0.52           | \$0.60     |
| Diluted  | \$0.27             | \$0.30     | \$0.51           | \$0.59     |

Warrants to purchase 465,117 shares of the Company's common stock were outstanding as of June 30, 2013 and 2012. These warrants, each representing the right to purchase one share of common stock, no par value per share, have an exercise price of \$12.20 and expire on December 23, 2018.

Stock options and warrants, where the exercise price was greater than the average market price of the common shares were not included in the computation of net income per diluted share as they would have been antidilutive. These out-of-the-money options were 654,616 and 737,228 at June 30, 2013 and 2012, respectively.

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ITEM 2-MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS (MD&A)  
FIRST FINANCIAL BANCORP. AND SUBSIDIARIES  
(Unaudited)

Reclassifications of prior period amounts, if applicable, have been made to conform to the current period's presentation and had no effect on previously reported net income amounts or financial condition.

SUMMARY

First Financial Bancorp. (First Financial or the Company) is a \$6.3 billion bank holding company headquartered in Cincinnati, Ohio. As of June 30, 2013 First Financial, through its subsidiaries, operated primarily in Ohio, Indiana and Kentucky. These subsidiaries include a commercial bank, First Financial Bank, N.A. (First Financial Bank or the Bank) with 110 banking centers and 139 ATMs. First Financial conducts three primary activities through its bank subsidiary: commercial banking, retail banking and wealth management. First Financial Bank provides credit-based products, deposit accounts, corporate cash management support and other services to commercial and retail clients. Additionally, the Bank provides franchise lending products, primarily equipment and leasehold improvement financing, for select franchisees and concepts in the quick service and casual dining restaurant sector throughout the United States. First Financial Wealth Management provides wealth planning, portfolio management, trust and estate, brokerage and retirement plan services.

First Financial acquired the banking operations of Peoples Community Bank (Peoples), and Irwin Union Bank and Trust Company and Irwin Union Bank, F.S.B. (collectively, Irwin), through Federal Deposit Insurance Corporation (FDIC)-assisted transactions in 2009. The acquisitions of the Peoples and Irwin franchises significantly expanded the First Financial footprint, opened new markets and strengthened the Company through the generation of additional capital.

In connection with the Peoples and Irwin FDIC-assisted transactions, First Financial entered into loss sharing agreements with the FDIC. Under the terms of these agreements the FDIC reimburses First Financial for a percentage of losses with respect to certain loans (covered loans) and other real estate owned (covered OREO) (collectively, covered assets). These agreements provide for loss protection on single-family, residential loans for a period of ten years and First Financial is required to share any recoveries of previously charged-off amounts for the same time period, on the same pro-rata basis with the FDIC. All other loans are provided loss protection for a period of five years and recoveries of previously charged-off amounts must be shared with the FDIC for an additional three year period, again on the same pro-rata basis. The FDIC's obligation to reimburse First Financial for losses with respect to covered assets for all three assisted transactions began with the first dollar of loss incurred.

Covered assets represent approximately 10% of First Financial's total assets at June 30, 2013.

MARKET STRATEGY

First Financial serves a combination of metropolitan and non-metropolitan markets in Ohio, Indiana and Kentucky through its full-service banking centers, while providing franchise lending services to borrowers throughout the United States. First Financial's market selection process includes a number of factors, but markets are primarily chosen for their potential for growth and long-term profitability. First Financial's goal is to develop a competitive advantage utilizing a local market focus, building long-term relationships with clients to help them reach greater levels of success in their financial life and providing a superior level of service. First Financial intends to continue to concentrate future growth plans and capital investments in its metropolitan markets. Smaller markets have historically provided stable, low-cost funding sources to First Financial and remain an important part of its funding base.



## OVERVIEW OF OPERATIONS

Second quarter 2013 net income was \$15.8 million and earnings per diluted common share were \$0.27. This compares with second quarter 2012 net income of \$17.8 million and earnings per diluted common share of \$0.30.

For the six months ended June 30, 2013, net income was \$29.7 million, and earnings per diluted common share were \$0.51. This compares with net income of \$34.8 million and earnings per diluted common share of \$0.59 for the first six months of 2012.

Return on average assets for the second quarter of 2013 was 1.01% compared to 1.13% for the comparable period in 2012. Return on average shareholders' equity for the second quarter of 2013 was 9.02% compared to 9.98% for the comparable period in 2012.

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Return on average assets for the six months ended June 30, 2013 was 0.94% compared to 1.09% for the same period in 2012. Return on average shareholders' equity was 8.47% and 9.83% for the same periods in 2013 and 2012, respectively.

A discussion of First Financial's results of operations for the three and six months ended June 30, 2013 follows.

## NET INTEREST INCOME

Net interest income, First Financial's principal source of income, is the excess of interest received from earning assets over interest paid on interest-bearing liabilities. For analytical purposes, net interest income is also presented in the table that follows, adjusted to a tax equivalent basis assuming a 35% marginal tax rate for interest earned on tax-exempt assets such as municipal loans and investments. This is to recognize the income tax savings that facilitates a comparison between taxable and tax-exempt assets. Management believes that it is a standard practice in the banking industry to present net interest margin and net interest income on a fully tax equivalent basis. Therefore, management believes these measures provide useful information to make peer comparisons.

| (Dollars in thousands)                                    | Three months ended |             | Six months ended |             |   |
|---|--------------------|-------------|------------------|-------------|---|
|   | June 30,           | 2012        | June 30,         | 2012        |   |
| Net interest income                                       | \$58,078           | \$64,830    | \$116,744        | \$131,519   |   |
| Tax equivalent adjustment                                 | 514                | 216         | 991              | 434         |   |
| Net interest income - tax equivalent                      | \$58,592           | \$65,046    | \$117,735        | \$131,953   |   |
| Average earning assets                                    | \$5,791,715        | \$5,813,267 | \$5,839,497      | \$5,881,709 |   |
| Net interest margin <sup>(1)</sup>                        | 4.02               | % 4.49      | % 4.03           | % 4.50      | % |
| Net interest margin (fully tax equivalent) <sup>(1)</sup> | 4.06               | % 4.50      | % 4.07           | % 4.51      | % |

<sup>(1)</sup> Margins are calculated using annualized net interest income divided by average earning assets.

Net interest income for the second quarter 2013 was \$58.1 million, declining \$6.8 million or 10.4% from second quarter 2012 net interest income of \$64.8 million. Net interest income on a fully tax-equivalent basis for the second quarter 2013 was \$58.6 million as compared to \$65.0 million for the second quarter 2012. Net interest margin was 4.02% for the second quarter 2013 as compared to 4.49% for the second quarter 2012. The declines in net interest income and net interest margin were primarily related to changes in the composition of the Company's earning assets as well as the current low interest rate environment for loans and investment securities.

The decline in net interest income in the second quarter 2013 as compared to the second quarter 2012 was the result of a \$9.6 million or 13.4% decline in total interest income, partially offset by a \$2.9 million or 40.2% decline in total interest expense. The decline in total interest income resulted from a decline in interest income and fees earned on loans, primarily as a result of continued amortization and paydowns in the Company's high-yielding covered loan portfolio, as well as lower interest income earned on the investment portfolio due to the current low rate environment.

Contributing to the lower interest income earned on loans, and a related decline in net interest margin, was a \$296.3 million or 31.2% decline in the average balance of covered loans as compared to the second quarter 2012. Declines in covered loan balances are a result of payments received, including full payoffs, charge-offs and other loan resolution activities. The decline in covered loan balances was partially offset by growth in lower yielding assets as average uncovered loan balances increased \$318.3 million or 10.7% from the second quarter of 2012.

While average uncovered loan balances increased from the second quarter 2012 as a result of strong new loan origination activity in recent periods, payoff activity has also been elevated. As a result of the low interest rate environment and heightened competition, recent loan originations have been recorded at yields significantly lower than the yields on loans that paid off during the same period, muting the impact of increased balances on interest income earned and net interest margin.

The decline in total interest income was also due to lower interest income earned on investment securities. While the average balance of investment securities decreased modestly in the second quarter 2013 as compared to the second quarter 2012, the average yield on investment securities declined 38 basis points, to 2.08% in the second quarter 2013 from 2.46% in the second

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quarter 2012. The lower yields on investment securities are primarily related to elevated prepayment activity on higher yielding mortgage-backed securities (MBS) and lower reinvestment rates in recent periods.

Interest expense and net interest margin continued to benefit from the impact of the Company's deposit pricing and rationalization strategies as the average balance of interest-bearing deposits declined \$417.2 million or 9.9% and the cost of funds related to these deposits decreased 26 basis points to 35 basis points for the second quarter 2013 compared to 61 basis points for the comparable quarter in 2012. However, interest expense and net interest margin were also impacted by a \$410.2 million increase in the average balance of short-term borrowings for the second quarter 2013 as compared with the comparable quarter in 2012. Short-term borrowings, which are utilized to manage the Company's normal liquidity needs, increased as a result of loan demand as well as deposit rationalization, banking center consolidation and investment portfolio strategies during 2012 and 2013.

For the six month period ended June 30, 2013, net interest income was \$116.7 million, a decline of \$14.8 million, from \$131.5 million for the comparable period in 2012. Net interest income on a fully tax-equivalent basis for the period ended June 30, 2013, was \$117.7 million as compared to \$132.0 million for the comparable period in 2012. Similar to the quarterly year-over-year items discussed above, these declines were primarily related to lower covered loan balances, a reduced yield on the FDIC indemnification asset and declining yields on recent loan originations.

Net interest margin for the six month period ended June 30, 2013 declined 47 bps to 4.03% from 4.50% for the comparable period in 2012.

The Consolidated Average Balance Sheets and Net Interest Income Analysis that follows are presented on a GAAP basis.

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## CONSOLIDATED AVERAGE BALANCE SHEETS AND NET INTEREST INCOME ANALYSIS

| (Dollars in thousands)                     | Quarterly Averages |       |                |       | Year-to Date Averages |       |               |       |               |       |
|--|--------------------|-------|----------------|-------|-----------------------|-------|---------------|-------|---------------|-------|
|  | June 30, 2013      |       | March 31, 2013 |       | June 30, 2012         |       | June 30, 2013 |       | June 30, 2012 |       |
|  | Balance            | Yield | Balance        | Yield | Balance               | Yield | Balance       | Yield | Balance       | Yield |
| Earning assets                             |                    |       |                |       |                       |       |               |       |               |       |
| Investments:                               |                    |       |                |       |                       |       |               |       |               |       |
| Investment securities                      | \$1,705,219        | 2.08% | \$1,838,783    | 1.98% | \$1,713,503           | 2.46% | \$1,771,632   | 2.03% | \$1,689,073   | 2.53% |
| Interest-bearing deposits with other banks | 13,890             | 0.32% | 3,056          | 0.53% | 4,454                 | 0.18% | 8,503         | 0.36% | 65,392        | 0.28% |
| Gross loans <sup>(1)</sup>                 | 4,072,606          | 5.26% | 4,045,971      | 5.47% | 4,095,310             | 6.02% | 4,059,362     | 5.37% | 4,127,244     | 6.15% |
| Total earning assets                       | 5,791,715          | 4.32% | 5,887,810      | 4.37% | 5,813,267             | 4.96% | 5,839,497     | 4.35% | 5,881,709     | 5.04% |
| Nonearning assets                          |                    |       |                |       |                       |       |               |       |               |       |
| Allowance for loan and lease losses        | (92,033 )          |       | (95,512 )      |       | (98,317 )             |       | (93,763 )     |       | (99,491 )     |       |
| Cash and due from banks                    | 119,909            |       | 111,599        |       | 121,114               |       | 115,777       |       | 122,374       |       |
| Accrued interest and other assets          | 491,011            |       | 487,152        |       | 498,909               |       | 489,093       |       | 502,360       |       |
| Total assets                               | \$6,310,602        |       | \$6,391,049    |       | \$6,334,973           |       | \$6,350,604   |       | \$6,406,952   |       |
| Interest-bearing liabilities               |                    |       |                |       |                       |       |               |       |               |       |
| Deposits:                                  |                    |       |                |       |                       |       |               |       |               |       |
| Interest-bearing demand                    | \$1,141,767        | 0.09% | \$1,112,664    | 0.12% | \$1,192,868           | 0.11% | \$1,127,296   | 0.10% | \$1,239,032   | 0.12% |
| Savings                                    | 1,639,834          | 0.10% | 1,618,239      | 0.10% | 1,610,411             | 0.12% | 1,629,096     | 0.10% | 1,646,459     | 0.13% |
| Time                                       | 1,011,290          | 1.04% | 1,054,499      | 1.20% | 1,406,800             | 1.60% | 1,032,775     | 1.12% | 1,492,124     | 1.66% |
| Total interest-bearing deposits            | 3,792,891          | 0.35% | 3,785,402      | 0.41% | 4,210,079             | 0.61% | 3,789,167     | 0.38% | 4,377,615     | 0.65% |
| Borrowed fund:                             |                    |       |                |       |                       |       |               |       |               |       |
| Short-term borrowings                      | 569,929            | 0.21% | 660,587        | 0.20% | 159,681               | 0.09% | 615,008       | 0.21% | 122,786       | 0.08% |
| Long-term debt                             | 74,129             | 3.54% | 74,740         | 3.55% | 75,314                | 3.59% | 74,433        | 3.54% | 75,667        | 3.61% |
| Total borrowed funds                       | 644,058            | 0.60% | 735,327        | 0.54% | 234,995               | 1.22% | 689,441       | 0.57% | 198,453       | 1.43% |
| Total interest-bearing liabilities         | 4,436,949          | 0.38% | 4,520,729      | 0.43% | 4,445,074             | 0.64% | 4,478,608     | 0.41% | 4,576,068     | 0.68% |
| Noninterest-bearing liabilities            |                    |       |                |       |                       |       |               |       |               |       |
| Noninterest-bearing demand deposits        | 1,063,102          |       | 1,049,943      |       | 1,044,405             |       | 1,056,559     |       | 987,876       |       |
| Other liabilities                          | 106,747            |       | 111,515        |       | 128,383               |       | 109,118       |       | 131,179       |       |
| Shareholders' equity                       | 703,804            |       | 708,862        |       | 717,111               |       | 706,319       |       | 711,829       |       |
|  | \$6,310,602        |       | \$6,391,049    |       | \$6,334,973           |       | \$6,350,604   |       | \$6,406,952   |       |

Total liabilities and  
shareholders' equity

|  |          |          |          |           |           |       |
|--|----------|----------|----------|-----------|-----------|-------|
| Net interest income  | \$58,078 | \$58,666 | \$64,830 | \$116,744 | \$131,519 |       |
| Net interest spread  | 3.94%    | 3.94%    | 4.32%    | 3.94%     | 4.36%     | 4.36% |
| Contribution of<br>noninterest-bearing<br>sources of funds | 0.08%    | 0.10%    | 0.17%    | 0.09%     | 0.14%     | 0.14% |
| Net interest margin <sup>(2)</sup>                         | 4.02%    | 4.04%    | 4.49%    | 4.03%     | 4.50%     | 4.50% |

(1) Loans held for sale, nonaccrual loans, covered loans, and indemnification asset are included in gross loans.

(2) Because noninterest-bearing funding sources, demand deposits, other liabilities and shareholders' equity also support earning assets, the net interest margin exceeds the interest spread.

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## RATE/VOLUME ANALYSIS

The impact of changes in the volume of interest-earning assets and interest-bearing liabilities and interest rates on net interest income is illustrated in the table below:

| (Dollars in thousands)                | Changes for the Three Months Ended June 30, 2013 |         |         |                                 |         |           |
|---------------------------------------|--|---------|---------|---------------------------------|---------|-----------|
|                                       | Linked Qtr. Income Variance                      |         |         | Comparable Qtr. Income Variance |         |           |
|                                       | Rate   | Volume  | Total   | Rate                            | Volume  | Total     |
| Earning assets                        |  |         |         |                                 |         |           |
| Investment securities                 | \$488  | \$(589) | \$(101) | \$(1,602)                       | \$(43)  | \$(1,645) |
| Other earning assets                  | (2)  | 9       | 7       | 2                               | 7       | 9         |
| Gross loans <sup>(1)</sup>            | (2,027)  | 933     | (1,094) | (7,668)                         | (298)   | (7,966)   |
| Total earning assets                  | (1,541)  | 353     | (1,188) | (9,268)                         | (334)   | (9,602)   |
| Interest-bearing liabilities          |  |         |         |                                 |         |           |
| Total interest-bearing deposits       | \$(619)  | \$43    | \$(576) | \$(2,736)                       | \$(361) | \$(3,097) |
| Borrowed funds                        |  |         |         |                                 |         |           |
| Short-term borrowings                 | 21   | (45)    | (24)    | 48                              | 220     | 268       |
| Federal Home Loan Bank long-term debt | (2)  | 2       | 0       | (11)                            | (10)    | (21)      |
| Total borrowed funds                  | 19   | (43)    | (24)    | 37                              | 210     | 247       |
| Total interest-bearing liabilities    | (600)  | 0       | (600)   | (2,699)                         | (151)   | (2,850)   |
| Net interest income                   | \$(941)  | \$353   | \$(588) | \$(6,569)                       | \$(183) | \$(6,752) |

(1) Loans held for sale, nonaccrual loans, covered loans and indemnification asset are included in gross loans.

| (Dollars in thousands)                | Changes for the Six Months Ended June 30, 2013 |           |            |
|---------------------------------------|--|-----------|------------|
|                                       | Year-to-Date Income Variance                   |           |            |
|                                       | Rate   | Volume    | Total      |
| Earning assets                        |  |           |            |
| Investment securities                 | \$(4,170)                                      | \$830     | \$(3,340)  |
| Other earning assets                  | 24   | (100)     | (76)       |
| Gross loans <sup>(1)</sup>            | (15,968)                                       | (1,806)   | (17,774)   |
| Total earning assets                  | (20,114)                                       | (1,076)   | (21,190)   |
| Interest-bearing liabilities          |  |           |            |
| Total interest-bearing deposits       | \$(5,844)                                      | \$(1,109) | \$(6,953)  |
| Borrowed funds                        |  |           |            |
| Short-term borrowings                 | 78   | 507       | 585        |
| Federal Home Loan Bank long-term debt | (25)   | (22)      | (47)       |
| Total borrowed funds                  | 53   | 485       | 538        |
| Total interest-bearing liabilities    | (5,791)  | (624)     | (6,415)    |
| Net interest income                   | \$(14,323)                                     | \$(452)   | \$(14,775) |

(1) Loans held for sale, nonaccrual loans, covered loans and indemnification asset are included in gross loans.

## NONINTEREST INCOME

Second quarter 2013 noninterest income was \$11.6 million, a \$21.9 million or 65.4% decrease from noninterest income of \$33.5 million in the second quarter 2012. The decline in noninterest income from the comparable quarter in 2012 was due primarily to a \$15.7 million decline in FDIC loss sharing income, a \$1.8 million decline in accelerated discount on covered loans and a \$5.1 million decline in other noninterest income. These declines were

partially offset by a \$0.6 million increase in bankcard income in the second quarter 2013 from the comparable quarter in 2012.

When losses are incurred on covered loans, the Company recognizes those credit losses as provision expense, while losses incurred on covered OREO are recognized as noninterest expense. Reimbursements due from the FDIC under loss sharing agreements related to these credit losses are referred to as FDIC loss sharing income and are recorded as noninterest income.



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The impact on earnings of this offsetting activity is the net effect of the credit losses and FDIC reimbursement, representing the Company's proportionate share of the credit losses realized on covered assets.

Lower FDIC loss sharing income during the second quarter 2013 was primarily the result of a decline in the Company's allowance for loan and lease losses on covered loans during the period reflecting lower estimated impairment on covered loans and lower loss reimbursements expected to be received from the FDIC as a result.

Accelerated discount is recognized when covered loans, which are recorded on the Company's balance sheet at an amount less than the unpaid principal balance, prepay at an amount greater than their recorded book value. Prepayments can occur either through customer driven payments before the maturity date or loan sales. The amount of discount attributable to the credit loss component of each loan varies and the recognized amount is offset by a related reduction in the FDIC indemnification asset. Lower income from the accelerated discount on covered loans during the second quarter 2013 was related to declines in both the volume and size of covered loans prepaying during the period as well as declines in the size of the remaining discounts on these loans at the time of prepayment.

The decrease in other noninterest income was primarily related to a \$5.0 million litigation settlement received by the Bank in the second quarter 2012.

Noninterest income for the six months ended June 30, 2013 was \$38.3 million, a \$27.2 million or 41.5% decrease from noninterest income of \$65.5 million for the six months ended June 30, 2012. The decline in noninterest income from the comparable period in 2012 was due primarily to a \$19.5 million decline in FDIC loss sharing income, a \$3.5 million decline in accelerated discount on covered loans and a \$5.9 million decline in other noninterest income primarily related to the previously mentioned \$5.0 million litigation settlement received in the second quarter of 2012. These declines were partially offset by \$1.7 million of gains on sales of investment securities during 2013.

## NONINTEREST EXPENSE

Second quarter 2013 noninterest expense was \$53.3 million compared with \$57.5 million in the second quarter of 2012. The \$4.2 million or 7.3% decrease from the comparable quarter in 2012 was primarily attributable to a \$2.8 million decline in salaries and benefits expense, a \$3.5 million decline in losses recorded on both covered and uncovered OREO, a \$0.4 million decline in professional services expense, a \$1.5 million decline in loss sharing expenses and a \$0.7 million decline in other noninterest expense. These declines were partially offset by increases of \$0.4 million in net occupancy expenses, \$0.5 million in data processing expenses and \$4.3 million of pension settlement charges.

The decline in salaries and benefits expenses was primarily attributable to staffing reductions and branch consolidations throughout 2012 and into 2013. The Company recognized net gains on covered OREO of \$2.2 million during the quarter, which were partially offset by losses on uncovered OREO of \$0.2 million during the quarter. Gains or losses on OREO are generally the result of declines in the estimated fair value of, and gains or losses on final disposition of, OREO properties during the period. Loss sharing expense represents costs incurred to resolve problem covered assets, including legal fees, appraisal costs and delinquent taxes. The decrease in loss sharing expense relates to a decline in collection costs incurred on covered assets. Losses on covered OREO and loss sharing expenses are partially reimbursed by the FDIC.

First Financial views the combination of provision expense on covered loans, gains or losses on covered OREO and loss sharing expense, net of the related reimbursements due under loss sharing agreements recorded as FDIC loss sharing income, as the total net credit costs associated with covered assets during the period. For additional discussion of the credit costs associated with covered assets, see "Allowance for loan and lease losses - covered loans."

The decline in other noninterest expenses was primarily due to \$0.5 million of accelerated amortization expense recognized in the second quarter 2012 related to intangible assets associated with the disposal of certain acquired branches.

Higher net occupancy expenses during the second quarter of 2013 were primarily attributable to \$0.3 million of additional costs associated with facilities that the Company began utilizing during 2012. The increase in data processing expense was due to software and system implementations, including new internet and mobile banking platforms introduced in late 2012.

During the second quarter 2013, First Financial recognized \$4.3 million of pension settlement charges as a result of the year to date level of lump sum distributions from the Company's pension plan. Consistent with FASB ASC Topic 715, Compensation - Retirement Benefits, pension settlement charges are an acceleration of previously deferred costs that would have been recognized in future periods and are triggered when lump sum distributions exceed an annual accounting threshold for the plan. First Financial incurred these pension settlement charges as a result of employee-related actions, including staff retirements as

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well as recent efficiency initiatives, and the resulting lump sum distributions from the plan. As First Financial has exceeded the annual accounting threshold for lump sum distributions, the Company will recognize a proportionate share of any further lump sum distributions from its pension plan as additional pension settlement charges through the remainder of 2013. The accounting threshold for lump sum distributions will reset at the beginning of 2014.

During the third quarter 2012, First Financial completed a comprehensive efficiency study across all business lines and support functions. As a result, the Company identified approximately \$17.1 million of annualized cost savings impacting several expense categories. In the second quarter 2013, the Company incurred certain pre-tax expenses resulting from its efficiency initiative and other staffing-related changes of \$1.5 million. Approximately \$0.5 million was related to employee benefit expenses associated with staffing reductions and \$1.0 million was related to real estate expenses associated with previously announced banking center consolidation and closure plans. Realization of the identified cost savings began during the fourth quarter 2012, and the Company recognized annualized net savings of approximately \$15.0 million through the end of the second quarter 2013 as one-time costs associated with implementing the efficiency plan offset estimated expense reductions. Ultimately, the achievement of these cost savings will be contingent upon management's ability to successfully implement the efficiency plan while managing external factors, such as regulatory changes and a dynamic business environment, without impacting service levels throughout the Company and to our customers.

Noninterest expense for the six months ended June 30, 2013 was \$106.4 million compared with \$113.2 million in the six months ended June 30, 2012. The \$6.8 million or 6.0% decrease from the comparable period in 2012 was primarily attributable to a \$4.4 million decline in salaries and benefits expense as a result of staffing reductions and branch consolidations throughout 2012 and into 2013, a \$5.5 million decline in losses recorded on both covered and uncovered OREO as the Company recorded gains of \$2.4 million on covered OREO in 2013, a \$0.7 million decline in professional services expense, a \$1.0 million decline in loss sharing expenses and a \$1.2 million decline in other noninterest expense. These declines were partially offset by increases of \$1.1 million in net occupancy expenses associated with facilities that the Company began utilizing during 2012, \$1.1 million in data processing expenses related to software and system implementations, including new internet and mobile banking platforms introduced in late 2012 and \$4.3 million of pension settlement charges.

## INCOME TAXES

Income tax expense was \$6.5 million and \$8.7 million for the second quarters of 2013 and 2012, respectively. The effective tax rates for the second quarters of 2013 and 2012 were 29.0% and 32.8%, respectively. Income tax expense for the six months ended June 30, 2013 and 2012 was \$12.8 million and \$18.3 million, respectively. The year-to-date effective tax rate through June 30, 2013 was 30.2% compared to 34.5% for the comparable period in 2012.

The declines in the effective tax rates for the second quarter 2013 and the six months ended June 30, 2013, as compared to the same periods in 2012, were primarily the result of higher income earned on tax-exempt investment securities, favorable tax reversals related to an intercompany tax obligation associated with an unconsolidated former Irwin subsidiary and an adjustment to deferred tax liabilities relating to a favorable change in state tax laws. The Company anticipates this will be the last meaningful adjustment related to the resolution of the former Irwin subsidiary and that a normalized effective tax rate in future periods is estimated to be 34.5%.

## LOANS - EXCLUDING COVERED LOANS

Loans, excluding covered loans and loans held for sale, totaled \$3.4 billion as of June 30, 2013, increasing \$203.1 million, or 12.9% on an annualized basis, compared to December 31, 2012. The increase in loan balances from December 31, 2012 was primarily related to a \$79.4 million increase in commercial loans and a \$60.2 million increase in commercial real estate loans, with contributions also coming from residential mortgage, construction lending and

lease financing, which increased \$24.8 million, \$23.7 million and \$19.2 million, respectively.

Second quarter 2013 average loans, excluding covered loans and loans held for sale, increased \$318.3 million or 10.7% from the second quarter of 2012. The increase in average loans, excluding covered loans and loans held for sale, was primarily the result of a \$165.8 million increase in commercial real estate loans, a \$76.3 million increase in commercial loans, a \$44.3 million increase in residential real estate loans and a \$39.0 million increase in lease financing, partially offset by decreases of \$10.5 million and \$5.3 million in installment and real estate construction loans, respectively.

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### LOANS - COVERED

Covered loans continued to decline during the quarter, totaling \$622.3 million at June 30, 2013, a \$125.9 million or 16.8% decline compared to December 31, 2012. Declines in covered loan balances were expected as there were no acquisitions of loans subject to loss sharing agreements during the period. The covered loan portfolio will continue to decline through payoffs, loan sales, charge-offs and termination or expiration of loss share coverage unless First Financial acquires additional loans subject to loss sharing agreements in the future. Loans with coverage terminated, or removed, generally represent loans to primarily high quality borrowers involving a change in loan terms which caused the respective loans to no longer qualify for reimbursement from the FDIC in the event of credit losses.

### INVESTMENTS

First Financial's investment portfolio totaled \$1.6 billion or 26.0% of total assets at June 30, 2013, compared with \$1.9 billion or 28.8% of total assets at December 31, 2012. Securities available-for-sale at June 30, 2013, totaled \$884.7 million, compared with \$1.0 billion at December 31, 2012, while held-to-maturity securities totaled \$670.2 million at June 30, 2013 compared to \$770.8 million at December 31, 2012.

The investment portfolio decreased \$243.8 million, or 13.0%, during the first six months of 2013 as \$109.6 million of purchases were offset by amortizations and paydowns in the portfolio, driven partially by continued elevated prepayment activity. The Company also sold of \$90.3 million of agency MBSs and collateralized mortgage obligations (CMOs) during the year in order to enhance liquidity and reduce prepayment and premium risks, resulting in a gain of \$1.7 million. The overall duration of the investment portfolio increased to 4.0 years as of June 30, 2013 from 2.8 years as of December 31, 2012 primarily due to rising long-term interest rates, which are impactful to mortgage related assets and the primary driver of extension risk.

First Financial had previously implemented a strategy during 2012 to pre-fund the next twelve months of estimated securities portfolio with short-term borrowings. The Company began to unwind this strategy late in the first quarter of 2013 by slowing the pace of reinvestment in the securities portfolio in order to balance loan demand and deposit outflows. This strategy continued through the second quarter of 2013 as a result of sustained loan demand and as part of the Company's strategies to manage the potential impact of rising long-term interest rates on balance sheet sensitivity and capital. First Financial routinely monitors these components of interest rate risk and could accelerate the decline in the size of the securities portfolio in future periods.

First Financial recorded, as a component of equity in accumulated other comprehensive income, a \$5.8 million unrealized after-tax loss on the investment portfolio at June 30, 2013, which declined \$18.6 million from a \$12.8 million unrealized after-tax gain at December 31, 2012. The declines in value of the Company's investment portfolio at June 30, 2013 is primarily due to rising interest rates during 2013.

### DEPOSITS AND FUNDING

Total deposits as of June 30, 2013 were \$4.8 billion, a decrease of \$185.2 million or 3.7% compared to December 31, 2012. The decrease in total deposits at June 30, 2013 as compared to December 31, 2012 was driven by a \$90.0 million or 8.4% decline in total time deposits as well as a \$95.2 million or 2.5% decline in total non-time deposit balances. The decline in time deposit balances was primarily the result of lower consumer balances stemming from the Company's continued efforts to manage deposit funding costs, as well as declines in certain public fund deposits. The decline in non-time deposit balances was driven primarily by a \$64.7 million decrease in public fund balances.

Year-to-date average deposits declined to \$4.8 billion at June 30, 2013 from \$5.4 billion at June 30, 2012 primarily due to decreases in average interest-bearing demand deposits of \$111.7 million and average time deposits of \$459.3

million, partially offset by an increase in noninterest-bearing deposits of \$68.7 million. The year-over-year decline in average time deposits was a result of the Company's continued efforts to reduce higher-cost time deposits.

Borrowed funds decreased to \$693.9 million at June 30, 2013 from \$699.8 million at December 31, 2012, due to an \$8.5 million decrease in federal funds purchased and securities sold under agreements to repurchase, slightly offset by a \$3.9 million increase in long-term borrowings as a result of the Bank's funding needs.

For further discussion of First Financial's borrowing capacity and liquidity management, see the Liquidity section of Management's Discussion and Analysis.

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### RISK MANAGEMENT

First Financial manages risk through a structured enterprise risk management (ERM) approach that routinely assesses the overall level of risk, identifies specific risks and evaluates the steps being taken to mitigate those risks. First Financial continues to enhance its risk management capabilities and the development of risk awareness as a component of the culture of the Company and the operating policies of its business lines. First Financial has identified nine types of risk that it monitors in its ERM framework. These risks include information technology, market, legal, strategic, reputation, credit, regulatory (compliance), operational and external/environmental.

For further discussion of these risks, see the Risk Management section of the Management's Discussion and Analysis of First Financial's 2012 Annual Report and the information below.

### CREDIT RISK

Credit risk represents the risk of loss due to failure of a customer or counterparty to meet its financial obligations in accordance with contractual terms. First Financial manages credit risk through its underwriting process and periodically reviewing and approving its credit exposures using credit policies and guidelines approved by its board of directors. Due to the significant differences in the accounting for covered loans and the loss sharing agreements with the FDIC, management believes that asset quality measures excluding covered loans are generally more meaningful. Therefore, management has included asset quality measures that exclude covered loans in this section.

Allowance for loan and lease losses - excluding covered loans. Management maintains the allowance for loan and lease losses at a level that it considers sufficient to absorb probable loan and lease losses inherent in the portfolio. Management determines the adequacy of the allowance based on historical loss experience and other significant factors. This evaluation is inherently subjective as it requires utilizing material estimates that may be susceptible to significant change. See Note 10, Allowance for Loan and Lease Losses, to the Consolidated Financial Statements for further discussion of First Financial's allowance for uncovered loans.

The allowance for uncovered loan and lease losses was \$47.0 million as of June 30, 2013 compared to \$47.8 million as of December 31, 2012. As a percentage of period-end loans, the allowance for loan and lease losses was 1.39% as of June 30, 2013 compared to 1.50% as of December 31, 2012. The decrease in the allowance for uncovered loan and lease losses from December 31, 2012 was primarily the result of paydowns, charge-offs and other resolution activities related to impaired loans that resulted in lower specific reserves as well as modest improvement in historical loss rates and consumer loan credit expectations. The decrease in the allowance as a percentage of loans was also impacted by loan growth as newly originated loans are generally reserved for at lower rates.

Second quarter 2013 net charge-offs were \$3.7 million or 0.45% of average loans and leases on an annualized basis, compared with \$6.8 million or 0.93% of average loans and leases on an annualized basis for the comparable quarter in 2012. The \$3.2 million decrease from the comparable period in 2012 was primarily the result of declines in commercial, commercial real estate and construction real estate charge-offs.

Net charge-offs for the six months ended June 30, 2013, were \$6.2 million or 0.38% of average loans and leases on an annualized basis compared to \$13.2 million or 0.90% of average loans and leases on an annualized basis for the same period in 2012. The \$7.1 million decrease in net charge-offs for the six months ended June 30, 2013 compared to June 30, 2012 was also primarily related to declines in commercial, commercial real estate and construction real estate charge-offs.

Significant items driving net charge-offs during the six month period ended June 30, 2013 included a \$0.9 million charge-off during the second quarter related to a single commercial real estate credit as well as \$0.8 million related to

three commercial real estate credits and \$0.7 million related to two commercial credits charged off during the first quarter, none of which were individually significant. Significant items driving net charge-offs during the comparable period in 2012 included \$2.0 million related to the dispositions of a commercial real estate credit and a construction and land development credit and \$1.2 million related to valuation adjustments of two commercial real estate credits during the second quarter of 2012 and \$1.7 million related to a commercial construction and land development credit, \$1.1 million related to a hotel real estate loan and three commercial credits totaling \$0.9 million in the aggregate during the first quarter of 2012. The timing and amount of net charge-offs are dependent on the individual credit characteristics of each loan relationship as well as the Company's resolution strategies and can vary from period to period.

Provision expense related to uncovered loans and leases is a product of the Company's allowance for loan and lease losses model as well as net charge-off activity during the period. Second quarter 2013 provision expense related to uncovered loans



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and leases was \$2.4 million as compared to \$8.4 million during the comparable quarter in 2012. Provision expense for the six months ended June 30, 2013 was \$5.5 million compared to \$11.6 million for the comparable period in 2012.

The table that follows includes the activity in the allowance for loan losses, excluding covered loans, for the quarterly periods presented.

| (Dollars in thousands)                     | Three months ended |          |                  |          | Six months ended |          |          |
|--|--------------------|----------|------------------|----------|------------------|----------|----------|
|  | 2013<br>June 30,   | Mar. 31, | 2012<br>Dec. 31, | Sep. 30, | June 30,         | 2013     | 2012     |
| Allowance for loan and lease loss activity |                    |          |                  |          |                  |          |          |
| Balance at beginning of period             | \$48,306           | \$47,777 | \$49,192         | \$50,952 | \$49,437         | \$47,777 | \$52,576 |
| Provision for loan losses                  | 2,409              | 3,041    | 3,882            | 3,613    | 8,364            | 5,450    | 11,622   |
| Gross charge-offs                          |                    |          |                  |          |                  |          |          |
| Commercial                                 | 859                | 781      | 657              | 1,340    | 1,129            | 1,640    | 2,315    |
| Real estate-construction                   | 0                  | 0        | 0                | 180      | 717              | 0        | 2,504    |
| Real estate-commercial                     | 2,044              | 995      | 2,221            | 2,736    | 3,811            | 3,039    | 6,055    |
| Real estate-residential                    | 326                | 223      | 454              | 565      | 191              | 549      | 795      |
| Installment                                | 97                 | 100      | 267              | 134      | 116              | 197      | 176      |
| Home equity                                | 591                | 701      | 1,722            | 380      | 915              | 1,292    | 1,559    |
| All other                                  | 277                | 410      | 227              | 469      | 259              | 687      | 556      |
| Total gross charge-offs                    | 4,194              | 3,210    | 5,548            | 5,804    | 7,138            | 7,404    | 13,960   |
| Recoveries                                 |                    |          |                  |          |                  |          |          |
| Commercial                                 | 67                 | 319      | 71               | 202      | 48               | 386      | 120      |
| Real estate-construction                   | 0                  | 136      | 0                | 0        | 0                | 136      | 0        |
| Real estate-commercial                     | 57                 | 39       | 46               | 38       | 68               | 96       | 181      |
| Real estate-residential                    | 5                  | 4        | 3                | 33       | 9                | 9        | 37       |
| Installment                                | 110                | 77       | 53               | 72       | 75               | 187      | 198      |
| Home equity                                | 225                | 52       | 32               | 31       | 28               | 277      | 52       |
| All other                                  | 62                 | 71       | 46               | 55       | 61               | 133      | 126      |
| Total recoveries                           | 526                | 698      | 251              | 431      | 289              | 1,224    | 714      |
| Total net charge-offs                      | 3,668              | 2,512    | 5,297            | 5,373    | 6,849            | 6,180    | 13,246   |
| Ending allowance for loan and lease losses | \$47,047           | \$48,306 | \$47,777         | \$49,192 | \$50,952         | \$47,047 | \$50,952 |

## Net charge-offs to average loans and leases (annualized)

|                          |        |          |         |        |        |          |          |    |
|--------------------------|--------|----------|---------|--------|--------|----------|----------|----|
| Commercial               | 0.35   | % 0.22   | % 0.28  | % 0.56 | % 0.53 | % 0.29   | % 0.53   | %  |
| Real estate-construction | 0.00   | % (0.68) | )% 0.00 | % 0.78 | % 2.91 | % (0.31) | )% 4.75  | %  |
| Real estate-commercial   | 0.55   | % 0.27   | % 0.63  | % 0.81 | % 1.18 | % 0.42   | % 0.94   | %  |
| Real estate-residential  | 0.38   | % 0.27   | % 0.58  | % 0.72 | % 0.25 | % 0.33   | % 0.53   | %  |
| Installment              | (0.10) | )% 0.17  | % 1.46  | % 0.41 | % 0.26 | % 0.04   | % (0.07) | )% |
| Home equity              | 0.40   | % 0.72   | % 1.82  | % 0.38 | % 0.99 | % 0.56   | % 0.84   | %  |
| All other                | 0.90   | % 1.63   | % 0.94  | % 2.51 | % 1.46 | % 1.24   | % 1.66   | %  |
| Total net charge-offs    | 0.45   | % 0.32   | % 0.68  | % 0.71 | % 0.93 | % 0.38   | % 0.90   | %  |

Allowance for loan and lease losses - covered loans. The majority of the Company's covered loans are accounted for under FASB ASC Topic 310-30, whereby First Financial is required to periodically re-estimate the expected cash flows on the loans. For purposes of applying the guidance under FASB ASC Topic 310-30, First Financial grouped acquired loans into pools based on common risk characteristics. A decline in expected cash flows for a pool of loans is referred to as impairment and recorded as provision expense, and a related allowance for loan and lease losses on

covered loans, on a discounted basis during the period. Estimated reimbursements due from the FDIC under loss sharing agreements related to any declines in expected loan cash flows are recorded as noninterest income and an increase to the FDIC indemnification asset in the same period. Improvement in expected cash flows for a pool of loans, once any previously recorded impairment is recaptured, is recognized prospectively as an adjustment to the yield on the loans in the pool and a related adjustment to the yield on the FDIC

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indemnification asset. These cash flow evaluations are inherently subjective as they require material estimates, all of which may be susceptible to significant change. See Note 10, Allowance for Loan and Lease Losses, to the Consolidated Financial Statements for further discussion of First Financial's allowance for covered loans.

During the second quarter 2013, the Company implemented certain enhancements to its valuation methodology and the estimation of impairment to place greater emphasis on changes in total expected cash flows and less emphasis on changes in the net present value of expected cash flows. As a result of these enhancements, the allowance for loan losses related to covered loans was reduced by \$7.8 million with an equivalent amount reflected in the negative provision for covered loan losses for the quarter. Additionally, the Company also recognized a corresponding reduction in the FDIC indemnification asset of \$6.3 million with an equivalent amount reflected in the negative FDIC loss sharing income for the quarter. These enhancements also resulted in a decline in the yield on covered loans during the second quarter and are expected to result in lower yields on certain covered loan pools on a prospective basis.

The Company recognized negative provision expense, or impairment recapture, of \$8.3 million and realized net charge-offs of \$4.3 million during the quarter, resulting in an allowance for covered loan losses of \$33.0 million as of June 30, 2013. For the second quarter of 2012, First Financial recognized provision expense on covered loans of \$6.0 million and realized net charge-offs of \$3.9 million during the period, resulting in an allowance for covered loan losses of \$48.3 million as of June 30, 2012. The difference between provision expense and net charge-offs primarily relates to the quarterly re-estimation of cash flow expectations required under FASB ASC Topic 310-30.

First Financial recognized provision expense on covered loans of \$0.8 million and realized net charge-offs of \$13.0 million for the six months ended June 30, 2013. The Company recognized total provision expense related to covered loans of \$19.0 million and net charge-offs of \$13.5 million for the six months ended June 30, 2012.

During the second quarter 2013, the Company also incurred loss sharing and covered asset expenses of \$1.6 million, consisting primarily of credit expenses, offset by \$2.2 million of net gains related to covered OREO. For the six months ended June 30, 2013, the Company incurred loss sharing and covered asset expenses of \$3.9 million offset by \$2.4 million of net gains related to covered OREO. The negative FDIC loss sharing income for the quarter reflects the quarterly re-estimation of expected cash flows, including the enhancements to the quarterly estimation discussed above, as well as the corresponding offset related to the net gains on covered OREO and loss sharing and covered asset expenses.

The receivables due from the FDIC under loss sharing agreements related to covered provision expense, loss sharing expense and losses on covered OREO of \$1.6 million and \$21.1 million for the six months ended June 30, 2013 and 2012, respectively, were recognized as FDIC loss sharing income and corresponding increases to the FDIC indemnification asset in those periods.

|  | Three months ended |          | 2012     |          |          | Six months ended |           |
|--|--------------------|----------|----------|----------|----------|------------------|-----------|
| (Dollars in thousands)                   | 2013               |          | 2012     |          |          | June 30,         |           |
|  | June 30,           | Mar. 31, | Dec. 31, | Sep. 30, | June 30, | 2013             | 2012      |
| Balance at beginning of period           | \$45,496           | \$45,190 | \$48,895 | \$48,327 | \$46,156 | \$45,190         | \$42,835  |
| Provision for loan and lease losses      | (8,283             | ) 9,042  | 5,283    | 6,622    | 6,047    | 759              | 18,998    |
| Loans charged-off                        | (4,681             | ) (9,684 | ) (9,568 | ) (9,058 | ) (5,163 | ) (14,365        | ) (15,281 |
| Recoveries                               | 429                | 948      | 580      | 3,004    | 1,287    | 1,377            | 1,775     |
| Ending allowance for covered loan losses | \$32,961           | \$45,496 | \$45,190 | \$48,895 | \$48,327 | \$32,961         | \$48,327  |

Nonperforming/Underperforming Assets - excluding covered assets. Nonperforming loans totaled \$74.9 million and nonperforming assets totaled \$86.7 million as of June 30, 2013 compared with \$75.9 million and \$88.4 million, respectively, at December 31, 2012. Nonaccrual loans, including troubled debt restructurings (TDRs) classified as nonaccrual, totaled \$62.0 million as of June 30, 2013 compared to \$65.0 million as of December 31, 2012, representing a \$3.0 million, or 4.7% decrease.

The second quarter 2013 allowance for loan and lease losses as a percentage of nonaccrual loans, including nonaccrual TDRs was 75.9% compared with 73.5% at December 31, 2012. The allowance for loan and lease losses as a percentage of nonperforming loans, which include TDRs classified as accrual, was 62.8% at June 30, 2013 compared with 63.0% at December 31, 2012.

Total classified assets as of June 30, 2013 totaled \$129.8 million compared to \$129.0 million at December 31, 2012. Classified assets are defined by the Company as nonperforming assets plus performing loans internally rated substandard or worse.

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Troubled Debt Restructurings - excluding covered loans. TDRs totaled \$32.9 million at June 30, 2013, a \$7.9 million increase from December 31, 2012. Accruing TDRs increased \$2.1 million from December 31, 2012, generally as a result of renewals and term extensions of performing, substandard-rated loans that are experiencing operating cash flow stress but have strong underlying collateral and guarantor support. TDRs classified as nonaccrual increased \$5.8 million from December 31, 2012 primarily as a result of modified borrowing terms related to a \$6.9 million commercial nonaccrual credit in the first quarter 2013.

TDRs are generally classified as nonaccrual for a minimum period of six months and may qualify for return to accrual status once they have demonstrated performance with the terms of the loan modification.

Delinquent Loans - excluding covered loans. At June 30, 2013, loans 30-to-89 days past due decreased to \$13.4 million, or 0.40% of period end loans, as compared to \$16.3 million, or 0.51%, at December 31, 2012. The decrease in delinquent loans compared to December 31, 2012 was driven primarily by the reclassification of a \$2.0 million commercial real estate credit to nonaccrual status as well as a commercial real estate credit and an equipment finance credit, totaling \$1.9 million in the aggregate, where the borrowers made payments to bring the loans current.

Other Real Estate Owned. At June 30, 2013, First Financial had OREO properties originating from uncovered loans totaling \$11.8 million, compared with \$12.5 million at December 31, 2012. Uncovered OREO decreased \$0.7 million from December 31, 2012 to June 30, 2013 as resolutions and valuation adjustments of \$3.4 million exceeded \$2.7 million of additions during the first half of 2013. There were two large commercial loans included in the additions and seven property resolutions during the first half of 2013.

OREO originating from covered loans was \$22.5 million at June 30, 2013, compared with \$28.9 million at December 31, 2012. Covered OREO decreased \$6.4 million, or 22.1%, from December 31, 2012 as resolutions and valuation adjustments of \$19.3 million exceeded additions of \$12.9 million during the first half of 2013.

The table that follows shows the categories that are included in nonperforming and underperforming assets, excluding covered assets, as well as related credit quality ratios as of June 30, 2013, and the four previous quarters.

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| (Dollars in thousands)  | Quarter ended    |           |                  |           |           |   |
|---|------------------|-----------|------------------|-----------|-----------|---|
|   | 2013<br>June 30, | Mar. 31,  | 2012<br>Dec. 31, | Sep. 30,  | June 30,  |   |
| Nonperforming loans, nonperforming assets, and underperforming assets |                  |           |                  |           |           |   |
| Nonaccrual loans  |                  |           |                  |           |           |   |
| Commercial  | \$2,904          | \$4,044   | \$10,562         | \$4,563   | \$12,065  |   |
| Real estate - construction  | 808              | 945       | 950              | 2,536     | 7,243     |   |
| Real estate - commercial  | 30,977           | 30,311    | 31,002           | 33,961    | 36,116    |   |
| Real estate - residential   | 5,149            | 4,371     | 5,045            | 5,563     | 5,069     |   |
| Installment   | 153              | 211       | 376              | 284       | 319       |   |
| Home equity   | 1,576            | 1,750     | 2,499            | 2,497     | 2,281     |   |
| Lease financing   | 496              | 496       | 496              | 0         | 0         |   |
| Nonaccrual loans  | 42,063           | 42,128    | 50,930           | 49,404    | 63,093    |   |
| Troubled debt restructurings (TDRs)                                   |                  |           |                  |           |           |   |
| Accruing  | 12,924           | 12,757    | 10,856           | 11,604    | 9,909     |   |
| Nonaccrual  | 19,948           | 22,324    | 14,111           | 13,017    | 10,185    |   |
| Total TDRs  | 32,872           | 35,081    | 24,967           | 24,621    | 20,094    |   |
| Total nonperforming loans   | 74,935           | 77,209    | 75,897           | 74,025    | 83,187    |   |
| Other real estate owned (OREO)  | 11,798           | 11,993    | 12,526           | 13,912    | 15,688    |   |
| Total nonperforming assets  | 86,733           | 89,202    | 88,423           | 87,937    | 98,875    |   |
| Accruing loans past due 90 days or more                               | 158              | 157       | 212              | 108       | 143       |   |
| Total underperforming assets  | \$86,891         | \$89,359  | \$88,635         | \$88,045  | \$99,018  |   |
| Total classified assets   | \$129,832        | \$130,436 | \$129,040        | \$133,382 | \$145,621 |   |
| Credit quality ratios (excluding covered assets)                      |                  |           |                  |           |           |   |
| Allowance for loan and lease losses to                                |                  |           |                  |           |           |   |
| Nonaccrual loans  | 111.85           | % 114.66  | % 93.81          | % 99.57   | % 80.76   | % |
| Nonaccrual loans plus nonaccrual TDRs                                 | 75.87            | % 74.95   | % 73.46          | % 78.81   | % 69.53   | % |
| Nonperforming loans   | 62.78            | % 62.57   | % 62.95          | % 66.45   | % 61.25   | % |
| Total ending loans  | 1.39             | % 1.49    | % 1.50           | % 1.60    | % 1.69    | % |
| Nonperforming loans to total loans                                    | 2.22             | % 2.38    | % 2.39           | % 2.41    | % 2.76    | % |
| Nonperforming assets to   |                  |           |                  |           |           |   |
| Ending loans, plus OREO   | 2.56             | % 2.74    | % 2.77           | % 2.86    | % 3.27    | % |
| Total assets, including covered assets                                | 1.38             | % 1.40    | % 1.36           | % 1.41    | % 1.57    | % |
| Nonperforming assets, excluding accruing TDRs to                      |                  |           |                  |           |           |   |
| Ending loans, plus OREO   | 2.17             | % 2.34    | % 2.43           | % 2.48    | % 2.94    | % |
| Total assets, including covered assets                                | 1.18             | % 1.20    | % 1.19           | % 1.22    | % 1.42    | % |

## MARKET RISK

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates, foreign exchange rates and equity prices. The primary source of market risk for First Financial is interest rate risk. Interest rate risk is the risk to earnings and the value of equity arising from changes in market interest rates, and arises in the normal course of business to the extent that there is a divergence between the amount of First Financial's interest-earning assets and the amount of interest-bearing liabilities that are prepaid/withdrawn, re-price or mature in specified periods. First Financial seeks to achieve consistent growth in net interest income and equity while managing volatility arising from shifts in market interest rates. First Financial's board of directors establishes policy limits with respect to interest rate risk and changes in the economic value of equity. First Financial's Asset and

Liability Committee (ALCO), a group of senior officers from the lending, deposit gathering, finance, risk management and treasury areas, oversees market risk management, monitoring risk measures, limits and policy guidelines for managing the amount of interest rate risk and its effect on net interest income and capital.

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Interest rate risk management is an active process that encompasses monitoring loan and deposit flows complemented by investment and funding activities. Effective interest rate risk management begins with understanding the dynamic characteristics of assets and liabilities and determining the appropriate interest rate risk position given business activities, management objectives, market expectations and ALCO policy limits and guidelines.

## LIQUIDITY

Liquidity management is the process by which First Financial manages the continuing flow of funds necessary to meet its financial commitments on a timely basis and at a reasonable cost. These funding commitments include withdrawals by depositors, credit commitments to borrowers, shareholder dividends, operating and capital expenditures. Liquidity is monitored and closely managed by ALCO. It is ALCO's responsibility to ensure First Financial has the necessary level of funds available for normal operations as well as to maintain a contingency funding policy to ensure that liquidity stress events are quickly identified and management plans to respond are in place. This is accomplished through the use of policies which establish limits and require measurements to monitor liquidity trends, including modeling and management reporting that identifies the amounts and costs of all available funding sources. These sources are periodically tested for funding availability.

Liquidity is derived primarily from deposit growth, principal and interest payments on loans and investment securities, maturing loans and investment securities, access to wholesale funding sources and collateralized borrowings. First Financial's most stable source of liability-funded liquidity for both short and long-term needs is deposit growth and retention of the core deposit base. The deposit base is diversified among individuals, partnerships, corporations, public entities and geographic markets. This diversification helps First Financial minimize dependence on large concentrations of wholesale funding sources.

Capital expenditures, such as banking center expansions and technology investments were \$5.4 million and \$10.8 million for the first six months of 2013 and 2012, respectively. Management believes that First Financial has sufficient liquidity to fund its future capital expenditure commitments.

First Financial utilizes its short-term line of credit and longer-term advances from the Federal Home Loan Bank (FHLB) as funding sources. At June 30, 2013, the Company had \$505.9 million in short-term borrowings from the FHLB. At December 31, 2012, the Company had \$502.0 million in short-term borrowings from the FHLB. At June 30, 2013, and December 31, 2012, total long-term borrowings from the FHLB were \$8.2 million and \$9.4 million, respectively. First Financial's total remaining borrowing capacity from the FHLB was \$391.9 million at June 30, 2013.

First Financial had pledged certain eligible residential and farm real estate loans, home equity lines of credit and government and agency securities, totaling \$3.1 billion as collateral for borrowings from the FHLB as of June 30, 2013. For ease of borrowing execution, First Financial utilizes a blanket collateral agreement with the FHLB.

First Financial's principal source of asset-funded liquidity is marketable investment securities, particularly those of shorter maturities. The market value of investment securities classified as available-for-sale totaled \$884.7 million at June 30, 2013. Securities classified as held-to-maturity that are maturing within a short period of time are also a source of liquidity and totaled \$0.2 million at June 30, 2013. Other types of assets such as cash and due from banks, interest-bearing deposits with other banks, as well as loans maturing within one year, are also sources of liquidity.

In addition to liquidity on hand at June 30, 2013 of \$117.4 million, First Financial had unused and available overnight wholesale funding of \$2.0 billion, or 31.6%, of total assets to fund new loans, any deposit runoff that may occur as a result of continued deposit rationalization efforts and from markets that the Company is exiting or for general corporate requirements.



Certain restrictions exist regarding the ability of First Financial's subsidiaries to transfer funds to First Financial in the form of cash dividends, loans, other assets or advances. The approval of the subsidiaries' respective primary federal regulators is required for First Financial's subsidiaries to pay dividends in excess of regulatory limitations. Dividends paid to First Financial from its subsidiaries totaled \$28.9 million for the first six months of 2013. As of June 30, 2013, First Financial's subsidiaries had retained earnings of \$354.4 million of which \$29.2 million was available for distribution to First Financial without prior regulatory approval. Additionally, First Financial had \$89.8 million in cash as of June 30, 2013, which is approximately two times the Company's annual regular shareholder dividend (currently \$0.60 per share) and operating expenses.

Management is not aware of any other events or regulatory requirements that, if implemented, are likely to have a material effect on First Financial's liquidity.

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### CAPITAL

Risk-Based Capital. First Financial and its subsidiary, First Financial Bank, are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations involve quantitative measures of assets, liabilities and certain off-balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet minimum capital requirements can initiate regulatory action.

Quantitative measures established by regulation to ensure capital adequacy require First Financial to maintain minimum amounts and ratios as defined by the regulations of Total and Tier 1 capital to risk-weighted assets and to average assets. Management believes, as of June 30, 2013, that First Financial met all capital adequacy requirements to which it was subject. At June 30, 2013, and December 31, 2012, regulatory notifications categorized First Financial as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, First Financial must maintain minimum Total risk-based capital, Tier 1 risk-based capital, and Tier 1 leverage ratios as set forth in the table below. There have been no conditions or events since those notifications that management believes has changed the Company's category.

First Financial's Tier I capital is comprised of total shareholders' equity less unrealized gains and losses on investment securities available-for-sale accounted for under FASB ASC Topic 320, Investments-Debt and Equity Securities, and any amounts resulting from the application of FASB ASC Topic 715, Compensation-Retirement Benefits, that is recorded within accumulated other comprehensive income (loss), intangible assets and any valuation related to mortgage servicing rights. Total risk-based capital consists of Tier I capital plus qualifying allowance for loan and lease losses and gross unrealized gains on equity securities.

For purposes of calculating the leverage ratio, average assets represents quarterly average assets less assets not qualifying for total risk-based capital including intangible assets and non-qualifying mortgage servicing rights and allowance for loan and lease losses.

Consolidated regulatory capital ratios at June 30, 2013, included the leverage ratio of 10.12%, Tier 1 capital ratio of 15.41%, and total capital ratio of 16.68%. All regulatory capital ratios exceeded the amounts necessary to be classified as "well capitalized," and total regulatory capital exceeded the "minimum" requirement by \$355.4 million, on a consolidated basis. First Financial's tangible common equity ratio increased to 9.62% at June 30, 2013 as compared to 9.50% at December 31, 2012.

First Financial's Tier I and Total capital ratios were negatively impacted by an increase in risk weighted assets during 2013 primarily as a result of declines in lower risk weighted covered assets offset by increases in higher risk weighted uncovered loans and investment securities. First Financial's Leverage ratio was positively impacted by a decline in average assets in the first half of 2013. Contributions to shareholders' equity from earnings were limited in both 2013 and 2012 as a result of the Company's variable dividend payout.

On July 2, 2013, the Board of Governors of the Federal Reserve System approved a final rule implementing changes intended to strengthen the regulatory capital framework for all banking organizations (Basel III). The final rule includes transition periods to ease the potential burden, with community banks such as First Financial subject to the final rule beginning January 1, 2015. While First Financial continues to evaluate this final rule and its potential impact, preliminary assessments indicate that the Company will continue to exceed all regulatory capital requirements under Basel III.

The following tables illustrate the actual and required capital amounts and ratios as of June 30, 2013 and December 31, 2012.



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| (Dollars in thousands)                 | Actual    |       | For Capital Adequacy Purposes |       | To Be Well Capitalized Under Prompt Corrective Action Provisions |       |   |  |
|--|-----------|-------|-------------------------------|-------|--|-------|---|--|
|  | Amount    | Ratio | Amount                        | Ratio | Amount   | Ratio |   |  |
| June 30, 2013                          |           |       |                               |       |  |       |   |  |
| Total capital to risk-weighted assets  |           |       |                               |       |  |       |   |  |
| Consolidated                           | \$682,927 | 16.68 | % \$327,492                   | 8.00  | % N/A  | N/A   |   |  |
| First Financial Bank                   | 593,627   | 14.54 | % 326,646                     | 8.00  | % \$408,308  | 10.00 | % |  |
| Tier 1 capital to risk-weighted assets |           |       |                               |       |  |       |   |  |
| Consolidated                           | 630,819   | 15.41 | % 163,746                     | 4.00  | % N/A  | N/A   |   |  |
| First Financial Bank                   | 534,722   | 13.10 | % 163,323                     | 4.00  | % 244,985  | 6.00  | % |  |
| Tier 1 capital to average assets       |           |       |                               |       |  |       |   |  |
| Consolidated                           | 630,819   | 10.12 | % 249,267                     | 4.00  | % N/A  | N/A   |   |  |
| First Financial Bank                   | 534,722   | 8.59  | % 248,898                     | 4.00  | % 311,123  | 5.00  | % |  |
|  |           |       |                               |       |  |       |   |  |
| (Dollars in thousands)                 | Actual    |       | For Capital Adequacy Purposes |       | To Be Well Capitalized Under Prompt Corrective Action Provisions |       |   |  |
|  | Amount    | Ratio | Amount                        | Ratio | Amount   | Ratio |   |  |
| December 31, 2012                      |           |       |                               |       |  |       |   |  |
| Total capital to risk-weighted assets  |           |       |                               |       |  |       |   |  |
| Consolidated                           | \$686,961 | 17.60 | % \$312,328                   | 8.00  | % N/A  | N/A   |   |  |
| First Financial Bank                   | 586,023   | 15.04 | % 311,618                     | 8.00  | % \$389,523  | 10.00 | % |  |
| Tier 1 capital to risk-weighted assets |           |       |                               |       |  |       |   |  |
| Consolidated                           | 637,176   | 16.32 | % 156,164                     | 4.00  | % N/A  | N/A   |   |  |
| First Financial Bank                   | 529,196   | 13.59 | % 155,809                     | 4.00  | % 233,714  | 6.00  | % |  |
| Tier 1 capital to average assets       |           |       |                               |       |  |       |   |  |
| Consolidated                           | 637,176   | 10.25 | % 248,761                     | 4.00  | % N/A  | N/A   |   |  |
| First Financial Bank                   | 529,196   | 8.52  | % 248,408                     | 4.00  | % 310,511  | 5.00  | % |  |

Shareholder Dividends. First Financial's board of directors authorized a regular dividend of \$0.15 per common share and a variable dividend of \$0.12 per common share for the next regularly scheduled dividend, payable on October 1, 2013 to shareholders of record as of August 30, 2013. As previously disclosed, this will be the last variable dividend paid with subsequent quarterly dividends expected to be comprised solely of the regular dividend.

Share Repurchases. In October 2012, First Financial's board of directors approved a share repurchase plan under which the Company has the ability to repurchase up to 5,000,000 shares. Under the plan, the Company expects to repurchase approximately 1,000,000 shares annually. This annual target will be subject to market conditions and quarterly evaluation by the board as well as balance sheet composition and growth. Subsequent to the expiration of the variable dividend in 2013, the Company expects to return to shareholders a target range of 60% - 80% of earnings through a combination of its regular dividend and share repurchases while still maintaining capital ratios that exceed internal target thresholds, current regulatory capital requirements and proposed capital requirements under the Basel Committee on Banking Supervision's final framework for strengthening international capital and liquidity regulation

released in December 2010 (Basel III). The Company repurchased 590,400 shares under this plan at an average price of \$15.43 per share during the first six months of 2013, which

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included 291,400 shares at an average price of \$15.47 during the second quarter. At June 30, 2013, 3,999,100 common shares remained available for repurchase under this plan.

### CRITICAL ACCOUNTING POLICIES

First Financial's Consolidated Financial Statements are prepared based on the application of accounting policies. These policies require the reliance on estimates and assumptions. Changes in underlying factors, assumptions or estimates in any of these areas could have a material impact on First Financial's future financial condition and results of operations. In management's opinion, some of these areas have a more significant impact than others on First Financial's financial reporting. For First Financial, these areas currently include accounting for the allowance for loan and lease losses (excluding covered loans), covered loans, the allowance for loan and lease losses - covered loans, the FDIC indemnification asset, goodwill, pension and income taxes. These accounting policies are discussed in detail in the Critical Accounting Policies section of Management's Discussion and Analysis in First Financial's 2012 Annual Report. There were no material changes to these accounting policies during the six months ended June 30, 2013.

### ACCOUNTING AND REGULATORY MATTERS

Note 2 to the Consolidated Financial Statements discusses new accounting standards adopted by First Financial during 2013 and the expected impact of accounting standards recently issued but not yet required to be adopted. To the extent the adoption of new accounting standards materially affects financial condition, results of operations or liquidity, the impacts are discussed in the applicable section(s) of Management's Discussion and Analysis and the Notes to the Consolidated Financial Statements.

### FORWARD-LOOKING INFORMATION

Certain statements contained in this report which are not statements of historical fact constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act (the Act). In addition, certain statements in future filings by First Financial with the SEC, in press releases, and in oral and written statements made by or with the approval of First Financial which are not statements of historical fact constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to, projections of revenues, income or loss, earnings or loss per share, the payment or non-payment of dividends, capital structure and other financial items, statements of plans and objectives of First Financial or its management or board of directors and statements of future economic performances and statements of assumptions underlying such statements. Words such as "believes," "anticipates," "likely," "expected," "intends," and other similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements. Management's analysis contains forward-looking statements that are provided to assist in the understanding of anticipated future financial performance. However, such performance involves risks and uncertainties that may cause actual results to differ materially. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to:

- management's ability to effectively execute its business plan;
- the risk that the strength of the United States economy in general and the strength of the local economies in which we conduct operations may continue to deteriorate resulting in, among other things, a further deterioration in credit quality or a reduced demand for credit, including the resultant effect on our loan portfolio, allowance for loan and lease losses and overall financial performance;
- U.S. fiscal debt and budget matters;
- the ability of financial institutions to access sources of liquidity at a reasonable cost;

the impact of recent upheaval in the financial markets and the effectiveness of domestic and international governmental actions taken in response, and the effect of such governmental actions on us, our competitors and counterparties, financial markets generally and availability of credit specifically, and the U.S. and international economies, including potentially higher FDIC premiums arising from increased payments from FDIC insurance funds as a result of depository institution failures;

the effect of and changes in policies and laws or regulatory agencies (notably the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act);

the effect of the current low interest rate environment or changes in interest rates on our net interest margin and our loan originations and securities holdings;

our ability to keep up with technological changes;

failure or breach of our operational or security systems or infrastructure, or those of our third party vendors or other service providers;

our ability to comply with the terms of loss sharing agreements with the FDIC;

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mergers and acquisitions, including costs or difficulties related to the integration of acquired companies and the wind-down of non-strategic operations that may be greater than expected, such as the risks and uncertainties associated with the Irwin Mortgage Corporation bankruptcy proceedings and other acquired subsidiaries; the risk that exploring merger and acquisition opportunities may detract from management's time and ability to successfully manage our Company; expected cost savings in connection with the consolidation of recent acquisitions may not be fully realized or realized within the expected time frames, and deposit attrition, customer loss and revenue loss following completed acquisitions may be greater than expected; our ability to increase market share and control expenses; the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies as well as the Financial Accounting Standards Board and the SEC; adverse changes in the creditworthiness of our borrowers and lessees, collateral values, the value of investment securities and asset recovery values, including the value of the FDIC indemnification asset and related assets covered by FDIC loss sharing agreements; adverse changes in the securities, debt and/or derivatives markets; our success in recruiting and retaining the necessary personnel to support business growth and expansion and maintain sufficient expertise to support increasingly complex products and services; monetary and fiscal policies of the Board of Governors of the Federal Reserve System (Federal Reserve) and the U.S. government and other governmental initiatives affecting the financial services industry; unpredictable natural or other disasters could have an adverse effect on us in that such events could materially disrupt our operations or our vendors' operations or willingness of our customers to access the financial services we offer; our ability to manage loan delinquency and charge-off rates and changes in estimation of the adequacy of the allowance for loan losses; and the costs and effects of litigation and of unexpected or adverse outcomes in such litigation.

In addition, please refer to our Annual Report on Form 10-K for the year ended December 31, 2012, as well as our other filings with the SEC, for a more detailed discussion of these risks and uncertainties and other factors. Such forward-looking statements are meaningful only on the date when such statements are made, and First Financial undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such a statement is made to reflect the occurrence of unanticipated events.



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## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates, foreign exchange rates and equity prices. The primary source of market risk for First Financial is interest rate risk. Interest rate risk is the risk to earnings and the value of equity arising from changes in market interest rates and arises in the normal course of business to the extent that there is a divergence between the amount of First Financial's interest-earning assets and the amount of interest-bearing liabilities that are prepaid, withdrawn, re-priced or mature in specified periods. First Financial seeks to achieve consistent growth in net interest income and equity while managing volatility arising from shifts in market interest rates. First Financial's board of directors establishes policy limits with respect to interest rate risk. First Financial's ALCO oversees market risk management, monitoring risk measures, limits and policy guidelines for managing the amount of interest rate risk and its effect on net interest income and capital.

Interest rate risk management is an active process that encompasses monitoring loan and deposit flows complemented by investment and funding activities. Effective interest rate risk management begins with understanding the dynamic characteristics of assets and liabilities and determining the appropriate interest rate risk position given business activities, management objectives, market expectations and ALCO policy limits and guidelines.

Interest rate risk for First Financial's Consolidated Balance Sheets consists of repricing, option and basis risks. Repricing risk results from differences in the maturity, or repricing, of interest-bearing assets and liabilities. Option risk in financial instruments arises from embedded options such as loan prepayments, early withdrawal of certificates of deposits and calls on investments and debt instruments that are primarily driven by third party or client behavior. Basis risk refers to the potential for changes in the underlying relationship between market rates or indices, which subsequently result in a narrowing of the net interest margin. Basis risk is also present in managed rate liabilities, such as interest-bearing checking accounts and savings accounts, where historical pricing relationships to market rates may change due to the level or directional change in market interest rates or competitive pressures.

The interest rate risk position is measured and monitored using income simulation models and economic value of equity (EVE) sensitivity analysis that capture both short-term and long-term interest rate risk exposure. Income simulation involves forecasting net interest income (NII) under a variety of interest rate scenarios including instantaneous shocks. First Financial uses EVE sensitivity analysis to understand the impact of changes in interest rates on long-term cash flows, income and capital. EVE is calculated by discounting the cash flows for all balance sheet instruments under different interest-rate scenarios.

Presented below is the estimated impact on First Financial's NII and EVE position as of June 30, 2013, assuming immediate, parallel shifts in interest rates:

|            | % Change from Base Case for<br>Immediate Parallel Changes in Rates |          |         |   |
|------------|--|----------|---------|---|
|            | -100 BP <sup>(1)</sup>   | +100 BP  | +200 BP |   |
| NII-Year 1 | (5.79  | )% (0.30 | )% 1.39 | % |
| NII-Year 2 | (6.17  | )% 1.21  | % 4.12  | % |
| EVE        | (10.63   | )% 0.75  | % 5.87  | % |

(1) Because certain current interest rates are at or below 1.00%, the 100 basis point downward shock assumes that certain corresponding interest rates approach an implied floor that, in effect, reflects a decrease of less than the full 100 basis point downward shock.

Modeling the sensitivity of NII and EVE to changes in market interest rates is highly dependent on the assumptions incorporated into the modeling process. These assumptions are periodically reviewed in the context of balance sheet changes, product offerings, external economic factors and anticipated client behavior. In addition, the Company internally evaluates the impact of yield curve twist scenarios (i.e. flattening, steepening and inversions of the yield curve) on NII and EVE. First Financial's projected results for near-term earnings at risk indicate a risk-neutral to modestly asset-sensitive position. Long-term NII and EVE modeling indicate the Company is asset sensitive. First Financial is actively managing its balance sheet with a bias toward asset sensitivity while simultaneously balancing the potential earnings impact of this strategy.

First Financial's NII position became more asset sensitive, from both a near-term and long-term perspective, during the second quarter 2013 as a result of ongoing balance sheet management efforts. Similarly, the Company's EVE sensitivity to a +100 basis point interest rate shock also became more asset sensitive during the quarter. The Company's EVE sensitivity to a +200 basis point interest rate shock became modestly less asset sensitive as a result of rising long-term interest rates leading to higher

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discount rates, coupled with a shift in the Company's deposit mix away from time deposits toward market-driven deposit products, during the quarter.

"Risk-neutral position" refers to the absence of a strong bias toward either asset or liability sensitivity. "Asset sensitive position" refers to an increase in interest rates, primarily short-term rates, that is expected to generate higher net interest income as rates earned on our interest-earning assets would reprice upward more quickly or in greater quantities than rates paid on our interest-bearing liabilities would reprice. Conversely, "liability sensitive position" refers to an increase in short-term interest rates that is expected to generate lower net interest income as rates paid on our interest-bearing liabilities would reprice upward more quickly or in greater quantities than rates earned on our interest-earning assets.

The interest rate risk analysis provides a framework as to what First Financial's overall sensitivity is as of the Company's most recent reported position. Management strategies may impact future reporting periods, as actual results may differ from simulated results due to the timing, magnitude and frequency of interest rate changes, the difference between actual experience and the characteristics assumed, as well as changes in portfolio composition and market conditions. Market based and historical experience prepayment speeds are factored into the analysis for loan and securities portfolios. Deposit premiums and rate sensitivity for transactional deposit accounts are modeled based on both historical experience and external industry studies. Due to the current low interest rate environment, funding rates on deposit and wholesale funding instruments were not reduced below 0.0% in the down 100 basis point scenario. First Financial continues to refine the assumptions used in its interest rate risk modeling.

See also "Item 2-Management's Discussion and Analysis of Financial Condition and Results of Operations—Net Interest Income."

## ITEM 4. CONTROLS AND PROCEDURES

### Disclosure Controls and Procedures

Management is responsible for establishing and maintaining effective disclosure controls and procedures, as defined under Rule 13a-15 of the Securities Exchange Act of 1934, that are designed to cause the material information required to be disclosed by First Financial in the reports it files or submits under the Securities Exchange Act of 1934 to be recorded, processed, summarized, and reported to the extent applicable within the time periods required by the Securities and Exchange Commission's rules and forms. In designing and evaluating the disclosure controls and procedures, management recognized that a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

As of the end of the period covered by this report, First Financial performed an evaluation under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures pursuant to Rule 13a-15 of the Securities Exchange Act of 1934. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective at the reasonable assurance level.

### Changes in Internal Control over Financial Reporting

No changes were made to the Corporation's internal control over financial reporting (as defined in Rule 13a-15 under the Securities Exchange Act of 1934) during the last fiscal quarter that materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.



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PART II-OTHER INFORMATION

Item 1. Legal Proceedings.

Except as set forth below, there have been no material changes to the disclosure in response to "Part I - Item 3. Legal Proceedings" in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

With respect to the matter titled Irwin Mortgage Corporation Bankruptcy, on April 1, 2013, the Bankruptcy Court issued an order confirming IMC's plan. IMC and First Financial reached a global settlement with respect to all claims which did not have a material adverse effect on the financial statements of First Financial. The effective date of the plan was on June 28, 2013. Pursuant to the plan, a liquidating trust has been established to administer the liquidation of all remaining assets of IMC in accordance with law.

Item 1A. Risk Factors.

There are a number of factors that may adversely affect the Company's business, financial results, or stock price. See "Risk Factors" as disclosed in response to "Item 1A. to Part I - Risk Factors" of Form 10-K for the year ended December 31, 2012.

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## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(c) The following table shows the total number of shares repurchased in the second quarter of 2013.

## Issuer Purchases of Equity Securities

| Period                    | (a)<br>Total Number<br>Of Shares<br>Purchased <sup>(1)</sup> | (b)<br>Average<br>Price Paid<br>Per Share | (c)<br>Total Number of<br>Shares Purchased as<br>Part of Publicly<br>Announced Plans <sup>(2)</sup> | (d)<br>Maximum Number of<br>Shares that may yet<br>be purchased Under<br>the Plans |
|---------------------------|--|---|---|--|
| April 1 to April 30, 2013 |  |   |   |  |
| Share repurchase program  | 87,400   | \$ 15.65                                  | 87,400  | 4,203,100  |
| Director Fee Stock Plan   | 3,129  | 15.74                                     | NA  | NA   |
| Stock Plans               | 125  | 15.37                                     | NA  | NA   |
| May 1 to May 31, 2013     |  |   |   |  |
| Share repurchase program  | 127,500  | \$ 15.54                                  | 127,500   | 4,075,600  |
| Director Fee Stock Plan   | 0  | 0.00                                      | 0   | NA   |
| Stock Plans               | 3,576  | 15.67                                     | NA  | NA   |
| June 1 to June 30, 2013   |  |   |   |  |
| Share repurchase program  | 76,500   | \$ 15.15                                  | 76,500  | 3,999,100  |
| Director Fee Stock Plan   | 0  | 0.00                                      | 0   | NA   |
| Stock Plans               | 2,050  | 15.01                                     | 0   | NA   |
| Total                     |  |   |   |  |
| Share repurchase program  | 291,400  | \$ 15.47                                  | 291,400   |  |
| Director Fee Stock Plan   | 3,129  | \$ 15.74                                  | NA  |  |
| Stock Plans               | 5,751  | \$ 15.43                                  | NA  |  |

Except with respect to the share repurchase program, the number of shares purchased in column (a) and the average price paid per share in column (b) include the purchase of shares other than through publicly announced plans. The shares purchased other than through publicly announced plans were purchased pursuant to First Financial's Director Fee Stock Plan, 1999 Stock Option Plan for Non-Employee Directors, 1999 Stock Incentive (1) Plan for Officers and Employees, 2009 Employee Stock Plan, Amended and Restated 2009 Non-Employee Director Stock Plan and 2012 Stock Plan (the last five plans are referred to hereafter as the Stock Plans.) The table shows the number of shares purchased pursuant to those plans and the average price paid per share. The purchases for the Director Fee Stock Plan were made in open-market transactions. Under the Stock Plans, shares were purchased from plan participants at the then current market value in satisfaction of stock option exercise prices. First Financial has one previously announced stock repurchase plan under which it is authorized to purchase shares (2) of its common stock. The plan has no expiration date. The table that follows provides additional information regarding this plan.

| Announcement<br>Date | Total Shares<br>Approved for<br>Repurchase | Total Shares<br>Repurchased<br>Under<br>the Plan | Expiration<br>Date |
|----------------------|--|--|--------------------|
| 10/25/2012           | 5,000,000                                  | 1,000,900  | None               |



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Item 6. Exhibits

(a) Exhibits:

Exhibit  
Number

- |       |  |
|-------|--|
| 10.1  | Form of Agreement for Restricted Stock Awards under the First Financial Bancorp. 2012 Stock Plan (3-year vesting/accrual of dividends). <sup>(1)</sup>   |
| 10.2  | Agreement for Performance-Based Restricted Stock Awards under the First Financial Bancorp. 2012 Stock Plan between Bancorp and Claude E. Davis. <sup>(1)</sup>   |
| 31.1  | Certification by Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 filed herewith.   |
| 31.2  | Certification by Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 filed herewith.   |
| 32.1  | Certification of Periodic Financial Report by Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 furnished herewith.  |
| 32.2  | Certification of Periodic Financial Report by Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 furnished herewith.  |
| 101.1 | Financial statements from the Quarterly Report on Form 10-Q of the Company for the quarter ended June 30, 2013, formatted in XBRL (eXtensible Business Reporting Language) pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Changes in Shareholders' Equity, (v) Consolidated Statements of Cash Flows and (vi) Notes to Consolidated Financial Statements, as blocks of text and in detail. <sup>(2)</sup> |

First Financial will furnish, without charge, to a security holder upon request a copy of the documents and will furnish any other Exhibit upon payment of reproduction costs. Unless as otherwise noted, documents incorporated by reference involve File No. 000-12379.

(1) Compensation plan(s) or arrangement(s).

As provided in Rule 406T of Regulation S-T, this information shall not be deemed “filed” for purposes of Section 11 (2) and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934 or otherwise subject to liability under those sections.



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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

FIRST FINANCIAL BANCORP.  
(Registrant)

/s/ Anthony M. Stollings  
Anthony M. Stollings  
Executive Vice President and Chief Financial  
Officer

/s/ John M. Gavigan  
John M. Gavigan  
First Vice President and Corporate Controller  
(Principal Accounting Officer)

Date 8/6/2013

Date 8/6/2013