

FIRST MERCHANTS CORP
Form 10-Q
August 07, 2015

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

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

For the quarterly period ended June 30, 2015
OR

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

For the Transition Period from _____ to _____

Commission File Number 0-17071

FIRST MERCHANTS CORPORATION
(Exact name of registrant as specified in its charter)

Indiana 35-1544218
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

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

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

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

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

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

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

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

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

As of July 31, 2015, there were 37,852,852 outstanding common shares of the registrant.

1

Table of Contents

TABLE OF CONTENTS

FIRST MERCHANTS CORPORATION

<u>Part I. Financial Information</u>		Page No.
Item 1.	<u>Financial Statements:</u>	
	<u>Consolidated Condensed Balance Sheets</u>	<u>3</u>
	<u>Consolidated Condensed Statements of Income</u>	<u>4</u>
	<u>Consolidated Condensed Statements of Comprehensive Income</u>	<u>5</u>
	<u>Consolidated Condensed Statement of Stockholders' Equity</u>	<u>6</u>
	<u>Consolidated Condensed Statements of Cash Flows</u>	<u>7</u>
	<u>Notes to Consolidated Condensed Financial Statements</u>	<u>8</u>
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>42</u>
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>54</u>
Item 4.	<u>Controls and Procedures</u>	<u>55</u>
 <u>Part II. Other Information</u>		
Item 1.	<u>Legal Proceedings</u>	<u>56</u>
Item 1A.	<u>Risk Factors</u>	<u>56</u>
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>56</u>
Item 3.	<u>Defaults Upon Senior Securities</u>	<u>56</u>
Item 4.	<u>Mine Safety Disclosures</u>	<u>56</u>
Item 5.	<u>Other Information</u>	<u>56</u>
Item 6.	<u>Exhibits</u>	<u>57</u>
	<u>Signatures</u>	<u>58</u>
	<u>Index to Exhibits</u>	<u>59</u>

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

CONSOLIDATED CONDENSED BALANCE SHEETS

	June 30, 2015 (Unaudited)	December 31, 2014
ASSETS		
Cash and cash equivalents	\$105,928	\$118,616
Interest-bearing time deposits	26,669	47,520
Investment securities available for sale	575,415	549,543
Investment securities held to maturity (fair value of \$647,810 and \$647,723)	637,101	631,088
Loans held for sale	8,295	7,235
Loans, net of allowance for loan losses of \$62,550 and \$63,964	4,175,655	3,860,901
Premises and equipment	84,841	77,691
Federal Reserve and Federal Home Loan Bank stock	34,630	41,353
Interest receivable	19,880	19,984
Core deposit intangibles	14,820	16,031
Goodwill	205,376	202,724
Cash surrender value of life insurance	170,813	169,424
Other real estate owned	19,242	19,293
Tax asset, deferred and receivable	39,622	41,960
Other assets	22,021	20,764
TOTAL ASSETS	\$6,140,308	\$5,824,127
LIABILITIES		
Deposits:		
Noninterest-bearing	\$1,122,688	\$1,070,859
Interest-bearing	3,666,889	3,569,835
Total Deposits	4,789,577	4,640,694
Borrowings:		
Federal funds purchased	40,748	15,381
Securities sold under repurchase agreements	137,240	124,539
Federal Home Loan Bank advances	247,687	145,264
Subordinated debentures and term loans	126,882	126,810
Total Borrowings	552,557	411,994
Interest payable	3,211	3,201
Other liabilities	45,008	41,411
Total Liabilities	5,390,353	5,097,300
COMMITMENTS AND CONTINGENT LIABILITIES		
STOCKHOLDERS' EQUITY		
Cumulative Preferred Stock, \$1,000 par value, \$1,000 liquidation value:		
Authorized - 600 shares		
Issued and outstanding - 125 shares	125	125
Common Stock, \$.125 stated value:		
Authorized - 50,000,000 shares		
Issued and outstanding - 37,824,649 and 37,669,948 shares	4,728	4,709
Additional paid-in capital	432,294	431,220

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Retained earnings	319,298	292,403
Accumulated other comprehensive loss	(6,490	) (1,630)
Total Stockholders' Equity	749,955	726,827
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$6,140,308	\$5,824,127

See notes to consolidated condensed financial statements.

3

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

CONSOLIDATED CONDENSED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,	2014	June 30,	2014
	2015		2015	
INTEREST INCOME				
Loans receivable:				
Taxable	\$45,320	\$42,323	\$88,871	\$84,348
Tax exempt	736	58	984	119
Investment securities:				
Taxable	4,425	5,046	9,148	9,856
Tax exempt	4,231	3,570	8,066	7,008
Deposits with financial institutions	31	35	68	58
Federal Reserve and Federal Home Loan Bank stock	459	495	1,009	1,147
Total Interest Income	55,202	51,527	108,146	102,536
INTEREST EXPENSE				
Deposits	3,686	2,874	7,202	5,423
Federal funds purchased	19	23	42	72
Securities sold under repurchase agreements	90	187	168	383
Federal Home Loan Bank advances	706	676	1,397	1,358
Subordinated debentures and term loans	1,670	1,648	3,330	3,289
Total Interest Expense	6,171	5,408	12,139	10,525
NET INTEREST INCOME	49,031	46,119	96,007	92,011
Provision for loan losses	417	—	417	—
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	48,614	46,119	95,590	92,011
OTHER INCOME				
Service charges on deposit accounts	4,090	4,098	7,638	7,649
Fiduciary activities	2,309	2,360	4,816	4,572
Other customer fees	4,602	4,049	8,269	7,782
Commission income	1,815	1,886	4,143	4,154
Earnings on cash surrender value of life insurance	640	653	1,387	1,401
Net gains and fees on sales of loans	1,781	1,159	3,270	1,882
Net realized gains (losses) on sales of available for sale securities	(93	) 844	932	1,425
Gain on sale of insurance subsidiary	8,265		8,265	
Other income	1,224	1,130	2,145	2,748
Total Other Income	24,633	16,179	40,865	31,613
OTHER EXPENSES				
Salaries and employee benefits	26,434	23,430	50,975	48,731
Net occupancy	3,503	3,204	7,293	7,142
Equipment	2,840	2,096	5,406	4,835
Marketing	951	789	1,731	1,558

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Outside data processing fees	1,768	2,039	3,485	3,870
Printing and office supplies	303	393	667	851
Core deposit amortization	729	592	1,450	1,184
FDIC assessments	895	863	1,758	1,923
Other real estate owned and foreclosure expenses	1,372	2,613	2,601	4,370
Professional and other outside services	3,134	1,531	4,625	2,910
Other expenses	4,494	3,700	7,634	6,965
Total Other Expenses	46,423	41,250	87,625	84,339
INCOME BEFORE INCOME TAX	26,824	21,048	48,830	39,285
Income tax expense	8,856	5,888	14,690	10,505
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS	\$17,968	\$15,160	\$34,140	\$28,780
Per Share Data:				
Basic Net Income Available to Common Stockholders	\$0.47	\$0.42	\$0.90	\$0.80
Diluted Net Income Available to Common Stockholders	\$0.47	\$0.41	\$0.90	\$0.79
Cash Dividends Paid	\$0.11	\$0.08	\$0.19	\$0.13
Average Diluted Shares Outstanding (in thousands)	38,043	36,294	38,022	36,278

See notes to consolidated condensed financial statements.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2015	2014	June 30, 2015	2014
Net income	\$17,968	\$15,160	\$34,140	\$28,780
Other comprehensive income net of tax:				
Unrealized holding gain (loss) on securities available for sale arising during the period, net of tax of \$2,904, \$3,149, \$2,376 (5,393) and \$5,953		) 5,849	(4,413	) 11,055
Unrealized gain on securities available for sale for which a portion of an other than temporary impairment has been recognized in income, net of tax of \$290 and \$916		538		1,702
Unrealized gain (loss) on cash flow hedges arising during the period, net of tax of \$282, \$452, \$165 and \$895	525	(840	) (304	) (1,663
Reclassification adjustment for gains (losses) included in net income, net of tax of \$158, \$172, \$77 and \$256	293	(321	) (143	) (474
	(4,575	) 5,226	(4,860	) 10,620
Comprehensive income	\$13,393	\$20,386	\$29,280	\$39,400

See notes to consolidated condensed financial statements.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

CONSOLIDATED CONDENSED STATEMENT OF STOCKHOLDERS' EQUITY

(Unaudited)

	Preferred		Common Stock		Additional		Accumulated Other Comprehensive	
	Shares	Amount	Shares	Amount	Paid in Capital	Retained Earnings	Income (Loss)	Total
Balances, December 31, 2014	125	\$ 125	37,669,948	\$ 4,709	\$ 431,220	\$ 292,403	\$ (1,630)	\$ 726,827
Comprehensive income								
Net income						34,140		34,140
Other comprehensive income, net of tax							(4,860)	(4,860)
Cash dividends on common stock (\$.19 per share)						(7,245)		(7,245)
Share-based compensation			142,451	18	1,112			1,130
Stock issued under employee benefit plans			11,733	1	230			231
Stock issued under dividend reinvestment and stock purchase plan			12,871	2	308			310
Stock options exercised			42,042	5	649			654
Stock redeemed			(54,396)	(7)	(1,225)			(1,232)
Balances, June 30, 2015	125	\$ 125	37,824,649	\$ 4,728	\$ 432,294	\$ 319,298	\$ (6,490)	\$ 749,955

See notes to consolidated condensed financial statements.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

	June 30, 2015	2014
Cash Flow From Operating Activities:		
Net income	\$34,140	\$28,780
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	417	
Depreciation and amortization	3,123	3,000
Change in deferred taxes	7,002	10,077
Share-based compensation	1,130	1,059
Tax benefit from stock options exercised	(35	) (60
Loans originated for sale	(176,552	) (79,337
Proceeds from sales of loans	175,492	77,298
Gain on sale of insurance subsidiary	(8,265)
Gains on sales of securities available for sale	(932	) (1,425
Change in interest receivable	396	331
Change in interest payable	(19	) 718
Other adjustments	509	(11,799
Net cash provided by operating activities	\$36,406	\$28,642
Cash Flows from Investing Activities:		
Net change in interest-bearing deposits	\$21,773	\$27,213
Purchases of:		
Securities available for sale	(101,627	) (113,578
Securities held to maturity	(55,415	) (71,816
Proceeds from sales of securities available for sale	42,117	17,337
Proceeds from maturities of:		
Securities available for sale	31,917	30,399
Securities held to maturity	44,035	31,443
Change in Federal Reserve and Federal Home Loan Bank stock	7,578	(4,137
Net change in loans	(213,356	) (93,994
Net cash and cash equivalents paid in acquisition	(12,004)
Net cash received from sale of insurance subsidiary	15,155	
Proceeds from the sale of other real estate owned	4,444	6,229
Other adjustments	1,464	(2,082
Net cash used in investing activities	\$(213,919	) \$(172,986
Cash Flows from Financing Activities:		
Net change in :		
Demand and savings deposits	\$51,914	\$15,816
Certificates of deposit and other time deposits	(8,357	) 82,326
Borrowings	200,467	301,643
Repayment of borrowings	(71,916	) (244,198
Cash dividends on common stock	(7,246	) (4,735
Stock issued under employee benefit plans	231	252
Stock issued under dividend reinvestment and stock purchase plans	310	239

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Stock options exercised	619	450
Tax benefit from stock options exercised	35	60
Stock redeemed	(1,232	) (1,052)
Net cash provided by financing activities	\$164,825	\$150,801
Net Change in Cash and Cash Equivalents	(12,688	) 6,457
Cash and Cash Equivalents, January 1	118,616	109,434
Cash and Cash Equivalents, June 30	\$105,928	\$115,891
Additional cash flow information:		
Interest paid	\$12,129	\$9,807
Income tax paid	\$3,000	\$1,688
Loans transferred to other real estate owned	\$3,360	\$2,550
Fixed assets transferred to other real estate owned	\$1,003	\$297
Non-cash investing activities using trade date accounting	\$1,887	\$5,517

In conjunction with the acquisition, liabilities were assumed as follows:

Fair value of assets acquired	\$141,724	
Cash received (paid) in acquisition	\$(14,500)
Less: Common stock issued	\$—	
Liabilities assumed	\$127,224	\$—

See notes to consolidated condensed financial statements.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

NOTE 1

GENERAL

Financial Statement Preparation

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

The consolidated condensed balance sheet of the Corporation as of December 31, 2014, has been derived from the audited consolidated balance sheet of the Corporation as of that date. Certain information and note disclosures normally included in the Corporation's annual financial statements, prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted. These consolidated condensed financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2014 filed with the Securities and Exchange Commission. The results of operations for the three and six months ended June 30, 2015, are not necessarily indicative of the results to be expected for the year. Reclassifications have been made to prior financial statements to conform to the current financial statement presentation. These reclassifications had no effect on net income.

NOTE 2

ACQUISITIONS AND DIVESTITURES

Acquisitions

C Financial Corporation

On April 17, 2015, the Corporation acquired 100 percent of C Financial Corporation, ("C Financial"). C Financial merged with and into the Corporation (the "C Financial Merger") whereupon the separate corporate existence of C Financial ceased and the Corporation survived. Immediately following the C Financial Merger, Cooper State Bank, an Ohio state bank and wholly-owned subsidiary of C Financial, merged with and into First Merchants Bank, National Association, a national bank and wholly-owned subsidiary of the Corporation (the "Bank"), with the Bank continuing as the surviving bank. C Financial was headquartered in Columbus, Ohio and had 6 full service banking centers serving the Columbus, Ohio market. As part of the \$14.5 million C Financial Merger, shareholders of C Financial received \$6.738 in cash for each share of C Financial common stock held. The Corporation expects the transaction to be accretive to income within the first full year of operation, and expand the existing footprint in Columbus, Ohio. Goodwill resulted from this transaction due to the synergies and economies of scale that are expected.

Under the acquisition method of accounting, the total purchase price is allocated to net tangible and intangible assets based on their current estimated fair values on the date of the acquisition. Based on preliminary valuations of the fair value of tangible and intangible assets acquired and liabilities assumed, which are based on assumptions that are subject to change, the purchase price for the C Financial acquisition is detailed in the following table. Prior to the end of the one year measurement period for finalizing the purchase price allocation, if information becomes available which would indicate adjustments are required to the purchase price allocation, such adjustments will be included in the purchase price allocation retrospectively.

	Fair Value	
Cash and cash equivalents	\$2,496	
Federal Funds sold	7,018	
Interest-bearing time deposits	922	
Loans	110,625	
Premises and equipment	7,290	
Federal Home Loan Bank stock	855	
Interest receivable	292	
Other assets	119	
Deposits	(105,326)
Interest payable	(29)
Federal Home Loan Bank Advances	(18,958)
Other liabilities	(2,911)
Net tangible assets acquired	2,393	
Core deposit intangible	981	
Goodwill	11,126	
Purchase price	\$14,500	

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

Of the total purchase price, \$981,000 has been allocated to a core deposit intangible that will be amortized over its estimated life of 10 years. The remaining purchase price has been allocated to goodwill, which is deductible for tax purposes because the transaction was considered a taxable exchange.

Community Bancshares, Inc.

On November 7, 2014, the Corporation acquired 100 percent of Community Bancshares, Inc. ("Community"), pursuant to which, Community merged with and into the Corporation (the "Community Merger") whereupon the separate corporate existence of Community ceased and the Corporation survived. Immediately following the Community Merger, Community Bank, and Indiana state bank and wholly-owned subsidiary of Community, merged with and into the Bank, with the Bank continuing as the surviving bank. Community was headquartered in Noblesville, Indiana and had 10 full-service banking centers serving central Indiana. Pursuant to the merger agreement, each outstanding share of common stock of Community was converted into the right to receive either (a) 4.0926 shares of the Corporation's common stock, plus cash in lieu of fractional shares; or (b) \$85.94 in cash, based upon shareholder elections. The Corporation paid \$14.2 million in cash and issued approximately 1.6 million shares of common stock, valued at approximately \$35.0 million, for a total purchase price of approximately \$49.2 million. The Corporation expects the transaction to be accretive to income within the first full year of operation, and expand the existing footprint in central Indiana. Goodwill resulted from this transaction due to the synergies and economies of scale that are expected.

Under the acquisition method of accounting, the total purchase price is allocated to net tangible and intangible assets based on their current estimated fair values on the date of the acquisition. Based on preliminary valuations of the fair value of tangible and intangible assets acquired and liabilities assumed, which are based on assumptions that are subject to change, the purchase price for the Community acquisition is detailed in the following table. Prior to the end of the one year measurement period for finalizing the purchase price allocation, if information becomes available which would indicate adjustments are required to the purchase price allocation, such adjustments will be included in the purchase price allocation retrospectively.

	Fair Value	
Cash and cash equivalents	\$4,124	
Interest-bearing time deposits	16,526	
Investment Securities, available for sale	76,807	
Loans	145,064	
Premises and equipment	3,610	
Federal Home Loan Bank stock	1,950	
Interest receivable	767	
Cash surrender value of life insurance	3,266	
Other real estate owned	6,662	
Taxes, deferred and receivable	3,348	
Other assets	167	
Deposits	(228,424)
Interest payable	(98)

Other liabilities	(3,014)
Net tangible assets acquired	30,755	
Core deposit intangible	4,658	
Goodwill	13,776	
Purchase price	\$49,189	

Of the total purchase price, \$4,658,000 has been allocated to a core deposit intangible that will be amortized over its estimated life of 10 years. The remaining purchase price has been allocated to goodwill, which is not deductible for tax purposes due to the merger being accounted for as a tax-free exchange. The tax-free exchange resulted in a carryover of tax attributes and tax basis to the Corporation's subsequent income tax filings and was adjusted for any fair value adjustments required in accounting for the acquisition.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

Pro Forma Financial Information

The Corporation acquired CFS Bancorp ("CFS") on November 12, 2013 and Community on November 7, 2014. The results of operations of CFS and Community have been included in the Corporation's consolidated financial statements since the acquisition dates. The following schedule includes pro forma results for the periods ended December 31, 2014 and 2013 as if the CFS and Community acquisitions had occurred as of the beginning of the comparable prior annual reporting period. Pro forma financial information for the C Financial acquisition is not included in the table below as it is deemed immaterial.

	2014	2013
Total revenue (net interest income plus other income)	\$263,070	\$253,668
Net income	\$61,572	\$39,979
Net income available to common shareholders	\$61,572	\$37,599
Earnings per share:		
Basic	\$1.63	\$0.98
Diluted	\$1.61	\$0.97

The pro forma information includes adjustments for interest income on loans, amortization of intangibles arising from the transaction, interest expense on deposits acquired, premises expense for the banking centers acquired and the related income tax effects. The pro forma information for the year ended December 31, 2014 includes \$1.6 million of operating revenue from Community since the acquisition and approximately \$1.8 million, net of tax, of non-recurring expenses directly attributable to the Community acquisition. The pro forma information for the year ended December 31, 2013 includes \$4.9 million of operating revenue from CFS since the acquisition and approximately \$9.5 million, net of tax, of non-recurring expenses directly attributable to the CFS acquisition. The pro forma financial information is presented for information purposes only and is not indicative of the results of operations that actually would have been achieved had the acquisition been consummated as of that time, nor is it intended to be a projection of future results.

Subsidiary Divestiture

On June 12, 2015, the Corporation sold all of its stock in First Merchants Insurance Services, Inc., an Indiana corporation ("FMIG"), to USI Insurance LLC, a Delaware limited liability company ("USI"). The sale price was \$18 million, of which \$16 million was paid at closing with the remaining \$2 million paid through a two-year promissory note. The sale price is subject to a customary working capital adjustment once closing working capital is confirmed. The sale of FMIG generated a gain on sale of \$8.3 million.

NOTE 3

INVESTMENT SECURITIES

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at June 30, 2015				
U.S. Government-sponsored agency securities	\$100	\$6		\$106
State and municipal	281,965	8,370	\$1,707	288,628
U.S. Government-sponsored mortgage-backed securities	278,787	6,361	204	284,944
Corporate obligations	31			31
Equity securities	1,706			1,706
Total available for sale	562,589	14,737	1,911	575,415
Held to maturity at June 30, 2015				
State and municipal	223,615	4,047	1,262	226,400
U.S. Government-sponsored mortgage-backed securities	413,486	8,690	766	421,410
Total held to maturity	637,101	12,737	2,028	647,810
Total Investment Securities	\$1,199,690	\$27,474	\$3,939	\$1,223,225

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at December 31, 2014				
U.S. Government-sponsored agency securities	\$100	\$9		\$109
State and municipal	216,915	11,801	\$123	228,593
U.S. Government-sponsored mortgage-backed securities	310,460	8,771	127	319,104
Corporate obligations	31			31
Equity securities	1,706			1,706
Total available for sale	529,212	20,581	250	549,543
Held to maturity at December 31, 2014				
State and municipal	204,443	5,716	96	210,063
U.S. Government-sponsored mortgage-backed securities	426,645	11,527	512	437,660
Total held to maturity	631,088	17,243	608	647,723
Total Investment Securities	\$1,160,300	\$37,824	\$858	\$1,197,266

The amortized cost and fair value of available for sale securities and held to maturity securities at June 30, 2015, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Maturity Distribution at June 30, 2015:				
Due in one year or less	\$3,174	\$3,222	\$7,831	\$7,858
Due after one through five years	10,633	11,031	17,813	18,440
Due after five through ten years	51,968	53,927	82,412	84,331
Due after ten years	216,321	220,585	115,559	115,771
	\$282,096	\$288,765	\$223,615	\$226,400
U.S. Government-sponsored mortgage-backed securities	278,787	284,944	413,486	421,410
Equity securities	1,706	1,706		
Total Investment Securities	\$562,589	\$575,415	\$637,101	\$647,810

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Maturity Distribution at December 31, 2014				
Due in one year or less	\$3,127	\$3,153	\$6,258	\$6,329
Due after one through five years	9,565	9,840	18,440	18,930
Due after five through ten years	48,675	50,889	85,997	87,903

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Due after ten years	155,679	164,851	93,748	96,901
	\$217,046	\$228,733	\$204,443	\$210,063
U.S. Government-sponsored mortgage-backed securities	310,460	319,104	426,645	437,660
Equity securities	1,706	1,706		
Total Investment Securities	\$529,212	\$549,543	\$631,088	\$647,723

The carrying value of securities pledged as collateral, to secure public deposits and for other purposes, was \$438,010,000 at June 30, 2015, and \$449,408,000 at December 31, 2014.

The book value of securities sold under agreements to repurchase amounted to \$133,101,000 at June 30, 2015, and \$120,027,000 at December 31, 2014.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

Gross gains on the sales and redemptions of available for sale securities for the three and six months ended June 30, 2015, and 2014 are shown below.

	Three Months Ended		Six Months Ended	
	June 30, 2015	2014	June 30, 2015	2014
Sales and Redemptions of Available for Sale Securities:				
Gross gains	\$7,000	\$844,000	\$1,032,000	\$1,425,000
Gross losses	100,000		100,000	
Other-than-temporary impairment losses				

The following table shows investments securities with unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2015, and December 31, 2014:

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Temporarily Impaired Available for Sale Securities at June 30, 2015						
State and municipal	\$77,987	\$ 1,707			\$77,987	\$ 1,707
U.S. Government-sponsored mortgage-backed securities	33,083	107	2,212	97	35,295	204
Total Temporarily Impaired Available for Sale Securities	111,070	1,814	2,212	97	113,282	1,911
Temporarily Impaired Held to Maturity Securities at June 30, 2015						
State and municipal	51,644	1,262			51,644	1,262
U.S. Government-sponsored mortgage-backed securities	54,210	492	14,222	274	68,432	766
Total Temporarily Impaired Held to Maturity Securities	105,854	1,754	14,222	274	120,076	2,028
Total Temporarily Impaired Investment Securities	\$216,924	\$ 3,568	\$16,434	\$ 371	\$233,358	\$ 3,939
	Less than 12 Months		12 Months or Longer		Total	

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Temporarily Impaired Available for Sale Securities at December 31, 2014						
State and municipal	1,256	7	\$9,850	\$ 116	\$11,106	\$ 123
U.S. Government-sponsored mortgage-backed securities	2,186	13	5,447	114	7,633	127
Total Temporarily Impaired Available for Sale Securities	3,442	20	15,297	230	18,739	250
Temporarily Impaired Held to Maturity Securities at December 31, 2014						
State and municipal	5,119	96	250		5,369	96
U.S. Government-sponsored mortgage-backed securities	9,791	82	38,491	430	48,282	512
Total Temporarily Impaired Held to Maturity Securities	14,910	178	38,741	430	53,651	608
Total Temporarily Impaired Investment Securities	\$18,352	\$ 198	\$54,038	\$ 660	\$72,390	\$ 858

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

	June 30, 2015	December 31, 2014	
Investments reported at less than historical cost:			
Historical cost	\$237,297	\$73,249	
Fair value	\$233,358	\$72,390	
Percent of the Corporation's available for sale and held to maturity portfolio	19.2	% 6.1	%

Management believes the decline in fair value for these securities was temporary. Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income during the period the other-than-temporary ("OTTI") is identified.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

The Corporation's management has evaluated all securities with unrealized losses for OTTI as of June 30, 2015. The evaluations are based on the nature of the securities, the extent and duration of the loss and the intent and ability of the Corporation to hold these securities either to maturity or through the expected recovery period.

In determining the fair value of the investment securities portfolio, the Corporation utilizes a third party for portfolio accounting services, including market value input, for those securities classified as Level 1 and Level 2 in the fair value hierarchy. The Corporation has obtained an understanding of what inputs are being used by the vendor in pricing the portfolio and how the vendor was classifying these securities based upon these inputs. From these discussions, the Corporation's management is comfortable that the classifications are proper. The Corporation has gained trust in the data for two reasons: (a) independent spot testing of the data is conducted by the Corporation through obtaining market quotes from various brokers on a periodic basis and (b) actual gains or loss resulting from the sale of certain securities has proven the data to be accurate over time. Fair value of securities classified as Level 3 in the valuation hierarchy was determined using a discounted cash flow model that incorporated market estimates of interest rates and volatility in markets that have not been active.

State and Municipal

The unrealized losses on the Corporation's investments in securities of state and political subdivisions were caused by changes in interest rates. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. The Corporation does not intend to sell the investment and it is not more likely than not that the Corporation will be required to sell the investment before recovery of its new, lower amortized cost basis, which may be maturity. The Corporation does not consider the investment securities to be other-than-temporarily impaired at June 30, 2015.

U.S. Government-Sponsored Mortgage-Backed Securities

The unrealized losses on the Corporation's investment in U.S. Government-sponsored mortgage-backed securities were a result of changes in interest rates. The Corporation expects to recover the amortized cost basis over the term of the securities as the decline in market value is attributable to changes in interest rates and not credit quality. The Corporation does not intend to sell the investment and it is not more likely than not that the Corporation will be required to sell the investment before recovery of its new, lower amortized cost basis, which may be maturity. The Corporation does not consider the investment securities to be other-than-temporarily impaired at June 30, 2015.

Credit Losses Recognized on Investments

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

Accumulated Credit Losses in 2015	Accumulated Credit Losses in 2014
---	---

Credit losses on debt securities held:

Balance, January 1	\$ 500	\$ 11,355
Reductions for previous other-than-temporary losses realized on securities sold during the year	(500	) (10,855
Balance, June 30	\$—	\$ 500

In the first quarter of 2015, the Corporation sold its remaining trust preferred security which had no remaining book value as a result of OTTI of approximately \$500,000 taken in 2009. The sale of this security resulted in a gain of \$45,000, which is included in the Consolidated Condensed Statement of Income for the six months ended June 30, 2015.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

NOTE 4

LOANS AND ALLOWANCE

The Corporation's primary lending focus is small business and middle market commercial, commercial real estate, residential real estate and consumer lending, which results in portfolio diversification. The following tables show the composition of the loan portfolio, the allowance for loan losses and certain credit quality elements, all excluding loans held for sale. Loans held for sale as of June 30, 2015, and December 31, 2014, were \$8,295,000 and \$7,235,000, respectively.

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

	June 30, 2015	December 31, 2014
Commercial and industrial loans	\$984,223	\$896,688
Agricultural production financing and other loans to farmers	93,695	104,927
Real estate loans:		
Construction	256,082	207,221
Commercial and farmland	1,705,647	1,672,661
Residential	689,621	647,315
Home Equity	302,403	286,529
Individuals' loans for household and other personal expenditures	62,785	73,400
Lease financing receivables, net of unearned income	742	1,106
Other commercial loans	143,007	35,018
Loans	\$4,238,205	\$3,924,865
Allowance for loan losses	(62,550)	(63,964)
Net Loans	\$4,175,655	\$3,860,901

At June 30, 2015, Other commercial loans totaled \$143,007,000, an increase of 107,989,000 from December 31, 2014. This increase was primarily a result of organic growth in the obligations of the state and political subdivisions sector of the portfolio.

Allowance, Credit Quality and Loan Portfolio

The Corporation maintains an allowance for loan losses to cover probable credit losses identified during its loan review process. Management believes the allowance for loan losses is appropriate to cover probable losses inherent in the loan portfolio at June 30, 2015. The process for determining the adequacy of the allowance for loan losses is critical to the Corporation's financial results. It requires management to make difficult, subjective and complex judgments, to estimate the effect of uncertain matters. The allowance for loan losses considers current factors, including economic conditions and ongoing internal and external examinations, and will increase or decrease as deemed necessary to ensure the allowance remains adequate. In addition, the allowance as a percentage of charge offs

and nonperforming loans will change at different points in time based on credit performance, loan mix and collateral values.

The allowance is increased by the provision for loan losses and decreased by charge offs less recoveries. The Bank charges off a loan when a determination is made that all or a portion of the loan is uncollectible. The allowance for loan losses is maintained through the provision for loan losses, which is a charge against earnings. The amount provided for loan losses in a given period may be greater than or less than net loan losses experienced during the period, and is based on management's judgment as to the appropriate level of the allowance for loan losses. The determination of the provision amount in a given period is based on management's ongoing review and evaluation of the loan portfolio, including an internally administered loan "watch" list and independent loan reviews. The evaluation takes into consideration identified credit problems, the possibility of losses inherent in the loan portfolio that are not specifically identified and management's judgment as to the impact of the current environment and economic conditions on the portfolio.

In conformance with ASC 805 and ASC 820, loans purchased after December 31, 2008, are recorded at the acquisition date fair value. Such loans are only included in the allowance when deemed impaired in accordance with ASC 310-30.

The allowance consists of specific impairment reserves as required by ASC 310-10-35, a component for historical losses in accordance with ASC 450 and the consideration of current environmental factors in accordance with ASC 450. A loan is deemed impaired when, based on current information or events, it is probable that all amounts due of principal and interest according to the contractual terms of the loan agreement will not be collected.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

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

At June 30, 2015, the allowance for loan losses was \$62,550,000, a decrease of \$1,414,000 from the December 31, 2014 balance of \$63,964,000. Specific reserves on impaired loans increased \$319,000 to \$3,088,000, from \$2,769,000 at December 31, 2014. Net charge offs for the six months ended June 30, 2015, were \$1,831,000. Comparatively, the same period in 2014 had net recoveries of \$497,000. The provision for loan losses for the six months ended June 30, 2015 was \$417,000. There was no provision for loan losses recognized for the six months ended June 30, 2014. The determination of the provision for loan losses in any period is based on management's continuing review and evaluation of the loan portfolio, and its judgment as to the impact of current economic conditions on the portfolio.

The following tables summarize changes in the allowance for loan losses by loan segment for the three and six months ended June 30, 2015, and June 30, 2014:

	Three Months Ended June 30, 2015					Total
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	
Allowance for loan losses:						
Balances, April 1,	\$ 30,007	\$ 16,383	\$ 3,138	\$ 13,269	\$ 4	\$ 62,801
Provision for losses	1,190	(502)	(200)	(72)	1	417
Recoveries on loans	437	147	101	747		1,432
Loans charged off	(155)	(200)	(112)	(1,633)		(2,100)
Balances, June 30, 2015	\$ 31,479	\$ 15,828	\$ 2,927	\$ 12,311	\$ 5	\$ 62,550

Six Months Ended June 30, 2015

	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance for loan losses:						
Balances, January 1	\$28,824	\$19,327	\$2,658	\$13,152	\$3	\$63,964
Provision for losses	3,024	(3,398)	) 327	462	2	417
Recoveries on loans	887	559	179	879		2,504
Loans charged off	(1,256)	) (660)	) (237)	) (2,182)	)	(4,335)
Balances, June 30, 2015	\$31,479	\$15,828	\$2,927	\$12,311	\$5	\$62,550

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

	Three Months Ended June 30, 2014					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance for loan losses:						
Balances, April 1	\$30,907	\$22,358	\$2,410	\$13,908		\$69,583
Provision for losses	(2,036)	) 552	(140)	) 1,622	\$2	—
Recoveries on loans	448	351	81	325		1,205
Loans charged off	(705)	) (679)	) (108)	) (927)	) (2)	) (2,421)
Balances, June 30, 2014	\$28,614	\$22,582	\$2,243	\$14,928		\$68,367

	Six Months Ended June 30, 2014					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance for loan losses:						
Balances, January 1	\$27,176	\$23,102	\$2,515	\$15,077		\$67,870
Provision for losses	351	(705)	) (152)	) 524	\$(18)) —
Recoveries on loans	2,498	1,141	217	929	20	4,805
Loans charged off	(1,411)	) (956)	) (337)	) (1,602)	) (2)	) (4,308)
Balances, June 30, 2014	\$28,614	\$22,582	\$2,243	\$14,928		\$68,367

The following tables show the Corporation's allowance for credit losses and loan portfolio by loan segment as of the periods indicated:

	June 30, 2015					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance Balances:						
Individually evaluated for impairment	\$2,058	\$328		\$349		\$2,735
Collectively evaluated for impairment	29,421	15,340	\$2,927	11,769	\$5	59,462
Loans Acquired with Deteriorated Credit Quality		160		193		353
Total Allowance for Loan Losses	\$31,479	\$15,828	\$2,927	\$12,311	\$5	\$62,550
Loan Balances:						
Individually evaluated for impairment	\$8,077	\$21,945		\$5,012		\$35,034
Collectively evaluated for impairment	1,205,104	1,885,287	\$62,785	981,667	\$742	4,135,585
Loans Acquired with Deteriorated Credit Quality	7,743	54,498		5,345		67,586
Loans	\$1,220,924	\$1,961,730	\$62,785	\$992,024	\$742	\$4,238,205

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

	December 31, 2014					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance Balances:						
Individually evaluated for impairment	\$1,455	\$470		\$194		\$2,119
Collectively evaluated for impairment	27,369	18,207	\$2,658	12,958	\$3	61,195
Loans Acquired with Deteriorated Credit Quality		650				650
Total Allowance for Loan Losses	\$28,824	\$19,327	\$2,658	\$13,152	\$3	\$63,964
Loan Balances:						
Individually evaluated for impairment	\$16,108	\$23,963		\$4,022		\$44,093
Collectively evaluated for impairment	1,011,122	1,796,797	\$73,400	925,282	\$1,106	3,807,707
Loans Acquired with Deteriorated Credit Quality	9,403	59,122		4,540		73,065
Loans	\$1,036,633	\$1,879,882	\$73,400	\$933,844	\$1,106	\$3,924,865

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

Commercial

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

Commercial real estate

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

Residential and Consumer

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

Loans are reclassified to a non-accruing status when, in management's judgment, the collateral value and financial condition of the borrower do not justify accruing interest. Interest previously recorded, but not deemed collectible, is reversed and charged against current income. Payments subsequently received on non-accrual loans are applied to principal. A loan is returned to accrual status when principal and interest are no longer past due and collectability is probable, typically after a minimum of six consecutive months of performance. Payments received on impaired accruing or delinquent loans are applied to interest income as accrued.

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

	June 30, 2015	December 31, 2014
Commercial and industrial loans	\$5,510	\$7,048
Agriculture production financing and other loans to farmers	1,298	5,800
Real estate Loans:		
Construction	1,493	1,439
Commercial and farmland	16,964	19,350
Residential	10,515	12,933
Home Equity	1,874	1,988
Individuals' loans for household and other personal expenditures	59	231
Total	\$37,713	\$48,789

Commercial impaired loans include non-accrual loans, loans accounted for under ASC 310-30, as well as substandard, doubtful and loss grade loans that were still accruing but deemed impaired according to guidance set forth in ASC 310. Also included in impaired loans are accruing loans that are contractually past due 90 days or more and troubled debt restructurings.

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

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

The following tables show the composition of the Corporation's commercial impaired loans by loan class as of the periods indicated:

	June 30, 2015		
	Unpaid Principal Balance	Recorded Investment	Related Allowance
Impaired loans with no related allowance:			
Commercial and industrial loans	\$22,029	\$11,311	
Agriculture production financing and other loans to farmers	1,313	1,308	
Real estate Loans:			
Construction	10,805	7,311	
Commercial and farmland	91,071	66,184	
Residential	10,930	7,076	
Home equity	263	206	
Other commercial loans	25		
Total	\$136,436	\$93,396	
Impaired loans with related allowance:			
Commercial and industrial loans	\$3,496	\$3,201	\$2,058
Real estate Loans:			
Commercial and farmland	2,723	2,602	488
Residential	2,725	2,598	542
Total	\$8,944	\$8,401	\$3,088
Total Impaired Loans	\$145,380	\$101,797	\$3,088
	December 31, 2014		
	Unpaid Principal Balance	Recorded Investment	Related Allowance
Impaired loans with no related allowance:			
Commercial and industrial loans	\$35,514	\$18,029	
Agriculture production financing and other loans to farmers	26	22	
Real estate Loans:			
Construction	12,956	9,318	
Commercial and farmland	95,856	68,187	
Residential	10,591	6,839	
Home equity	3,590	398	
Other commercial loans	30		
Total	\$158,563	\$102,793	
Impaired loans with related allowance:			
Commercial and industrial loans	\$1,766	\$1,684	\$1,055

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Agriculture production financing and other loans to farmers	6,777	5,777	400
Real estate Loans:			
Commercial and farmland	7,159	4,971	1,120
Residential	1,001	998	194
Total	\$16,703	\$13,430	\$2,769
Total Impaired Loans	\$175,266	\$116,223	\$2,769

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

	Three Months Ended June 30, 2015		Six Months Ended June 30, 2015	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Impaired loans with no related allowance:				
Commercial and industrial loans	\$12,154	\$111	\$12,942	\$200
Agriculture production financing and other loans to farmers	1,325		1,343	
Real estate Loans:				
Construction	7,648	95	7,898	191
Commercial and farmland	66,625	894	66,957	1,765
Residential	7,114	57	7,150	107
Home equity	208		208	
Total	\$95,074	\$1,157	\$96,498	\$2,263
Impaired loans with related allowance:				
Commercial and industrial loans	\$3,204	\$10	\$3,214	\$19
Real estate Loans:				
Commercial and farmland	2,622		2,727	
Residential	2,600		2,603	
Total	\$8,426	\$10	\$8,544	\$19
Total Impaired Loans	\$103,500	\$1,167	\$105,042	\$2,282
	Three Months Ended June 30, 2014		Six Months Ended June 30, 2014	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Impaired loans with no related allowance:				
Commercial and industrial loans	\$12,060	\$84	\$12,872	\$185
Agriculture production financing and other loans to farmers	27		28	
Real estate Loans:				
Construction	10,331	114	10,412	227
Commercial and farmland	77,716	970	78,288	1,956

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Residential	4,017	31	4,212	57
Home equity	198		199	
Total	\$104,349	\$1,199	\$106,011	\$2,425
Impaired loans with related allowance:				
Commercial and industrial loans	\$3,575	\$10	\$3,590	\$20
Real estate Loans:				
Commercial and farmland	5,137	5	5,204	10
Total	\$8,712	\$15	\$8,794	\$30
Total Impaired Loans	\$113,061	\$1,214	\$114,805	\$2,455

As part of the ongoing monitoring of the credit quality of the Corporation's loan portfolio, management tracks certain credit quality indicators including trends related to: (i) the level of criticized commercial loans, (ii) net charge offs, (iii) non-performing loans and (iv) the general national and local economic conditions.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

The Corporation utilizes a risk grading of pass, special mention, substandard, doubtful and loss to assess the overall credit quality of large commercial loans. All large commercial credit grades are reviewed at a minimum of once a year for pass grade loans. Loans with grades below pass are reviewed more frequently depending on the grade. A description of the general characteristics of these grades is as follows:

Pass - Loans that are considered to be of acceptable credit quality.

Special Mention - Loans which possess some credit deficiency or potential weakness, which deserves close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Corporation's credit position at some future date. Special mention assets are not adversely classified and do not expose the Corporation to sufficient risk to warrant adverse classification. The key distinctions of this category's classification are that it is indicative of an unwarranted level of risk; and weaknesses are considered "potential", not "defined", impairments to the primary source of repayment. Examples include businesses that may be suffering from inadequate management, loss of key personnel or significant customer or litigation.

Substandard - A substandard loan is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified have a well-defined weakness that jeopardizes the liquidation of the debt. They are characterized by the distinct possibility that the Corporation will sustain some loss if the deficiencies are not corrected. Other characteristics may include:

- o the likelihood that a loan will be paid from the primary source of repayment is uncertain or financial deterioration is underway and very close attention is warranted to ensure that the loan is collected without loss,
- o the primary source of repayment is gone, and the Corporation is forced to rely on a secondary source of repayment, such as collateral liquidation or guarantees,
- o loans have a distinct possibility that the Corporation will sustain some loss if deficiencies are not corrected,
- o unusual courses of action are needed to maintain a high probability of repayment,
- o the borrower is not generating enough cash flow to repay loan principal; however, it continues to make interest payments,
- o the Corporation is forced into a subordinated or unsecured position due to flaws in documentation,
- o loans have been restructured so that payment schedules, terms and collateral represent concessions to the borrower when compared to the normal loan terms,
- o the Corporation is seriously contemplating foreclosure or legal action due to the apparent deterioration of the loan, and
- o there is significant deterioration in market conditions to which the borrower is highly vulnerable.

Doubtful - Loans that have all of the weaknesses of those classified as Substandard. However, based on currently existing facts, conditions and values, these weaknesses make full collection of principal highly questionable and improbable. Other credit characteristics may include the primary source of repayment is gone or there is considerable doubt as to the quality of the secondary sources of repayment. The possibility of loss is high, but because of certain important pending factors that may strengthen the loan, loss classification is deferred until the exact status of repayment is known.

•

Loss – Loans that are considered uncollectible and of such little value that continuing to carry them as an asset is not warranted. Loans will be classified as Loss when it is neither practical nor desirable to defer writing off or reserving all or a portion of a basically worthless asset, even though partial recovery may be possible at some time in the future.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

The following tables summarize the credit quality of the Corporation's loan portfolio, by loan class for the periods indicated. Consumer non-performing loans include accruing consumer loans 90 plus days delinquent and consumer non-accrual loans. The entire balance of a loan is considered delinquent if the minimum payment contractually required to be made is not received by the specified date. Loans that evidenced deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected are included in the applicable categories below.

	June 30, 2015							
	Commercial Pass	Commercial Special Mention	Commercial Substandard	Commercial Doubtful	Commercial Loss	Consumer Performing	Consumer Non-Performing	Total
Commercial and industrial loans	\$913,859	\$ 24,180	\$ 46,184					\$984,223
Agriculture production financing and other loans to farmers	84,781	3,002	5,912					93,695
Real estate Loans:								
Construction	237,568	1,611	1,268	\$ 565		\$ 14,967	\$ 103	256,082
Commercial and farmland	1,586,935	43,895	74,815				2	1,705,647
Residential	173,714	2,698	12,417			495,678	5,114	689,621
Home equity	7,088	66	472			293,071	1,706	302,403
Individuals' loans for household and other personal expenditures						62,666	119	62,785
Lease financing receivables, net of unearned income	643		99					742
Other commercial loans	143,007							143,007
Loans	\$3,147,595	\$ 75,452	\$ 141,167	\$ 565		\$ 866,382	\$ 7,044	\$4,238,205

	December 31, 2014							
	Commercial Pass	Commercial Special Mention	Commercial Substandard	Commercial Doubtful	Commercial Loss	Consumer Performing	Consumer Non-Performing	Total
Commercial and industrial loans	\$823,732	\$ 24,455	\$ 48,226	\$ 275				\$896,688
Agriculture production financing and other loans to farmers	96,155	1,195	7,577					104,927

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Real estate Loans:							
Construction	185,394	3,164	2,928		\$ 15,588	\$ 147	207,221
Commercial and farmland	1,552,781	29,484	90,161			235	1,672,661
Residential	149,430	6,321	10,918		470,972	9,674	647,315
Home equity	6,368	12	690		277,571	1,888	286,529
Individuals' loans for household and other personal expenditures					73,165	235	73,400
Lease financing receivables, net of unearned income	998		108				1,106
Other commercial loans	35,018						35,018
Loans	\$2,849,876	\$ 64,631	\$ 160,608	\$ 275	\$ 837,296	\$ 12,179	\$3,924,865

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

The following table shows a past due aging of the Corporation's loan portfolio, by loan class as of June 30, 2015, and December 31, 2014:

	June 30, 2015						Total Past Due & Non-Accrual	Total
	Current	30-59 Days Past Due	60-89 Days Past Due	Loans > 90 Days And Accruing	Non-Accrual			
Commercial and industrial loans	\$971,571	\$1,679	\$5,463		\$ 5,510	\$ 12,652	\$984,223	
Agriculture production financing and other loans to farmers	92,302	34	50	\$ 11	1,298	1,393	93,695	
Real estate Loans:								
Construction	253,330	1,069	190		1,493	2,752	256,082	
Commercial and farmland	1,685,194	3,090	17	382	16,964	20,453	1,705,647	
Residential	672,593	5,470	937	106	10,515	17,028	689,621	
Home equity	298,161	1,666	628	74	1,874	4,242	302,403	
Individuals' loans for household and other personal expenditures	62,288	300	79	59	59	497	62,785	
Lease financing receivables, net of unearned income	742						742	
Other commercial loans	143,007						143,007	
Loans	\$4,179,188	\$13,308	\$7,364	\$632	\$ 37,713	\$ 59,017	\$4,238,205	
	December 31, 2014							
	Current	30-59 Days Past Due	60-89 Days Past Due	Loans > 90 Days And Accruing	Non-Accrual	Total Past Due & Non-Accrual	Total	
Commercial and industrial loans	\$882,596	\$4,006	\$53	\$2,985	\$ 7,048	\$ 14,092	\$896,688	
Agriculture production financing and other loans to farmers	98,236	891			5,800	6,691	104,927	
Real estate Loans:								
Construction	204,683	1,017	82		1,439	2,538	207,221	
Commercial and farmland	1,642,016	9,846	778	671	19,350	30,645	1,672,661	
Residential	626,821	4,876	1,831	854	12,933	20,494	647,315	
Home equity	282,828	1,213	352	148	1,988	3,701	286,529	
Individuals' loans for household and other personal expenditures	72,853	258	53	5	231	547	73,400	
Lease financing receivables, net of unearned income	1,106						1,106	
Other commercial loans	35,018						35,018	

Loans	\$3,846,157	\$22,107	\$3,149	\$4,663	\$48,789	\$78,708	\$3,924,865
-------	-------------	----------	---------	---------	----------	----------	-------------

See the information regarding the analysis of loan loss experience in the "LOAN QUALITY/PROVISION FOR LOAN LOSSES" section of Management's Discussion and Analysis of Financial Condition and Results of Operations included as ITEM 2 of this Form 10-Q.

On occasion, borrowers experience declines in income and cash flow. As a result, these borrowers seek to reduce contractual cash outlays including debt payments. Concurrently, in an effort to preserve and protect its earning assets, specifically troubled loans, the Corporation works to maintain its relationship with certain customers who are experiencing financial difficulty by contractually modifying the borrower's debt agreement with the Corporation. In certain loan restructuring situations, the Corporation may grant a concession to a debtor experiencing financial difficulty, resulting in a trouble debt restructuring. A concession is deemed to be granted when, as a result of the restructuring, the Corporation does not expect to collect all amounts due, including interest accrued at the original contract rate. If the payment of principal at original maturity is primarily dependent on the value of collateral, the current value of the collateral is considered in determining whether the principal will be paid.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

The following tables summarize troubled debt restructurings in the Corporation's loan portfolio that occurred during the periods indicated:

	Three Months Ended June 30, 2015			Six Months Ended June 30, 2015		
	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans
Commercial and industrial loans	\$1,386	\$ 536	1	\$3,748	\$ 1,897	5
Real estate Loans:						
Construction				79	80	1
Commercial and farmland	537	537	1	537	2,280	2
Residential	20	871	2	44	895	3
Total	\$1,943	\$ 1,944	4	\$4,408	\$ 5,152	11

	Three Months Ended June 30, 2014			Six Months Ended June 30, 2014		
	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans
Real estate Loans:						
Commercial and farmland	\$259	\$ 259	1	\$259	\$ 259	1
Residential	242	242	3	372	376	6
Individuals' loans for household and other personal expenditures	11	11	1	26	26	2
Total	\$512	\$ 512	5	\$657	\$ 661	9

The following tables show the recorded investment of troubled debt restructurings, by modification type, that occurred during the periods indicated:

	Three Months Ended June 30, 2015			Total Modification
	Term Modification	Rate Modification	Combination	
Commercial and industrial loans	\$492			\$492
Real estate Loans:				
Commercial and farmland			\$240	240
Residential	850	\$21		871
Total	\$1,342	\$21	\$240	\$1,603

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

	Six Months Ended June 30, 2015			
	Term Modification	Rate Modification	Combination	Total Modification
Commercial and industrial loans	\$1,234		\$1,030	\$2,264
Real estate Loans:				
Construction	199			199
Commercial and farmland	1,442		240	1,682
Residential	850	\$47		897
Total	\$3,725	\$47	\$1,270	\$5,042

23

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

	Three Months Ended June 30, 2014			Total
	Term	Rate	Combination	Modification
	Modification	Modification		
Real estate Loans:				
Commercial and farmland	\$272			\$272
Residential	95		\$122	217
Home Equity		\$23		23
Individuals loans for household and other personal expenditures			11	11
Total	\$367	\$23	\$133	\$523

	Six Months Ended June 30, 2014			Total
	Term	Rate	Combination	Modification
	Modification	Modification		
Real estate Loans:				
Commercial and farmland	\$272			\$272
Residential	95	\$60	\$122	277
Home Equity		94		94
Individuals' loans for household and other personal expenditures			25	25
Total	\$367	\$154	\$147	\$668

Loans secured by commercial and farm real estate made up 44 percent of the post-modification balance of troubled debt restructured loans made in the six months ended June 30, 2015.

There were no troubled debt restructures that occurred during the twelve months ended June 30, 2015 and June 30, 2014, that subsequently defaulted during the period indicated and remained in default at period end. For purposes of this discussion, a loan is considered in default if it is 30 or more days past due.

For potential consumer loan restructures, impairment evaluation occurs prior to modification. Any subsequent impairment is typically addressed through the charge off process, or may be addressed through a specific reserve. Consumer troubled debt restructurings are generally included in the general historical allowance for loan loss at the post modification balance. Consumer non-accrual and delinquent troubled debt restructurings are also considered in the calculation of the non-accrual and delinquency trend environmental allowance allocation. Commercial troubled debt restructured loans risk graded special mention, substandard, doubtful and loss are individually evaluated for impairment under ASC 310. Any resulting specific reserves are included in the allowance for loan losses. Commercial 30 - 89 day delinquent troubled debt restructurings are included in the calculation of the delinquency trend environmental allowance allocation. All commercial non-impaired loans, including non-accrual and 90+ day delinquents, are included in the ASC 450 loss migration analysis.

NOTE 5

ACCOUNTING FOR CERTAIN LOANS ACQUIRED IN A PURCHASE

The acquired loans detailed in the tables below are included in Note 4. LOANS AND ALLOWANCE, in the Notes to Consolidated Condensed Financial Statements of this Form 10-Q. As described in Note 4, loans purchased after December 31, 2008 are recorded at the acquisition date fair value, which could result in a fair value discount or premium. Purchased loans with evidence of credit deterioration since origination and for which it is probable at the date of acquisition that the acquirer will not collect all contractually required principal and interest payments are accounted for under ASC 310-30, Loans Acquired with Deteriorated Credit Quality. The difference between contractually required payments and the cash flows expected to be collected at acquisition is referred to as the nonaccretable portion of the fair value discount or premium. The accretable portion of the fair value discount or premium is the difference between the expected cash flows and the net present value of expected cash flows, with such difference accreted into earnings over the term of the loans. All other loans not accounted for under ASC 310-30 are accounted for under ASC 310-20.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

The following table includes the outstanding balance and carrying amount of loans acquired during the years 2012, 2013, 2014 and 2015, which are included in the balance sheet amounts of loans receivable at June 30, 2015, and December 31, 2014 as applicable.

	June 30, 2015				Total
	C Financial	Community	CFS	SCB	
Commercial and industrial loans	\$ 114	\$7,245	\$59,166	\$5,272	\$71,797
Agricultural production financing and other loans to farmers		1,534	50	1,234	2,818
Real estate loans:					
Construction	7,267	12,600	6,612		26,479
Commercial and farmland	28,287	63,460	224,675	14,575	330,997
Residential	61,188	25,337	128,972	6,643	222,140
Home Equity	10,407	8,805	35,327	14,241	68,780
Individuals' loans for household and other personal expenditures	14	711	642	81	1,448
Other commercial loans			83		83
Total	\$ 107,277	\$ 119,692	\$455,527	\$42,046	\$724,542
Carrying Amount	\$ 104,714	\$ 112,171	\$433,744	\$36,467	\$687,096
Allowance		193	160		353
Carrying Amount Net of Allowance	\$ 104,714	\$ 111,978	\$433,584	\$36,467	\$686,743
		December 31, 2014			
		Community	CFS	SCB	Total
Commercial and industrial loans		\$8,168	\$64,897	\$6,059	\$79,124
Agricultural production financing and other loans to farmers		1,100		893	1,993
Real estate loans:					
Construction		19,063	9,113		28,176
Commercial and farmland		74,600	251,002	15,593	341,195
Residential		28,863	144,396	7,384	180,643
Home Equity		9,881	39,244	15,758	64,883
Individuals' loans for household and other personal expenditures		1,314	922	121	2,357
Other commercial loans			86		86
Total		\$ 142,989	\$509,660	\$45,808	\$698,457
Carrying Amount		\$ 134,198	\$484,949	\$39,324	\$658,471
Allowance			650		650
Carrying Amount Net of Allowance		\$ 134,198	\$484,299	\$39,324	\$657,821

The balance in the allowance for loan losses for loans acquired and accounted for under ASC 310-30 was \$353,000 and \$650,000 at June 30, 2015 and December 31, 2014, respectively.

25

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

As customer cash flow expectations improve, nonaccretable yield can be reclassified to accretable yield. The accretable yield, or income expected to be collected, and reclassifications from nonaccretable yield, are identified in the table below. The table reflects only purchased loans accounted for under ASC 310-30 and not the entire portfolio of purchased loans.

	Three Months Ended June 30, 2015				
	C Financial	Community	CFS	SCB	Total
Beginning balance		\$1,990	\$2,009	\$818	\$4,817
Additions	\$145				145
Accretion	(12	) (353	) (578	) (304	) (1,247
Reclassification from nonaccretable		181	309	244	734
Disposals			(8	)	(8
Ending balance	\$133	\$1,818	\$1,732	\$758	\$4,441

	Six Months Ended June 30, 2015				
	C Financial	Community	CFS	SCB	Total
Beginning balance		\$2,122	\$2,400	\$868	\$5,390
Additions	\$145				145
Accretion	(12	) (532	) (1,919	) (489	) (2,952
Reclassification from nonaccretable		228	1,259	379	1,866
Disposals			(8	)	(8
Ending balance	\$133	\$1,818	\$1,732	\$758	\$4,441

	Three Months Ended June 30, 2014		
	CFS	SCB	Total
Beginning balance	\$4,080	\$1,256	\$5,336
Additions			
Accretion	(1,242	) (215	) (1,457
Reclassification from nonaccretable	650	129	779
Disposals			
Ending balance	\$3,488	\$1,170	\$4,658

	Six Months Ended June 30, 2014		
	CFS	SCB	Total
Beginning balance	\$4,164	\$1,388	\$5,552
Additions			
Accretion	(1,543	) (402	) (1,945
Reclassification from nonaccretable	902	184	1,086
Disposals	(35	)	(35

Ending balance	\$3,488	\$1,170	\$4,658
----------------	---------	---------	---------

NOTE 6

GOODWILL

On April 17, 2015, the C Financial acquisition resulted in goodwill of \$11,126,000. Additionally, on June 12, 2015, the sale of FMIG resulted in a goodwill reduction of \$8,474,000. Additional details of these transactions can be found in NOTE 2. ACQUISITIONS AND DIVESTITURES, included within the Notes to Consolidated Condensed Financial Statements of this Form 10-Q.

	2015	2014
Balance, January 1	\$202,724	\$188,948
Goodwill acquired	11,126	
Goodwill reduction	(8,474)
Balance, June 30	\$205,376	\$188,948

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

NOTE 7

CORE DEPOSIT AND OTHER INTANGIBLES

On April 17, 2015, the C Financial acquisition resulted in a core deposit intangible of \$981,000. Additionally, on June 12, 2015, the sale of FMIG resulted in an other intangible reduction of \$742,000. Additional details of these transactions can be found in NOTE 2. ACQUISITIONS AND DIVESTITURES, included within the Notes to Consolidated Condensed Financial Statements of this Form 10-Q.

The carrying basis and accumulated amortization of recognized core deposit and other intangibles are noted below.

	June 30, 2015	June 30, 2014
Gross Carrying Amount	\$58,360	\$53,702
Core deposit and other intangibles acquired	981	
Accumulated amortization	(43,779	) (41,067
Core deposit and other intangibles reduction	(742)
Core deposit and other intangibles	\$ 14,820	\$ 12,635

Estimated future amortization expense is summarized as follows:

	Amortization Expense
2016	\$ 1,385
2017	2,734
2018	2,697
2019	1,584
2020	1,356
After 2020	5,064
	\$ 14,820

NOTE 8

DERIVATIVE FINANCIAL INSTRUMENTS

Risk Management Objective of Using Derivatives

The Corporation is exposed to certain risks arising from both its business operations and economic conditions. The Corporation principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Corporation manages economic risks, including interest rate, liquidity, and credit risk, primarily by managing the amount, sources, and duration of its assets and liabilities and through the use of derivative financial instruments. Specifically, the Corporation enters into derivative financial instruments to

manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Corporation's derivative financial instruments are used to manage differences in the amount, timing, and duration of the Corporation's known or expected cash payments principally related to certain variable-rate liabilities. The Corporation also has derivatives that are a result of a service the Corporation provides to certain qualifying customers, and, therefore, are not used to manage interest rate risk in the Corporation's assets or liabilities. The Corporation manages a matched book with respect to its derivative instruments offered as a part of this service to its customers in order to minimize its net risk exposure resulting from such transactions.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

Cash Flow Hedges of Interest Rate Risk

The Corporation's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish these objectives, the Corporation primarily uses interest rate swaps and interest rate caps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the payment of fixed amounts to a counterparty in exchange for the Corporation receiving variable payments over the life of the agreements without exchange of the underlying notional amount. Interest rate caps designated as cash flow hedges involve the receipt of variable amounts from a counterparty if interest rates rise above the strike rate on the contract in exchange for an up-front premium. As of June 30, 2015 and 2014, the Corporation had five interest rate swaps with a notional amount of \$56.0 million and one interest rate cap with a notional amount of \$13.0 million that were designated as cash flow hedges.

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. During 2015, \$26.0 million of the interest rate swaps and the \$13.0 million interest rate cap were used to hedge the variable cash outflows (LIBOR-based) associated with existing trust preferred securities when the outflows converted from a fixed rate to variable rate in September of 2012. In addition, the remaining \$30.0 million of interest rate swaps were used to hedge the variable cash outflows (LIBOR-based) associated with three Federal Home Loan Bank advances. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. During the three and six months ended June 30, 2015, and 2014, the Corporation did not recognize any ineffectiveness.

Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest payments are made on the Corporation's variable-rate liabilities. During the next twelve months, the Corporation expects to reclassify \$1,325,000 from accumulated other comprehensive income to interest expense.

Non-designated Hedges

The Corporation does not use derivatives for trading or speculative purposes. Derivatives not designated as hedges are not speculative and result from a service the Corporation provides to certain customers. The Corporation executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. Those interest rate swaps are simultaneously hedged by offsetting interest rate swaps that the Corporation executes with a third party, such that the Corporation minimizes its net risk exposure resulting from such transactions. As the interest rate swaps associated with this program do not meet the strict hedge accounting requirements, changes in the fair value of both the customer swaps and the offsetting swaps are recognized directly in earnings. As of June 30, 2015, the notional amount of customer-facing swaps was approximately \$152,839,000. This amount is offset with third party counterparties, as described above.

Fair Values of Derivative Instruments on the Balance Sheet

The table below presents the fair value of the Corporation's derivative financial instruments, as well as their classification on the Balance Sheet, as of June 30, 2015, and December 31, 2014.

	Asset Derivatives				Liability Derivatives			
	June 30, 2015		December 31, 2014		June 30, 2015		December 31, 2014	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments:								
Interest rate contracts	Other Assets	\$81	Other Assets	\$137	Other Liabilities	\$2,403	Other Liabilities	\$2,650
Derivatives not designated as hedging instruments:								
Interest rate contracts	Other Assets	\$3,559	Other Assets	\$3,730	Other Liabilities	\$3,661	Other Liabilities	\$3,887

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

Effect of Derivative Instruments on the Income Statement

The tables below present the effect of the Corporation's derivative financial instruments on the Income Statement for the three and six months ended June 30, 2015, and 2014.

Derivatives Not Designated as Hedging Instruments under FASB ASC 815-10	Location of Gain (Loss) Recognized Income on Derivative	Amount of Gain (Loss) Recognized Income on Derivative	
		Three Months Ended June 30, 2015	Three Months Ended June 30, 2014
Interest rate contracts	Other income	\$156	\$(31)

Derivatives Not Designated as Hedging Instruments under FASB ASC 815-10	Location of Gain (Loss) Recognized Income on Derivative	Amount of Gain (Loss) Recognized Income on Derivative	
		Six Months Ended June 30, 2015	Six Months Ended June 30, 2014
Interest rate contracts	Other income	\$55	\$(12)

The amount of gain (loss) recognized in other comprehensive income is included in the table below for the periods indicated.

Derivatives in Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in Other Comprehensive Income on Derivative (Effective Portion)			
	Three Months Ended		Six Months ended	
	June 30, 2015	June 30, 2014	June 30, 2015	June 30, 2014
Interest Rate Products	\$807	\$(1,292)	\$(469)	\$(2,558)

The amount of gain (loss) reclassified from other comprehensive income into income is included in the table below for the periods indicated.

Location of Loss Reclassified from Accumulated Other Comprehensive Income (Effective Portion)	Amount of Gain (Loss) Reclassified from Other Comprehensive Income into Income (Effective Portion)			
	Three Months Ended		Six Months ended	
	June 30, 2015	June 30, 2014	June 30, 2015	June 30, 2014
Interest Expense	\$(358)	\$(351)	\$(712)	\$(695)

The Corporation's exposure to credit risk occurs because of nonperformance by its counterparties. The counterparties approved by the Corporation are usually financial institutions, which are well capitalized and have credit ratings through Moody's and/or Standard & Poor's, at or above investment grade. The Corporation's control of such risk is through quarterly financial reviews, comparing mark-to-mark values with policy limitations, credit ratings and collateral pledging.

Credit-risk-related Contingent Features

The Corporation has agreements with certain of its derivative counterparties that contain a provision where if the Corporation fails to maintain its status as a well or adequate capitalized institution, then the Corporation could be required to terminate or fully collateralize all outstanding derivative contracts.

The Corporation also has agreements with certain of its derivative counterparties that contain a provision where if the Corporation defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, the Corporation could also be declared in default on its derivative obligations. As of June 30, 2015, the termination value of derivatives in a net liability position related to these agreements was \$6,234,000. As of June 30, 2015, the Corporation had minimum collateral posting thresholds with certain of its derivative counterparties and had posted collateral of \$10,031,000. If the Corporation had breached any of these provisions at June 30, 2015, it could have been required to settle its obligations under the agreements at their termination value.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

NOTE 9

DISCLOSURES ABOUT FAIR VALUE OF ASSETS AND LIABILITIES

The Corporation used fair value measurements to record fair value adjustments, to certain assets, and liabilities and to determine fair value disclosures. The accounting guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. ASC 820 applies only when other guidance requires or permits assets or liabilities to be measured at fair value; it does not expand the use of fair value in any new circumstances.

As defined in ASC 820, fair value is the price to sell an asset or transfer a liability in an orderly transaction between market participants. It represents an exit price at the measurement date. Market participants are buyers and sellers, who are independent, knowledgeable, and willing and able to transact in the principal (or most advantageous) market for the asset or liability being measured. Current market conditions, including imbalances between supply and demand, are considered in determining fair value. The Corporation values its assets and liabilities in the principal market where it sells the particular asset or transfers the liability with the greatest volume and level of activity. In the absence of a principal market, the valuation is based on the most advantageous market for the asset or liability (i.e., the market where the asset could be sold or the liability transferred at a price that maximizes the amount to be received for the asset or minimizes the amount to be paid to transfer the liability).

Valuation inputs refer to the assumptions market participants would use in pricing a given asset or liability. Inputs can be observable or unobservable. Observable inputs are those assumptions which market participants would use in pricing the particular asset or liability. These inputs are based on market data and are obtained from a source independent of the Corporation. Unobservable inputs are assumptions based on the Corporation's own information or estimate of assumptions used by market participants in pricing the asset or liability. Unobservable inputs are based on the best and most current information available on the measurement date. All inputs, whether observable or unobservable, are ranked in accordance with a prescribed fair value hierarchy which gives the highest ranking to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest ranking to unobservable inputs for which there is little or no market activity (Level 3). Fair values for assets or liabilities classified as Level 2 are based on one or a combination of the following factors: (i) quoted prices for similar assets; (ii) observable inputs for the asset or liability, such as interest rates or yield curves; or (iii) inputs derived principally from or corroborated by observable market data. The level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Corporation considers an input to be significant if it drives 10 percent or more of the total fair value of a particular asset or liability.

Recurring Measurements

Following is a description of the valuation methodologies and inputs used for instruments measured at fair value on a recurring basis and recognized in the accompanying Consolidated Condensed Balance Sheets, as well as the general classification of such instruments pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques as of June 30, 2015.

Available for Sale Investment Securities

Where quoted, market prices are available in an active market and securities are classified within Level 1 of the valuation hierarchy. There are no securities classified within Level 1 of the hierarchy. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities include agencies, mortgage backs, state and municipal, and equity securities. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. Level 3 fair value, including corporate obligations, state and municipal and equity securities, was determined using a discounted cash flow model that incorporated market estimates of interest rates and volatility in markets that have not been active.

Third party vendors compile prices from various sources and may apply such techniques as matrix pricing to determine the value of identical or similar investment securities classified within 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 specific investment securities but rather relying on the investment securities' relationship to other benchmark quoted investment securities. Any investment security not valued based upon the methods above are considered Level 3.

Interest Rate Derivative Agreements

See information regarding the Corporation's interest rate derivative products in NOTE 6. DERIVATIVE FINANCIAL INSTRUMENTS, included within the Notes to Consolidated Condensed Financial Statements of this Form 10-Q.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

The following table presents the fair value measurements of assets and liabilities recognized in the Consolidated Condensed Balance Sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2015, and December 31, 2014.

June 30, 2015	Fair Value	Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available for sale securities:				
U.S. Government-sponsored agency securities	\$ 106		\$ 106	
State and municipal	288,628		282,635	\$ 5,993
U.S. Government-sponsored mortgage-backed securities	284,944		284,944	
Corporate obligations	31			31
Equity securities	1,706		1,702	4
Interest rate swap asset	3,559		3,559	
Interest rate cap	81		81	
Interest rate swap liability	6,064		6,064	

December 31, 2014	Fair Value	Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available for sale securities:				
U.S. Government-sponsored agency securities	\$ 109		\$ 109	
State and municipal	228,593		221,982	\$ 6,611
U.S. Government-sponsored mortgage-backed securities	319,104		319,104	
Corporate obligations	31			31
Equity securities	1,706		1,702	4
Interest rate swap asset	3,730		3,730	
Interest rate cap	137		137	
Interest rate swap liability	6,537		6,537	

Level 3 Reconciliation

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the Consolidated Condensed Balance Sheets using significant unobservable (Level 3) inputs for three and six months ended June 30, 2015, and 2014.

	Available for Sale Securities			
	Three Months Ended June 30, 2015	Three Months Ended June 30, 2014	Six Months Ended June 30, 2015	Six Months Ended June 30, 2014
Balance at beginning of the period	\$6,198	\$11,494	\$6,646	\$9,977
Total realized and unrealized gains and losses:				
Included in net income				
Included in other comprehensive income	50	835	141	2,893
Purchases, issuances and settlements				
Transfers in/(out) of Level 3				
Principal payments	(220	) (4,796	) (759	) (5,337
Ending balance	\$6,028	\$7,533	\$6,028	\$7,533

There were no gains or losses for the period included in earnings that were attributable to the changes in unrealized gains or losses related to assets or liabilities held at June 30, 2015 or December 31, 2014.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

Transfers Between Levels

There were no transfers between Levels 1, 2 and 3 for the six months ended June 30, 2015 and 2014.

Nonrecurring Measurements

The following table presents the fair value measurement of assets and liabilities measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2015, and December 31, 2014.

June 30, 2015	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans (collateral dependent)	\$7,189			\$7,189
Other real estate owned	\$2,131			\$2,131

December 31, 2014	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans (collateral dependent)	\$17,134			\$17,134
Other real estate owned	\$5,155			\$5,155

Following is a description of valuation methodologies used for instruments measured at fair value on a nonrecurring basis and recognized in the Consolidated Condensed Balance Sheets, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Impaired Loans (collateral dependent)

Loans for which it is probable that the Corporation will not collect all principal and interest due according to contractual terms are measured for impairment. Allowable methods for determining the amount of impairment include estimating fair value of the collateral for collateral dependent loans. If the impaired loan is identified as collateral dependent, then the fair value method of measuring the amount of impairment is utilized. This method requires obtaining a current independent appraisal of the collateral and applying a discount factor to the value. A portion of the allowance for loan losses is allocated to impaired loans if the value of such loans is deemed to be less than the unpaid balance. If these allocations cause the allowance for loan losses to increase, such increase is reported as a component of the provision for loan losses. Loan losses are charged against the allowance when management believes the

uncollectability of the loan is confirmed. During 2015, certain impaired loans were partially charged off or re-evaluated. Impaired loans that are collateral dependent are classified within Level 3 of the fair value hierarchy when impairment is determined using the fair value method.

Other Real Estate Owned

The fair value for impaired loans and other real estate owned is measured based on the value of the collateral securing those loans or real estate and is determined using several methods. The fair value of real estate is generally determined based on appraisals by qualified licensed appraisers. The appraisers typically determine the value of the real estate by utilizing an income or market valuation approach. If an appraisal is not available, the fair value may be determined by using a cash flow analysis. Fair value on other collateral such as business assets is typically ascertained by assessing, either singularly or some combination of, asset appraisals, accounts receivable aging reports, inventory listings and/or customer financial statements. Both appraised values and values based on borrower's financial information are discounted as considered appropriate based on age and quality of the information and current market conditions.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

Unobservable (Level 3) Inputs

The following table presents quantitative information about unobservable inputs used in recurring and nonrecurring Level 3 fair value measurements, other than goodwill, at June 30, 2015 and December 31, 2014.

June 30, 2015	Fair Value	Valuation Technique	Unobservable Inputs	Range (Weighted-Average)
State and municipal securities	\$5,993	Discounted cash flow	Maturity/Call date Blend of US Muni BQ curve Discount rate	1 month to 15 yrs A- to BBB- .90% - 5%
Corporate obligations and Equity securities	\$35	Discounted cash flow	Risk free rate plus Premium for illiquidity	3 month LIBOR plus 200bps
Impaired loans (collateral dependent)	\$7,189	Collateral based measurements	Discount to reflect current market conditions and ultimate collectability	0% - 50% (1%)
Other real estate owned	\$2,131	Appraisals	Discount to reflect current market conditions	0% - 20% (6%)
December 31, 2014	Fair Value	Valuation Technique	Unobservable Inputs	Range (Weighted-Average)
State and municipal securities	\$6,611	Discounted cash flow	Maturity/Call date Blend of US Muni BQ curve Discount rate	1 month to 15 yrs A- to BBB- .90% - 5%
Corporate obligations and Equity securities	\$35	Discounted cash flow	Risk free rate plus Premium for illiquidity	3 month LIBOR plus 200bps
Impaired loans (collateral dependent)	\$17,134	Collateral based measurements	Discount to reflect current market conditions and ultimate collectability	0% - 50% (3%)
Other real estate owned	\$5,155	Appraisals	Discount to reflect current market conditions	0% - 20% (7%)

Sensitivity of Significant Unobservable Inputs

The following is a discussion of the sensitivity of significant unobservable inputs, the interrelationships between those inputs and other unobservable inputs used in recurring fair value measurement and of how those inputs might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement.

State and Municipal Securities, Corporate Obligations and Equity Securities

The significant unobservable inputs used in the fair value measurement of the Corporation's state and municipal securities, corporate obligations and equity securities are premiums for unrated securities and marketability discounts. Significant increases or decreases in either of those inputs in isolation would result in a significantly lower or higher fair value measurement. Generally, changes in either of those inputs will not affect the other input.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

Fair Value of Financial Instruments

The following table presents estimated fair values of the Corporation's financial instruments and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2015, and December 31, 2014.

		June 30, 2015 (unaudited)		
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash and cash equivalents	\$ 105,928	\$ 105,928		
Interest-bearing time deposits	26,669	26,669		
Investment securities available for sale	575,415		\$ 569,387	\$ 6,028
Investment securities held to maturity	637,101		616,834	30,976
Loans held for sale	8,295		8,295	
Loans	4,175,655			4,096,221
Federal Reserve Bank and Federal Home Loan Bank stock	34,630		34,630	
Interest rate swap and cap asset	3,640		3,640	
Interest receivable	19,880		19,880	
Liabilities:				
Deposits	\$ 4,789,577	\$ 3,650,409	\$ 1,124,038	
Borrowings:				
Federal funds purchased	40,748		40,748	
Securities sold under repurchase agreements	137,240		137,240	
Federal Home Loan Bank advances	247,687		248,993	
Subordinated debentures and term loans	126,882		116,950	
Interest rate swap liability	6,064		6,064	
Interest payable	3,211		3,211	
		December 31, 2014		
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash and cash equivalents	\$ 118,616	\$ 118,616		

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Interest-bearing time deposits	47,520	47,520		
Investment securities available for sale	549,543		\$542,897	\$6,646
Investment securities held to maturity	631,088		614,457	33,266
Loans held for sale	7,235		7,235	
Loans	3,860,901			3,810,912
Federal Reserve Bank and Federal Home Loan Bank stock	41,353		41,353	
Interest rate swap and cap asset	3,867		3,867	
Interest receivable	19,984		19,984	
Liabilities:				
Deposits	\$4,640,694	\$3,523,199	\$1,099,610	
Borrowings:				
Federal funds purchased	15,381		15,381	
Securities sold under repurchase agreements	124,539		124,539	
Federal Home Loan Bank advances	145,264		146,669	
Subordinated debentures and term loans	126,810		92,802	
Interest rate swap liability	6,537		6,537	
Interest payable	3,201		3,201	

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

The following methods were used to estimate the fair value of all other financial instruments recognized in the Consolidated Condensed Balance Sheets at amounts other than fair value.

Cash and cash equivalents: The fair value of cash and cash equivalents approximates carrying value.

Interest-bearing time deposits: The fair value of interest-bearing time deposits approximates carrying value.

Investment securities: Fair value is based on quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. The fair value of certain Level III securities is estimated using discounted cash flow analysis, using interest rates currently being offered on investments with similar maturities and investment quality.

Loans Held For Sale: The carrying amount approximates fair value due to the short duration between origination and date of sale.

Loans: The fair value for loans is estimated using discounted cash flow analysis, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. See Impaired Loans above.

Federal Reserve and Federal Home Loan Bank stock: The fair value of Federal Reserve Bank and Federal Home Loan Bank stock is based on the price which it may be resold to the Federal Reserve and Federal Home Loan Bank.

Derivative instruments: The fair value of the interest rate swaps reflects the estimated amounts that would have been received to terminate these contracts at the reporting date based upon pricing or valuation models applied to current market information. Interest rate caps are valued using the market standard methodology of discounting the future expected cash receipts that would occur if variable interest rates rose above the strike rate of the caps. The projected cash receipts on the caps are based on an expectation of future interest rates derived from observed market interest rate curves and volatilities.

Interest Receivable and Interest Payable: The fair value of interest receivables/payable approximates the carrying amount.

Deposits: The fair values of noninterest-bearing and interest-bearing demand accounts and savings deposits are equal to the amount payable on demand at the balance sheet date. The carrying amounts for variable rate, fixed-term certificates of deposit approximate their fair values at the balance sheet date. Fair values for fixed-rate certificates of deposit and other time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered to a schedule of aggregated expected monthly maturities on such time deposits.

Federal funds purchased: The fair value of Federal Funds purchased approximates the carrying amount.

Borrowings: The fair value of borrowings is estimated using a discounted cash flow calculation, based on current rates for similar debt.

NOTE 10

TRANSFERS ACCOUNTED FOR AS SECURED BORROWINGS

The collateral pledged for all repurchase agreements that are accounted for as secured borrowings were:

	Remaining Contractual Maturity of the Agreements				
	Overnight and Continuous	Up to 30 Days	30-90 Days	Greater Than 90 Days	Total
U.S. Government-sponsored mortgage-backed securities	\$111,271			\$25,969	\$137,240

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

NOTE 11

ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table summarizes the changes in the balances of each component of accumulated other comprehensive income (loss), net of tax, as of June 30, 2015 and 2014:

	Accumulated Other Comprehensive Income (Loss)				Total
	Unrealized Gains (Losses) on Securities Available for Sale	Unrealized Gains (Losses) on Securities Available for Sale which a Portion of Other-Than-Temporary Impairment has been Recognized in Income	Unrealized Gains (Losses) on Cash Flow Hedges	Unrealized Gains (Losses) on Defined Benefit Plans	
Balance at December 31, 2014	\$14,098		\$ (2,182)	\$ (13,546)	\$ (1,630)
Other comprehensive income before reclassifications	(4,413)		(304)		(4,717)
Amounts reclassified from accumulated other comprehensive income	(606)		463		(143)
Period change	(5,019)	—	159	—	(4,860)
Balance at June 30, 2015	\$9,079	\$ —	\$ (2,023)	\$ (13,546)	\$ (6,490)
Balance at December 31, 2013	\$1,566	\$ (1,847)	\$ (501)	\$ (5,628)	\$ (6,410)
Other comprehensive income before reclassifications	11,055	1,702	(1,663)		11,094
Amounts reclassified from accumulated other comprehensive income	(926)		452		(474)
Period change	10,129	1,702	(1,211)	—	10,620
Balance at June 30, 2014	\$11,695	\$ (145)	\$ (1,712)	\$ (5,628)	\$ 4,210

The following table presents the reclassification adjustments out of accumulated other comprehensive income (loss) that were included in net income in the Consolidated Condensed Statements of Income for the three and six months ended June 30, 2015 and 2014:

Amount Reclassified
from Accumulated
Other Comprehensive
Income (Loss) For the
Three Months Ended

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Details about Accumulated Other Comprehensive Income (Loss) Components	June 30,		Affected Line Item in the Statements of Income
	2015	2014	
Unrealized gains (losses) on available for sale securities ⁽¹⁾			
Realized securities gains (losses) reclassified into income	\$ (93)	\$ 844	Other income - net realized gains on sales of available for sale securities
Related income tax expense	33	(295)	Income tax expense
	\$ (60)	\$ 549	
Unrealized gains (losses) on cash flow hedges ⁽²⁾			
Interest rate contracts	\$ (358)	\$ (351)	Interest expense - subordinated debentures and term loans
Related income tax benefit	125	123	Income tax expense
	\$ (233)	\$ (228)	
Total reclassifications for the period, net of tax	\$ (293)	\$ 321	

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

Details about Accumulated Other Comprehensive Income (Loss) Components	Amount Reclassified from Accumulated Other Comprehensive Income (Loss) For the Six Months Ended June 30,		Affected Line Item in the Statements of Income
	2015	2014	
Unrealized gains (losses) on available for sale securities ⁽¹⁾			
Realized securities gains reclassified into income	\$932	\$1,425	Other income - net realized gains on sales of available for sale securities
Related income tax expense	(326)	(499)	Income tax expense
	\$606	\$926	
Unrealized gains (losses) on cash flow hedges ⁽²⁾			
Interest rate contracts	\$(712)	\$(695)	Interest expense - subordinated debentures and term loans
Related income tax benefit	249	243	Income tax expense
	\$(463)	\$(452)	
Total reclassifications for the period, net of tax	\$143	\$474	

⁽¹⁾ For additional detail related to unrealized gains (losses) on available for sale securities and related amounts reclassified from accumulated other comprehensive income see NOTE 3. INVESTMENT SECURITIES.

⁽²⁾ For additional detail related to unrealized gains (losses) on cash flow hedges and related amounts reclassified from accumulated other comprehensive income see NOTE 6. DERIVATIVE FINANCIAL INSTRUMENTS.

NOTE 12

SHARE-BASED COMPENSATION

Stock options and restricted stock awards ("RSAs") have been issued to directors, officers and other management employees under the Corporation's 1999 Long-term Equity Incentive Plan and the 2009 Long-term Equity Incentive Plan. The stock options, which have a ten year life, become 100 percent vested ranging from six months to two years and are fully exercisable when vested. Option exercise prices equal the Corporation's common stock closing price on NASDAQ on the date of grant. RSAs issued to employees and non-employee directors provide for the issuance of

shares of the Corporation's common stock at no cost to the holder and generally vest after three years. The RSAs vest only if the employee is actively employed by the Corporation on the vesting date and, therefore, any unvested shares are forfeited. For non-employee directors, the RSAs vest only if the non-employee director remains as an active board member on the vesting date and, therefore, any unvested shares are forfeited. RSAs for employees and non-employee directors retired from the Corporation are either immediately vested at retirement or continue to vest after retirement, depending on the plan under which the shares were granted. Deferred stock units ("DSUs") can be credited to non-employee directors who have elected to defer payment of compensation under the Corporation's 2008 Equity Compensation Plan for Non-employee Directors. DSUs credited are equal to the restricted shares that the non-employee director would have received under the plan. As of June 30, 2015, there were no outstanding DSUs.

The Corporation's 2009 Employee Stock Purchase Plan ("ESPP") provides eligible employees of the Corporation and its subsidiaries an opportunity to purchase shares of common stock of the Corporation through quarterly offerings financed by payroll deductions. The price of the stock to be paid by the employees shall be equal to 85 percent of the average of the closing price of the Corporation's common stock on each trading day during the offering period. However, in no event shall such purchase price be less than the lesser of an amount equal to 85 percent of the market price of the Corporation's stock on the offering date or an amount equal to 85 percent of the market value on the date of purchase. Common stock purchases are made quarterly and are paid through advance payroll deductions up to a calendar year maximum of \$25,000.

Compensation expense related to unvested share-based awards is recorded by recognizing the unamortized grant date fair value of these awards over the remaining service periods of those awards, with no change in historical reported fair values and earnings. Awards are valued at fair value in accordance with provisions of share-based compensation guidance and are recognized on a straight-line basis over the service periods of each award. To complete the exercise of vested stock options, RSA's and ESPP options, the Corporation generally issues new shares from its authorized but unissued share pool. Share-based compensation for the three and six months ended June 30, 2015 was \$614,000 and \$1,130,000, respectively, compared to \$554,000 and \$1,059,000, respectively, for the three and six months ended June 30, 2014. Share-based compensation has been recognized as a component of salaries and benefits expense in the accompanying CONSOLIDATED CONDENSED STATEMENTS OF INCOME.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

The estimated fair value of the stock options granted during 2014 and in prior years was calculated using a Black Scholes option pricing model. There have been no stock options granted in 2015.

The Black Scholes model incorporates assumptions to value share-based awards. The risk-free rate of interest, for periods equal to the expected life of the option, is based on a U.S. government instrument over a similar contractual term of the equity instrument. Expected price volatility is based on historical volatility of the Corporation's common stock. In addition, the Corporation generally uses historical information to determine the dividend yield and weighted-average expected life of the options until exercise. Separate groups of employees that have similar historical exercise behavior with regard to option exercise timing and forfeiture rates are considered separately for valuation and attribution purposes.

Share-based compensation expense recognized in the CONSOLIDATED CONDENSED STATEMENTS OF INCOME is based on awards ultimately expected to vest and is reduced for estimated forfeitures. Share-based compensation guidance requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods, if actual forfeitures differ from those estimates. Pre-vesting forfeitures were estimated to be approximately 4.9 percent for the six months ended June 30, 2015, based on historical experience.

The following table summarizes the components of the Corporation's share-based compensation awards recorded as expense:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Stock and ESPP Options				
Pre-tax compensation expense	\$28	\$30	\$54	\$74
Income tax expense (benefit)		(2)	(1)	(5)
Stock and ESPP option expense, net of income taxes	\$28	\$28	\$53	\$69
Restricted Stock Awards				
Pre-tax compensation expense	\$586	\$524	\$1,076	\$985
Income tax benefit	(198)	(183)	(366)	(344)
Restricted stock awards expense, net of income taxes	\$388	\$341	\$710	\$641
Total Share-Based Compensation				
Pre-tax compensation expense	\$614	\$554	\$1,130	\$1,059
Income tax benefit	(198)	(185)	(367)	(349)
Total share-based compensation expense, net of income taxes	\$416	\$369	\$763	\$710

As of June 30, 2015, unrecognized compensation expense related to RSAs was \$3,950,000 and is expected to be recognized over a weighted-average period of 1.62 years. The Corporation did not have any unrecognized compensation expense related to stock options as of June 30, 2015.

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Stock option activity under the Corporation's stock option plans as of June 30, 2015 and changes during the six months ended June 30, 2015, were as follows:

	Number of Shares	Weighted-Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2015	737,931	\$ 20.99		
Granted				
Exercised	(46,266)	\$ 15.28		
Canceled	(100)	\$ 28.25		
Outstanding June 30, 2015	691,565	\$ 21.37	2.64	2,942,311
Vested and Expected to Vest at June 30, 2015	691,565	\$ 21.37	2.60	2,942,311
Exercisable at June 30, 2015	691,565	\$ 21.37	2.64	2,942,311

There were no options granted during the six months ended June 30, 2015 and June 30, 2014.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Corporation's closing stock price on the last trading day of the first six months of 2015 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their stock options on June 30, 2015. The amount of aggregate intrinsic value will change based on the fair market value of the Corporation's common stock. The aggregate intrinsic value of stock options exercised during the six months ended June 30, 2015 and 2014 was \$356,000 and \$388,000, respectively. Cash receipts of stock options exercised during this same period were \$619,000 and \$450,000, respectively.

The following table summarizes information on unvested RSAs outstanding as of June 30, 2015:

	Number of Shares	Weighted-Average Grant Date Fair Value
Unvested RSAs at January 1, 2015	385,450	\$15.65
Granted	105,622	\$23.00
Vested	(142,451)	) \$11.74
Forfeited	(1,487)	) \$15.04
Unvested RSAs at June 30, 2015	347,134	\$19.49

The grant date fair value of ESPP options was estimated at the beginning of the April 1, 2015 quarterly offering period of approximately \$28,000. The ESPP options vested during the three months ending June 30, 2015, leaving no unrecognized compensation expense related to unvested ESPP options at June 30, 2015.

NOTE 13

Income Tax

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Income Tax Expense :				
Currently Payable:				
Federal	\$7,658	\$1,947	\$7,688	\$428
Deferred:				
Federal	1,081	3,806	6,750	9,832
State	117	135	252	245
Total Income Tax Expense	\$8,856	\$5,888	\$14,690	\$10,505
Reconciliation of Federal Statutory to Actual Tax Expense:				
Federal statutory income tax at 35%	\$9,389	\$7,367	\$17,091	\$13,750
Tax-exempt interest income	(1,738	) (1,270	) (3,167	) (2,495
Basis difference on sale of insurance subsidiary	2,252		2,252	

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Stock compensation	10	8	18	21	
Earnings on life insurance	(223	) (228	) (485	) (490)
Tax credits	(148	) (297	) (292	) (595)
Other	(686	) 308	(727	) 314	
Actual Tax Expense	\$8,856	\$5,888	\$14,690	\$10,505	

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

NOTE 14

Net Income Per Share

Basic net income per share is computed by dividing net income by the weighted-average shares outstanding during the reporting period. Diluted net income per share is computed by dividing net income by the combination of all dilutive common share equivalents, comprised of shares issuable under the Corporation's share-based compensation plans, and the weighted-average shares outstanding during the reporting period.

Dilutive common share equivalents include the dilutive effect of in-the-money share-based awards, which are calculated based on the average share price for each period using the treasury stock method. Under the treasury stock method, the exercise price of share-based awards, the amount of compensation expense, if any, for future service that the Corporation has not yet recognized, and the amount of estimated tax benefits that would be recorded in additional paid-in capital when share-based awards are exercised, are assumed to be used to repurchase common stock in the current period.

The following table reconciles basic and diluted net income per share for the three and six months ended June 30, 2015 and 2014.

	Three Months Ended June 30, 2015			2014		
	Net Income	Weighted-Average Shares	Per Share Amount	Net Income	Weighted-Average Shares	Per Share Amount
Net income available to common stockholders	17,968	37,793,448	\$0.47	15,160	36,026,763	\$0.42
Effect of dilutive stock options and warrants		249,911			267,386	
Diluted net income per share	\$17,968	38,043,359	\$0.47	\$15,160	36,294,149	\$0.41

	Six Months Ended June 30, 2015			2014		
	Net Income	Weighted-Average Shares	Per Share Amount	Net Income	Weighted-Average Shares	Per Share Amount
Net income available to common stockholders	34,140	37,751,896	\$0.90	28,780	35,991,794	\$0.80
Effect of dilutive stock options and warrants		270,036			285,754	
Diluted net income per share	\$34,140	38,021,932	\$0.90	\$28,780	36,277,548	\$0.79

Stock options to purchase 367,525 and 584,194 shares for the three months ended June 30, 2015 and 2014, respectively, were not included in the earnings per share calculation because the exercise price exceeded the average market price.

Stock options to purchase 367,550 and 619,890 shares for the six months ended June 30, 2015 and 2014, respectively, were not included in the earnings per share calculation because the exercise price exceeded the average market price.

NOTE 15

IMPACT OF ACCOUNTING CHANGES

FASB ASU 2015-07, Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)

In May 2015, FASB, issued 2015-07, Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent), which addresses the diversity in practice related to how certain investments measured at net asset value with future redemption dates are categorized. The amendments remove the requirement to categorize investments for which fair values are measured using the net asset value per share practical expedient. It also limits disclosures to investments for which the entity has elected to measure the fair value using the practical expedient. The amendments are effective for annual reporting periods beginning after December 15, 2015. Early adoption is permitted. Adoption of this ASU is not expected to have a significant effect on the Corporation's consolidated financial statements.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

NOTE 16

GENERAL LITIGATION AND REGULATORY EXAMINATIONS

On July 8, 2015, a purported shareholder of Ameriana Bancorp filed a putative class action lawsuit captioned Shiva Stein, individually and on behalf of other similarly situated vs. Ameriana Bancorp et al., Cause No. 49D10-1507-PL-022566 in Marion County, Indiana Superior Court 10 against Ameriana Bancorp, its board of directors and First Merchants Corporation. Plaintiff's complaint alleges breach of fiduciary duty and/or aiding and abetting a breach of fiduciary duty regarding the proposed merger of Ameriana into First Merchants. The plaintiff seeks (1) class certification, (2) to enjoin the merger, (3) compensatory damages in an unspecified amount, and (4) an accounting of unspecified damages, and costs, disbursements and professional fees. At this early stage of the litigation, it is not possible to assess the probability of a material adverse outcome or reasonably estimate any potential financial impact of the lawsuit on First Merchants. The defendants believe the claims against them are without merit and intend to contest the matter vigorously.

The Corporation is also subject to other claims and lawsuits that arise primarily in the ordinary course of business. Additionally, the Corporation is subject to periodic examinations by various regulatory agencies. It is the opinion of management that the disposition or ultimate resolution of such claims, lawsuits, and examinations will not have a material adverse effect on the consolidated financial position, results of operations and cash flow of the Corporation.

NOTE 17

CONSUMMATION OF MERGER

On June 26, 2015, the Corporation and Ameriana Bancorp, an Indiana corporation ("Ameriana Bancorp"), entered into an Agreement and Plan of Reorganization and Merger (the "Ameriana Merger Agreement"), pursuant to which, Ameriana Bancorp will, subject to the terms and conditions of the Ameriana Merger Agreement, merge with and into the Corporation (the "Ameriana Merger"), whereupon the separate corporate existence of Ameriana Bancorp will cease and the Corporation will survive. Immediately following the Ameriana Merger, Ameriana Bank, an Indiana state commercial bank and wholly-owned subsidiary of Ameriana Bancorp, will be merged with and into the Bank, with the Bank, as the surviving bank. Based on the closing price of the Corporation's common stock on June 26, 2015 of \$25.13 per share, the transaction value is estimated at approximately \$68.8 million. The transaction is expected to be a tax-free stock exchange for Ameriana Bancorp's shareholders who will be receiving the Corporation's common stock pursuant to the Ameriana Merger. Subject to Ameriana Bancorp's shareholders' approval of the Ameriana Merger, regulatory approvals and other customary closing conditions, the parties anticipate completing the Ameriana Merger in the fourth quarter of 2015 or the first quarter of 2016.

Table of Contents

PART I: FINANCIAL INFORMATION

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

From time to time, we include forward-looking statements in our oral and written communication. We may include forward-looking statements in filings with the Securities and Exchange Commission, such as this Form 10-Q, in other written materials and in oral statements made by senior management to analysts, investors, representatives of the media and others. We intend these forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and we are including this statement for purposes of these safe harbor provisions. Forward-looking statements can often be identified by the use of words like "believe", "continue", "pattern", "estimate", "project", "intend", "anticipate", "expect" and similar expressions, future or conditional verbs such as "will", "would", "should", "could", "might", "can", "may", or similar expressions. These forward-looking statements include:

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

These forward-looking statements are subject to significant risks, assumptions and uncertainties, including, among other things, the following important factors which could affect the actual outcome of future events:

- fluctuations in market rates of interest and loan and deposit pricing, which could negatively affect our net interest margin, asset valuations and expense expectations;
- adverse changes in the economy, which might affect our business prospects and could cause credit-related losses and expenses;
- adverse developments in our loan and investment portfolios;
- competitive factors in the banking industry, such as the trend towards consolidation in our market;
- changes in the banking legislation or the regulatory requirements of federal and state agencies applicable to bank holding companies and banks like our affiliate bank;
- acquisitions of other businesses by us and integration of such acquired businesses;
- changes in market, economic, operational, liquidity, credit and interest rate risks associated with our business; and
- the continued availability of earnings and excess capital sufficient for the lawful and prudent declaration and payment of cash dividends.

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

CRITICAL ACCOUNTING POLICIES

Generally accepted accounting principles are complex and require us to apply significant judgments to various accounting, reporting and disclosure matters. We must use assumptions and estimates to apply those principles where actual measurement is not possible or practical. For a complete discussion of our significant accounting policies, see

“Notes to the Consolidated Financial Statements” in our Annual Report on Form 10-K for the year ended December 31, 2014. Certain policies are considered critical because they are highly dependent upon subjective or complex judgments, assumptions and estimates. Changes in such estimates may have a significant impact on the financial statements. We have reviewed the application of these policies with the Audit Committee of our Board of Directors.

We believe there have been no significant changes during the six months ended June 30, 2015, to the items that we disclosed as our critical accounting policies and estimates in Management’s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2014.

BUSINESS SUMMARY

First Merchants Corporation (the “Corporation”) is a financial holding company headquartered in Muncie, Indiana and was organized in September 1982. The Corporation’s Common Stock is traded on NASDAQ’s Global Select Market System under the symbol FRME. The Corporation has one full-service bank charter, First Merchants Bank, National Association (the “Bank”), which opened for business in Muncie, Indiana, in March 1893. The Bank also operates Lafayette Bank and Trust, Commerce National Bank and First Merchants Trust Company as divisions of First Merchants Bank, National Association. The Bank includes 109 banking locations in twenty-six Indiana, two Illinois and two Ohio counties. In addition to its branch network, the Corporation’s delivery channels include ATMs, check cards, remote deposit capture, interactive voice response systems and internet technology. The Corporation’s business activities are currently limited to one significant business segment, which is community banking.

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

The Corporation also operated First Merchants Insurance Services, Inc., operating as First Merchants Insurance Group (“FMIG”), a full-service property, casualty, personal lines, and employee benefit insurance agency headquartered in Muncie, Indiana. On June 12, 2015, the Corporation sold all of its stock in FMIG to USI Insurance Services LLC for \$18,000,000. Additional details of the transaction are included in NOTE 2. ACQUISITIONS AND DIVESTITURES, included within the Notes to Consolidated Condensed Financial Statements of this Form 10-Q.

Table of Contents

PART I: FINANCIAL INFORMATION

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

Executive Summary

First Merchants Corporation reported net income available to common stockholders of \$18.0 million for the three months ended June 30, 2015, an increase of \$2.8 million, compared to net income available to common stockholders of \$15.2 million for the three months ended June 30, 2014. Earnings per share for the three months ended June 30, 2015 totaled \$0.47 per share, an increase of \$0.06 per share, or 14.6%, over \$0.41 per share for the same period in 2014. Net income available to common stockholders was \$34.1 million, or \$0.90 per share, for the six months ended June 30, 2015, compared to \$28.8 million, or \$0.79 per share for the same period of 2014.

On November 7, 2014, the Corporation acquired Community and on April 17, 2015, the Corporation acquired C Financial. Additionally, on June 12, 2015, the Corporation sold all of its stock in FMIG, resulting in a gain of \$8.3 million. Details of these transactions are included in NOTE 2. ACQUISITIONS AND DIVESTITURES, included within the Notes to Consolidated Condensed Financial Statements of this Form 10-Q.

As of June 30, 2015, total assets equaled \$6.1 billion, an increase of \$316.2 million from December 31, 2014. The Corporation's loan portfolio increased \$313.3 million, with the largest increases in Other Commercial and Commercial and Industrial loans. The Corporation acquired \$141.7 million in assets as a result of the C Financial acquisition, of which, loans accounted for \$110.6 million. Additional details of the changes in the Corporation's loans and other earning assets are discussed within NOTE 4. LOANS AND ALLOWANCE, included within the Notes to Consolidated Condensed Financial Statements, and the "EARNING ASSETS" section of Management's Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-Q.

The Corporation's allowance for loan losses totaled \$62.6 million as of June 30, 2015. The allowance provided 165.9 percent coverage of all non-accrual loans and 1.47 percent of total loans. The Corporation's provision expense totaled \$417,000 during the second quarter of 2015 as net charge-offs totaled \$668,000. Non-performing loans declined \$12.2 million, or 24.0 percent, from December 31, 2014. During the same period of 2014, the Corporation did not expense a provision for loan losses and had net charge-offs during the period of \$1.2 million. Additional details are discussed within the "LOAN QUALITY/PROVISION FOR LOAN LOSSES" section of Management's Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-Q.

As of June 30, 2015, total deposits equaled \$4.8 billion, an increase of \$148.9 million from December 31, 2014. The Corporation acquired \$105.3 million in deposits as a result of the C Financial acquisition. The largest increases were in demand and savings deposits, which accounted for \$127.2 million of the overall increase. This increase was offset by decreases in other certificates and time deposits and brokered deposits of \$12.8 million compared to December 31, 2014.

Total borrowings increased \$140.6 million as of June 30, 2015 compared to December 31, 2014 as Federal Home Loan Bank advances and Federal Funds purchased increased \$102.4 million and \$25.4 million, respectively. The Corporation acquired \$19.0 million of Federal Home Loan Bank advances as a result of the C Financial acquisition.

The Corporation was able to maintain all regulatory capital ratios in excess of the regulatory definition of "well-capitalized" as discussed in the "CAPITAL" section of Management's Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-Q.

NET INTEREST INCOME

Net interest income is the primary source of the Corporation's earnings. Net interest margin is a function of net interest income and the level of average earning assets. Net interest income and net interest margin are presented in the following table on a fully taxable equivalent basis ("FTE"), which adjusts tax-exempt or nontaxable interest income to an amount that would be comparable to interest subject to income taxes using the federal statutory tax rate of 35 percent in effect for all periods.

For the periods presented, the increases in net interest income and average earning assets were primarily driven by the acquisitions of Community in November 2014 and C Financial in April 2015. As a result of the acquisitions, the Corporation recognized fair value accretion, which is included in interest income, of \$2,158,000 and \$2,173,000, respectively, for the three months ended June 30, 2015 and 2014. Net interest margin for the second quarter of 2015 decreased to 3.81 percent compared to the second quarter of 2014 at 3.89 percent, while earning assets increased by \$488,000. Asset yields decreased 7 basis points FTE and interest costs increased 1 basis point, resulting in a 8 basis points FTE decrease in net interest margin as compared to the same period in 2014.

Net interest margin for the six months ended June 30, 2015 decreased to 3.79 percent compared to the six months ended June 30, 2014 at 3.93 percent, while earning assets increased by \$444,000. Asset yields decreased 11 basis points FTE and interest costs increased 3 basis points, resulting in a 14 basis points FTE decrease in net interest margin as compared to the same period in 2014. Interest income included \$4,328,000 and \$3,942,000 of fair value accretion for the six months ended June 30, 2015 and 2014, respectively.

Additional details of the Corporation's acquisitions, remaining loan fair value discount, accretable and nonaccretable yield can be found in NOTE 2. ACQUISITIONS AND DIVESTITURES and NOTE 5. ACCOUNTING FOR CERTAIN LOANS ACQUIRED IN A PURCHASE, included within the Notes to Consolidated Condensed Financial Statements of this Form 10-Q.

Table of Contents

PART I: FINANCIAL INFORMATION

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following table presents the Corporation's average balance sheet, interest income/interest expense, and the average rate as a percent of average earning assets for the three months ended June 30, 2015, and 2014.

(Dollars in Thousands)	For the Three Months Ended			June 30, 2014		
	Average Balance	Interest Income / Expense	Average Rate	Average Balance	Interest Income / Expense	Average Rate
Assets:						
Interest-bearing time deposits	\$59,979	\$31	0.21 %	\$59,030	\$35	0.24 %
Federal Reserve and Federal Home Loan Bank stock	39,195	459	4.68	42,809	495	4.63
Investment Securities: ⁽¹⁾						
Taxable	696,505	4,425	2.54	772,384	5,046	2.61
Tax-Exempt ⁽²⁾	484,541	6,510	5.37	389,772	5,492	5.64
Total Investment Securities	1,181,046	10,935	3.70	1,162,156	10,538	3.63
Loans held for sale	6,033	146	9.68	5,775	108	7.48
Loans: ⁽³⁾						
Commercial	3,193,314	35,661	4.47	2,850,068	31,730	4.45
Real Estate Mortgage	455,470	4,962	4.36	450,462	5,636	5.00
Installment	396,378	4,552	4.59	362,455	4,849	5.35
Tax-Exempt ⁽²⁾	100,665	1,131	4.49	11,761	89	3.03
Total Loans	4,151,860	46,452	4.48	3,680,521	42,412	4.61
Total Earning Assets	5,432,080	57,877	4.26	4,944,516	53,480	4.33
Net unrealized gain on securities available for sale	12,575			8,820		
Allowance for loan losses	(62,881)			(69,188)		
Cash and cash equivalents	97,738			79,974		
Premises and equipment	84,359			74,869		
Other assets	496,606			481,492		
Total Assets	\$6,060,477			\$5,520,483		
Liabilities:						
Interest-bearing deposits:						
Interest-bearing NOW deposits	\$1,088,896	\$283	0.10 %	\$1,081,709	\$282	0.10 %
Money market deposits	853,776	446	0.21	776,396	397	0.20
Savings deposits	612,920	166	0.11	528,261	153	0.12
Certificates and other time deposits	1,148,463	2,791	0.97	1,051,596	2,042	0.78
Total Interest-bearing Deposits	3,704,055	3,686	0.40	3,437,962	2,874	0.33
Borrowings	471,467	2,485	2.11	459,602	2,534	2.21
Total Interest-bearing Liabilities	4,175,522	6,171	0.59	3,897,564	5,408	0.56
Noninterest-bearing deposits	1,093,031			927,237		
Other liabilities	45,743					