

GERMAN AMERICAN BANCORP, INC.

Form 10-K

March 09, 2017

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

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2016

Commission File Number 001-15877

GERMAN AMERICAN BANCORP, INC.

(Exact name of registrant as specified in its charter)

INDIANA

35-1547518

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

711 Main Street, Box 810, Jasper, Indiana 47546

(Address of Principal Executive Offices) (Zip Code)

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

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

Title of Each Class Name of each exchange on which registered

Common Shares, no par value The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ☐ Yes ☒ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. ☐ Yes ☒ No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K: ☒
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company:

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐ Smaller reporting company ☐

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

The aggregate market value of the registrant's common shares held by non-affiliates as of June 30, 2016 was approximately \$447,857,132. This calculation does not reflect a determination that persons are (or are not) affiliates for any other purpose.

As of March 1, 2017, there were outstanding 15,261,431 common shares, no par value, of the registrant.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement of German American Bancorp, Inc., for the Annual Meeting of its Shareholders to be held May 18, 2017, to the extent stated herein, are incorporated by reference into Part III (Items 10 through 14).

GERMAN AMERICAN BANCORP, INC.
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For Fiscal Year Ended December 31, 2016

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Information included in or incorporated by reference in this Annual Report on Form 10-K, our other filings with the Securities and Exchange Commission and our press releases or other public statements, contain or may contain “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Please refer to a discussion of our forward- looking statements and associated risks in Item 1, “Business - Forward-Looking Statements and Associated Risks” and our discussion of risk factors in Item 1A, “Risk Factors” in this Annual Report on Form 10-K.

PART I

Item 1. Business.

General

German American Bancorp, Inc., is a NASDAQ-traded (symbol: GABC) bank holding company based in Jasper, Indiana. German American, through its banking subsidiary German American Bancorp, operates 51 banking offices in 19 contiguous southern Indiana counties and one northern Kentucky county. The Company also owns an investment brokerage subsidiary (German American Investment Services, Inc.) and a full line property and casualty insurance agency (German American Insurance, Inc.).

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

The Company’s lines of business include retail and commercial banking, comprehensive financial planning, full service brokerage and trust administration, and a full range of personal and corporate insurance products. Financial and other information by segment is included in Note 15 (Segment Information) of the Notes to the Consolidated Financial Statements included in Item 8 of this Report and is incorporated into this Item 1 by reference. Substantially all of the Company’s revenues are derived from customers located in, and substantially all of its assets are located in, the United States.

Subsidiaries

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

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

Business Developments

On March 1, 2016, the Company acquired by merger River Valley Bancorp (“River Valley”) and its subsidiary, River Valley Financial Bank. River Valley Financial Bank, headquartered in Madison, Indiana, provided a full range of commercial and consumer banking services from 15 banking offices predominantly located in southeast Indiana. At the time of acquisition, River Valley reported on its balance sheet consolidated assets and equity (unaudited) as of February 29, 2016 that totaled \$516.3 million and \$56.6 million, respectively. For further information regarding the River Valley merger transaction, see Note 17 (Business Combinations) in the Notes to the Consolidated Financial Statements included in Item 8 of this Report, which Note 17 is incorporated into this Item 1 by reference.

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

Office Locations

The Indiana map below illustrates the locations of the Company's 52 retail and commercial banking, insurance and investment offices as of March 1, 2017.

Competition

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

Employees

At March 1, 2017 the Company and its subsidiaries employed approximately 597 full-time equivalent employees. There are no collective bargaining agreements, and employee relations are considered to be good.

Regulation and Supervision Overview

The Company is subject to regulation and supervision by the Board of Governors of the Federal Reserve System (“FRB”) under the Bank Holding Company Act of 1956, as amended (“BHC Act”), and is required to file with the FRB annual reports and such additional information as the FRB may require. The FRB may also make examinations or inspections of the Company. The Bank is under the supervision of and subject to examination by the Indiana Department of Financial Institutions (“DFI”), and the Federal Deposit Insurance Corporation (“FDIC”). Regulation and examination by banking regulatory agencies are primarily for the benefit of depositors rather than shareholders. Under FRB policy and the Dodd-Frank Wall Street Reform and Consumer Protection Act, a complex and wide-ranging statute that was enacted by Congress and signed into law during July 2010 (the “Dodd-Frank Act”), the Company is required to act as a source of financial and managerial strength to the Bank, and to commit resources to support the Bank, even in circumstances where the Company might not do so absent such a requirement. Under current federal law, the FRB may require a bank holding company to make capital injections into a troubled subsidiary bank. It may charge the bank holding company with engaging in unsafe and unsound practices if the bank holding company fails to commit resources to such a subsidiary bank or if it undertakes actions that the FRB believes might jeopardize the bank holding company’s ability to commit resources to such subsidiary bank.

With certain exceptions, the BHC Act prohibits a bank holding company from engaging in (or acquiring direct or indirect control of more than 5 percent of the voting shares of any company engaged in) nonbanking activities. One of the principal exceptions to this prohibition is for activities deemed by the FRB to be “closely related to banking.” Under current regulations, bank holding companies and their subsidiaries are permitted to engage in such banking-related business ventures as consumer finance; equipment leasing; credit life insurance; computer service bureau and software operations; mortgage banking; and securities brokerage.

Under the BHC Act, certain well-managed and well-capitalized bank holding companies may elect to be treated as a “financial holding company” and, as a result, be permitted to engage in a broader range of activities that are “financial in nature” and in activities that are determined to be incidental or complementary to activities that are financial in nature. These activities include underwriting and dealing in and making a market in securities (subject to certain limits and compliance procedures required by the so-called Volcker Rule provisions added by the Dodd-Frank Act, described below under “Other Aspects of the Dodd-Frank Act”); insurance underwriting, and merchant banking. Banks may also engage through financial subsidiaries in certain of the activities permitted for financial holding companies, subject to certain conditions. The Company has not elected to become a financial holding company and its subsidiary bank has not elected to form financial subsidiaries.

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

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

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

Capital Requirements

We are subject to various regulatory capital requirements both at the parent company and at the Bank level administered by the FRB and by the FDIC and DFI, respectively. Failure to meet minimum capital requirements could result in certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have an adverse material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for “Prompt Corrective Action” (described below), we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance sheet

items as calculated under regulatory accounting policies. Our capital amounts and classification are also subject to judgments by the regulators regarding qualitative components, risk weightings, and other factors. We have consistently maintained regulatory capital ratios at or above the well-capitalized standards.

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

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

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

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

Tier 1 Capital under the new rules consists of CET1 (subject to certain adjustments) and “additional Tier 1 capital” instruments meeting specified requirements, plus, in the case of smaller holding companies like ours, trust preferred securities in accordance with prior requirements for their inclusion in Tier I Capital.

Pursuant to the present rules, we and our bank subsidiary elected, in our March 31, 2015 financial report filed with banking agencies, to opt-out of the requirement to include AOCI in our CET1. As a result, most AOCI items will be treated, for regulatory capital purposes, in the same manner in which they were prior to Basel III.

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

Prompt Corrective Action Classifications

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

Under FDICIA, a depository institution that is not well-capitalized is generally prohibited from accepting brokered deposits and offering interest rates on deposits higher than the prevailing rate in its market. Since the Bank throughout

2016 was well-capitalized, the FDICIA brokered deposit rule did not adversely affect its ability to accept brokered deposits. The Bank had \$9.1 million of such brokered deposits at December 31, 2016. Further, a depository institution or its holding company that is not well-capitalized will generally not be successful in seeking regulatory approvals that may be necessary in connection with any plan or agreement to expand its business, such as through the acquisition (by merger or consolidation, purchase or otherwise) of the stock, business or properties of other banks or other companies.

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

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

To qualify as a “well-capitalized” institution, a depository institution under the Prompt Corrective Action requirements must have a leverage ratio of no less than 5%, a Tier I Capital ratio of no less than 8%, a CET1 ratio of no less than 6.5%, and a total risk-based capital ratio of no less than 10%, and the bank must not have been under any order or directive from the appropriate regulatory agency to meet and maintain a specific capital level. As of December 31, 2016, the Bank exceeded the requirements contained in the applicable regulations, policies and directives pertaining to capital adequacy to be classified as “well-capitalized”, and is unaware of any material violation or alleged violation of these regulations, policies or directives. For a tabular presentation of our regulatory capital ratios and those of the Bank as of December 31, 2016, see Note 8 (Shareholders' Equity) of the Notes to the Consolidated Financial Statements included in Item 8 of this Report, which Note 8 is incorporated herein by reference.

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

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

German American Bancorp, Inc., which is the publicly-held parent of the Bank (German American Bancorp), is a corporation that is separate and distinct from the Bank and its other subsidiaries. Most of the parent company’s revenues historically have been comprised of dividends, fees, and interest paid to it by the Bank, and this is expected to continue in the future. There are, however, statutory limits under Indiana law on the amount of dividends that the Bank can pay to its parent company without regulatory approval. The Bank may not, without the approval of the DFI, pay a dividend in an amount greater than its undivided profits. In addition, the prior approval of the DFI is required for the payment of a dividend by an Indiana state-chartered bank if the total of all dividends declared in a calendar year would exceed the total of its net income for the year combined with its retained net income for the two preceding years, unless such a payment qualifies under certain exemptive criteria that exempt certain dividend payments by certain qualified banks from the prior approval requirement. At December 31, 2016, the Bank was eligible for payment of dividends under the exemptive criteria established by DFI policy for this purpose, and could have declared and paid to the holding company \$35.0 million of its undivided profits without approval by the DFI in accordance with such criteria. See Note 8 (Shareholders' Equity) of the Notes to Consolidated Financial Statements included in Item 8 of this Report for further discussion.

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

In addition, the FRB and other bank regulatory agencies have issued policy statements or advisories that provide that insured banks and bank holding companies should generally only pay dividends out of current operating earnings. In addition to these statutory restrictions, if, in the opinion of the applicable regulatory authority, a bank under its jurisdiction is engaged in, or is about to engage in, an unsafe or unsound practice, such authority may require, after notice and hearing, that such bank cease and desist from such practice. Accordingly, if the Bank were to experience financial difficulties, it is possible that the applicable regulatory authority could determine that the Bank would be engaged in an unsafe or unsound practice if the Bank were to pay dividends and could prohibit the Bank from doing so, even if availability existed for dividends under the statutory formula.

Further, the Bank is subject to affiliate transaction restrictions under federal laws, which limit certain transactions generally involving the transfer of funds by a subsidiary bank or its subsidiaries to its parent corporation or any nonbank subsidiary of its parent corporation, whether in the form of loans, extensions of credit, investments, or asset purchases, or otherwise undertaking certain obligations on behalf of such affiliates. Furthermore, covered transactions that are loans and extensions of credit must be

secured within specified amounts. In addition, all covered transactions and other affiliate transactions must be conducted on terms and under circumstances that are substantially the same as such transactions with unaffiliated entities.

Other Aspects of the Dodd-Frank Act

The Dodd-Frank Act (in addition to the regulatory changes discussed elsewhere in this “Regulation and Supervision” discussion and below under “Federal Deposit Insurance Premiums and Assessments”) made a variety of changes that affect the business and affairs of the Company and the Bank in other ways. For instance, the Dodd-Frank Act (or agency regulations adopted and implemented (or to be adopted and implemented) under the Dodd-Frank Act) altered the authority and duties of the federal banking and securities regulatory agencies, implemented certain corporate governance requirements for all public companies including financial institutions with regard to executive compensation, proxy access by shareholders, and certain whistleblower provisions; restricted certain proprietary trading and hedge fund and private equity activities of banks and their affiliates; eliminated the former statutory prohibition against the payment of interest on business checking accounts; limited interchange fees on debit card transactions by certain large processors; and established the Consumer Financial Protection Bureau (“CFPB”). The CFPB was granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, the Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act and certain other statutes. The CFPB has examination and primary enforcement authority with respect to depository institutions with \$10 billion or more in assets. Smaller institutions are subject to rules promulgated by the CFPB but continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB has authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. The Dodd-Frank Act authorized the CFPB to establish certain minimum standards for the origination of residential mortgages including a determination of the borrower’s ability to repay. In addition, Dodd-Frank allows borrowers to raise certain defenses to foreclosure if they receive any loan other than a “qualified mortgage” as defined by the CFPB. The Dodd-Frank Act permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

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

On December 10, 2013, five financial regulatory agencies, including the FRB and FDIC, adopted final rules implementing the so-called Volcker Rule added to banking law by Section 619 of the Dodd-Frank Act. These final rules prohibit banking entities from, among other things, (1) engaging in short-term proprietary trading for their own accounts, and (2) having certain ownership interests in and relationships with hedge funds or private equity funds (“covered funds”). Community banks like the Bank have been afforded some relief under these final rules from onerous compliance obligations created by the rules; if banks are engaged only in exempted proprietary trading, such as trading in U.S. government, agency, state and municipal obligations, they are exempt entirely from compliance program requirements. Moreover, even if a community bank engages in proprietary trading or covered fund activities under the rule, they need only incorporate references to the Volcker Rule into their existing policies and procedures. The Final Rules were effective April 1, 2014, but the conformance period was extended from its statutory end date of July 21, 2014 until July 21, 2015. In addition, the FRB granted extensions until July 21, 2017 of the conformance period for banking entities to conform investments in and relationships with covered funds that were in place prior to

December 31, 2013 and, in December 2016, provided guidance allowing for additional extensions to the conformance period for certain illiquid funds. We do not expect that the Volcker Rule will have any material financial implications on us or our investments or activities.

Certain Other Laws and Regulations

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

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

A major focus of governmental policy on financial institutions is combating money laundering and terrorist financing. The Bank Secrecy Act (the "BSA") requires financial institutions to develop policies, procedures, and practices to prevent and deter money laundering, and mandates that every bank have a written, board-approved program that is reasonably designed to assure and monitor compliance with the BSA. In addition, banks are required to adopt a customer identification program as part of its BSA compliance program, and are required to file Suspicious Activity Reports when they detect certain known or suspected violations of federal law or suspicious transactions related to a money laundering activity or a violation of the BSA. In May 2016, the regulations implementing the BSA were amended to require covered institutions such as the Bank to (1) identify and verify, subject to certain exceptions, the identity of the beneficial owners of all legal entity customers at the time a new account is opened, and (2) include, in its anti-money laundering program, risk-based procedures for conducting ongoing customer due diligence, which are to include procedures that: (a) assist in understanding the nature and purpose of customer relationships for the purpose of developing a customer risk profile, and (b) require the covered institutions to conduct ongoing monitoring to identify and report suspicious transactions and, on a risk basis, to maintain and update customer information. The Bank must comply with these amendments and new requirements by May 11, 2018.

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

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

The Bank is subject to a wide variety of other laws with respect to the operation of its businesses, and regulations adopted under those laws, including but not limited to the Truth in Lending Act, Truth in Savings Act, Equal Credit Opportunity Act, Electronic Funds Transfer Act, Fair Housing Act, Home Mortgage Disclosure Act, Fair Debt Collection Practices Act, Fair Credit Reporting Act, Expedited Funds Availability (Regulation CC), Reserve Requirements (Regulation D), Insider Transactions (Regulation O), Privacy of Consumer Information (Regulation P), Margin Stock Loans (Regulation U), Right To Financial Privacy Act, Flood Disaster Protection Act, Homeowners Protection Act, Servicemembers Civil Relief Act, Real Estate Settlement Procedures Act, TILA-RESPA Integrated Disclosure Rule, Telephone Consumer Protection Act, CAN-SPAM Act, Children's Online Privacy Protection Act, the

Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act) and the John Warner National Defense Authorization Act. The laws and regulations to which we are subject are constantly under review by Congress, the federal regulatory agencies, and the state authorities.

Federal Deposit Insurance Premiums and Assessments

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

Under the current assessment system, the FDIC assigns a banking institution to one of four risk categories designed to measure risk. Total base assessment rates currently range from 0.025% of deposits for an institution in the highest rated sub-category of the highest rated category to 0.45% of deposits for an institution in the lowest rated category. The FDIC may increase or decrease its rates by 2.0 basis points without further rulemaking. In an emergency, the FDIC may also impose a special assessment.

In addition, all FDIC insured institutions are required to pay assessments to the FDIC at an annual rate of approximately six tenths of a basis point of insured deposits to fund interest payments on bonds issued by the Financing Corporation, an agency of the federal government established to recapitalize the predecessor to the Savings Association Insurance Fund. These assessments will continue until the Financing Corporation bonds mature in 2017 through 2019.

Internet Address; Internet Availability of SEC Reports

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

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

Forward-Looking Statements and Associated Risks

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

Such forward-looking statements are based on the beliefs of our management, as well as assumptions made by and information currently available to our management, and are subject to risks, uncertainties, and other factors.

Actual results may differ materially and adversely from the expectations of the Company that are expressed or implied by any forward-looking statement. The discussions in Item 1A, "Risk Factors," and in Item 7 of this Form 10-K, "Management's Discussion and Analysis of Financial Condition and Results of Operations," list some of the factors that could cause the Company's actual results to vary materially from those expressed or implied by any forward-looking statements. Other risks, uncertainties, and factors that could cause the Company's actual results to vary materially from those expressed or implied by any forward-looking statement include but not limited to:

- the unknown future direction of interest rates and the timing and magnitude of any changes in interest rates;
- changes in competitive conditions;
- the introduction, withdrawal, success and timing of asset/liability management strategies or of mergers and acquisitions and other business initiatives and strategies;
- changes in customer borrowing, repayment, investment and deposit practices;
- changes in fiscal, monetary and tax policies;
- changes in financial and capital markets;
-

potential deterioration in general economic conditions, either nationally or locally, resulting in, among other things, credit quality deterioration;

capital management activities, including possible future sales of new securities, or possible repurchases or redemptions by the Company of outstanding debt or equity securities;

risks of expansion through acquisitions and mergers, such as unexpected credit quality problems of the acquired loans or other assets, unexpected attrition of the customer base or employee base of the acquired institution or branches, and difficulties in integration of the acquired operations;

factors driving impairment charges on investments;

the impact, extent and timing of technological changes;

potential cyber-attacks, information security breaches and other criminal activities;

- litigation liabilities, including related costs, expenses, settlements and judgments, or the outcome of matters before regulatory agencies, whether pending or commencing in the future;
- actions of the FRB;
- changes in accounting principles and interpretations;
- potential increases of federal deposit insurance premium expense, and possible future special assessments of FDIC premiums, either industry wide or specific to the Company's banking subsidiary;
- actions of the regulatory authorities under the Dodd-Frank Act and the Federal Deposit Insurance Act and other possible legislative and regulatory actions and reforms; and
- the continued availability of earnings and excess capital sufficient for the lawful and prudent declaration and payment of cash dividends.

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

Item 1A. Risk Factors.

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

Risks Related to the Financial Services Industry

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

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

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

The Dodd-Frank Act (discussed in Item 1 - Business - Regulation and Supervision) has resulted in sweeping changes in the regulation of financial institutions. The Dodd-Frank Act contains numerous provisions that affect all banks and bank holding companies. Many of these provisions remain subject to regulatory rule-making and implementation, the effects of which are not yet known. Accordingly, we cannot predict the specific impact and long-term effects that the Dodd-Frank Act and the regulations promulgated thereunder will have on us and our prospects, our target markets and the financial industry more generally. However, the Dodd-Frank Act and the regulations promulgated thereunder have

imposed additional administrative and regulatory burdens that obligate us to incur additional expenses (which adversely affect our margins and profitability) and increase the risk that we might not comply in all respects with the new requirements. Further, the CFPB's rule on qualified mortgages could limit our ability or desire to make certain types of loans or loans to certain borrowers, or could make it more expensive and/or time consuming to make these loans, which could adversely impact our growth or profitability.

The banking industry, as well as the broader economy, may be subject to new legislation, regulation, and government policy. At this time, we are not able to predict the legislative and regulatory changes that may occur in the future. Future legislation, regulation, and government policy could affect the banking industry as a whole, including our business and results of operations, in ways that cannot accurately be predicted. In addition, our financial condition and results of operations also could be adversely affected by changes in the way in which existing statutes and regulations are interpreted or applied by courts and government agencies.

The continued phase-in of the Basel III Capital Rules may have an adverse effect on us.

We are subject to certain capital rules adopted by the federal banking agencies that are based on the international Basel III guidelines, which became effective January 1, 2015. See Item 1- Business - Regulation and Supervision. Some of the requirements of these capital rules are being phased in over a three year period that began in 2016. The impact of the continued phase-in of the rules may require us to maintain higher levels of capital in the future than we have maintained in recent years, which could lower our return on equity.

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

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

Risks Related to Our Business and Financial Strategies

Economic weakness in our geographic markets could negatively affect us.

We conduct business from offices that are located in 19 contiguous southern Indiana counties and one northern Kentucky county, from which substantially all of our customer base is drawn. Because of the geographic concentration of our operations and customer base, our results depend largely upon economic conditions in this area. Any material deterioration in the economic conditions in these markets could have direct or indirect material adverse impacts on us, or on our customers or on the financial institutions with whom we deal as counterparties to financial transactions. Such deterioration could negatively impact customers' ability to obtain new loans or to repay existing loans, diminish the values of any collateral securing such loans and could cause increases in the number of the Company's customers experiencing financial distress and in the levels of the Company's delinquencies, non-performing loans and other problem assets, charge-offs and provision for credit losses, all of which could materially adversely affect our financial condition and results of operations. The underwriting and credit monitoring policies and procedures that we have adopted cannot eliminate the risk that we might incur losses on account of factors relating to the economy like those identified above, and those losses could have a material adverse effect on our business, financial condition, results of operations and cash flows.

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

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

We could be adversely affected by changes in interest rates.

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

positively impact the value of these securities. Any substantial, prolonged change in market interest rates could have a material adverse effect on our financial condition, results of operations, and cash flows.

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

We compete with much larger regional, national, and international competitors, including competitors that have no (or only a limited number of) offices physically located within our markets, many of which compete with us via Internet and other electronic

product and service offerings. In addition, banking and other financial services competitors (including newly organized companies) that are not currently represented by physical locations within our geographic markets could establish office facilities within our markets, including through their acquisition of existing competitors. In December 2016, the OCC announced its intent to make special purpose national bank charters available to financial technology companies. The agency published a paper discussing issues related to chartering special purpose national banks and solicited public comment to help guide its approach to financial innovation. Developments increasing the nature or level of our competition, or decreasing the effectiveness by which we compete, could have a material adverse effect on our business, financial condition, results of operations or liquidity. See also Part I, Item 1, of this Report, “Business - Competition,” and “Business - Regulation and Supervision.”

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

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

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

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

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

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

The soundness of other financial institutions could adversely affect us.

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

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

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

Our controls and procedures may fail or be circumvented.

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

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

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

Risks Related to Our Operations

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

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

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

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

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

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

cannot be sure that their information security protocols are sufficient to withstand a cyber-attack or other security breach.

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

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

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

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

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

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

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

Risks Relating to Expansion of Our Businesses by Acquisition

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

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

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

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

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

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

Integration efforts for any future acquisitions may not be successful and following any future acquisition, after giving it effect, we may not achieve financial results comparable to or better than our historical experience. We may participate in FDIC-assisted acquisitions, which could present additional risks to our financial condition. We may make opportunistic whole or partial acquisitions of troubled financial institutions in transactions facilitated by the FDIC. In addition to the risks frequently associated with acquisitions, an acquisition of a troubled financial institution may involve a greater risk that the acquired assets underperform compared to our expectations. Because these acquisitions are structured in a

manner that would not allow us the time normally associated with preparing for and evaluating an acquisition, including preparing for integration of an acquired institution, we may face additional risks including, among other things, the loss of customers, strain on management resources related to collection and management of problem loans and problems related to integration of personnel and operating systems. Additionally, while the FDIC may agree to assume certain losses in transactions that it facilitates, there can be no assurances that we would not be required to raise additional capital as a condition to, or as a result of, participation in an FDIC-assisted transaction. Any such transactions and related issuances of stock may have dilutive effect on earnings per share and share ownership.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

The Company's executive offices are located in the main office building of the Bank at 711 Main Street, Jasper, Indiana. The main office building, which is owned by the Bank and also serves as the main office of the Company's other subsidiaries, contains approximately 23,600 square feet of office space. The Bank and the Company's other subsidiaries also conduct their operations from 53 other locations in Southern Indiana and one in Northern Kentucky of which 37 are owned by the Company and 17 are leased from third parties.

Item 3. Legal Proceedings.

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

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

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

Market and Dividend Information

German American Bancorp, Inc.'s stock is traded on NASDAQ's Global Select Market under the symbol GABC. The quarterly high and low closing prices for the Company's common stock as reported by NASDAQ and quarterly cash dividends declared and paid are set forth in the table below.

	2016			2015		
	High	Low	Cash Dividend	High	Low	Cash Dividend
Fourth Quarter	\$53.92	\$37.86	\$ 0.18	\$34.61	\$28.78	\$ 0.17
Third Quarter	\$39.37	\$31.06	\$ 0.18	\$30.71	\$28.32	\$ 0.17
Second Quarter	\$34.12	\$30.35	\$ 0.18	\$30.38	\$28.18	\$ 0.17
First Quarter	\$32.76	\$29.99	\$ 0.18	\$29.78	\$27.84	\$ 0.17
			\$ 0.72			\$ 0.68

The Common Stock was held of record by approximately 3,485 shareholders at March 1, 2017.

Cash dividends paid to the Company's shareholders are primarily funded from dividends received by the parent company from its bank subsidiary. The declaration and payment of future dividends will depend upon the earnings and financial condition of the Company and its subsidiaries, general economic conditions, compliance with regulatory requirements affecting the ability of the bank subsidiary and the Company to declare dividends, (for further discussion of such requirements, see Item 1, "Business - Regulation and Supervision - Restrictions on Bank Dividends or Loans to, or other Transactions with, the Parent Company and Parent Company Dividends"), and other factors.

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

Stock Performance Graph

The following graph compares the Company's five-year cumulative total returns with those of the Russell 2000 Stock Index, Russell Microcap Stock Index, and the Indiana Bank Peer Group. The Indiana Bank Peer Group (which is a custom peer group identified by Company management) includes all Indiana-based commercial bank holding companies (excluding companies owning thrift institutions that are not regulated as bank holding companies) that have been in existence as commercial bank holding companies throughout the five-year period ended December 31, 2016, the stocks of which have been traded on an established securities market (NYSE, AMEX, NASDAQ) throughout that five-year period. The companies comprising the Indiana Bank Peer Group for purposes of the December 2016 comparison were: 1st Source Corp., First Financial Corp., First Merchants Corp., Lakeland Financial Corp., MainSource Financial Group, Old National Bancorp, and Horizon Bancorp. The returns of each company in the Indiana Bank Peer Group have been weighted to reflect the company's market capitalization. The Russell 2000 Stock Index, which is designed to measure the performance of the small-cap segment of the U.S. equity universe, is a subset of the Russell 3000 Index (which measures the performance of the largest 3,000 U.S. companies) that includes approximately 2,000 of the smallest securities in that index based on a combination of their market cap and current index membership, and is annually reconstituted at the end of each June. The Russell Microcap Stock Index is an index representing the smallest 1,000 securities in the small-cap Russell 2000 Index plus the next 1,000 securities, which is also annually reconstituted at the end of each June. The Company's stock is currently included in the Russell 2000 Index and Russell Microcap Index.

Stock Repurchase Program Information

The following table sets forth information regarding the Company's purchases of its common shares during each of the three months ended December 31, 2016.

Period	Total Number of Shares (or Units) Purchased	Average Price Paid Per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs ⁽¹⁾
October 2016	—	—	—	272,789
November 2016	—	—	—	272,789
December 2016	—	—	—	272,789

⁽¹⁾ On April 26, 2001, the Company announced that its Board of Directors had approved a stock repurchase program for up to 607,754 of its outstanding common shares, of which the Company had purchased 334,965 common shares through December 31, 2016 (both such numbers adjusted for subsequent stock dividends). The Board of Directors established no expiration date for this program. The Company purchased no shares under this program during the quarter ended December 31, 2016.

Equity Compensation Plan Information

The Company maintains four plans under which it has authorized the issuance of its Common Shares to employees and non-employee directors as compensation: its 1992 Stock Option Plan (under which no new grants may be made), its 1999 Long-Term Equity Incentive Plan (under which no new grants may be made), its 2009 Long-Term Equity Incentive Plan, and its 2009 Employee Stock Purchase Plan. Each of these four plans was approved by the requisite vote of the Company's common shareholders in the year of adoption by the Board of Directors. The Company is not a party to any individual compensation arrangement involving the authorization for issuance of its equity securities to any single person, other than option agreements and restricted stock award agreements that have been granted under the terms of one of the four plans identified above. The following table sets forth information regarding these plans as of December 31, 2016:

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

Equity compensation plans approved by security holders	—	(a)\$	—659,687	(b)
Equity compensation plans not approved by security holders	—	—	—	
Total	—	\$	—659,687	

(a) Any shares that employees may have the right to purchase under the Employee Stock Purchase Plan in August 2017 in respect of employee payroll deductions of participating employees that had accumulated as of December 31, 2016 during the plan year that commenced in August 2016 have been excluded. Although these employees have the right under this Plan to have their accumulated payroll deductions applied to the purchase of Common Shares at a discounted price in August 2017, the price at which such shares may be purchased and the number of shares that may be purchased under that Plan at that time is not presently determinable.

Represents 384,951 shares that the Company may in the future issue to employees under the Employee Stock Purchase Plan (although the Company typically purchases the shares needed for sale to participating employees on the open market rather than issuing new issue shares to such employees) and 274,736 shares that were available for grant or issuance at December 31, 2016 under the 2009 Long-Term Equity Incentive Plan. Under the Long-Term Equity Incentive Plan, the aggregate number of Common Shares available for the grant of awards (subject to

(b) customary anti-dilution adjustment provisions) cumulatively following the adoption of the Plan in 2009 through the expiration of the Plan in 2019 may not exceed the sum of the following: (a) 500,000 shares, plus (b) any shares exchanged by a participant as full or partial payment to the Company of the exercise price of an option granted to the participant under the Plan; plus (c) at the beginning of each calendar year, an additional number of shares (if any) equal to the number of shares that would result in the number of shares available for awards as of such date being equal to one percent (1%) of the total number of the Company's shares outstanding as of the immediately preceding December 31, on a fully-diluted basis.

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

Item 6. Selected Financial Data.

The following selected data should be read in conjunction with the consolidated financial statements and related notes that are included in Item 8 of this Report, and “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” which is included in Item 7 of this Report (dollars in thousands, except per share data).

Year-to-year financial information comparability is affected by the acquisition accounting treatment for mergers and acquisitions, including but not limited to the Company’s acquisition of United Commerce Bancorp, effective October 1, 2013 and the Company's acquisition of River Valley Bancorp, effective March 1, 2016.

	2016	2015	2014	2013	2012	
Summary of Operations:						
Interest Income	\$103,365	\$81,620	\$80,386	\$75,672	\$77,160	
Interest Expense	8,461	6,068	6,047	7,155	10,912	
Net Interest Income	94,904	75,552	74,339	68,517	66,248	
Provision for Loan Losses	1,200	—	150	350	2,412	
Net Interest Income after Provision For Loan Losses	93,704	75,552	74,189	68,167	63,836	
Non-interest Income	32,013	27,444	23,937	23,615	21,811	
Non-interest Expense	76,587	61,326	57,713	54,905	50,923	
Income before Income Taxes	49,130	41,670	40,413	36,877	34,724	
Income Tax Expense	13,946	11,606	12,069	11,464	10,669	
Net Income	\$35,184	\$30,064	\$28,344	\$25,413	\$24,055	
Year-end Balances:						
Total Assets	\$2,955,994	\$2,373,701	\$2,237,099	\$2,163,827	\$2,006,300	
Total Loans, Net of Unearned Income	1,989,955	1,564,347	1,447,982	1,382,382	1,204,866	
Total Deposits	2,349,551	1,826,376	1,779,761	1,812,156	1,640,931	
Total Long-term Debt	120,560	95,606	64,591	87,237	89,472	
Total Shareholders' Equity	330,267	252,348	228,824	200,097	185,026	
Average Balances:						
Total Assets	\$2,841,096	\$2,267,555	\$2,170,761	\$2,037,236	\$1,934,123	
Total Loans, Net of Unearned Income	1,904,779	1,483,752	1,406,000	1,272,055	1,147,891	
Total Deposits	2,249,892	1,825,913	1,783,348	1,695,796	1,618,712	
Total Shareholders' Equity	321,520	241,018	214,496	189,689	177,207	
Per Share Data:						
Net Income ⁽¹⁾	\$2.36	\$2.27	\$2.14	\$1.98	\$1.90	
Cash Dividends	0.72	0.68	0.64	0.60	0.56	
Book Value at Year-end	21.64	19.00	17.31	15.19	14.64	
Other Data at Year-end:						
Number of Shareholders	3,513	3,343	3,398	3,444	3,105	
Number of Employees	605	479	473	478	439	
Weighted Average Number of Shares ⁽¹⁾	14,927,410	13,258,916	13,223,178	12,807,678	12,637,743	
Selected Performance Ratios:						
Return on Assets	1.24	% 1.33	% 1.31	% 1.25	% 1.24	%
Return on Equity	10.94	% 12.47	% 13.21	% 13.40	% 13.57	%
Equity to Assets	11.17	% 10.63	% 10.23	% 9.25	% 9.22	%

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Dividend Payout	30.21	% 29.97	% 29.81	% 30.18	% 29.38	%
Net Charge-offs (Recoveries) to Average Loans	0.04	% 0.03	% (0.01)% 0.10	% 0.19	%
Allowance for Loan Losses to Loans	0.74	% 0.92	% 1.03	% 1.05	% 1.29	%
Net Interest Margin	3.75	% 3.70	% 3.76	% 3.67	% 3.74	%

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

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

INTRODUCTION

German American Bancorp, Inc., is a NASDAQ-traded (symbol: GABC) bank holding company based in Jasper, Indiana. German American, through its banking subsidiary German American Bancorp, operates 51 banking offices in 19 contiguous southern Indiana counties and one northern Kentucky county. The Company also owns an investment brokerage subsidiary (German American Investment Services, Inc.) and a full line property and casualty insurance agency (German American Insurance, Inc.).

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

This Management's Discussion and Analysis includes an analysis of the major components of the Company's operations for the years 2014 through 2016 and its financial condition as of December 31, 2016 and 2015. This information should be read in conjunction with the accompanying consolidated financial statements and footnotes contained elsewhere in this Report and with the description of business included in Item 1 of this Report (including the cautionary disclosure regarding "Forward Looking Statements and Associated Risks"). Financial and other information by segment is included in Note 15 (Segment Information) of the Notes to the Consolidated Financial Statements included in Item 8 of this Report and is incorporated into this Item 7 by reference.

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

On March 1, 2016 (as discussed in Note 17 (Business Combinations) of the Notes to the Consolidated Financial Statements included in Item 8 of this Report, which Note 17 is incorporated herein by reference), the Company completed its acquisition of River Valley Bancorp and its subsidiaries, including River Valley Financial Bank. This transaction significantly increased the levels of the Company's total assets, liabilities, shareholders equity. River Valley's consolidated assets and equity (unaudited) as of February 29, 2016 totaled \$516.3 million and \$56.6 million, respectively. The transaction was accounted for under the acquisition method of accounting. Under the acquisition method, the purchase price was allocated to identifiable assets and assumed liabilities based on their fair values. Any excess was accounted for as goodwill. Intangible assets with definite lives are being amortized over their estimated useful lives. Goodwill and intangible assets determined to have indefinite lives will not be amortized, but will be tested for impairment at least annually (more frequently if certain indicators are present). In the event that management of the Company determines that the value of goodwill or intangible assets has become impaired, an impairment charge will be recorded in the fiscal quarter in which such determination is made.

Any statements of management's expectations and goals concerning the Company's future operations and performance, and future financial condition, liquidity and capital resources that are set forth in the following Management Overview

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

MANAGEMENT OVERVIEW

Net income for the year ended December 31, 2016 totaled \$35,184,000 or \$2.36 per share, an increase of \$5,120,000, or approximately 4% on a per share basis, from the year ended December 31, 2015 net income of \$30,064,000 or \$2.27 per share. The level of earnings during 2016 represented the Company's seventh consecutive year of record earnings performance and also represented the twelfth consecutive year of double digit return on shareholders' equity.

On March 1, 2016, the Company completed its acquisition of River Valley Bancorp and its subsidiaries, including River Valley Financial Bank. Immediately following this transaction, River Valley Bancorp's subsidiary bank, River Valley Financial Bank, was merged into German American's similarly-named subsidiary bank, German American Bancorp. This transaction provided a strategic opportunity for German American to enhance its presence in the Southeast Indiana market area.

The 2016 results of operations included the operations of River Valley for ten months and were impacted by merger related charges associated with the closing of the River Valley transaction. These merger related charges totaled approximately \$4,318,000, or \$2,725,000 on an after tax basis, which represented approximately \$0.18 per share during 2016.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

Allowance for Loan Losses

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

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

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

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

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

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

Securities Valuation

Securities available-for-sale are carried at fair value, with unrealized holding gains and losses reported separately in accumulated other comprehensive income (loss), net of tax. The Company obtains market values from a third party on a monthly basis in order to adjust the securities to fair value. Equity securities that do not have readily determinable fair values are carried at cost. Additionally, when securities are deemed to be other than temporarily impaired, a charge will be recorded through earnings; therefore, future changes in the fair value of securities could have a significant impact on the Company's operating results. In determining whether a market value decline is other than temporary, management considers the reason for the decline, the extent of the decline, the duration of the decline and whether the Company intends to sell or believes it will be required to sell the securities prior to recovery. As of December 31, 2016, gross unrealized gains on the securities available-for-sale portfolio totaled approximately \$4,327,000 and gross unrealized losses totaled approximately \$14,096,000.

Income Tax Expense

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

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

Goodwill and Other Intangible Assets

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

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

RESULTS OF OPERATIONS

NET INCOME

Net income for the year ended December 31, 2016 totaled \$35,184,000 or \$2.36 per share, an increase of \$5,120,000, or approximately 4% on a per share basis, from the year ended December 31, 2015 net income of \$30,064,000 or \$2.27 per share. The 2016 results of operations included ten month's operations of River Valley and were impacted by merger related charges associated with the closing of the River Valley transaction which was effective March 1, 2016. These merger related charges totaled approximately \$4,318,000, or \$2,725,000 on an after tax basis, which represented approximately \$0.18 per share during 2016.

Net income for the year ended December 31, 2015 totaled \$30,064,000 or \$2.27 per diluted share, an increase of \$1,720,000 or approximately 6% on a per share basis, from the year ended December 31, 2014 net income of \$28,344,000 or \$2.14 per diluted

share. For 2015, the improvement in earnings was attributable to an increased level of net interest income, improved non-interest income, and a modestly reduced level of provision for loan loss partially offset by a higher level of non-interest expense.

NET INTEREST INCOME

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

Net interest income increased \$19,352,000, or 26% (an increase of \$20,398,000 or 26% on a tax-equivalent basis), for year ended December 31, 2016 compared with 2015. The increased level of net interest income during 2016 compared with 2015 was driven primarily by a higher level of earning assets resulting from the acquisition of River Valley and from organic loan growth, which excludes the purchased River Valley loan portfolio.

The net interest margin represents tax-equivalent net interest income expressed as a percentage of average earning assets. The tax equivalent net interest margin was 3.75% during 2016 compared to 3.70% during 2015. The tax equivalent yield on earning assets totaled 4.07% during 2016 compared to 3.98% in 2015, while the cost of funds (expressed as a percentage of average earning assets) totaled 0.32% during 2016 compared to 0.28% in 2015.

The increase in the net interest margin during 2016 was primarily attributable to an increase in the amount of accretion of loan discounts on acquired loans combined with an increased loan yield stemming largely from the addition of the River Valley loan portfolio and a securities portfolio mix shift to a higher percentage of total securities in non-taxable securities rather than in taxable securities, partially offset by a higher cost of funds. Accretion of loan discounts on acquired loans contributed approximately 13 basis points to the net interest margin on an annualized basis during 2016 and 4 basis points in 2015. The increase in accretion during 2016 was largely attributable to loans acquired in the River Valley merger transaction. The increase in the cost of funds was largely attributable to the increase in short-term market interest rates that occurred late in the fourth quarter of 2015 and to the addition of the River Valley deposit portfolio.

Net interest income increased \$1,213,000 or 2% (an increase of \$2,081,000 or 3% on a tax-equivalent basis) during year ended December 31, 2015 compared with 2014. The increased level of net interest income during 2015 compared with 2014 was driven by a higher level of earning assets and in particular growth of the loan portfolio. In addition, the increased level of net interest income was attributable to a shift from the taxable securities portfolio to the non-taxable securities portfolio.

The tax equivalent net interest margin was 3.70% in 2015 compared to 3.76% during 2014. The yield on earning assets totaled 3.98% during 2015 compared to 4.06% in 2014 while the cost of funds totaled 0.28% during 2015 compared to 0.30% in 2014.

The decline in the net interest margin during 2015 compared with 2014 was largely attributable to the continued downward pressure on earning asset yields that was driven by the low market interest rate environment and a competitive marketplace for lending opportunities. Partially mitigating the decline in earning asset yields was the continued decline in the Company's cost of funds. Accretion of loan discounts on acquired loans contributed approximately 4 basis points to the net interest margin during 2015 compared with 6 basis points during 2014.

The following table summarizes net interest income (on a tax-equivalent basis) for each of the past three years. For tax-equivalent adjustments, an effective tax rate of 35% was used for all years presented ⁽¹⁾.

Average Balance Sheet

(Tax-equivalent basis, dollars in thousands)

	Twelve Months Ended December 31, 2016			Twelve Months Ended December 31, 2015			Twelve Months Ended December 31, 2014		
	Principal Balance	Income / Expense	Yield / Rate	Principal Balance	Income / Expense	Yield / Rate	Principal Balance	Income / Expense	Yield / Rate
ASSETS									
Federal Funds Sold and Other Short-term Investments	\$22,180	\$74	0.33 %	\$19,187	\$13	0.07 %	\$14,056	\$12	0.09 %
Securities:									
Taxable	484,744	9,638	1.99 %	455,303	9,017	1.98 %	493,144	10,409	2.11 %
Non-taxable	238,300	11,464	4.81 %	178,929	9,001	5.03 %	131,962	6,721	5.09 %
Total Loans and Leases (2)	1,904,779	86,755	4.55 %	1,483,752	67,109	4.52 %	1,406,000	65,896	4.69 %
TOTAL INTEREST EARNING ASSETS	2,650,003	107,931	4.07 %	2,137,171	85,140	3.98 %	2,045,162	83,038	4.06 %
Other Assets	206,213			145,517			141,287		
Less: Allowance for Loan Losses	(15,120)			(15,133)			(15,688)		
TOTAL ASSETS	\$2,841,096			\$2,267,555			\$2,170,761		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Interest-bearing Demand Deposits	\$755,775	\$1,745	0.23 %	\$574,021	\$796	0.14 %	\$552,966	\$724	0.13 %
Savings Deposits and Money Market Accounts	566,818	770	0.14 %	471,058	547	0.12 %	485,277	570	0.12 %
Time Deposits	414,100	2,672	0.65 %	350,522	2,633	0.75 %	336,269	2,834	0.84 %
FHLB Advances and Other Borrowings	242,483	3,274	1.35 %	178,767	2,092	1.17 %	160,101	1,919	1.20 %
TOTAL INTEREST-BEARING LIABILITIES	1,979,176	8,461	0.43 %	1,574,368	6,068	0.39 %	1,534,613	6,047	0.39 %
Demand Deposit Accounts	513,199			430,312			408,836		
Other Liabilities	27,201			21,857			12,816		

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TOTAL LIABILITIES	2,519,576	2,026,537	1,956,265
Shareholders' Equity	321,520	241,018	214,496
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$2,841,096	\$2,267,555	\$2,170,761
COST OF FUNDS	0.32 %	0.28 %	0.30 %
NET INTEREST INCOME	\$99,470	\$79,072	\$76,991
NET INTEREST MARGIN	3.75 %	3.70 %	3.76 %

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

(2) Loans held-for-sale and non-accruing loans have been included in average loans. Interest income on loans includes loan fees of \$4,283, \$2,102 and \$2,036 for 2016, 2015 and 2014, respectively.

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

Net Interest Income – Rate / Volume Analysis

(Tax-Equivalent basis, dollars in thousands)

	2016 compared to 2015			2015 compared to 2014		
	Increase / (Decrease) Due to ⁽¹⁾			Increase / (Decrease) Due to ⁽¹⁾		
	Volume	Rate	Net	Volume	Rate	Net
Interest Income:						
Federal Funds Sold and Other						
Short-term Investments	\$3	\$58	\$61	\$4	\$(3)	\$1
Taxable Securities	585	36	621	(771)	(621)	(1,392)
Non-taxable Securities	2,871	(408)	2,463	2,363	(83)	2,280
Loans and Leases	19,172	474	19,646	3,566	(2,353)	1,213
Total Interest Income	22,631	160	22,791	5,162	(3,060)	2,102
Interest Expense:						
Savings and Interest-bearing Demand	418	754	1,172	9	40	49
Time Deposits	440	(401)	39	116	(317)	(201)
FHLB Advances and Other Borrowings	826	356	1,182	219	(46)	173
Total Interest Expense	1,684	709	2,393	344	(323)	21
Net Interest Income	\$20,947	\$(549)	\$20,398	\$4,818	\$(2,737)	\$2,081

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

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

PROVISION FOR LOAN LOSSES

The Company provides for loan losses through regular provisions to the allowance for loan losses. The provision is affected by net charge-offs on loans and changes in specific and general allocations required on the allowance for loan losses. Provisions for loan losses totaled \$1,200,000, \$0, and \$150,000 in 2016, 2015, and 2014, respectively.

During 2016, the provision for loan loss represented approximately 6 basis points of average loans on an annualized basis. The increased level of provision during 2016 was done in accordance with the Company's standard methodology for determining the adequacy of its allowance for loan loss and was largely related to an increased level of allowance for loan loss that has been allocated to the Company's agricultural loan portfolio. The Company realized net charge-offs of \$830,000 or 4 basis points of average loans outstanding during 2016, compared with net charge-offs of \$491,000 or 3 basis points of average loans outstanding during 2015.

The Company's allowance for loan losses represented 0.74% of total loans at year-end 2016 compared with 0.92% of total loans at year-end 2015. The year-over-year decline in the allowance for loan loss as a percent of total loans was the result of the acquisition of River Valley. Under acquisition accounting, loans are recorded at fair value which includes a credit risk component, and therefore the allowance on loans acquired is not carried over from the seller.

Provisions for loan losses in all periods were made at a level deemed necessary by management to absorb estimated, probable incurred losses in the loan portfolio. A detailed evaluation of the adequacy of the allowance for loan losses is completed quarterly by management, the results of which are used to determine provisions for loan losses.

Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other qualitative factors. Refer also to the sections entitled CRITICAL ACCOUNTING POLICIES AND ESTIMATES and “RISK MANAGEMENT - Lending and Loan Administration” for further discussion of the provision and allowance for loan losses.

NON-INTEREST INCOME

During 2016, non-interest income increased approximately 17% from with the increase largely the result of the acquisition of River Valley and an increase in the level of gains on the sale of securities. The year ended December 31, 2016 included ten months of River Valley operations while 2015 had no operations of River Valley included. During 2015, non-interest income increased \$3,507,000 or 15% compared with 2014.

Non-interest Income (dollars in thousands)	Years Ended December 31,			% Change From Prior Year	
	2016	2015	2014	2016	2015
Trust and Investment Product Fees	\$4,644	\$3,957	\$3,675	17 %	8 %
Service Charges on Deposit Accounts	5,973	4,826	4,829	24	n/m ⁽¹⁾
Insurance Revenues	7,741	7,489	7,255	3	3
Company Owned Life Insurance	987	846	826	17	2
Interchange Fee Income	2,532	2,127	1,961	19	8
Other Operating Income	4,798	4,515	2,018	6	124
Subtotal	26,675	23,760	20,564	12	16
Net Gains on Sales of Loans	3,359	2,959	1,892	14	56
Net Gains on Securities	1,979	725	1,481	173	(51)
TOTAL NON-INTEREST INCOME	\$32,013	\$27,444	\$23,937	17	15

⁽¹⁾ n/m = not meaningful

Trust and investment product fees increased \$687,000, or 17%, during 2016 compared with 2015 primarily due to growth in assets under management within the Company's trust advisory group with this growth coming through both the existing footprint of the Company and the River Valley acquisition. Trust and investment product fees increased \$282,000, or 8%, during 2015 compared with 2014 primarily due to growth in assets under management within the Company's trust advisory group.

Service charges on deposit accounts increased \$1,147,000, or 24%, during 2016 compared with 2015 due primarily to the River Valley acquisition. Service charges on deposit accounts were flat during 2015 compared with 2014.

Insurance revenues increased \$252,000, or 3%, during 2016 as compared to 2015 as a result of increased commercial insurance revenue, personal lines insurance revenue and contingency revenue. Insurance revenues increased \$234,000, or 3%, during 2015 as compared to 2014 as a result of increased commercial insurance revenue partially offset by a decline in contingency revenue. Contingency revenue totaled \$1,114,000 in 2016 compared with \$949,000 in 2015 and \$1,049,000 in 2014. Contingency revenue is reflective of claims and loss experience with insurance carriers that the Company represents through its property and casualty insurance agency.

Net gains on sales of loans increased \$400,000, or 14%, during 2016 compared with 2015. Net gains on sales of loans increased \$1,067,000, or 56%, during 2015 compared with 2014. Loan sales for 2016, 2015, and 2014 totaled \$133.6 million, \$132.6 million, \$99.4 million, respectively.

During 2016, the Company realized net gains on the sale of securities of \$1,979,000 related to the sale of approximately \$163.1 million. During 2015, the Company realized net gains on the sale of securities of \$725,000 related to the sale of approximately \$18.3 million of securities. During 2014, the Company realized net gains on the sale of securities of \$1,481,000 related to the sale of approximately \$58.7 million of securities.

NON-INTEREST EXPENSE

During 2016, non-interest expense increased \$15,261,000, or 25%, compared with 2015. During 2016, the Company recorded costs related to the River Valley merger transaction that totaled \$4,318,000. The majority of the remainder of the increase in operating expenses during 2016 compared with 2015 were related to the operating costs of River Valley. During 2015, non-interest expense increased \$3,613,000, or 6%, compared with 2014.

Non-interest Expense (dollars in thousands)	Years Ended December 31,			% Change From Prior Year	
	2016	2015	2014	2016	2015
Salaries and Employee Benefits	\$43,961	\$35,042	\$32,710	25 %	7 %
Occupancy, Furniture and Equipment Expense	8,558	6,812	7,047	26	(3)
FDIC Premiums	1,151	1,144	1,113	1	3
Data Processing Fees	5,686	3,541	3,675	61	(4)
Professional Fees	3,672	2,661	2,294	38	16
Advertising and Promotion	2,657	3,669	1,977	(28)	86
Intangible Amortization	1,062	790	1,254	34	(37)
Other Operating Expenses	9,840	7,667	7,643	28	n/m ⁽¹⁾
TOTAL NON-INTEREST EXPENSE	\$76,587	\$61,326	\$57,713	25	6

⁽¹⁾ n/m = not meaningful

Salaries and benefits increased \$8,919,000, or 25%, in 2016 compared with 2015. Included in the increase in 2016 was \$1,934,000 of merger costs related to the settlement of various employment and benefit arrangements. The remainder of the increase was largely related to a higher number of full-time equivalent employees stemming from the acquisition of River Valley. Salaries and benefits increased \$2,332,000, or 7%, during 2015 compared with 2014. The increase in salaries and benefits during 2015 compared with 2014 was attributable to increased costs associated with the Company's partially self insured health insurance plan, costs related to the Company's long-term equity and short-term cash incentive compensation plans and variable compensation related to an increased level of secondary market mortgage loan production and insurance revenues.

Occupancy, furniture and equipment expense increased \$1,746,000, or 26%, in 2016 compared with 2015. This increase was related to the operation of River Valley's 15 branch network during 2016. Occupancy, furniture and equipment expense decreased \$235,000, or 3%, in 2015 compared with 2014.

Data processing fees increased \$2,145,000, or 61%, in 2016 compared with 2015. Included in the increase was \$1,288,000 of merger costs related to the consolidation of various data processing and information systems. Data processing fees declined \$134,000, or 4%, in 2015 compared with 2014.

Professional fees increased \$1,011,000, or 38%, in 2016 compared with 2015. Included in the increase in 2016 was \$770,000 of merger related costs. Professional fees increased \$367,000, or 16%, during 2015 compared with 2014. The increase was largely attributable to professional fees associated with the acquisition of River Valley.

Advertising and promotion declined \$1,012,000, or 28%, during 2016 compared with 2015. The decline in advertising and promotion during 2016 compared with 2015 was related to the recognition of a \$1,750,000 contribution expense during 2015 in connection with the donation of a building and accompanying real estate to an economic development foundation in one of the Company's market areas. Advertising and promotion expense increased \$1,692,000, or 86%, during 2015 compared with 2014 primarily due to the aforementioned donation.

Intangible amortization increased \$272,000, or 34%, during 2016 compared with 2015 due primarily to amortization of the core deposit intangible related to the River Valley acquisition. Intangible amortization declined \$464,000, or 37%, during 2015 compared with 2014 due primarily to lower levels of amortization of core deposit intangible from previous bank acquisition transactions.

Other operating expenses increased \$2,173,000, or 28%, in 2016 compared with 2015. Included in the increase in 2016 was \$284,000 of merger related costs. The inclusion of River Valley's operations was the primary driver of the remainder of the increase. Other operating expenses were flat in 2015 compared with 2014.

PROVISION FOR INCOME TAXES

The Company records a provision for current income taxes payable, along with a provision for deferred taxes payable in the future. Deferred taxes arise from temporary differences, which are items recorded for financial statement purposes in a different period

than for income tax returns. The Company's effective tax rate was 28.4%, 27.9%, and 29.9%, respectively, in 2016, 2015, and 2014. The effective tax rate in all periods is lower than the blended statutory rate. The lower effective rate in all periods primarily resulted from the Company's tax-exempt investment income on securities, loans, and company owned life insurance, income tax credits generated by investments in affordable housing projects, and income generated by subsidiaries domiciled in a state with no state or local income tax. See Note 10 to the Company's consolidated financial statements included in Item 8 of this Report for additional details relative to the Company's income tax provision.

CAPITAL RESOURCES

As of December 31, 2016, shareholders' equity increased by \$77.9 million to \$330.3 million compared with \$252.3 million at year-end 2015. The increase in shareholders' equity was largely attributable to the issuance of the Company's common shares in the acquisition of River Valley. Approximately 1,942,000 shares were issued to River Valley shareholders resulting in an increase to shareholders' equity of \$61.9 million. The increase in shareholders' equity was also attributable to an increase of \$24.6 million in retained earnings offset by a decline of \$10.2 million in accumulated other comprehensive income primarily related to the decrease in value of the Company's available-for-sale securities portfolio. Shareholders' equity represented 11.2% of total assets at December 31, 2016 and 10.6% of total assets at December 31, 2015. Shareholders' equity included \$56.9 million of goodwill and other intangible assets at December 31, 2016 compared to \$21.8 million of goodwill and other intangible assets at December 31, 2015. The increase in goodwill and other intangible assets was attributable to the acquisition of River Valley.

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

As of January 1, 2015, the Company and its subsidiary bank adopted the new Basel III regulatory capital framework. The adoption of this new framework modified the regulatory capital calculations, minimum capital levels and well-capitalized thresholds and added the new Common Equity Tier 1 capital ratio. Additionally, under the new rules, in order to avoid limitations on capital distributions, including dividend payments, the Company is required to maintain a capital conservation buffer above the adequately capitalized regulatory capital ratios. The capital conservation buffer is being phased in from 0.00% in 2015 to 2.50% in 2019. For December 31, 2016, the capital conservation buffer was 0.625%. At December 31, 2016, the capital levels for the Company and its subsidiary bank remained well in excess of the minimum amounts needed for capital adequacy purposes and the bank's capital levels met the necessary requirements to be considered well-capitalized.

The tables below present the Company's consolidated and the subsidiary bank's capital ratios under regulatory guidelines:

	12/31/2016		12/31/2015		Minimum for Capital Adequacy Purposes (1)		Well-Capitalized Guidelines	
	Ratio		Ratio					
Total Capital (to Risk Weighted Assets)								
Consolidated	13.30	%	13.71	%	8.00	%	N/A	
Bank	12.48	%	12.08	%	8.00	%	10.00	%

Tier 1 (Core) Capital (to Risk Weighted Assets)								
Consolidated	12.66	%	12.92	%	6.00	%	N/A	
Bank	11.84	%	11.28	%	6.00	%	8.00	%
Common Tier 1, (CET 1) Capital Ratio (to Risk Weighted Assets)								
Consolidated	12.19	%	12.63	%	4.50	%	N/A	
Bank	11.84	%	11.28	%	4.50	%	6.50	%
Tier 1 Capital (to Average Assets)								
Consolidated	10.09	%	10.15	%	4.00	%	N/A	
Bank	9.46	%	8.87	%	4.00	%	5.00	%

⁽¹⁾ Excludes capital conservation buffer.

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

USES OF FUNDS

LOANS

December 31, 2016 total loans increased \$425.3 million, or 27%, compared with December 31, 2015. The year-over-year increase was largely attributable to the acquisition of River Valley as well as growth within the Company's existing branch network, excluding River Valley, which totaled approximately \$117.8 million, or 8% growth. During 2016, from the Company's existing branch network, commercial real estate loans increased \$82.2 million, or 13%, agricultural loans increased \$15.2 million, or 6%, and consumer loans including home equity loans increased \$19.6 million, or 13%.

December 31, 2015 loans outstanding increased \$116.1 million, or 8% from year-end 2014. The increase in loans during 2015 was from virtually all categories with the exception of residential mortgage loans which experienced a modest decline. This growth came from across the Company's entire Southern Indiana market area. Commercial and industrial loans increased \$38.1 million, or 10%, commercial real estate loans increased \$35.7 million, or 6%, agricultural loans increased \$30.1 million, or 14%, consumer loans increased \$13.1 million, or 10%, and residential mortgage loans decreased \$888,000 or less than 1%.

The composition of the loan portfolio has remained relatively stable and diversified over the past several years, including 2016. The portfolio is most heavily concentrated in commercial real estate loans at 43% of the portfolio. The Company's exposure to non-owner occupied commercial real estate, including multi-family housing, was limited to 31% of the total loan portfolio at year-end 2016. The Company's commercial lending is extended to various industries, including multi-family housing and hotel, agribusiness and manufacturing, as well as health care, wholesale, and retail services. The Company has only limited exposure in construction and development lending with this segment representing approximately 4% of the total loan portfolio.

Loan Portfolio (dollars in thousands)	December 31,				
	2016	2015	2014	2013	2012
Commercial and Industrial Loans and Leases	\$457,372	\$418,154	\$380,079	\$350,955	\$335,373
Commercial Real Estate Loans	856,094	618,788	583,086	582,066	488,496
Agricultural Loans	303,128	246,886	216,774	192,880	179,906
Home Equity and Consumer Loans	193,520	147,931	134,847	130,628	115,540
Residential Mortgage Loans	183,290	136,316	137,204	128,683	88,586
Total Loans	1,993,404	1,568,075	1,451,990	1,385,212	1,207,901
Less: Unearned Income	(3,449)	(3,728)	(4,008)	(2,830)	(3,035)
Subtotal	1,989,955	1,564,347	1,447,982	1,382,382	1,204,866
Less: Allowance for Loan Losses	(14,808)	(14,438)	(14,929)	(14,584)	(15,520)
Loans, Net	\$1,975,147	\$1,549,909	\$1,433,053	\$1,367,798	\$1,189,346

Ratio of Loans to Total Loans

Commercial and Industrial Loans and Leases	23	% 27	% 26	% 25	% 28	%
Commercial Real Estate Loans	43	% 39	% 40	% 42	% 40	%
Agricultural Loans	15	% 16	% 15	% 14	% 15	%
Home Equity and Consumer Loans	10	% 9	% 9	% 10	% 10	%
Residential Mortgage Loans	9	% 9	% 10	% 9	% 7	%
Total Loans	100	% 100	% 100	% 100	% 100	%

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

The following table indicates the amounts of loans (excluding residential mortgages on 1-4 family residences and consumer loans) outstanding as of December 31, 2016, which, based on remaining scheduled repayments of principal, are due in the periods indicated (dollars in thousands). \$723.5 million included in the table below are variable loans that are currently at their floors.

	Within One Year	One to Five Years	After Five Years	Total
Commercial and Agricultural	\$636,013	\$807,970	\$172,611	\$1,616,594
Interest Sensitivity				
Fixed Rate		Variable		
Loans Maturing After One Year	\$184,577	\$796,004		

INVESTMENTS

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

Investment Portfolio, at Amortized Cost (dollars in thousands)	December 31, 2016		%	2015		%	2014		%
Federal Funds Sold and Other Short-term Investments	\$16,349	2	%	\$15,947	2	%	\$8,965	2	%
U.S. Treasury and Agency Securities	—	—		10,000	2		20,000	3	
Obligations of State and Political Subdivisions	247,350	34		195,360	30		147,505	23	
MBS/CMO - Residential	471,852	64		426,087	66		458,709	72	
Equity Securities	353	n/m ⁽¹⁾		353	n/m ⁽¹⁾		353	n/m ⁽¹⁾	
Total Securities Portfolio	\$735,904	100	%	\$647,747	100	%	\$635,532	100	%

⁽¹⁾ n/m = not meaningful

The amortized cost of investment securities, including federal funds sold and short-term investments, increased \$88.2 million, or 14%, at year-end 2016 compared with year-end 2015 and increased \$12.2 million at year-end 2015 compared with year-end 2014. The increase during 2016 was largely attributable to the River Valley acquisition. The largest concentration in the investment portfolio continues to be in mortgage related securities representing 64% of the total securities portfolio at December 31, 2016. The Company's level of obligations of state and political subdivisions increased to \$247.4 million or 34% of the portfolio at December 31, 2016.

Investment Securities, at Carrying Value (dollars in thousands)

	December 31,		
	2016	2015	2014
Securities Held-to-Maturity			
Obligations of State and Political Subdivisions	\$—	\$95	\$184
Securities Available-for-Sale			
U.S. Treasury and Agency Securities	\$—	\$9,898	\$19,561

Obligations of State and Political Subdivisions	247,519	203,628	153,777
MBS/CMO - Residential	461,914	423,961	457,304
Equity Securities	353	353	353
Subtotal of Securities Available-for-Sale	709,786	637,840	630,995
Total Securities	\$709,786	\$637,935	\$631,179

The Company's \$709.8 million available-for-sale portion of the investment portfolio provides an additional funding source for the liquidity needs of the Company's subsidiaries and for asset/liability management requirements. Although management has the

ability to sell these securities if the need arises, their designation as available-for-sale should not necessarily be interpreted as an indication that management anticipates such sales.

The amortized cost of available-for-sale debt securities at December 31, 2016 is shown in the following table by contractual maturity. MBS/CMO - Residential securities are based on estimated average lives. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations. Equity securities do not have contractual maturities, and are excluded from the table below.

Maturities and Average Yields of Securities at December 31, 2016
(dollars in thousands)

	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Obligations of State and Political Subdivisions	\$3,387	5.12 %	\$16,300	5.15 %	\$75,164	4.97 %	\$152,499	4.41 %
MBS/CMO - Residential	4	3.82 %	68	4.59 %	3,194	3.29 %	468,586	2.20 %
Total Securities	\$3,391	5.12 %	\$16,368	5.15 %	\$78,358	4.90 %	\$621,085	2.74 %

A tax-equivalent adjustment using a tax rate of 35 percent was used in the above table.

In addition to the other uses of funds discussed previously, the Company had certain long-term contractual obligations as of December 31, 2016. These contractual obligations primarily consisted of long-term borrowings with the Federal Home Loan Bank ("FHLB") and junior subordinated debentures, time deposits, and lease commitments for certain office facilities. Scheduled principal payments on long-term borrowings, time deposits, and future minimum lease payments are outlined in the table below.

Contractual Obligations (dollars in thousands)	Payments Due By Period				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Long-term Borrowings	\$116,795	\$53,984	\$46,285	\$5,551	\$10,975
Time Deposits	378,181	212,480	111,104	54,479	118
Capital Lease Obligations	7,625	519	1,038	1,038	5,030
Operating Lease Commitments	6,180	951	1,280	1,033	2,916
Total Contractual Obligations	\$508,781	\$267,934	\$159,707	\$62,101	\$19,039

SOURCES OF FUNDS

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

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

Funding Sources - Average Balances (dollars in thousands)	December 31,			% Change From Prior Year	
	2016	2015	2014	2016	2015
Demand Deposits					
Non-interest-bearing	\$513,199	\$430,312	\$408,836	19%	5%
Interest-bearing	755,775	574,021	552,966	32	4
Savings Deposits	215,032	165,302	150,773	30	10
Money Market Accounts	351,786	305,756	334,504	15	(9)
Other Time Deposits	219,408	193,263	210,294	14	(8)
Total Core Deposits	2,055,200	1,668,654	1,657,373	23	1
Certificates of Deposits of \$100,000 or more and Brokered Deposits	194,692	157,259	125,975	24	25
FHLB Advances and Other Borrowings	242,483	178,767	160,101	36	12
Total Funding Sources	\$2,492,375	\$2,004,680	\$1,943,449	24	3

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

	3 Months Or Less	3 Thru 6 Months	6 Thru 12 Months	Over 12 Months	Total
December 31, 2016	\$44,314	\$39,445	\$33,283	\$53,315	\$170,357

CORE DEPOSITS

The Company's overall level of average core deposits increased approximately \$386.5 million, or 23%, during 2016 following a \$11.3 million, or 1%, increase during 2015. During 2016, the most significant contributor to the increase level of core deposits was the acquisition of River Valley, which occurred on March 1, 2016. All categories of average core deposits increased. During 2015, average demand deposits (non-interest bearing and interest bearing) increased \$42.5 million and average savings deposits increased \$14.5 million while average money market demand deposits declined \$28.7 million and average time deposits under \$100,000 declined \$17.0 million.

The Company's ability to attract core deposits continues to be influenced by competition and the interest rate environment, as well as the availability of alternative investment products. Core deposits continue to represent a significant funding source for the Company's operations and represented 82% of average total funding sources during 2016 compared with 83% during 2015 and 85% during 2014.

Demand, savings, and money market deposits have provided a growing source of funding for the Company in each of the periods reported. Average demand, savings, and money market deposits increased 24% during 2016 following 2% growth during 2015. Average demand, savings, and money market deposits totaled \$1.836 billion or 89% of core deposits (74% of total funding sources) in 2016 compared with \$1.475 billion or 88% of core deposits (74% of total funding sources) in 2015 and \$1.447 billion or 87% of core deposits (74% of total funding sources) in 2014.

Other time deposits consist of certificates of deposits in denominations of less than \$100,000. These average deposits increased by 14% during 2016 following a decline of 8% during 2015. Other time deposits comprised 11% of core deposits in 2016, 12% in 2015 and 13% in 2014.

OTHER FUNDING SOURCES

Federal Home Loan Bank advances and other borrowings represent the Company's most significant source of other funding. Average borrowed funds increased \$63.7 million, or 36%, during 2016 following an increase of \$18.7 million, or 12%, during 2015. Borrowings comprised approximately 10% of average total funding sources during 2016 compared with 9% in 2015 and 8% in 2014.

Certificates of deposits in denominations of \$100,000 or more and brokered deposits are an additional source of other funding for the Company's bank subsidiary. Large denomination certificates and brokered deposits increased \$37.4 million, or 24% during 2016 following an increase of \$31.3 million, or 25% during 2015. Large certificates and brokered deposits comprised approximately

8% of average total funding sources in 2016 compared with 8% in 2015 and 7% in 2014. This type of funding is used as both long-term and short-term funding sources.

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

PARENT COMPANY FUNDING SOURCES

The parent company is a corporation separate and distinct from its bank and other subsidiaries. For information regarding the financial condition, result of operations, and cash flows of the Company, presented on a parent-company-only basis, see Note 16 (Parent Company Financial Statements) of the Notes to the Consolidated Financial Statements included in Item 8 of this Report.

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

At year-end 2016, the Company has available to it a \$20 million revolving line of credit facility that will mature on December 27, 2017. Borrowings are available for general working capital purposes. Interest is payable quarterly at a floating rate based upon 90-day LIBOR plus a margin payable in respect of any principal amounts advanced under the revolving line of credit. There was no outstanding balance as of December 31, 2016.

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

The junior subordinated debentures were issued to certain statutory trusts established by American Community and River Valley (in support of related issuances of trust preferred securities issued by those trusts) and mature in installments of principal payable in 2035 and 2033, respectively, and bear interest payable on a quarterly basis at a floating rate, adjustable quarterly based on the 90-day LIBOR plus a specified percentage. These debentures are of a type that are eligible (under current regulatory capital requirements) to qualify as Tier 1 capital (with certain limitations) for regulatory purposes and as of December 31, 2016 approximately \$10.8 million of the junior subordinated debentures were treated as Tier 1 capital for regulatory capital purposes.

See Note 16 (Parent Company Financial Statements) of the Notes to the Consolidated Financial Statements included in Item 8 of this Report for further information regarding the parent company borrowed funds and other indebtedness.

RISK MANAGEMENT

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

LENDING AND LOAN ADMINISTRATION

Primary responsibility and accountability for day-to-day lending activities rests with the Company's subsidiary bank. Loan personnel at the subsidiary bank have the authority to extend credit under guidelines approved by the bank's board of directors. The executive loan committee serves as a vehicle for communication and for the pooling of knowledge, judgment and experience of its members. The committee provides valuable input to lending personnel, acts as an approval body, and monitors the overall

quality of the bank's loan portfolio. The Corporate Credit Risk Management Committee comprised of members of the Company's and its subsidiary bank's executive officers and board of directors, strives to ensure a consistent application of the Company's lending policies. The Company also maintains a comprehensive risk-grading and loan review program, which includes quarterly reviews of problem loans, delinquencies and charge-offs. The purpose of this program is to evaluate loan administration, credit quality, loan documentation and the adequacy of the allowance for loan losses.

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

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

Allowance for Loan Losses (dollars in thousands)	Years Ended December 31,				
	2016	2015	2014	2013	2012
Balance of Allowance for Possible Losses at Beginning of Period	\$ 14,438	\$ 14,929	\$ 14,584	\$ 15,520	\$ 15,312
Loans Charged-off:					
Commercial and Industrial Loans and Leases	66	36	199	503	162
Commercial Real Estate Loans	54	350	329	538	1,789
Agricultural Loans	22	—	—	—	—
Home Equity and Consumer Loans	612	345	370	607	380
Residential Mortgage Loans	346	233	117	24	199
Total Loans Charged-off	1,100	964	1,015	1,672	2,530
Recoveries of Previously Charged-off Loans:					
Commercial and Industrial Loans and Leases	32	102	111	128	74
Commercial Real Estate Loans	10	107	863	102	97
Agricultural Loans	1	—	—	—	—
Home Equity and Consumer Loans	211	246	215	148	125
Residential Mortgage Loans	16	18	21	8	30
Total Recoveries	270	473	1,210	386	326
Net Loans Recovered (Charged-off)	(830)	(491)	195	(1,286)	(2,204)
Additions to Allowance Charged to Expense	1,200	—	150	350	2,412
Balance at End of Period	\$ 14,808	\$ 14,438	\$ 14,929	\$ 14,584	\$ 15,520

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Net Charge-offs (Recoveries) to Average Loans Outstanding	0.04	% 0.03	% (0.01))% 0.10	% 0.19	%
Provision for Loan Losses to Average Loans Outstanding	0.06	% 0.00	% 0.01	% 0.03	% 0.21	%
Allowance for Loan Losses to Total Loans at Year-end	0.74	% 0.92	% 1.03	% 1.05	% 1.29	%

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

	Years Ended December 31,				
	2016	2015	2014	2013	2012
Commercial and Industrial Loans and Leases	\$3,725	\$4,242	\$4,627	\$3,983	\$4,555
Commercial Real Estate Loans	5,452	6,342	7,273	8,335	8,931
Agricultural Loans	4,094	2,115	1,123	946	989
Home Equity and Consumer Loans	518	613	600	427	355
Residential Mortgage Loans	329	414	622	281	186
Unallocated	690	712	684	612	504
Total Allowance for Loan Losses	\$14,808	\$14,438	\$14,929	\$14,584	\$15,520

The Company's allowance for loan losses totaled \$14.8 million at December 31, 2016 representing an increase of \$370,000, or 3%, compared with year-end 2015. During 2016, the overall allowance for loan and lease losses was increased in the agricultural sector as a result of qualitative considerations for current economic conditions and trends which included a decline in the aggregate debt service coverage ratios for agricultural borrowers and a decline in per acre values of crop production real estate. The allowance for commercial real estate loans declined during 2016 primarily as a result of the repayment of a single non-accrual commercial real estate credit during the third quarter of 2016. This credit relationship was considered impaired and therefore had a specific allocation assigned prior to repayment.

The allowance for loan losses represented 0.74% of period-end loans at December 31, 2016 compared with 0.92% of period-end loans at December 31, 2015. The decline in the allowance for loan loss as a percent of total loans was the result of the acquisition of River Valley. Under acquisition accounting treatment, loans acquired are recorded at fair value which includes a credit risk component, and therefore the allowance on loans acquired is not carried over from the seller. The Company held a discount on acquired loans of \$10.0 million as of December 31, 2016 and \$3.0 million at December 31, 2015.

The Company realized net charge-offs of \$830,000, or 0.04% of average loans outstanding during 2016, compared with net charge-offs of \$491,000, or 0.03% of average loans during 2015.

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

NON-PERFORMING ASSETS

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

Non-performing Assets (dollars in thousands)	December 31,				
	2016	2015	2014	2013	2012
Non-accrual Loans	\$3,793	\$3,143	\$5,970	\$8,378	\$10,357
Past Due Loans (90 days or more)	2	143	140	8	—
Total Non-performing Loans	3,795	3,286	6,110	8,386	10,357
Other Real Estate	242	169	356	1,029	1,645
Total Non-performing Assets	\$4,037	\$3,455	\$6,466	\$9,415	\$12,002
Restructured Loans	\$28	\$2,203	\$2,726	\$2,418	\$362
Non-performing Loans to Total Loans	0.19 %	0.21 %	0.42 %	0.61 %	0.86 %
Allowance for Loan Losses to Non-performing Loans	390.20 %	439.38 %	244.34 %	173.91 %	149.85 %

Non-performing assets totaled \$4.0 million, or 0.14% of total assets at December 31, 2016 compared to \$3.5 million, or 0.15% of total assets at December 31, 2015. Non-performing loans totaled \$3.8 million, or 0.19% of total loans at December 31, 2016 compared to \$3.3 million, or 0.21% of total loans at December 31, 2015. The increase in non-performing assets and non-performing loans during the 2016 was primarily attributable to the merger transaction with River Valley which included \$2.5 million of non-accrual loans at December 31, 2016.

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

Non-Accrual Loans (dollars in thousands)	December 31,				
	2016	2015	2014	2013	2012
Commercial and Industrial Loans and Leases	\$86	\$134	\$161	\$31	\$2,480
Commercial Real Estate Loans	1,408	2,047	3,460	6,658	7,275
Agricultural Loans	792	—	—	—	—
Home Equity Loans	73	204	268	114	178
Consumer Loans	85	90	196	236	167
Residential Mortgage Loans	1,349	668	1,885	1,339	257
Total	\$3,793	\$3,143	\$5,970	\$8,378	\$10,357

Loans Past Due 90 Days or More & Still Accruing (dollars in thousands)	December 31,				
	2016	2015	2014	2013	2012
Commercial and Industrial Loans and Leases	\$2	\$96	\$68	\$ —	\$ —
Commercial Real Estate Loans	—	47	—	8	—
Agricultural Loans	—	—	72	—	—
Home Equity Loans	—	—	—	—	—
Consumer Loans	—	—	—	—	—
Residential Mortgage Loans	—	—	—	—	—
Total	\$2	\$143	\$140	\$ 8	\$ —

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

Purchased loans that indicated evidence of credit deterioration since origination at the time of acquisition by the Company did not have a material adverse impact on the Company's key credit metrics during 2016 or 2015. The key credit metrics the Company measures generally include non-performing loans, past due loans, and adversely classified loans.

Loan impairment is reported when full repayment under the terms of the loan is not expected. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate, or at the fair value of collateral if repayment is expected solely from the collateral. Commercial and industrial loans, commercial real estate loans, and agricultural loans are evaluated individually for impairment. Smaller balance homogeneous loans are evaluated for impairment in total. Such loans include real estate loans secured by one-to-four family residences and loans to individuals for household, family and other personal expenditures. Individually evaluated loans on non-accrual are generally considered impaired. Impaired loans, or portions thereof, are charged off when deemed uncollectible. The amount of loans individually evaluated for impairment, including purchase credit impaired loans, totaled \$2.5 million at December 31, 2016. For additional detail on impaired loans, see Note 4 to the Company's consolidated financial statements included in Item 8 of this Report.

Interest income recognized on non-accrual loans for 2016 was \$127,000. The gross interest income that would have been recognized in 2016 on non-performing loans if the loans had been current in accordance with their original terms was \$532,000. Loans are typically placed on non-accrual status when scheduled principal or interest payments are past due for 90 days or more, unless the loan is well secured and in the process of collection.

LIQUIDITY AND INTEREST RATE RISK MANAGEMENT

Liquidity is a measure of the ability of the Company's subsidiary bank to fund new loan demand, existing loan commitments and deposit withdrawals. The purpose of liquidity management is to match sources of funds with anticipated customer borrowings and withdrawals and other obligations to ensure a dependable funding base, without unduly penalizing earnings. Failure to properly manage liquidity requirements can result in the need to satisfy customer withdrawals and other obligations on less than desirable terms. The liquidity of the parent company is dependent upon the receipt of dividends from its bank subsidiary, which are subject to certain regulatory limitations explained in Note 8 (Shareholders' Equity) of the Notes to the Consolidated Financial Statements included in Item 8 of this Report, as enhanced by its ability to draw upon term financing arrangements and a line of credit established by the parent company with a correspondent bank lender as described under "SOURCES OF FUNDS - Parent Company Funding

Sources”, above. The subsidiary bank’s source of funding is predominately core deposits, time deposits in excess of \$100,000 and brokered certificates of deposit, maturities of securities, repayments of loan principal and interest, federal funds purchased, securities sold under agreements to repurchase and borrowings from the Federal Home Loan Bank and Federal Reserve Bank.

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

OFF-BALANCE SHEET ARRANGEMENTS

The Company has no off-balance sheet arrangements other than stand-by letters of credit as disclosed in Note 13 (Commitments and Off-balance Sheet Items) of the Notes to the Consolidated Financial Statements included in Item 8 of this Report.

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

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

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

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

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

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

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

Interest Rate Sensitivity as of December 31, 2016 - Net Interest Income

Changes in Rates	Amount	% Change
+2%	\$93,644	(4.27)%
+1%	95,589	(2.29)%
Base	97,825	—
-1%	94,348	(3.55)%
-2%	91,548	(6.42)%

The above table is a measurement of the Company's net interest income at risk, assuming a static balance sheet as of December 31, 2016 and instantaneous parallel changes in interest rates. The Company also monitors interest rate risk under other scenarios including a more gradual movement in market interest rates. This type of scenario can at times produce different modeling results in measuring interest rate risk sensitivity. As an example, a gradual change in rates

compared with a sudden and significant change in interest rates can impact rate movement of the Company's variable rate commercial and agricultural loan portfolio due to the Company's extensive utilization of interest rate floors in its commercial and agricultural portfolio.

The Company's loan portfolio as of December 31, 2016 totaled approximately \$2.0 billion of which approximately \$1.6 billion were commercial and industrial, commercial real estate, and agricultural loans and leases. Within the commercial and agricultural portfolio, approximately 19% were fixed rate and 81% were variable rate loans. Of the total commercial and agricultural variable rate loans, approximately 14% are currently at their interest rate floors, which are, on a weighted average basis, approximately 86 basis points above their fully indexed rate based on current market interest rates.

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

Interest Rate Sensitivity as of December 31, 2016 - Net Portfolio Value

Changes in Rates	Net Portfolio Value		Net Portfolio Value as a % of Present Value of Assets	
	Amount	% Change	NPV Ratio	Change
+2%	\$370,975	(10.11)%	13.44%	(75) b.p.
+1%	392,322	(4.94)%	13.85%	(34) b.p.
Base	412,697	—	14.19%	—
-1%	388,446	(5.88)%	13.09%	(110) b.p.
-2%	327,413	(20.67)%	10.94%	(325) b.p.

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

Item 8. Financial Statements and Supplementary Data.

Report of Independent Registered Public Accounting Firm

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

We have audited the accompanying consolidated balance sheets of German American Bancorp, Inc. (the Company) as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2016. We also have audited German American Bancorp, Inc.'s internal control over financial reporting as of December 31, 2016, based on criteria established in the 2013 Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). German American Bancorp, Inc.'s management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of German American Bancorp, Inc. as of December 31, 2016 and 2015, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2016 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, German American Bancorp, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in the 2013 Internal Control – Integrated Framework issued by the COSO.

/s/ Crowe Horwath LLP
Crowe Horwath LLP

Indianapolis, Indiana
March 9, 2017

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Consolidated Balance Sheets

Dollars in thousands, except per share data

	December 31,	
	2016	2015
ASSETS		
Cash and Due from Banks	\$48,467	\$36,062
Federal Funds Sold and Other Short-term Investments	16,349	15,947
Cash and Cash Equivalents	64,816	52,009
Securities Available-for-Sale, at Fair Value	709,786	637,840
Securities Held-to-Maturity, at Cost (Fair value of \$0 and \$95 on December 31, 2016 and 2015, respectively)	—	95
Loans Held-for-Sale, at Fair Value	15,273	10,762
Loans	1,993,404	1,568,075
Less: Unearned Income	(3,449)	(3,728)
Allowance for Loan Losses	(14,808)	(14,438)
Loans, Net	1,975,147	1,549,909
Stock in FHLB of Indianapolis and Other Restricted Stock, at Cost	13,048	8,571
Premises, Furniture and Equipment, Net	48,230	37,817
Other Real Estate	242	169
Goodwill	54,058	20,536
Intangible Assets	2,835	1,283
Company Owned Life Insurance	46,642	32,732
Accrued Interest Receivable and Other Assets	25,917	21,978
TOTAL ASSETS	\$2,955,994	\$2,373,701
LIABILITIES		
Non-interest-bearing Demand Deposits	\$571,989	\$465,357
Interest-bearing Demand, Savings, and Money Market Accounts	1,399,381	1,054,983
Time Deposits	378,181	306,036
Total Deposits	2,349,551	1,826,376
FHLB Advances and Other Borrowings	258,114	273,323
Accrued Interest Payable and Other Liabilities	18,062	21,654
TOTAL LIABILITIES	2,625,727	2,121,353
Commitments and Contingencies (Note 13)		
SHAREHOLDERS' EQUITY		
Preferred Stock, no par value; 500,000 shares authorized, no shares issued	—	—
Common Stock, no par value, \$1 stated value; 30,000,000 shares authorized	15,261	13,279

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Additional Paid-in Capital	171,744	110,145
Retained Earnings	149,666	125,112
Accumulated Other Comprehensive (Loss) Income	(6,404	) 3,812
 TOTAL SHAREHOLDERS' EQUITY	 330,267	 252,348
 TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	 \$2,955,994	 \$2,373,701
 End of period shares issued and outstanding	 15,261,431	 13,278,824

See accompanying notes to the consolidated financial statements.

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Consolidated Statements of Income

Dollars in thousands, except per share data

	Years Ended December 31,		
	2016	2015	2014
INTEREST INCOME			
Interest and Fees on Loans	\$86,202	\$66,740	\$65,597
Interest on Federal Funds Sold and Other Short-term Investments	74	13	12
Interest and Dividends on Securities:			
Taxable	9,638	9,017	10,409
Non-taxable	7,451	5,850	4,368
TOTAL INTEREST INCOME	103,365	81,620	80,386
INTEREST EXPENSE			
Interest on Deposits	5,187	3,976	4,128
Interest on FHLB Advances and Other Borrowings	3,274	2,092	1,919
TOTAL INTEREST EXPENSE	8,461	6,068	6,047
NET INTEREST INCOME	94,904	75,552	74,339
Provision for Loan Losses	1,200	—	150
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	93,704	75,552	74,189
NON-INTEREST INCOME			
Trust and Investment Product Fees	4,644	3,957	3,675
Service Charges on Deposit Accounts	5,973	4,826	4,829
Insurance Revenues	7,741	7,489	7,255
Company Owned Life Insurance	987	846	826
Debit Interchange Fee Income	2,532	2,127	1,961
Other Operating Income	4,798	4,515	2,018
Net Gains on Sales of Loans	3,359	2,959	1,892
Net Gains on Securities	1,979	725	1,481
TOTAL NON-INTEREST INCOME	32,013	27,444	23,937
NON-INTEREST EXPENSE			
Salaries and Employee Benefits	43,961	35,042	32,710
Occupancy Expense	6,297	4,939	5,094
Furniture and Equipment Expense	2,261	1,873	1,953
FDIC Premiums	1,151	1,144	1,113
Data Processing Fees	5,686	3,541	3,675

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Professional Fees	3,672	2,661	2,294
Advertising and Promotion	2,657	3,669	1,977
Intangible Amortization	1,062	790	1,254
Other Operating Expenses	9,840	7,667	7,643
 TOTAL NON-INTEREST EXPENSE	 76,587	 61,326	 57,713
 Income before Income Taxes	 49,130	 41,670	 40,413
Income Tax Expense	13,946	11,606	12,069
 NET INCOME	 \$35,184	 \$30,064	 \$28,344
 Basic Earnings per Share	 \$2.36	 \$2.27	 \$2.15
Diluted Earnings per Share	\$2.36	\$2.27	\$2.14

See accompanying notes to the consolidated financial statements

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

	Years Ended December 31,		
	2016	2015	2014
NET INCOME	\$35,184	\$30,064	\$28,344
Other Comprehensive Income (Loss):			
Unrealized Gains (Losses) on Securities:			
Unrealized Holding Gain (Loss) Arising During the Period	(13,830)	2,153	14,146
Reclassification Adjustment for Gains Included in Net Income	(1,979)	(725)	(1,481)
Tax Effect	5,607	(496)	(4,476)
Net of Tax	(10,202)	932	8,189
Postretirement Benefit Obligation:			
Net (Loss) Arising During the Period	(24)	(22)	(96)
Reclassification Adjustment for Amortization of Prior Service Cost and Net Loss Included in Net Periodic Pension Cost	6	5	50
Tax Effect	4	7	10
Net of Tax	(14)	(10)	(36)
Total Other Comprehensive Income (Loss)	(10,216)	922	8,153
COMPREHENSIVE INCOME	\$24,968	\$30,986	\$36,497

See accompanying notes to the consolidated financial statements.

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Consolidated Statements of Changes in Shareholders' Equity

Dollars in thousands, except per share data

	Common Stock					
	Shares	Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances, January 1, 2014	13,173,793	\$ 13,174	\$ 108,022	\$ 84,164	\$ (5,263)	\$ 200,097
Net Income				28,344		28,344
Other Comprehensive Income (Loss)					8,153	8,153
Cash Dividends (\$.64 per share)				(8,450)		(8,450)
Issuance of Common Stock for:						
Exercise of Stock Options	6,640	7	43			50
Restricted Share Grants	35,367	35	592			627
Employee Stock Purchase Plan			(37)			(37)
Income Tax Benefit From Restricted Share Vesting			40			40
Balances, December 31, 2014	13,215,800	13,216	108,660	104,058	2,890	228,824
Net Income				30,064		30,064
Other Comprehensive Income (Loss)					922	922
Cash Dividends (\$.68 per share)				(9,010)		(9,010)
Issuance of Common Stock for:						
Exercise of Stock Options	12,985	13	36			49
Restricted Share Grants	34,826	35	928			963
Employee Stock Purchase Plan	15,213	15	432			447
Income Tax Benefit From Restricted Share Vesting			89			89
Balances, December 31, 2015	13,278,824	13,279	110,145	125,112	3,812	252,348
Net Income				35,184		35,184
Other Comprehensive Income (Loss)					(10,216)	(10,216)
Cash Dividends (\$.72 per share)				(10,630)		(10,630)
Issuance of Common Stock for:						
Exercise of Stock Options	4,166	4	51			55
Acquisition of River Valley Bancorp	1,942,429	1,942	59,977			61,919
Restricted Share Grants	36,012	36	1,371			1,407
Income Tax Benefit From Restricted Share Vesting			200			200
Balances, December 31, 2016	15,261,431	\$ 15,261	\$ 171,744	\$ 149,666	\$ (6,404)	\$ 330,267

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Cash Flows
Dollars in thousands

	Years Ended December 31,		
CASH FLOWS FROM	2016	2015	2014
OPERATING			
ACTIVITIES			
Net Income	\$ 35,184	\$ 30,064	\$ 28,344
Adjustments to Reconcile Net Income to Net Cash from Operating Activities:			
Net Amortization on Securities	3,675	2,548	2,025
Depreciation and Amortization	4,315	4,264	4,810
Loans Originated for Sale	(138,192)	(137,687)	(96,760)
Proceeds from Sales of Loans Held-for-Sale	137,307	136,088	101,608
Provision for Loan Losses	1,200	—	150
Gain on Sale of Loans, net	(3,359)	(2,959)	(1,892)
Gain on Securities, net	(1,979)	(725)	(1,481)
Loss (Gain) on Sales of Other Real Estate and Repossessed Assets	(55)	63	(58)
Loss on Disposition and Donation of Premises and Equipment	5	389	93
Post Retirement Medical Benefit	7	15	29
Increase in Cash Surrender Value of Company Owned Life Insurance	(1,068)	(689)	(865)
Equity Based Compensation	1,407	963	627
Excess Tax Benefit from Restricted Share Grant	200	89	40
Change in Assets and Liabilities:			
Interest Receivable and Other Assets	5,813	172	(10,119)
Interest Payable and Other Liabilities	(2,547)	(1,328)	9,917
	41,913	31,267	36,468

Net Cash from
Operating Activities

CASH FLOWS FROM
INVESTING
ACTIVITIES

Purchase of Other Short-term Investments	(1,000)	—	—
Proceeds from Maturity of Other Short-term Investments	1,992		100	—
Proceeds from Maturities, Calls, Redemptions of Securities	103,301		90,702	78,735
Available-for-Sale Proceeds from Sales of Securities	165,102		18,999	60,164
Purchase of Securities Available-for-Sale	(225,456	)	(116,942	) (151,740
Proceeds from Maturities of Securities	95		89	84
Held-to-Maturity Purchase of Federal Home Loan Bank Stock	(1,350	)	(2,395	) (91
Proceeds from Redemption of Federal Home Loan Bank Stock	—		864	2,055
Purchase of Loans	(5,383	)	(9,895	) (8,132
Proceeds from Sales of Loans	2,029		—	—
Loans Made to Customers, net of Payments Received	(106,198	)	(108,007	) (58,587
Proceeds from Sales of Other Real Estate	1,429		1,170	2,045
Property and Equipment Expenditures	(5,234	)	(1,614	) (3,053
Proceeds from Sales of Property and Equipment	—		—	23
Acquisition of River Valley Bancorp	(1,016)	—	—
Net Cash from Investing Activities	(71,689)	(126,929) (78,497

CASH FLOWS FROM
FINANCING
ACTIVITIES

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Change in Deposits	118,231	46,630	(32,364)
Change in Short-term Borrowings	(40,163)	36,244	87,940
Advances in Long-term Debt	—	75,000	20,321
Repayments of Long-term Debt	(24,910)	(44,135)	(43,117)
Issuance of Common Stock	55	49	50
Employee Stock Purchase Plan	—	447	(37)
Dividends Paid	(10,630)	(9,010)	(8,450)
Net Cash from Financing Activities	42,583	105,225	24,343
Net Change in Cash and Cash Equivalents	12,807	9,563	(17,686)
Cash and Cash Equivalents at Beginning of Year	52,009	42,446	60,132
Cash and Cash Equivalents at End of Year	\$ 64,816	\$ 52,009	\$ 42,446
Cash Paid During the Year for			
Interest	\$ 8,348	\$ 6,146	\$ 6,071
Income Taxes	9,254	9,083	11,267
Supplemental Non Cash Disclosures (See Note 17 for Business Combinations)			
Loans Transferred to Other Real Estate	\$ 565	\$ 1,046	\$ 1,314
Reclassification of Land to Other Assets	664	—	—

See accompanying notes to the consolidated financial statements.

Notes to the Consolidated Financial Statements

Dollars in thousands, except per share data

NOTE 1 – Summary of Significant Accounting Policies

Description of Business and Basis of Presentation

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

Securities

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

Premium amortization is deducted from, and discount accretion is added to, interest income using the level yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Gains and losses on sales are recorded on trade date and are computed on the identified securities method.

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

Loans Held for Sale

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

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

Loans

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

Notes to the Consolidated Financial Statements

Dollars in thousands, except per share data

NOTE 1 – Summary of Significant Accounting Policies (continued)

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

Certain Purchased Loans

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

Such purchased loans are accounted for individually. The Company estimates the amount and timing of expected cash flows for each purchased loan or pool, and the expected cash flows in excess of amount paid is recorded as interest income over the remaining life of the loan or pool (accretable yield). The excess of the loan's or pool's contractual principal and interest over expected cash flows is not recorded (nonaccretable difference).

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

Allowance for Loan Losses

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

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

Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered

to be a collateral dependent loan, the loan is reported at the fair value of the collateral net of disposition costs. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

Notes to the Consolidated Financial Statements

Dollars in thousands, except per share data

NOTE 1 – Summary of Significant Accounting Policies (continued)

The general component of the allowance for loan losses covers non-impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and risk classifications and is based on the actual loss history experienced by the Company over a 20 quarter average. The Company separately assigns allocations for substandard and special mention commercial and agricultural credits as well as other categories of loans based on migration analysis techniques. This actual loss experience is supplemented with other external and internal factors based on the risks present for each portfolio segment. These factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. The following portfolio segments have been identified: Commercial Loans and Retail Loans. Commercial Loans have been classified according to the following risk characteristics: Commercial and Industrial Loans and Leases, Commercial Real Estate, and Agricultural Loans. Commercial and Industrial loans are primarily based on the cash flows of the business operations and secured by assets being financed and other assets such as accounts receivable and inventory. Commercial Real Estate Loans and Agricultural Loans are primarily based on cash flow of the borrower and their business and further secured by real estate. All types of commercial and agricultural (real estate secured and non-real estate) may also come with personal guarantees of the borrowers and business owners. Retail Loans have been classified according to the following risk characteristics: Home Equity Loans, Consumer Loans and Residential Mortgage Loans. Retail loans are generally dependent on personal income of the customer, and repayment is dependent on borrower's personal cash flow and employment status which can be affected by general economic conditions. Additionally, collateral values may fluctuate based on the impact of economic conditions on residential real estate values and other consumer type assets such as automobiles.

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

Servicing Rights

When mortgage loans are sold with servicing retained, servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on market prices for comparable mortgage servicing contracts when available or, alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans. Through the acquisition of River Valley Bancorp in 2016, German American acquired a portfolio of servicing rights on mortgage loans. The fair value of mortgage servicing rights were \$611 at December 31, 2016.

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

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

Federal Home Loan Bank (FHLB) Stock

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

Premises, Furniture and Equipment

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

Notes to the Consolidated Financial Statements

Dollars in thousands, except per share data

NOTE 1 – Summary of Significant Accounting Policies (continued)

Other Real Estate

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

Goodwill and Other Intangible Assets

Goodwill resulting from business combinations prior to January 1, 2009 represents the excess of the purchase price over the fair value of the net assets of businesses acquired. Goodwill resulting from business combinations after January 1, 2009, is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually. The Company has selected December 31 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on the Company's balance sheet.

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

Company Owned Life Insurance

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

Loss Contingencies

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

Loan Commitments and Related Financial Instruments

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

Restrictions on Cash

At December 31, 2016 and 2015, respectively, the Company was required to have \$11,659 and \$8,262 on deposit with the Federal Reserve, or as cash on hand.

Long-term Assets

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

Stock Based Compensation

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

Comprehensive Income

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

Income Taxes

Income tax is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax liabilities and assets are determined at each balance sheet date and are the result of differences in the financial statement and

Notes to the Consolidated Financial Statements

Dollars in thousands, except per share data

NOTE 1 – Summary of Significant Accounting Policies (continued)

tax bases of assets and liabilities. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

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

Retirement Plans

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

Earnings Per Share

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

Cash Flow Reporting

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

Fair Values of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 14. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (the "FASB") amended existing guidance (ASU 2014-09 Revenue From Contracts With Customers) related to revenue from contracts with customers. This amendment supersedes and replaces nearly all existing revenue recognition guidance, including industry-specific guidance, establishes a new control-based revenue recognition model, changes the basis for deciding when revenue is recognized over time or at a point in time, provides new and more detailed guidance on specific topics and expands and improves disclosures about revenue. In addition, this amendment specifies the accounting for some costs to obtain or fulfill a contract with a customer. These amendments are effective for public business entities for fiscal periods beginning after December 15, 2017, including interim periods within that reporting period. The Company does not expect this pronouncement to have a material impact on the Company's consolidated results of operations and financial condition as the Company's core revenue does not fall under this guidance.

In January 2016, the FASB amended existing guidance (ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities) that requires existing guidance that requires equity investments (except those accounted for under the equity method of account, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. It

requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. It requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables). It eliminates that requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. These amendments are effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within that reporting period. The Company notes that the impact of adoption is to carry the equity security at fair value through the income statement or at cost, less impairment when fair value is not readily determinable, with observable price changes being recognized in earnings. The Company doesn't expect the impact to be material. For additional information on this equity security, see Note 2 - Securities.

In February 2016, the FASB amended existing guidance (ASU No. 2016-02, Leases (Topic 842)) that requires lessees recognize the following for all leases (with the exception of short-term leases) at the commencement date (1) A lease liability, which is a

Notes to the Consolidated Financial Statements

Dollars in thousands, except per share data

NOTE 1 – Summary of Significant Accounting Policies (continued)

lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. These amendments are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within that reporting period. Based on our leases outstanding as of December 31, 2016, the Company does not expect this new guidance to have a material impact on the consolidated results of operation. However as a result of this new guidance, the Company anticipates an estimated increase in its Consolidated Balance Sheet of approximately \$6,000. This impact will vary based on the Company's future decisions to enter into new lease agreements or exit/renew current lease agreements prior to the date of implementation.

In June 2016, the FASB issued guidance (ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326)) to replace the incurred loss model with an expected loss model, which is referred to as the current expected credit loss (CECL) model. The CECL model is applicable to the measurement of credit losses on financial assets measured at amortized cost, including loan receivables, held-to-maturity debt securities, and reinsurance receivables. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investments in leases recognized by a lessor. These amendments are effective for public business entities for fiscal years beginning after December 15, 2019, including interim periods within that reporting period. The Company recognizes that there may be a cumulative adjustment at the time of adoption, but can not estimate the amount at this time.

In August 2016, the FASB issued this ASU (ASU No. 2016-15, Statement of Cash Flows (Topic 320): Classification of Certain Cash Receipts and Cash Payments) to address the diversity in how certain cash receipts and cash payments are presented and classified in the statement of cash flows including the following:

- Debt Prepayment or Debt Extinguishment Costs;
- Settlement of Zero-Coupon Bonds or Debt with Coupon Interest Rates That Are Insignificant in Relation to the Effective Interest Rate;
- Contingent Consideration payments Made Soon After a Business Combination;
- Proceeds From the Settlement of Insurance Claims;
- Proceeds From the Settlement of BOLI and COLI Policies;
- Distributions Received From Equity Method Investees;
- Beneficial Interests in Securitization Transactions; and
- Application of the Predominance Principle.

These amendments are effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within that reporting period. This guidance currently has no material impact on the Company's Consolidated Statements of Cash Flows; however, the Company will continue to monitor it going forward.

NOTE 2 - Securities

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

Securities Available-for-Sale:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
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2016

U.S. Treasury and Agency Securities	\$—	\$ —	\$—	\$—
Obligations of State and Political Subdivisions	247,350	3,847	(3,678)	247,519
MBS/CMO – Residential	471,852	480	(10,418)	461,914
Equity Securities	353	—	—	353
Total	\$ 719,555	\$ 4,327	\$ (14,096)	\$ 709,786

2015

U.S. Treasury and Agency Securities	\$ 10,000	\$ —	\$ (102)	\$ 9,898
Obligations of State and Political Subdivisions	195,360	8,286	(18)	203,628
MBS/CMO - Residential	426,087	2,114	(4,240)	423,961
Equity Securities	353	—	—	353
Total	\$ 631,800	\$ 10,400	\$ (4,360)	\$ 637,840

Notes to the Consolidated Financial Statements

Dollars in thousands, except per share data

NOTE 2 – Securities (continued)

Equity securities that do not have readily determinable fair values are included in the above totals and are evaluated for impairment on a periodic basis. All mortgage-backed securities in the above table are residential mortgage-backed securities and guaranteed by government sponsored entities.

The carrying amount, unrecognized gains and losses and fair value of Securities Held-to-Maturity were as follows:

Securities Held-to-Maturity:	Carrying Amount	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
2016				
Obligations of State and Political Subdivisions	\$ —	\$ —	\$ —	\$ —
2015				
Obligations of State and Political Subdivisions	\$ 95	\$ —	\$ —	\$ 95

The amortized cost and fair value of Securities at December 31, 2016 by contractual maturity are shown below. Expected maturities may differ from contractual maturities because some issuers have the right to call or prepay certain obligations with or without call or prepayment penalties. Mortgage-backed and Equity Securities are not due at a single maturity date and are shown separately.

	Amortized Cost	Fair Value
Securities Available-for-Sale:		
Due in one year or less	\$ 3,387	\$ 3,413
Due after one year through five years	16,300	16,806
Due after five years through ten years	75,164	77,023
Due after ten years	152,499	150,277
MBS/CMO - Residential	471,852	461,914
Equity Securities	353	353
Total	\$ 719,555	\$ 709,786

Proceeds from the Sales of Securities are summarized below:

	2016	2015	2014
	Available- for-Sale	Available- for-Sale	Available- for-Sale
Proceeds from Sales	\$ 165,102	\$ 18,999	\$ 60,164
Gross Gains on Sales	1,979	725	1,481
Income Taxes on Gross Gains	693	254	518

The carrying value of securities pledged to secure repurchase agreements, public and trust deposits, and for other purposes as required by law was \$186,572 and \$154,628 as of December 31, 2016 and 2015, respectively.

Below is a summary of securities with unrealized losses as of year-end 2016 and 2015, presented by length of time the securities have been in a continuous unrealized loss position:

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	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
At December 31, 2016						
U.S. Treasury and Agency Securities	\$—	\$—	\$—	\$—	\$—	\$—
Obligations of State and Political Subdivisions	108,918	(3,678)	—	—	108,918	(3,678)
MBS/CMO - Residential	356,040	(8,782)	47,271	(1,636)	403,311	(10,418)
Equity Securities	—	—	—	—	—	—
Total	\$464,958	\$(12,460)	\$47,271	\$(1,636)	\$512,229	\$(14,096)

Notes to the Consolidated Financial Statements

Dollars in thousands, except per share data

NOTE 2 – Securities (continued)

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
At December 31, 2015						
U.S. Treasury and Agency Securities	\$—	\$—	\$9,898	\$ (102)	\$9,898	\$ (102)
Obligations of State and Political Subdivisions	1,891	(15)	356	(3)	2,247	(18)
MBS/CMO - Residential	150,427	(1,173)	129,040	(3,067)	279,467	(4,240)
Equity Securities	—	—	—	—	—	—
Total	\$152,318	\$ (1,188)	\$139,294	\$ (3,172)	\$291,612	\$ (4,360)

Securities are written down to fair value when a decline in fair value is not considered temporary. In estimating other-than-temporary losses, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Company has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The Company doesn't intend to sell or expect to be required to sell these securities, and the decline in fair value is largely due to changes in market interest rates, therefore, the Company does not consider these securities to be other-than-temporarily impaired. All mortgage-backed securities and collateralized mortgages obligations (MBS/CMO - Residential) in the Company's portfolio are guaranteed by government sponsored entities, are investment grade, and are performing as expected.

The Company's equity securities consist of one non-controlling investment in a single banking organization at December 31, 2016 and 2015. The original investment totaled \$1,350 and other-than-temporary impairment was previously recorded totaling \$997. When a decline in fair value below cost is deemed to be other-than-temporary, the unrealized loss must be recognized as a charge to earnings.

NOTE 3 – Derivatives

The Company executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. The notional amounts of these interest rate swaps and the offsetting counterparty derivative instruments were \$67.9 million and \$36.8 million at December 31, 2016 and 2015, respectively. These interest rate swaps are simultaneously hedged by offsetting interest rate swaps that the Company executes with a third party, such that the Company minimizes its net risk exposure resulting from such transactions with approved, reputable, independent counterparties with substantially matching terms. The agreements are considered stand alone derivatives and changes in the fair value of derivatives are reported in earnings as non-interest income.

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

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

December 31,	December 31,
2016	2015

	Notional Fair		Notional Fair	
	Amount	Value	Amount	Value
Included in Other Assets:				
Interest Rate Swaps	\$67,902	\$1,291	\$36,781	\$1,201
Included in Other Liabilities:				
Interest Rate Swaps	\$67,902	\$1,238	\$36,781	\$1,232

Notes to the Consolidated Financial Statements

Dollars in thousands, except per share data

NOTE 3 – Derivatives (continued)

The following table presents the effect of derivative instruments on the Consolidated Statements of Income for the years ended December 31, 2016, 2015 and 2014 are as follows:

2016 2015 2014

Interest Rate Swaps:

Included in Other Income \$1,207 \$491 \$15

NOTE 4 – Loans

Loans were comprised of the following classifications at December 31:

	2016	2015
Commercial:		
Commercial and Industrial Loans and Leases	\$457,372	\$418,154
Commercial Real Estate Loans	856,094	618,788
Agricultural Loans	303,128	246,886
Retail:		
Home Equity Loans	133,575	97,902
Consumer Loans	59,945	50,029
Residential Mortgage Loans	183,290	136,316
Subtotal	1,993,404	1,568,075
Less: Unearned Income	(3,449)	(3,728)
Allowance for Loan Losses	(14,808)	(14,438)
Loans, net	\$1,975,147	\$1,549,909

As further described in Note 17, during 2016 the company acquired loans with a fair value of \$317,760 as a part of a business combination. This was made up of loans with an acquired balance of \$328,431, net of \$10,671 of fair value discounts at date of acquisition. At December 31, 2016, the remaining carrying amount of such loans total \$261,450, which is included in the December 31, 2016 table above. This amount is made up of loans with a remaining unpaid principal balance of \$269,014 net of remaining fair value discounts of \$7,564.

The following tables present the activity in the allowance for loan losses by portfolio class for the years ended December 31, 2016, 2015, and 2014:

	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated	Total
December 31, 2016								
Beginning Balance	\$ 4,242	\$ 6,342	\$ 2,115	\$ 383	\$ 230	\$ 414	\$ 712	\$14,438
Provision for Loan Losses	(483)	(846)	2,000	33	273	245	(22)	1,200
Recoveries	32	10	1	3	208	16	—	270
Loans Charged-off	(66)	(54)	(22)	(136)	(476)	(346)	—	(1,100)
Ending Balance	\$ 3,725	\$ 5,452	\$ 4,094	\$ 283	\$ 235	\$ 329	\$ 690	\$14,808

Notes to the Consolidated Financial Statements

Dollars in thousands, except per share data

NOTE 4 – Loans (continued)

	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated	Total
December 31, 2015								
Beginning Balance	\$ 4,627	\$ 7,273	\$ 1,123	\$ 246	\$ 354	\$ 622	\$ 684	\$14,929
Provision for Loan Losses	(451)	(688)	992	160	(48)	7	28	—
Recoveries	102	107	—	10	236	18	—	473
Loans Charged-off	(36)	(350)	—	(33)	(312)	(233)	—	(964)
Ending Balance	\$ 4,242	\$ 6,342	\$ 2,115	\$ 383	\$ 230	\$ 414	\$ 712	\$14,438
December 31, 2014								
Beginning Balance	\$ 3,983	\$ 8,335	\$ 946	\$ 239	\$ 188	\$ 281	\$ 612	\$14,584
Provision for Loan Losses	732	(1,596)	177	37	291	437	72	150
Recoveries	111	863	—	42	173	21	—	1,210
Loans Charged-off	(199)	(329)	—	(72)	(298)	(117)	—	(1,015)
Ending Balance	\$ 4,627	\$ 7,273	\$ 1,123	\$ 246	\$ 354	\$ 622	\$ 684	\$14,929

In determining the adequacy of the allowance for loan loss, general allocations are made for pools of loans, including non-classified loans, homogeneous portfolios of consumer and residential real estate loans, and loans within certain industry categories believed to present unique risk of loss. General allocations of the allowance are primarily made based on historical averages for loan losses for these portfolios, judgmentally adjusted for current economic factors and portfolio trends. During 2016, the overall allowance for loan and lease losses was increased in the agricultural sector as a result of qualitative considerations for current economic conditions and trends which included a decline in the aggregate debt service coverage ratios for agricultural borrowers and a decline in per acre values of crop production real estate.

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

Specific allocations on impaired loans are determined by comparing the loan balance to the present value of expected cash flows or expected collateral proceeds. Allocations are also applied to categories of loans not considered individually impaired but for which the rate of loss is expected to be greater than historical averages, including non-performing consumer or residential real estate loans. Such allocations are based on past loss experience and information about specific borrower situations and estimated collateral values. The allowance for commercial real estate loans declined during 2016 primarily as a result of the repayment of a single non-accrual commercial real estate credit during the third quarter of 2016. This credit relationship was considered impaired and therefore had a specific allocation assigned prior to repayment.

Notes to the Consolidated Financial Statements

Dollars in thousands, except per share data

NOTE 4 – Loans (continued)

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio class and based on impairment method as of December 31, 2016 and 2015:

		Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated
December 31, 2016	Total							
Allowance for Loan Losses:								