

FIRST MERCHANTS CORP  
Form 10-K  
March 15, 2013

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-K

[Mark One]

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

For the fiscal year ended December 31, 2012

OR

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

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

Commission file number 0-17071

FIRST MERCHANTS CORPORATION

(Exact name of registrant as specified in its charter)

Indiana

35-1544218

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer Identification No.)

200 East Jackson

Muncie, Indiana

47305-2814

(Address of principal executive offices)

(Zip Code)

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

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

Title of Each Class

Name of each exchange on which registered

Common Stock, \$0.125 stated value per share

The NASDAQ Stock Market

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 website, 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 of Regulation S-K is not contained herein, and will not be contained, to the best

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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 or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. Large accelerated filer [ ] Accelerated filer[X] Non-accelerated filer [ ] Small Reporting Company [ ]

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

The aggregate market value (not necessarily a reliable indication of the price at which more than a limited number of shares would trade) of the voting stock held by non-affiliates of the registrant was \$356,895,000 as of the last business day of the registrant's most recently completed second fiscal quarter (June 30, 2012).

As of February 28, 2013 there were 28,695,887 outstanding common shares, without par value, of the registrant.

DOCUMENTS INCORPORATED BY REFERENCE

Documents	Part of Form 10-K into which incorporated
Portions of the Registrant's Definitive	Part III (Items 10 through 14)
Proxy Statement for Annual Meeting of	
Shareholders to be held May 9, 2013	

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## FIVE-YEAR SUMMARY OF SELECTED FINANCIAL DATA

(Dollars in Thousands, Except Share Data)	2012	2011	2010	2009	2008
Operations <sup>(1) (2)</sup>					
Net Interest Income Fully Taxable Equivalent (FTE) Basis	\$ 158,081	\$ 149,114	\$ 149,434	\$ 159,068	\$ 133,083
Less Tax Equivalent Adjustment	5,745	5,759	5,865	5,722	3,699
Net Interest Income	152,336	143,355	143,569	153,346	129,384
Provision for Loan Losses	18,534	22,630	46,483	122,176	28,238
Net Interest Income After Provision for Loan Losses	133,802	120,725	97,086	31,170	101,146
Total Other Income	64,302	49,120	48,544	51,201	36,367
Total Other Expenses	137,115	135,938	142,311	151,558	108,792
Income (Loss) Before Income Tax Expense (Benefit)	60,989	33,907	3,319	(69,187 )	28,721
Income Tax Expense (Benefit)	15,867	8,655	(3,590 )	(28,424 )	8,083
Net Income (Loss)	45,122	25,252	6,909	(40,763 )	20,638
Gain on Exchange of Preferred Stock to Trust Preferred Debt			11,353		
Loss on CPP Unamortized Discount		(1,401 )	(1,301 )		
Loss on Extinguishment of Trust Preferred Securities		(10,857 )			
Preferred Stock Dividends and Discount Accretion	(4,539 )	(3,981 )	(5,239 )	(4,979 )	
Net Income (Loss) Available to Common Stockholders	\$ 40,583	\$ 9,013	\$ 11,722	\$ (45,742 )	\$ 20,638
Per Share Data					
Basic Net Income (Loss) Available to Common Stockholders	\$ 1.42	\$ 0.34	\$ 0.48	\$ (2.17 )	\$ 1.14
Diluted Net Income (Loss) Available to Common Stockholders	1.41	0.34	0.48	(2.17 )	1.14
Cash Dividends Paid - Common	0.10	0.04	0.04	0.47	0.92
December 31 Book Value - Common	16.08	14.83	15.11	16.55	18.69
December 31 Tangible Book Value - Common	10.95	9.64	9.21	9.25	10.93
December 31 Market Value (Bid Price) - Common	14.84	8.47	8.86	5.94	22.21
Average Balances <sup>(1) (2)</sup>					
Total Assets	\$ 4,245,996	\$ 4,143,850	\$ 4,271,715	\$ 4,674,590	\$ 3,811,166
Total Loans <sup>(3)</sup>	2,819,816	2,748,684	3,050,850	3,546,316	3,002,628
Total Deposits	3,263,020	3,175,762	3,337,747	3,603,509	2,902,902
Securities Sold Under Repurchase Agreements (long-term portion)	10,000	12,773	24,250	24,250	34,250
Total Federal Home Loan Bank Advances	113,730	110,729	107,753	243,105	237,791

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Total Subordinated Debentures, Revolving Credit Lines and Term Loans	109,339	133,673	126,650	110,826	107,752	
Total Stockholders' Equity	535,497	478,440	470,379	477,148	349,594	
Year-End Balances <sup>(1) (2)</sup>						
Total Assets	\$4,304,821	\$4,173,076	\$4,170,848	\$4,480,952	\$4,784,155	
Total Loans <sup>(3)</sup>	2,924,509	2,731,279	2,857,152	3,277,824	3,726,247	
Total Deposits	3,346,383	3,134,655	3,268,880	3,536,536	3,718,811	
Securities Sold Under Repurchase Agreements (long-term portion)	10,000	10,000	24,250	24,250	34,250	
Total Federal Home Loan Bank Advances	94,238	138,095	82,684	129,749	360,217	
Total Subordinated Debentures, Revolving Credit Lines and Term Loans	112,161	194,974	226,440	194,790	135,826	
Total Stockholders' Equity	552,236	514,467	454,408	463,785	395,903	
Financial Ratios <sup>(1) (2)</sup>						
Return on Average Assets	0.96	% 0.22	% 0.27	% (0.98	)% 0.54	%
Return on Average Stockholders' Equity	7.58	1.88	2.49	(9.59	)	5.90
Average Earning Assets to Total Assets	90.28	90.35	90.42	94.74		72.39
Allowance for Loan Losses as % of Total Loans	2.37	2.60	2.90	2.81		1.33
Dividend Payout Ratio	7.09	11.76	8.33	n/m	<sup>(4)</sup> 80.70	
Average Stockholders' Equity to Average Assets	12.61	11.55	11.01	10.21		9.17
Tax Equivalent Yield on Earning Assets	4.74	4.99	5.32	5.56		6.44
Cost of Supporting Liabilities	0.62	1.01	1.45	1.82		2.60
Net Interest Margin on Earning Assets	4.12	3.98	3.87	3.74		3.84

(1) On December 31, 2008, the Corporation acquired 100 percent of the outstanding stock of Lincoln Bancorp, the holding company of Lincoln Bank, which was headquartered in Plainfield, Indiana. Lincoln Bank was a state chartered bank with branches in central Indiana. Lincoln Bancorp was merged into the Corporation and in 2009, Lincoln Bank was ultimately merged into First Merchants Bank, National Association, a subsidiary of the Corporation. The Corporation issued approximately 3,040,415 shares of its common stock at a cost of \$19.78 per share and approximately \$16.8 million in cash to complete the transaction. As a result of the acquisition, the Corporation increased its customer base and market share. The purchase had a recorded acquisition price of \$77,290,000, including investments of \$122,093,000; loans of \$628,277,000, premises and equipment of \$15,624,000; other assets of \$86,091,000; deposits of \$655,370,000; other liabilities of \$136,280,000 and goodwill of \$19,813,000. Additionally, core deposit intangibles totaling \$12,461,000 were recognized and are amortizing over ten years. The combination was accounted for under the purchase method of accounting. All assets and liabilities were recorded at their fair values as of December 31, 2008. The purchase accounting adjustments are being amortized over the life of the respective asset or liability.

(2) Effective February 10, 2012, the Bank assumed substantially all of the deposits and certain other liabilities and acquired certain assets of SCB Bank, a federal savings bank headquartered in Shelbyville, Indiana, from the Federal Deposit Insurance Corporation ("FDIC"), as receiver for SCB Bank (the "Acquisition"), pursuant to the terms of the Purchase and Assumption Agreement - Modified Whole Bank; All Deposits (the "Agreement"), entered into by the Bank, the FDIC as receiver of SCB Bank and the FDIC. Under the terms of the Agreement, the Bank acquired

\$147,700,000 in assets, including approximately \$11,900,000 of cash and cash equivalents, \$18,900,000 of marketable securities, \$1,800,000 in Federal Home Loan Bank stock, \$113,000,000 in loans and \$2,100,000 of premises and other assets. The asset balances are book balances and do not reflect the fair value discount of \$29,000,000 from book value. The Bank assumed approximately \$135,700,000 of liabilities, including approximately \$125,900,000 in customer deposits, \$9,600,000 of other borrowed money and \$402,000 in other liabilities. The bid accepted by the FDIC included no deposit premium.

(3) Includes loans held for sale.

(4) Not meaningful.

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FORWARD-LOOKING STATEMENTS

First Merchants Corporation (the “Corporation”) from time to time includes forward-looking statements in its oral and written communication. The Corporation may include forward-looking statements in filings with The Securities and Exchange Commission (“SEC”), such as Form 10-K and Form 10-Q, in other written materials and oral statements made by senior management to analysts, investors, representatives of the media and others. The Corporation intends these forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and the Corporation is including this statement for purposes of these safe harbor provisions. Forward-looking statements can often be identified by the use of words like “believe”, “continue”, “pattern”, “estimate”, “project”, “intend”, “anticipate”, “expect” and similar expressions or future or conditional verbs such as “will”, “would”, “should”, “could”, “might”, “can”, “may” or similar expressions. These forward-looking statements include:

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

These forward-looking statements are subject to significant risks, assumptions and uncertainties, including, among other things, those discussed in Item 1A, “RISK FACTORS”.

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

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PART I: ITEM 1. BUSINESS

PART I

ITEM 1. BUSINESS

GENERAL

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

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

The Corporation also operates First Merchants Insurance Services, Inc., operating as First Merchants Insurance Group, a full-service property, casualty, personal lines, and employee benefit insurance agency headquartered in Muncie, Indiana.

The Corporation had operated First Merchants Reinsurance Co. Ltd. (“FMRC”), a small life reinsurance company whose primary business included short-duration credit life, accidental/health insurance and debt cancellation contracts. This company was dissolved in December of 2011. There is no remaining exposure for the Corporation.

All inter-company transactions are eliminated during the preparation of consolidated financial statements.

As of December 31, 2012, the Corporation had consolidated assets of \$4.3 billion, consolidated deposits of \$3.3 billion and stockholders’ equity of \$552 million. As of December 31, 2012, the Corporation and its subsidiaries had 1,149 full-time equivalent employees.

AVAILABLE INFORMATION

The Corporation makes its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, available on its website at [www.firstmerchants.com](http://www.firstmerchants.com) without charge, as soon as reasonably practicable, after such reports are electronically filed with, or furnished to, the Securities and Exchange Commission. These documents can also be read and copied at the Securities and Exchange Commission’s Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Please call the Securities and Exchange Commission at 1-800-SEC-0330 for further information on the public reference room. SEC filings are also available to the public at the Securities and Exchange Commission’s website at [www.sec.gov](http://www.sec.gov). Additionally, the Corporation will also provide without charge, a copy of its Annual Report on Form 10-K to any shareholder by mail. Requests should be sent to Cynthia Holaday, Shareholder Relations, First Merchants Corporation, P.O. Box 792, Muncie, IN 47308-0792.



## ACQUISITION POLICY

The Corporation anticipates that it will continue its policy of geographic expansion of its banking business through the acquisition of banks whose operations are consistent with its banking philosophy. Management routinely explores opportunities to acquire financial institutions and other financial services-related businesses and to enter into strategic alliances to expand the scope of its services and its customer base.

Effective February 10, 2012, the Bank assumed substantially all of the deposits and certain other liabilities and acquired certain assets of SCB Bank, a federal savings bank headquartered in Shelbyville, Indiana, from the Federal Deposit Insurance Corporation (“FDIC”), as receiver for SCB Bank (the “Acquisition”), pursuant to the terms of the Purchase and Assumption Agreement - Modified Whole Bank; All Deposits (the “Agreement”), entered into by the Bank, the FDIC as receiver of SCB Bank and the FDIC. Under the terms of the Agreement, the Bank acquired \$147,700,000 in assets, including approximately \$11,900,000 of cash and cash equivalents, \$18,900,000 of marketable securities, \$1,800,000 in Federal Home Loan Bank stock, \$113,000,000 in loans and \$2,100,000 of premises and other assets. The asset balances are book balances and do not reflect the fair value discount of \$29,000,000 from book value. The Bank assumed approximately \$135,700,000 of liabilities, including approximately \$125,900,000 in customer deposits, \$9,600,000 of other borrowed money and \$402,000 in other liabilities. The bid accepted by the FDIC included no deposit premium.

## COMPETITION

The Bank is located in Indiana and Ohio counties where other financial services companies provide similar banking services. In addition to the competition provided by the lending and deposit gathering subsidiaries of national manufacturers, retailers, insurance companies and investment brokers, the Bank competes vigorously with other banks, thrift institutions, credit unions and finance companies located within their service areas.

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PART I: ITEM 1. BUSINESS

REGULATION AND SUPERVISION OF FIRST MERCHANTS CORPORATION AND SUBSIDIARIES

Bank Holding Company Regulation

The Corporation is registered as a bank holding company and has elected to be a financial holding company. It is subject to the supervision of, and regulation by the Board of Governors of the Federal Reserve System (“Federal Reserve”) under the Bank Holding Company Act of 1956 (the “BHC Act”), as amended. Bank holding companies are required to file periodic reports with and are subject to periodic examination by the Federal Reserve. The Federal Reserve has issued regulations under the BHC Act requiring a bank holding company to serve as a source of financial and managerial strength to the Bank. Thus, it is the policy of the Federal Reserve that a bank holding company should stand ready to use its resources to provide adequate capital funds to the Bank during periods of financial stress or adversity. Additionally, under the Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”), a bank holding company is required to guarantee the compliance of any subsidiary bank that may become “undercapitalized” (as defined in the FDICIA section of this Form 10-K) with the terms of any capital restoration plan filed by such subsidiary with its appropriate federal banking agency. Under the BHC Act, the Federal Reserve has the authority to require a bank holding company to terminate any activity or relinquish control of a non-bank subsidiary (other than a non-bank subsidiary of a bank) upon the determination that such activity constitutes a serious risk to the financial stability of any bank subsidiary.

The BHC Act requires the Corporation to obtain the prior approval of the Federal Reserve before:

- acquiring direct or indirect control or ownership of any voting shares of any bank or bank holding company if, after such acquisition, the bank holding company will directly or indirectly own or control more than 5 percent of the voting shares of the bank or bank holding company;
- merging or consolidating with another bank holding company; or
- acquiring substantially all of the assets of any bank.

The BHC Act generally prohibits bank holding companies that have not become financial holding companies from (i) engaging in activities other than banking or managing or controlling banks or other permissible subsidiaries, and (ii) acquiring or retaining direct or indirect control of any company engaged in the activities other than those activities determined by the Federal Reserve to be closely related to banking or managing or controlling banks.

Capital Adequacy Guidelines for Bank Holding Companies

The BHC Act does not place territorial restrictions on such non-banking related activities. The Corporation is required to comply with the Federal Reserve’s risk-based capital guidelines. These guidelines require a minimum ratio of capital to risk-weighted assets of 8 percent (including certain off-balance sheet activities such as standby letters of credit). At least half of the total required capital must be “Tier 1 capital,” consisting principally of stockholders’ equity, noncumulative perpetual preferred stock, a limited amount of cumulative perpetual preferred stock and minority interest in the equity accounts of consolidated subsidiaries, less certain goodwill items. The remainder may consist of a limited amount of subordinate debt and intermediate-term preferred stock, certain hybrid capital instruments and other debt securities, cumulative perpetual preferred stock, and a limited amount of the general loan loss allowance.

In addition to the risk-based capital guidelines, the Federal Reserve has adopted a Tier 1 (leverage) capital ratio under which the Corporation must maintain a minimum level of Tier 1 capital to average total consolidated assets. The ratio is 3 percent in the case of bank holding companies, which have the highest regulatory examination ratings and are not contemplating significant growth or expansion.

The following are the Corporation's regulatory capital ratios as of December 31, 2012:

	Corporation	Regulatory Minimum Requirement	
Tier 1 risk-based capital ratio	14.15	% 4.00	%
Total risk-based capital ratio	16.34	% 8.00	%

#### Bank Regulation

The Bank is supervised, regulated and examined by the Office of the Comptroller of the Currency (the "OCC"). The OCC has the authority to issue cease-and-desist orders if it determines that activities of the Bank regularly represent an unsafe and unsound banking practice or a violation of law. Federal law extensively regulates various aspects of the banking business such as reserve requirements, truth-in-lending and truth-in-savings disclosures, equal credit opportunity, fair credit reporting, trading in securities and other aspects of banking operations. Current federal law also requires banks, among other things, to make deposited funds available within specified time periods.

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PART I: ITEM 1. BUSINESS

Bank Capital Requirements

The OCC has adopted risk-based capital ratio guidelines to which national banks are subject. The guidelines establish a framework that makes regulatory capital requirements more sensitive to differences in risk profiles. Risk-based capital ratios are determined by allocating assets and specified off-balance sheet commitments to four risk-weighted categories, with higher levels of capital being required for the categories perceived as representing greater risk.

Like the capital guidelines established by the Federal Reserve, these guidelines divide a bank's capital into tiers. Banks are required to maintain a total risk-based capital ratio of 8 percent. The OCC may, however, set higher capital requirements when a bank's particular circumstances warrant. Banks experiencing or anticipating significant growth are expected to maintain capital ratios, including tangible capital positions, well above the minimum levels.

In addition, the OCC established guidelines prescribing a minimum Tier 1 leverage ratio (Tier 1 capital to adjusted total assets as specified in the guidelines). These guidelines provide for a minimum Tier 1 leverage ratio of 3 percent for banks that meet specified criteria, including that they have the highest regulatory rating and are not experiencing or anticipating significant growth. All other banks are required to maintain a Tier 1 leverage ratio of 3 percent plus an additional 1 to 2 percent.

The Bank exceeded the minimum risk-based capital guidelines of the OCC as of December 31, 2012.

FDIC Improvement Act of 1991

The FDICIA requires, among other things, federal bank regulatory authorities to take "prompt corrective action" with respect to banks, which do not meet minimum capital requirements. For these purposes, FDICIA establishes five capital tiers: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. The Federal Deposit Insurance Corporation ("FDIC") has adopted regulations to implement the prompt corrective action provisions of FDICIA.

"Undercapitalized" banks are subject to growth limitations and are required to submit a capital restoration plan. A bank's compliance with such plan is required to be guaranteed by the bank's parent holding company. If an "undercapitalized" bank fails to submit an acceptable plan, it is treated as if it is significantly undercapitalized. "Significantly undercapitalized" banks are subject to one or more restrictions, including an order by the FDIC to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets and cease receipt of deposits from correspondent banks, and restrictions on compensation of executive officers. "Critically undercapitalized" institutions may not, beginning 60 days after becoming "critically undercapitalized," make any payment of principal or interest on certain subordinated debt or extend credit for a highly leveraged transaction or enter into any transaction outside the ordinary course of business. In addition, "critically undercapitalized" institutions are subject to appointment of a receiver or conservator.

As of December 31, 2012, the Bank was "well capitalized" based on the "prompt corrective action" ratios described above. It should be noted that a bank's capital category is determined solely for the purpose of applying the OCC's "prompt corrective action" regulations and that the capital category may not constitute an accurate representation of the bank's overall financial condition or prospects.

LEGISLATIVE AND REGULATORY INITIATIVES TO ADDRESS FINANCIAL AND ECONOMIC CRISES

Troubled Asset Relief Program; Capital Purchase Program

Congress, The United States Department of the Treasury (the “Treasury”) and the federal banking regulators, including the FDIC, have taken broad action since early September 2008 to address volatility in the U.S. banking system and financial markets.

In October 2008, the Emergency Economic Stabilization Act of 2008 (“EESA”) was enacted. The EESA authorized the Treasury to purchase from financial institutions and their holding companies up to \$700 billion in mortgage loans, mortgage-related securities and certain other financial instruments, including debt and equity securities issued by financial institutions and their holding companies in a Troubled Asset Relief Program (“TARP”). The purpose of TARP was to restore confidence and stability to the U.S. banking system and to encourage financial institutions to increase their lending to customers and to each other. The Treasury allocated \$250 billion towards the TARP Capital Purchase Program. Under the TARP Capital Purchase Program, the Treasury purchased debt or equity securities from participating institutions. TARP also included direct purchases or guarantees of troubled assets of financial institutions. Participants in the TARP Capital Purchase Program are subject to executive compensation limits and are encouraged to expand their lending and mortgage loan modifications.

On February 20, 2009, the Corporation entered into a Letter Agreement (Purchase Agreement) with the Treasury, pursuant to which the Corporation sold (a) 116,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the “Series A Preferred Stock”) and (b) a warrant to purchase 991,453 shares of the Corporation’s common stock for an aggregate purchase price of \$116 million in cash (“Warrant”).

The Preferred Stock qualified as Tier I capital and was to pay cumulative dividends at a rate of 5 percent per annum for the first five years and 9 percent per annum thereafter. The Series A Preferred Stock was non-voting except with respect to certain matters affecting the rights of the holders thereof, and was redeemable by the Corporation after three years. The Warrant had a ten year term and was immediately exercisable with an exercise price of \$17.55 per share of common stock. Pursuant to the Purchase Agreement, the Treasury had agreed not to exercise voting power with respect to any shares of common stock issued upon exercise of the Warrant.

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PART I: ITEM 1. BUSINESS

On June 30, 2010, the Corporation entered into an Exchange Agreement with the Treasury whereby the Treasury exchanged 46,400 shares of the Series A Preferred Stock for 46,400 shares of trust preferred securities, having a liquidation amount of \$1,000 per share (the "Capital Securities") issued by the Corporation's wholly-owned subsidiary trust, First Merchants Capital Trust III, a Delaware Statutory Trust (the "Trust"). The Trust simultaneously issued 1,435 shares of the Trust's common securities (the "Common Securities") to the Corporation for the purchase price of \$1.4 million which constituted all of the issued and outstanding common securities of the Trust. The Trust used the tendered Series A Preferred Stock and the proceeds from the sale of the Common Securities to purchase \$47.8 million in aggregate principal amount of Fixed Rate Perpetual Junior Subordinated Debentures, Series A issued by the Corporation (the "Debentures"). The Capital Securities and the Debentures bore interest, payable quarterly, at a rate of 5 percent until February 20, 2014 when the rate would increase to 9 percent. The Capital Securities and Debentures were redeemable by the Corporation upon proper notice and regulatory approval (a) at any time, so long as the Capital Securities were held by the Treasury and (b) at any time after June 30, 2015, if the Capital Securities were held by a person or entity other than the Treasury. The 46,400 shares of Series A Preferred Stock, purchased from the Treasury were cancelled. Following the exchange, the Treasury continued to hold 69,600 shares of Series A Preferred Stock along with the Warrant to initially purchase up to 991,453 shares of the Corporation's common stock. This particular exchange resulted in a gain on retirement of Preferred Stock and favorably impacted retained earnings by \$10.1 million (net of deferred taxes), which was also considered as part of earnings available to common stockholders in the earnings per common share ("EPS") computations.

On September 22, 2011, the Corporation entered into a Securities Purchase Agreement (the "Purchase Agreement") with the Treasury, pursuant to which the Corporation issued 90,782.94 shares of the Corporation's Senior Non-Cumulative Perpetual Preferred Stock, Series B (the "Series B Preferred Stock"), having a liquidation amount per share equal to \$1,000, for a total purchase price of \$90,782,940. The Purchase Agreement was entered into, and the Series B Preferred Stock was issued, pursuant to the Small Business Lending Fund ("SBLF") program, a \$30 billion fund established under the Small Business Jobs Act of 2010, that encourages lending to small businesses by providing capital to qualified community banks with assets of less than \$10 billion.

The Series B Preferred Stock is entitled to receive non-cumulative dividends, payable quarterly, on each January 1, April 1, July 1 and October 1, beginning October 1, 2011. The Purchase Agreement defines the dividend rate as a percentage of the liquidation amount, and can fluctuate on a quarterly basis during the first ten quarters during which the Series B Preferred Stock is outstanding, based upon changes in the level of Qualified Small Business Lending ("QSBL") by the Bank. Based upon the Bank's level of QSBL over the baseline level calculated under the terms of the Purchase Agreement (the "Baseline"), the dividend rate for the initial dividend period has been set at 5 percent. For the second through tenth dividend periods, the dividend rate may be adjusted to between 1 percent and 5 percent per annum, to reflect the amount of change in the Bank's level of QSBL. In addition to the dividend, in the event the Bank's level of QSBL has not increased relative to the Baseline, at the beginning of the tenth calendar quarter, the Corporation will be subject to an additional lending incentive fee equal to 2 percent per annum. For the eleventh dividend period through the eighteenth dividend period, inclusive, and that portion of the nineteenth dividend period before, but not including, the four and one half year anniversary of the date of issuance, the dividend rate will be fixed at between 1 percent and 7 percent per annum based upon the increase in QSBL as compared to the baseline. After four and one half years from issuance, the dividend rate will increase to 9 percent.

The Series B Preferred Stock is non-voting, except in limited circumstances. In the event that the Corporation misses five dividend payments, whether or not consecutive, the holder of the Series B Preferred Stock will have the right, but not the obligation, to appoint a representative as an observer on the Corporation's Board of Directors. In the event that the Corporation misses six dividend payments, whether or not consecutive, and if the then outstanding aggregate liquidation amount of the Series B Preferred Stock is at least \$25,000,000, then the holder of the Series B Preferred

Stock will have the right to designate two directors to the Board of Directors of the Corporation.

The Series B Preferred Stock may be redeemed at any time at the Corporation's option, at a redemption price of 100 percent of the liquidation amount plus accrued but unpaid dividends to the date of redemption for the current period, subject to the approval of its federal banking regulator.

The Series B Preferred Stock was issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. The Corporation has agreed to register the Series B Preferred Stock under certain circumstances set forth in Annex E to the Purchase Agreement. The Series B Preferred Stock is not subject to any contractual restrictions on transfer.

Also on September 22, 2011, the Corporation entered into and consummated two letter agreements (each, a "Repurchase Letter") with the Treasury, pursuant to which the Corporation redeemed, out of the proceeds of the issuance of the Series B Preferred Stock in the amount of \$90,782,940 and cash of \$25,813,171 (of which \$21,165,000 was raised through a private placement of the Corporation's common stock on September 9, 2011) for an aggregate redemption price of \$116,596,111, including accrued but unpaid dividends to the date of redemption: (i) the remaining 69,600 shares of the Corporation's Series A Preferred Stock, and (ii) all 46,400 Capital Securities held by the Treasury .

The foregoing summary of the terms of the Repurchase Letters is subject to, and qualified in its entirety by, the full text of the Repurchase Letters.

On November 23, 2011, the Corporation also repurchased the Warrant to purchase 991,453 shares of the Corporation's common stock at an exercise price of \$17.55 per share with an expiration date of February 20, 2019 held by the Treasury. The Corporation was the successful bidder in a private auction for the Warrant conducted by the Treasury with a winning bid of \$367,500.

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Dodd-Frank Wall Street Reform and Consumer Protection Act

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) into law. The Dodd-Frank Act is likely to have a broad impact on the financial services industry, including significant regulatory and compliance changes. Many of the requirements called for in the Dodd-Frank Act will be implemented over time and most will be subject to various federal agencies implementing regulations over the course of several years. Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the various regulatory agencies through regulatory guidance, the full extent of the impact such requirements will have on the financial services industry, and on operations specifically, is currently unclear. The changes resulting from the Dodd-Frank Act may materially impact the profitability of the Corporation’s business activities, require changes to certain business practices, impose more stringent capital, liquidity and leverage requirements or otherwise adversely affect the business. At a minimum, the Dodd-Frank Act is likely to:

- increase the cost of operations due to greater regulatory oversight, supervision and examination of banks and bank holding companies, including higher deposit insurance premiums;
- limit the Corporation’s ability to raise additional capital through the use of trust preferred securities as new issuances of these securities may no longer be included as Tier 1 capital;
- reduce the flexibility to generate or originate certain revenue-producing assets based on increased regulatory capital standards; and
- limit the ability to expand consumer product and service offerings due to anticipated stricter consumer protection laws and regulations.

The timing and extent of these increases and limitations will remain unclear until the underlying implementing regulations are promulgated by the applicable federal agencies. In the interim, the Corporation’s management is currently taking steps to best prepare for the implementation and to minimize the adverse impact on the business, financial condition and results of operation.

On February 7, 2011, the FDIC adopted final rules implementing a portion of the Dodd-Frank Act relating to deposit insurance assessments. The rules modify the base amount for a financial institution’s insurance assessments from an institution’s insured deposits to the difference between an institution’s daily average consolidated assets and its daily average tangible equity. The rules also eliminated the requirement that the FDIC provide rebates to institutions on their deposit premiums once the reserve ratio exceeded 1.5 percent. These new rules became effective on April 1, 2011.

Deposit Insurance

The Bank is insured up to regulatory limits by the FDIC; and, accordingly, is subject to deposit insurance assessments to maintain the Deposit Insurance Fund administered by the FDIC. The FDIC has adopted regulations establishing a permanent risk-related deposit insurance assessment system. Under this system, the FDIC places each insured bank in one of four risk categories based on (i) the bank’s capital evaluation, and (ii) supervisory evaluations provided to the FDIC by the bank’s primary federal regulator. Each insured bank’s annual assessment rate is then determined by the risk category in which it is classified by the FDIC.

When Dodd-Frank became effective, it permanently raised the previous Standard Maximum Deposit Insurance Amount (“SMDIA”) to \$250,000. The FDIC insurance coverage limit applies per depositor, per insured depository institution for each account ownership category. This provision became effective for depositors December 31, 2010.



On November 9, 2010, the FDIC implemented section 343 of the Dodd-Frank Act providing unlimited insurance coverage on noninterest-bearing transaction accounts. Beginning December 31, 2010, through December 31, 2012, all noninterest-bearing transaction accounts were fully insured, regardless of the balance of the account, at all FDIC-insured institutions. As of January 1, 2013, noninterest-bearing transaction deposit accounts are no longer insured separately from other accounts at the same FDIC-insured institution. Instead, noninterest-bearing transaction accounts will be added to other accounts, and the aggregate balance insured up to at least the Standard Maximum Deposit Insurance Amount of \$250,000, at each institution.

#### Temporary Liquidity Guarantee Program

Following a systemic risk determination, on October 14, 2008, the FDIC established the Temporary Liquidity Guarantee Program ("TLGP"). The TLGP included the Transaction Account Guarantee Program ("TAGP"), which provided unlimited deposit insurance coverage for noninterest-bearing transaction accounts (typically business checking accounts) and certain funds swept into noninterest-bearing savings accounts. Prior to December 31, 2009, institutions participating in the TAGP paid a 10 basis points fee (annualized) on the balance of each covered account in excess of \$250,000, while the extra deposit insurance is in place. After December 31, 2009, those institutions that have not opted out of the TAGP extension will be charged an assessment rate ranging from 15 to 25 basis points, depending on the institution's risk category. This program was extended to December 31, 2010 and the Bank continued its participation until the program expired on December 31, 2010, when the Dodd-Frank Wall Street Reform and Consumer Protection Act became effective which, in part, permanently raised the previous SMDIA to \$250,000.

The TLGP also included the Debt Guarantee Program ("DGP"), under which the FDIC guaranteed certain senior unsecured debt of FDIC-insured institutions and their holding companies. The guarantee was effective through the earlier of the maturity date or June 30, 2012. Depending on the term of the debt maturity, the nonrefundable DGP fee ranged from 50 to 100 basis points (annualized) for covered debt outstanding until the earlier of maturity or June 30, 2012. The TAGP and the DGP were in effect for all eligible entities, unless the entity opted out on or before December 5, 2008. On March 17, 2009, the FDIC extended the DGP to June 30, 2009 from the original expiration date of April 30, 2009. In addition, beginning in the second quarter of 2009, the FDIC determined to impose a surcharge on debt issued under the DGP with a maturity of one-year or more.

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On March 31, 2009, the Bank completed the issuance and sale of an aggregate of \$79,000,000 of 2.625 percent Senior Notes (the "Notes") due March 30, 2012 through a pooled offering under the DGP. Including the FDIC fee, underwriting, legal and accounting expenses the effective rate was 3.812 percent. The Notes were issued by the Bank and were not obligations of, or guaranteed by, the Corporation. In connection with the terms of the TLGP, the Bank entered into a Master Agreement with the FDIC on January 16, 2009. The Master Agreement contained, among other things, certain terms and conditions that must be included in the governing documents for any senior debt securities issued by the Bank that are guaranteed pursuant to the FDIC's TLGP. On March 30, 2012, the Bank completed repayment of these Notes.

DIVIDEND LIMITATIONS

National banking laws restrict the amount of dividends that an affiliate bank may declare in a year without obtaining prior regulatory approval. National banks are limited to the bank's retained net income (as defined) for the current year plus those for the previous two years. At December 31, 2012, the Corporation's affiliates (including the Bank and other affiliates) had a total of \$70,704,000 retained net profits available for 2013 dividends to the Corporation without prior regulatory approval.

BROKERED DEPOSITS

Under FDIC regulations, no FDIC-insured depository institution can accept brokered deposits unless it (i) is well capitalized, or (ii) is adequately capitalized and received a waiver from the FDIC. In addition, these regulations prohibit any depository institution that is not well capitalized from (a) paying an interest rate on deposits in excess of 76 basis points over certain prevailing market rates or (b) offering "pass through" deposit insurance on certain employee benefit plan accounts unless it provides certain notice to affected depositors.

INTERSTATE BANKING AND BRANCHING

Under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ("Riegle-Neal"), subject to certain concentration limits, required regulatory approvals and other requirements, (i) financial holding companies such as the Corporation are permitted to acquire banks and bank holding companies located in any state; (ii) any bank that is a subsidiary of a bank holding company is permitted to receive deposits, renew time deposits, close loans, service loans and receive loan payments as an agent for any other bank subsidiary of that holding company; and (iii) banks are permitted to acquire branch offices outside their home states by merging with out-of-state banks, purchasing branches in other states, and establishing de novo branch offices in other states.

FINANCIAL SERVICES MODERNIZATION ACT

The Gramm-Leach-Bliley Act of 1999 (the "Financial Services Modernization Act") establishes a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms, and other financial service providers by revising and expanding the existing BHC Act. Under this legislation, bank holding companies would be permitted to conduct essentially unlimited securities and insurance activities as well as other activities determined by the Federal Reserve Board to be financial in nature or related to financial services. As a result, the Corporation is able to provide securities and insurance services. Furthermore, under this legislation, the Corporation is able to acquire, or be acquired, by brokerage and securities firms and insurance underwriters. In addition, the Financial Services Modernization Act broadens the activities that may be conducted by national banks through the formation of financial subsidiaries. Finally, the Financial Services Modernization

Act modifies the laws governing the implementation of the Community Reinvestment Act and addresses a variety of other legal and regulatory issues affecting both day-to-day operations and long-term activities of financial institutions.

A bank holding company may become a financial holding company if each of its subsidiary banks is well capitalized, is well managed and has at least a satisfactory rating under the Community Reinvestment Act, by filing a declaration that the bank holding company wishes to become a financial holding company. Also effective March 11, 2000, no regulatory approval is required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve Board. The Federal Reserve Bank of Chicago approved the Corporation's application to become a Financial Holding Company effective September 13, 2000.

#### USA PATRIOT ACT

As part of the USA Patriot Act, signed into law on October 26, 2001, Congress adopted the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 (the "Act"). The Act authorizes the Secretary of the Treasury, in consultation with the heads of other government agencies, to adopt special measures applicable to financial institutions such as banks, bank holding companies, broker-dealers and insurance companies. Among its other provisions, the Act requires each financial institution: (i) to establish an anti-money laundering program; (ii) to establish due diligence policies, procedures and controls that are reasonably designed to detect and report instances of money laundering in United States private banking accounts and correspondent accounts maintained for non-United States persons or their representatives; and (iii) to avoid establishing, maintaining, administering, or managing correspondent accounts in the United States for, or on behalf of, a foreign shell bank that does not have a physical presence in any country. In addition, the Act expands the circumstances under which funds in a bank account may be forfeited and requires covered financial institutions to respond under certain circumstances to requests for information from federal banking agencies within 120 hours.

Treasury regulations implementing the due diligence requirements were issued in 2002. These regulations required minimum standards to verify customer identity, encouraged cooperation among financial institutions, federal banking agencies, and law enforcement authorities regarding possible money laundering or terrorist activities, prohibited the anonymous use of "concentration accounts," and required all covered financial institutions to have in place an anti-money laundering compliance program.

The Act also amended the Bank Holding Company Act and the Bank Merger Act to require the federal banking agencies to consider the effectiveness of a financial institution's anti-money laundering activities when reviewing an application under these acts.

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THE SARBANES-OXLEY ACT

The Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley Act”), which became law on July 30, 2002, added new legal requirements for public companies affecting corporate governance, accounting and corporate reporting. The Sarbanes-Oxley Act provides for, among other things:

- a prohibition on personal loans made or arranged by the issuer to its directors and executive officers (except for loans made by a bank subject to Regulation O);
- independence requirements for audit committee members;
- independence requirements for company auditors;
- certification of financial statements on Forms 10-K and 10-Q reports by the chief executive officer and the chief financial officer;
- the forfeiture by the chief executive officer and chief financial officer of bonuses or other incentive-based compensation and profits from the sale of an issuer’s securities by such officers in the twelve-month period following initial publication of any financial statements that later require restatement due to corporate misconduct;
- disclosure of off-balance sheet transactions;
- two-business day filing requirements for insiders filing Form 4s;
- disclosure of a code of ethics for financial officers and filing a Form 8-K for a change in or waiver of such code;
- the reporting of securities violations “up the ladder” by both in-house and outside attorneys;
- restrictions on the use of non-GAAP financial measures in press releases and SEC filings;
- the formation of a public accounting oversight board; and
- various increased criminal penalties for violations of securities laws.

The Sarbanes-Oxley Act contains provisions, which became effective upon enactment on July 30, 2002, including provisions, which became effective from within 30 days to one year from enactment. The SEC has been delegated the task of enacting rules to implement various provisions. In addition, each of the national stock exchanges developed new corporate governance rules, including rules strengthening director independence requirements for boards, the adoption of corporate governance codes and charters for the nominating, corporate governance and audit committees.

ADDITIONAL MATTERS

The Corporation and the Bank are subject to the Federal Reserve Act, which restricts financial transactions between banks and affiliated companies. The statute limits credit transactions between banks, affiliated companies and its executive officers and its affiliates. The statute prescribes terms and conditions for bank affiliate transactions deemed to be consistent with safe and sound banking practices. It also restricts the types of collateral security permitted in connection with the bank’s extension of credit to an affiliate. Additionally, all transactions with an affiliate must be on terms substantially the same or at least as favorable to the institution as those prevailing at the time for comparable transactions with non-affiliated parties.

In addition to the matters discussed above, the Bank is subject to additional regulation of its activities, including a variety of consumer protection regulations affecting its lending, deposit and collection activities and regulations affecting secondary mortgage market activities.

The earnings of financial institutions are also affected by general economic conditions and prevailing interest rates, both domestic and foreign, and by the monetary and fiscal policies of the United States Government and its various agencies, particularly the Federal Reserve. The Federal Reserve regulates the supply of credit in order to influence general economic conditions, primarily through open market operations in United States Government obligations,

varying the discount rate on financial institution borrowings, varying reserve requirements against financial institution deposits, and restricting certain borrowings by financial institutions and their subsidiaries. The monetary policies of the Federal Reserve have had a significant effect on the operating results of the Bank in the past and are expected to continue to do so in the future.

Additional legislation and administrative actions affecting the banking industry may be considered by the United States Congress, state legislatures and various regulatory agencies, including those referred to above. It cannot be predicted with certainty whether such legislation or administrative action will be enacted or the extent to which the banking industry, the Corporation or the Bank would be affected.

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## STATISTICAL DATA

The following tables set forth statistical data on the Corporation and its subsidiaries.

## DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS' EQUITY; INTEREST RATES AND INTEREST DIFFERENTIAL

The daily average balance sheet amounts, the related interest income or interest expense, and average rates earned or paid are presented in the following table:

	Average Balance	Interest Income / Expense	Average Rate	Average Balance	Interest Income / Expense	Average Rate	Average Balance	Interest Income / Expense	Average Rate
(Dollars in Thousands)	2012			2011			2010		
Assets:									
Federal Funds Sold				\$3,270	\$3	0.1 %	\$21,524	\$26	0.1 %
Interest-bearing Deposits	\$57,842	\$100	0.2 %	69,030	282	0.4	106,820	381	0.4
Federal Reserve and Federal Home Loan	32,819	1,408	4.3	32,396	1,319	4.1	36,338	1,252	3.4
Bank Stock									
Securities: <sup>(1)</sup>									
Taxable	670,973	17,027	2.5	648,167	19,230	3.0	399,721	12,957	3.2
Tax-Exempt <sup>(2)</sup>	251,724	15,675	6.2	242,480	15,642	6.5	247,240	15,965	6.5
Total Securities	922,697	32,702	3.5	890,647	34,872	3.9	646,961	28,922	4.5
Mortgage Loans Held for Sale	20,648	1,024	5.0	9,322	554	5.9	11,878	684	5.8
Loans: <sup>(3)</sup>									
Commercial	2,166,238	114,078	5.3	2,102,933	114,079	5.4	2,288,883	130,276	5.7
Real Estate Mortgage	293,384	13,848	4.7	306,567	15,810	5.2	350,646	19,473	5.6
Installment	324,553	17,795	5.5	320,570	19,273	6.0	380,293	23,637	6.2
Tax-Exempt <sup>(2)</sup>	14,993	739	4.9	9,292	812	8.7	19,150	792	4.1
Total Loans	2,819,816	147,484	5.2	2,748,684	150,528	5.5	3,050,850	174,862	5.7
Total Earning Assets	3,833,174	181,694	4.7 %	3,744,027	187,004	5.0 %	3,862,493	205,443	5.3 %
Net Unrealized Gain on									
Securities Available for Sale	16,116			9,225			14,245		
Allowance for Loan Losses	(71,038 )			(78,500 )			(87,058 )		
Cash and Due from Banks	66,109			62,659			56,635		
Premises and Equipment	51,692			51,895			53,870		
Other Assets	349,943			354,544			371,530		
Total Assets	\$4,245,996			\$4,143,850			\$4,271,715		
Liabilities:									
Interest-bearing									
Deposits:									
NOW Accounts	\$814,831	\$1,007	0.1 %	\$774,593	\$1,453	0.2 %	\$755,793	\$3,300	0.4 %

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Money Market Deposit Accounts	501,537	1,370	0.3	469,621	1,557	0.3	467,313	2,520	0.5
Savings Deposits	327,644	528	0.2	297,073	668	0.2	285,760	812	0.3
Certificates and Other Time Deposits	935,713	11,895	1.3	1,032,781	18,603	1.8	1,295,367	33,244	2.6
Total Interest-bearing Deposits	2,579,725	14,800	0.6	2,574,068	22,281	0.9	2,804,233	39,876	1.4
Borrowings	411,915	8,813	2.1	455,135	15,609	3.4	427,242	16,133	3.8
Total Interest-bearing Liabilities	2,991,640	23,613	0.8	3,029,203	37,890	1.3	3,231,475	56,009	1.7
Noninterest-bearing Deposits	683,295			601,694			533,514		
Other Liabilities	35,564			34,513			36,347		
Total Liabilities	3,710,499			3,665,410			3,801,336		
Stockholders' Equity	535,497			478,440			470,379		
Total Liabilities and Stockholders' Equity	\$4,245,996	23,613	0.6	\$4,143,850	37,890	1.0	\$4,271,715	56,009	1.5
Net Interest Income		\$158,081			\$149,114			\$149,434	
Net Interest Margin			4.1 %			4.0 %			3.9 %

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(1) Average balance of securities is computed based on the average of the historical amortized cost balances without the effects of the fair value adjustment.

(2) Tax-exempt securities and loans are presented on a fully taxable equivalent basis, using a marginal tax rate of 35 percent for 2012, 2011 and 2010. These totals equal \$5,745, \$5,759 and \$5,865, respectively.

(3) Non-accruing loans have been included in the average balances.

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## ANALYSIS OF CHANGES IN NET INTEREST INCOME

The following table presents net interest income components on a tax-equivalent basis and reflects changes between periods attributable to movement in either the average balance or average interest rate for both earning assets and interest-bearing liabilities. The volume differences were computed as the difference in volume between the current and prior year times the interest rate of the prior year, while the interest rate changes were computed as the difference in rate between the current and prior year times the volume of the prior year. Volume/rate variances have been allocated on the basis of the absolute relationship between volume variances and rate variances.

(Dollars in Thousands, Fully Taxable Equivalent Basis)	2012 Compared to 2011 Increase (Decrease) Due To			2011 Compared to 2010 Increase (Decrease) Due To			2010 Compared to 2009 Increase (Decrease) Due To		
	Volume	Rate	Total	Volume	Rate	Total	Volume	Rate	Total
<b>Interest Income:</b>									
Federal Funds Sold	\$ (3 )		\$ (3 )	\$ (18 )	\$ (5 )	\$ (23 )	\$ (73 )	\$ (19 )	\$ (92 )
Interest-bearing Deposits	(40 )	(142 )	(182 )	(149 )	50	(99 )	119	(104 )	15
Federal Reserve and Federal Home Loan Bank Stock	17	72	89	(145 )	212	67	32	(159 )	(127 )
Securities	1,222	(3,392 )	(2,170 )	9,877	(3,927 )	5,950	6,686	(4,849 )	1,837
Mortgage Loans Held for Sale	575	(105 )	470	(151 )	21	(130 )	(136 )	(34 )	(170 )
Loans	3,226	(6,740 )	(3,514 )	(16,643 )	(7,561 )	(24,204 )	(28,329 )	(3,852 )	(32,181 )
Totals	4,997	(10,307 )	(5,310 )	(7,229 )	(11,210 )	(18,439 )	(21,701 )	(9,017 )	(30,718 )
<b>Interest Expense:</b>									
NOW Accounts	72	(518 )	(446 )	80	(1,927 )	(1,847 )	274	(580 )	(306 )
Money Market Deposit Accounts	101	(288 )	(187 )	12	(975 )	(963 )	275	(1,305 )	(1,030 )
Savings Deposits	64	(204 )	(140 )	31	(175 )	(144 )	(60 )	(347 )	(407 )
Certificates and Other Time Deposits	(1,624 )	(5,084 )	(6,708 )	(5,926 )	(8,715 )	(14,641 )	(10,619 )	(6,153 )	(16,772 )
Borrowings	(1,370 )	(5,426 )	(6,796 )	1,013	(1,537 )	(524 )	(5,050 )	2,481	(2,569 )
Totals	(2,757 )	(11,520 )	(14,277 )	(4,790 )	(13,329 )	(18,119 )	(15,180 )	(5,904 )	(21,084 )
Change in Net Interest Income (Fully Taxable Equivalent Basis)	\$ 7,754	\$ 1,213	8,967	\$ (2,439)	\$ 2,119	(320 )	\$ (6,521)	\$ (3,113)	(9,634 )
Tax Equivalent Adjustment Using Marginal Rate of 35% for 2012, 2011, and 2010			14			106			(143 )
Change in Net Interest Income			\$ 8,981			\$ (214 )			\$ (9,777)

## INVESTMENT SECURITIES

Management evaluates securities for other-than-temporary impairment (“OTTI”) at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. The investment securities portfolio is evaluated for OTTI by segregating the portfolio into two general segments and applying the appropriate OTTI model. Investment securities are generally evaluated for OTTI under Accounting Standards Codification (“ASC”) 320,



Investments – Debt and Equity Securities. However, certain purchased beneficial interest, including certain non-agency government-sponsored mortgage-backed securities, asset-backed securities and collateralized debt obligations are evaluated using the model outlined in ASC 325-10, Investments - Other.

In determining OTTI under ASC 320, 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 Corporation 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 assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

When OTTI occurs, the amount of OTTI recognized in the income statement depends on whether the Corporation intends to sell the security or it is more likely than not that the Corporation will be required to sell the security before recovery of its amortized cost basis, less any recognized credit loss. If the intent is to sell or it is more likely than not that the Corporation will be required to sell the security before recovery of its amortized cost basis, less any recognized credit loss, the OTTI shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis, less any recognized credit loss, and its fair value at the balance sheet date. If the intent is not to sell the security and it is not more likely than not that the Corporation will be required to sell the security before the recovery of its amortized cost basis less any recognized credit loss, the OTTI has been separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized in earnings. The amount of the total OTTI related to other factors has been recognized in other comprehensive income, net of applicable income taxes. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment. The Corporation's management has evaluated all securities with unrealized losses for other-than-temporary impairment as of December 31, 2012.

The current unrealized losses are primarily concentrated within trust preferred securities held by the Corporation. Such investments have an amortized cost of \$6.1 million and a fair value of \$194,000, which is less than 1 percent of the Corporation's entire investment portfolio. On all but one small pool investment, the Corporation utilized Moody's to determine their fair value.

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During 2012, management reviewed the trust preferred pool securities for OTTI related to credit losses using a cash flow analysis of the present value of cash flows expected to be collected. These cash flow analyses included forecasted loss rates applied at an individual security level based upon the characteristics of that individual security. Of the six partially impaired securities, remaining book values represent between 33 percent and 83 percent of par value. Discount rates used in the cash flow analyses on these variable rate securities were those margins in effect at the inception of the security added to the appropriate three-month LIBOR spot rate obtained from the forward LIBOR curve used to project future principal and interest payments. These spreads ranged from .85 percent to 1.57 percent spread over three-month LIBOR.

In determining the fair value of the trust preferred securities, the Corporation utilizes a third party for portfolio accounting services, including market value input. The Corporation has obtained an understanding of what inputs were used by the vendor in pricing the portfolio and how the vendor classified the securities based upon these inputs. From these discussions, the Corporation's management is comfortable that the classifications are proper. The Corporation has gained trust in the data for two reasons: (a) independent spot testing of the data is conducted by the Corporation through obtaining market quotes from various brokers on a periodic basis and (b) actual gains or loss resulting from the sale of certain securities has proven the data to be accurate over time.

See additional information regarding the analysis of the investment portfolio in Note 4. INVESTMENT SECURITIES, in the Notes to Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

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

(Dollars in Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at December 31, 2012				
U.S. Government-sponsored agency securities	\$4,475	\$165		\$4,640
State and municipal	148,187	10,025	\$18	158,194
U.S. Government-sponsored mortgage-backed securities	337,631	10,994	46	348,579
Corporate obligations	6,105		5,881	224
Equity securities	1,706			1,706
Total available for sale	498,104	21,184	5,945	513,343
Held to maturity at December 31, 2012				
State and municipal	117,227	5,489	1	122,715
U.S. Government-sponsored mortgage-backed securities	243,793	11,681	15	255,459
Total held to maturity	361,020	17,170	16	378,174
Total Investment Securities	\$859,124	\$38,354	\$5,961	\$891,517

(Dollars in Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at December 31, 2011				
U.S. Government-sponsored agency securities	\$99	\$18		\$117
State and municipal	136,857	10,496		147,353

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U.S. Government-sponsored mortgage-backed securities	358,928	10,086	\$16	368,998
Corporate obligations	5,765		5,572	193
Equity securities	1,830			1,830
Total available for sale	503,479	20,600	5,588	518,491
Held to maturity at December 31, 2011				
State and municipal	120,171	3,785		123,956
U.S. Government-sponsored mortgage-backed securities	307,738	10,775		318,513
Total held to maturity	427,909	14,560		442,469
Total Investment Securities	\$931,388	\$35,160	\$5,588	\$960,960

(Dollars in Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at December 31, 2010				
U.S. Government-sponsored agency securities	\$600	\$16		\$616
State and municipal	233,622	7,108	\$740	239,990
U.S. Government-sponsored mortgage-backed securities	293,311	4,293	2,287	295,317
Corporate obligations	5,856		5,674	182
Equity securities	3,265			3,265
Total available for sale	536,654	11,417	8,701	539,370
Held to maturity at December 31, 2010				
State and municipal	10,070	389	5	10,454
U.S. Government-sponsored mortgage-backed securities	277,357	2,064	3,605	275,816
Total held to maturity	287,427	2,453	3,610	286,270
Total Investment Securities	\$824,081	\$13,870	\$12,311	\$825,640

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The cost and yields for Federal Reserve and Federal Home Loan Bank stock are included in the table below.

(Dollars in Thousands)	2012		2011		2010	
	Cost	Yield	Cost	Yield	Cost	Yield
Federal Reserve and Federal Home Loan Bank Stock at December 31:						
Federal Reserve Bank Stock	\$13,261	6.0 %	\$13,238	6.0 %	\$13,522	6.0 %
Federal Home Loan Bank Stock	19,524	2.0 %	18,032	2.0 %	20,362	1.6 %
Total	\$32,785	3.6 %	\$31,270	4.0 %	\$33,884	3.3 %

Federal Reserve and Federal Home Loan Bank stock have been reviewed for impairment and the analysis reflected no impairment. The Corporation's Federal Home Loan Bank stock is primarily in the Federal Home Loan Bank of Indianapolis and it continues to produce sufficient financial results to pay dividends.

There were no issuers included in the investment security portfolio at December 31, 2012, 2011 or 2010 where the aggregate carrying value of any one issuer exceeded 10 percent of the Corporation's stockholders' equity at those dates. The term "issuer" excludes the U.S. Government and its sponsored agencies and corporations.

The maturity distribution and average yields for the securities portfolio at December 31, 2012 were:

(Dollars in Thousands)	Within 1 Year		1-5 Years		5-10 Years	
	Amount	Yield <sup>(1)</sup>	Amount	Yield <sup>(1)</sup>	Amount	Yield <sup>(1)</sup>
Securities available for sale December 31, 2012						
U.S. Government-sponsored agency securities			\$116	4.9 %		
State and municipal Equity securities	\$4,415	7.8 %	15,322	5.7 %	\$57,442	5.5 %
Corporate obligations			30	0.0 %		
U.S. Government-sponsored mortgage-backed securities	\$4,415	7.8 %	\$15,468	5.6 %	\$57,442	5.5 %
	Due After Ten Years		Equity and U.S. Government-Sponsored Mortgage - Backed Securities		Total	
	Amount	Yield <sup>(1)</sup>	Amount	Yield <sup>(1)</sup>	Amount	Yield <sup>(1)</sup>
U.S. Government-sponsored agency securities	\$4,524	3.5 %			\$4,640	3.5 %
State and municipal Equity securities	81,015	6.0 %			158,194	5.8 %
Corporate obligations	194	3.7 %	\$1,706	6.5 %	224	3.7 %
U.S. Government-sponsored mortgage-backed securities			348,579	2.7 %	348,579	2.7 %
	\$85,733	5.6 %	\$350,285	2.7 %	\$513,343	3.7 %

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(Dollars in Thousands)	Within 1 Year		1-5 Years		5-10 Years			
	Amount	Yield <sup>(1)</sup>	Amount	Yield <sup>(1)</sup>	Amount	Yield <sup>(1)</sup>		
Securities held to maturity at December 31, 2012								
State and municipal	\$2,590	2.2	% \$2,554	3.3	% \$57,811	6.2	%	
U.S. Government-sponsored mortgage-backed securities	\$2,590	2.2	% \$2,554	3.3	% \$57,811	6.2	%	
			Equity and U.S. Government-Sponsored Mortgage - Backed Securities			Total		
	Due After Ten Years							
	Amount	Yield <sup>(1)</sup>	Amount	Yield <sup>(1)</sup>	Amount	Yield <sup>(1)</sup>		
State and municipal	\$54,272	6.4	%		\$117,227	6.1	%	
U.S. Government-sponsored mortgage-backed securities			\$243,793	3.1	% 243,793	3.1	%	
	\$54,272	6.4	% \$243,793	3.1	% \$361,020	4.1	%	

(1) Interest yields are presented on a fully taxable equivalent basis using a 35 percent tax rate.

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The following tables show the Corporation's gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2012 and 2011:

	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	Less than 12 Months		12 Months or Longer		Total	
(Dollars in Thousands)						
Temporarily Impaired Investment Securities at December 31, 2012:						
State and municipal	\$4,524	\$ (19 )			\$4,524	\$ (19 )
U.S. Government-sponsored mortgage-backed securities	11,685	(49 )	\$635	\$ (12 )	12,320	(61 )
Corporate obligations			194	(5,881 )	194	(5,881 )
Total Temporarily Impaired Investment Securities	\$16,209	\$ (68 )	\$829	\$ (5,893 )	\$17,038	\$ (5,961 )

	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	Less than 12 Months		12 Months or Longer		Total	
(Dollars in Thousands)						
Temporarily Impaired Investment Securities at December 31, 2011:						
U.S. Government-sponsored mortgage-backed securities	\$6,176	\$ (16 )			\$6,176	\$ (16 )
Corporate obligations			\$163	\$ (5,572 )	163	(5,572 )
Total Temporarily Impaired Investment Securities	\$6,176	\$ (16 )	\$163	\$ (5,572 )	\$6,339	\$ (5,588 )

## LOAN PORTFOLIO

The following table shows the composition of the Corporation's loan portfolio for the years indicated:

	2012		2011		2010		2009		2008	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
(Dollars in Thousands)										
Loans at December 31:										
Commercial and Industrial Loans	\$622,579	21.5 %	\$532,523	19.6 %	\$530,322	18.7 %	\$675,860	20.7 %	\$904,646	24.3 %
Agricultural Production Financing and Other	112,527	3.9	104,526	3.9	95,516	3.4	121,031	3.7	135,099	3.6

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Loans to Farmers Real Estate Loans:										
Construction	98,639	3.4	81,780	3.0	106,615	3.8	158,725	4.9	252,487	6.8
Commercial and Farm Land	1,266,682	43.6	1,194,230	44.0	1,229,037	43.3	1,276,164	39.0	1,230,442	33.1
Residential	473,537	16.3	481,493	17.7	522,051	18.4	621,442	19.0	806,765	21.7
Home Equity	203,406	7.0	191,631	7.1	201,969	7.1	220,142	6.7	149,480	4.0
Individuals' Loans for Household and Other Personal Expenditures	75,748	2.6	84,172	3.1	115,295	4.1	154,132	4.7	201,632	5.4
Lease Financing Receivables, Net of Unearned Income	2,590	0.1	3,555	0.1	5,157	0.2	7,135	0.2	8,996	0.2
Other Loans	46,501	1.6	39,505	1.5	29,721	1.0	35,157	1.1	32,405	0.9
Loans Allowance for Loan Losses	2,902,209	100.0%	2,713,415	100.0%	2,835,683	100.0%	3,269,788	100.0%	3,721,952	100.0%
	(69,366 )		(70,898 )		(82,977 )		(92,131 )		(49,543 )	
Net Loans	\$2,832,843		\$2,642,517		\$2,752,706		\$3,177,657		\$3,672,409	

Residential Real Estate Loans Held for Sale at December 31, 2012, 2011, 2010, 2009 and 2008 were \$22,300,000, \$17,864,000, \$21,469,000, \$8,036,000 and \$4,295,000, respectively.

The majority of the Corporation's loan portfolio is comprised of commercial and industrial, commercial real estate and residential real estate loans. Commercial and industrial loans made up 21.5 percent and 19.6 percent of total loans at December 31, 2012, and 2011. Commercial real estate loans made up 43.6 percent and 44 percent of total loans and residential real estate loans, including home equity, made up 23.3 percent and 24.8 percent of total loans at December 31, 2012, and 2011, respectively. The Bank generates loans from customers primarily in central Indiana, and Butler and Franklin counties in Ohio. The Bank's loans are generally secured by specific items of collateral, including real property, consumer assets, and business assets.

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## PART I: ITEM 1. BUSINESS

## LOAN MATURITIES

Presented in the table below are the maturities of loans (excluding residential real estate, home equity, individuals' loans for household and other personal expenditures and lease financing) outstanding as of December 31, 2012. Also presented are the amounts due after one year classified according to the sensitivity to changes in interest rates.

(Dollars in Thousands)	Maturing Within 1 Year	Maturing 1-5 Years	Maturing Over 5 Years	Total
Commercial and Industrial Loans	\$403,463	\$143,323	\$75,793	\$622,579
Agricultural Production Financing and Other Loans to Farmers	98,833	11,703	1,991	112,527
Real Estate - Construction	52,768	43,086	2,785	98,639
Real Estate - Commercial and Farm Land	512,532	536,197	217,953	1,266,682
Other Loans	27,343	16,263	2,895	46,501
Total	\$1,094,939	\$750,572	\$301,417	\$2,146,928

(Dollars in Thousands)	Maturing 1-5 Years	Maturing Over 5 Years
Loans Maturing After One Year with:		
Fixed Rate	\$504,583	\$285,584
Variable Rate	245,989	15,833
Total	\$750,572	\$301,417

## NON-PERFORMING ASSETS

The table below summarizes non-performing assets and impaired loans for the years indicated:

(Dollars in Thousands)	December 31, 2012	December 31, 2011	December 31, 2010	December 31, 2009	December 31, 2008
Non-Performing Assets:					
Non-accrual loans	\$53,399	\$69,592	\$90,591	\$118,409	\$87,546
Renegotiated loans	12,681	14,308	7,139	8,833	130
Non-performing loans (NPL)	66,080	83,900	97,730	127,242	87,676
Other real estate owned	13,263	16,289	20,927	14,879	18,458
Non-performing assets (NPA)	79,343	100,189	118,657	142,121	106,134
90+ days delinquent and still accruing	2,037	580	1,330	3,967	5,982
NPAs & 90+ days delinquent	\$81,380	\$100,769	\$119,987	\$146,088	\$112,116
Impaired Loans	\$79,179	\$79,775	\$116,204	\$178,754	\$206,126

Loans are reclassified to a non-accruing status when, in management's judgment, the collateral value and financial condition of the borrower do not justify accruing interest. Interest previously recorded, but not deemed collectible, is reversed and charged against current income. Interest income on these loans is then recognized when collected.



Renegotiated loans are loans for which concessions are granted to the borrower due to deterioration in the financial condition of the borrower resulting in the inability of the borrower to meet the original contractual terms of the loans. These concessions may include interest rate reductions, principal forgiveness, extensions of maturity date or other actions intended to minimize losses. Certain loans restructured may be excluded from restructured loan disclosures in years subsequent to the restructuring if the loans are in compliance with their modified terms. A non-accrual loan that is restructured may remain non-accrual for a period of approximately six months until the borrower can demonstrate their ability to meet the restructured terms. A borrower's performance prior to the restructuring, as well as after, will be considered in assessing whether the borrower can meet the new terms resulting in the loan being returned to accruing status in a shorter or longer period of time than the standard six months. If the borrower's performance under the modified terms is not reasonably assured, the loan will remain non-accrual.

Interest income of \$2,369,000 for the year ended December 31, 2012, was recognized on the non-accruing and renegotiated loans listed in the table above, whereas interest income of \$8,365,000 would have been recognized under their original loan terms.

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In years prior to 2009, the Corporation globally included all classified loans, including substandard, doubtful and loss credits in impaired loans. At December 31, 2009, management refined the definition of impaired loans to be more specific and include all non-accrual loans and renegotiated loans as well as substandard, doubtful and loss grade loans that were still accruing but deemed impaired according to guidance set forth in ASC 310. Also included in impaired loans are accruing loans that are contractually past due 90 days or more. Furthermore, at December 31, 2012, the Corporation included loans accounted for under SOP 03-3 in the impaired loan total. A loan is deemed impaired under ASC310 when, based on current information or events, it is probable that all amounts due of principal and interest according to the contractual terms of the loan agreement will not be collected. At December 31, 2012, commercial impaired loans totaled \$79,179,000. A specific allowance for losses was not deemed necessary for a subset of the impaired loans totaling \$67,333,000, but a specific allowance of \$4,243,000 was recorded for the remaining balance of \$11,846,000 and is included in the Corporation's allowance for loan losses at December 31, 2012. The average balance of the total aforementioned impaired loans for 2012 was \$88,614,000.

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

In addition to the impaired loans discussed above, management has also identified loans totaling \$143,991,000 as of December 31, 2012 that are deemed to be criticized, but not impaired. These loans are not included in the table above, or the impaired loan table in the footnotes to the consolidated financial statements. A criticized loan is a loan in which there are concerns as to the borrower's ability to comply with present repayment terms, whether or not those concerns rise to the level of serious doubt.

See additional information regarding loan credit quality in Note 5. LOANS AND ALLOWANCE, in the Notes to Consolidated Financial Statements included as Item 8 of this Annual Report on Form 10-K.

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## PART I: ITEM 1. BUSINESS

## SUMMARY OF LOAN LOSS EXPERIENCE

The following table summarizes the loan loss experience for the years indicated:

(Dollars in Thousands)	2012	2011	2010	2009	2008	
Allowance for Loans Losses:						
Balance at January 1	\$70,898	\$82,977	\$92,131	\$49,543	\$28,228	
Charge Offs:						
Commercial <sup>(1)</sup>	8,311	9,818	22,832	42,147	7,475	
Commercial Real Estate <sup>(2)</sup>	12,322	29,807	32,823	34,775	6,580	
Consumer	1,130	1,441	2,426	3,770	3,018	
Residential	5,475	7,407	9,437	8,491	5,536	
Finance Leases	34		54	411	17	
Total Charge Offs	27,272	48,473	67,572	89,594	22,626	
Recoveries:						
Commercial <sup>(3)</sup>	1,744	8,828	6,750	5,248	1,354	
Commercial Real Estate <sup>(4)</sup>	3,652	2,811	1,420	993	3,435	
Consumer	695	942	938	1,015	1,002	
Residential	1,113	1,176	2,827	701	1,233	
Finance Leases	2	7		9		
Total Recoveries	7,206	13,764	11,935	7,966	7,024	
Net Charge Offs	20,066	34,709	55,637	81,628	15,602	
Provisions for Loan Losses	18,534	22,630	46,483	122,176	28,238	
Adjustment Related to Acquisition				2,040		
Allowance Acquired in Acquisition					8,679	
Balance at December 31	\$69,366	\$70,898	\$82,977	\$92,131	\$49,543	
Ratio of Net Charge Offs During the Period to Average Loans Outstanding During the Period	0.71	% 1.26	% 1.82	% 2.30	% 0.52	%

The \$2,040,000 adjustment related to acquisition in 2009 in the table above was an adjustment to the carrying amount of Goodwill resulting from the continued evaluation of the credit quality of Lincoln Bank's acquired loan portfolio in accordance with ASC 805, Business Combinations. In the first quarter 2009, immediately following the acquisition of Lincoln, further analysis of the loan portfolio identified certain loans that were determined to have a lower fair value than was originally identified.

See the information regarding the analysis of loan loss experience in the "PROVISION/ALLOWANCE FOR LOAN LOSSES" section of Management's Discussion and Analysis of Financial Condition and Results of Operations included as Item 7 of this Annual Report on Form 10-K.

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(1) Category includes the charge offs for commercial and industrial, agricultural production financing and other loans to farmers and other non-consumer loans.

(2) Category includes the charge offs for construction, commercial and farm land.

(3) Category includes the recoveries for commercial and industrial, agricultural production financing and other loans to farmers and other non-consumer loans.

(4) Category includes the recoveries for construction, commercial and farm land.

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## PART I: ITEM 1. BUSINESS

## ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES

Presented below is an analysis of the composition of the allowance for loan losses and percent of loans in each category to total loans as of December 31, 2012, 2011, 2010, 2009 and 2008.

(Dollars in Thousands)	2012		2011		2010		2009		2008	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Balance at December 31:										
Commercial	\$25,913	26.9 %	\$17,731	24.9 %	\$32,508	23.1 %	\$48,771	25.5 %	\$16,368	28.8 %
Commercial Real Estate	26,703	47.1	37,919	47.1	36,341	47.1	30,188	43.9	14,408	39.8
Consumer	2,593	2.6	2,902	3.1	3,622	4.1	2,242	4.7	6,608	5.5
Residential	14,157	23.3	12,343	24.8	10,408	25.5	10,751	25.7	12,122	25.7
Finance Leases		0.1	3	0.1	98	0.2	179	0.2	37	0.2
Totals	\$69,366	100.0 %	\$70,898	100.0 %	\$82,977	100.0 %	\$92,131	100.0 %	\$49,543	100.0 %

Loan concentrations are considered to exist when there are amounts loaned to multiple borrowers engaged in similar activities, which would cause them to be similarly impacted by economic or other conditions. As of December 31, 2012, the only concentrations of commercial loans within a single industry (as segregated by North American Industry Classification System (“NAICS code”)), in excess of 10 percent of total loans were Lessors of Nonresidential Buildings at 14.0 percent and Lessors of Residential Buildings and Dwellings at 12.1 percent.

## LOAN LOSS CHARGE OFF PROCEDURES

The Corporation maintains an allowance for loan losses to cover probable credit losses identified during its loan review process. The allowance is increased by the provision for loan losses and decreased by charge offs less recoveries. All charge offs are approved by the Bank’s senior loan officers or loan committees, depending on the amount of the charge off, and are reported to the Bank’s Board of Directors. The Bank charges off loans when a determination is made that all or a portion of a loan is uncollectible.

## PROVISION FOR LOAN LOSSES

In banking, loan losses are a cost of doing business. Although Bank management emphasizes the early detection and charge off of loan losses, it is inevitable that certain losses, which have not been specifically identified, exist in the portfolio. Accordingly, the provision for loan losses is charged to earnings on an anticipatory basis, and recognized loan losses are deducted from the established allowance. Over time, all net loan losses are charged to earnings. During the year, an estimate of the expected losses for the year serves as a starting point in determining the appropriate level of the provision for loan losses. Based on management’s judgment as to the appropriate level of the allowance for loan losses the amount actually provided in any period may be greater or less than net loan losses for the same period. The determination of the provision for loan losses in any period is based on management’s continuing review and evaluation of the loan portfolio, and its judgment as to the impact of current economic conditions on the portfolio. The evaluation by management includes consideration of past loan loss experience, changes in the composition of the loan portfolio, and the current condition and amount of loans outstanding. See additional information in the “PROVISION/ALLOWANCE FOR LOAN LOSSES” section of Management’s Discussion and Analysis of Financial

Condition and Results of Operations included as Item 7 of this Annual Report on Form 10-K.

## DEPOSITS

The average balances, interest expense and average rates on deposits for the years ended December 2012, 2011 and 2010 are presented within the "DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS' EQUITY, INTEREST RATES AND INTEREST DIFFERENTIAL" table on page 12 of this Annual Report on Form 10-K.

As of December 31, 2012, certificates of deposit and other time deposits of \$100,000 or more mature as follows:

(Dollars in Thousands)	Maturing 3 Months or Less	Maturing 3-6 Months	Maturing 6-12 Months	Maturing Over 12 Months	Total	
Certificates of Deposit and Other Time Deposits	\$52,045	\$41,854	\$61,858	\$80,713	\$236,470	
Percent	22	% 18	% 26	% 34	% 100	%

## RETURN ON EQUITY AND ASSETS

See the information regarding return on equity and assets presented within the "FIVE – YEAR SUMMARY OF SELECTED FINANCIAL DATA" on page 3 of this Annual Report on Form 10-K.

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## PART I: ITEM 1. BUSINESS

## SHORT-TERM BORROWINGS

Borrowings maturing in one year or less are included in the following table:

(Dollars in Thousands)	2012	2011	2010
Balance at December 31:			
Federal Funds Purchased	\$18,862		
Securities Sold Under Repurchase Agreements (Short-term Portion)	131,828	\$146,305	\$85,621
Federal Home Loan Bank Advances (Short-term Portion)	1,434	49,785	18,930
Subordinated Debentures and Term Loans	459	78,996	
Total Short-term Borrowings	\$152,583	\$275,086	\$104,551

Securities sold under repurchase agreements are categorized as borrowings maturing within one year and are secured by U.S. Treasury and U.S. Government-Sponsored Enterprise obligations, certain municipal securities and mortgage loans.

Pertinent information with respect to short-term borrowings is summarized below:

(Dollars in Thousands)	2012	2011	2010
Weighted Average Interest Rate on Outstanding Balance at December 31:			
Federal Funds Purchased	0.2	%	
Securities Sold Under Repurchase Agreements (Short-term Portion)	0.2	0.7	% 0.5
Federal Home Loan Bank Advances (Short-term Portion)	2.0	4.8	4.9
Subordinated Debentures and Term Loans		2.7	
Total Short-term Borrowings	0.2	% 2.0	% 1.3
Weighted Average Interest Rate During the Year:			
Federal Funds Purchased	0.3	% 0.4	% 0.5
Securities Sold Under Repurchase Agreements (Short-term Portion)	0.3	0.9	0.7
Federal Home Loan Bank Advances (Short-term Portion)	3.4	4.4	5.4
Subordinated Debentures and Term Loans	2.9	2.8	
Total Short-term Borrowings	0.9	% 2.3	% 2.0
Highest Amount Outstanding at Any Month End During the Year:			
Federal Funds Purchased	\$87,571	\$27,945	\$7,746
Securities Sold Under Repurchase Agreements (Short-term Portion)	150,126	152,315	93,321
Federal Home Loan Bank Advances (Short-term Portion)	52,504	104,029	47,854
Subordinated Debentures and Term Loans	79,467	78,996	
Total Short-term Borrowings	\$369,668	\$363,285	\$148,921
Average Amount Outstanding During the Year:			
Federal Funds Purchased	\$20,072	\$6,180	\$1,125
Securities Sold Under Repurchase Agreements (Short-term Portion)	134,555	107,641	83,323
Federal Home Loan Bank Advances (Short-term Portion)	20,869	55,678	33,154
Subordinated Debentures and Term Loans	19,337	78,988	
Total Short-term Borrowings	\$194,833	\$248,487	\$117,602





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PART I: ITEM 1A. AND ITEM 1B.

ITEM 1A. RISK FACTORS

RISK FACTORS

There are a number of factors, including those specified below, that may adversely affect the Corporation's business, financial results or stock price. Additional risks that the Corporation currently does not know about or currently views as immaterial may also impair the Corporation's business or adversely impact its financial results or stock price.

INDUSTRY AND CORPORATE RISK FACTORS

The recent banking crisis, including the Enactment of EESA and American Recovery and Reinvestment Act of 2009 ("ARRA") may significantly affect the financial condition, results of operations, liquidity or stock price of the Corporation.

The capital and credit markets have been experiencing volatility and disruption for the last couple of years, reaching unprecedented levels. In some cases, the markets have produced downward pressure on stock prices and credit availability for certain issuers seemingly without regard to those issuers' underlying financial strength.

EESA, which established TARP, was signed into law in October 2008. As part of TARP, the Treasury established the Capital Purchase Program ("CPP") to provide up to \$700 billion of funding to eligible financial institutions through the purchase of capital stock and other financial instruments for the purpose of stabilizing and providing liquidity to the U.S. financial markets. Then, on February 17, 2009, President Obama signed ARRA, as a sweeping economic recovery package intended to stimulate the economy and provide for broad infrastructure, energy, health, and education needs. There can be no assurance as to the actual impact that EESA or its programs, including the CPP, and ARRA or its programs, will have on the national economy or financial markets. The failure of these significant legislative measures to help stabilize the financial markets and a continuation or worsening of current financial market conditions could materially and adversely affect the Corporation's business, financial condition, results of operations, access to credit or the trading price of common shares.

There have been numerous actions undertaken in connection with or following EESA and ARRA by the Federal Reserve Board, Congress, the Treasury, the FDIC, the SEC and others in efforts to address the current liquidity and credit crisis in the financial industry that followed the sub-prime mortgage market meltdown which began in 2007. These measures include homeowner relief that encourages loan restructuring and modification; the establishment of significant liquidity and credit facilities for financial institutions and investment banks; the lowering of the federal funds rate; emergency action against short selling practices; a temporary guaranty program for money market funds; the establishment of a commercial paper funding facility to provide back-stop liquidity to commercial paper issuers; and coordinated international efforts to address illiquidity and other weaknesses in the banking sector. The purpose of these legislative and regulatory actions is to help stabilize the U.S. banking system. EESA, ARRA and the other regulatory initiatives described above may not have their desired effects. If the volatility in the markets continues and economic conditions fail to improve or worsen, the business, financial condition and results of operations could be materially and adversely affected.

The Corporation's business and financial results are significantly affected by general business and economic conditions.

The Corporation's business activities and earnings are affected by general business conditions in the United States and abroad. These conditions include short-term and long-term interest rates, inflation, monetary supply, fluctuations in

both debt and equity capital markets, and the strength of the United States economy and the state and local economies in which the Corporation operates. For example, a prolonged economic downturn, continued increase in unemployment, or other events that affect household and/or corporate incomes could result in further deterioration of credit quality, an increase in the allowance for loan losses, or reduced demand for loan or fee-based products and services. Changes in the financial performance and condition of the Corporation's borrowers could negatively affect repayment of those borrowers' loans. In addition, changes in securities market conditions and monetary fluctuations could adversely affect the availability and terms of funding necessary to meet the Corporation's liquidity needs.

Changes in the domestic interest rate environment could reduce the Corporation's net interest income.

The operations of financial institutions, such as the Corporation, are dependent to a large degree on net interest income, which is the difference between interest income from loans and investments and interest expense on deposits and borrowings. An institution's net interest income is significantly affected by market rates of interest, which in turn are affected by prevailing economic conditions, by the fiscal and monetary policies of the federal government and by the policies of various regulatory agencies. Like all financial institutions, the Corporation's balance sheet is affected by fluctuations in interest rates. Volatility in interest rates can also result in the flow of funds away from financial institutions into direct investments. Direct investments, such as U.S. Government and corporate securities and other investment vehicles, including mutual funds, generally pay higher rates of return than financial institutions, because of the absence of federal insurance premiums and reserve requirements.

Changes in the laws, regulations and policies governing banks and financial services companies could alter the Corporation's business environment and adversely affect operations.

The Board of Governors of the Federal Reserve System regulates the supply of money and credit in the United States. Its fiscal and monetary policies determine in a large part the Corporation's cost of funds for lending and investing and the return that can be earned on those loans and investments, both of which affect the Corporation's net interest margin. Federal Reserve Board policies can also materially affect the value of financial instruments that the Corporation holds, such as debt securities. The Corporation and the Bank are heavily regulated at the federal and state levels. This regulation is to protect depositors, federal deposit insurance funds and the banking system as a whole. Congress and state legislatures and federal and state agencies continually review banking laws, regulations and policies for possible changes. Changes in statutes, regulations or policies could affect the Corporation in substantial and unpredictable ways, including limiting the types of financial services and products that the Corporation offers and/or increasing the ability of non-banks to offer competing financial services and products.

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PART I: ITEM 1A. AND ITEM 1B.

The Corporation cannot predict whether any of this potential legislation will be enacted, and if enacted, the effect that it or any regulations would have on the Corporation's financial condition or results of operations. See a description of recent legislation in the "Legislature and Regulatory Initiatives to Address Financial and Economic Crises" section of Item 1: Business of this Annual Report on Form 10-K.

• The banking and financial services industry is highly competitive, and competitive pressures could intensify and adversely affect the Corporation's financial results.

The Corporation operates in a highly competitive industry that could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. The Corporation competes with other banks, savings and loan associations, mutual savings banks, finance companies, mortgage banking companies, credit unions and investment companies. In addition, technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks. Many of the Corporation's competitors have fewer regulatory constraints and some have lower cost structures. Also, the potential need to adapt to industry changes in information technology systems, on which the Corporation and financial services industry are highly dependent, could present operational issues and require capital spending.

• Acts or threats of terrorism and political or military actions taken by the United States or other governments could adversely affect general economic or industry conditions.

Geopolitical conditions may also affect the Corporation's earnings. Acts or threats of terrorism and political or military actions taken by the United States or other governments in response to terrorism, or similar activity, could adversely affect general economic or industry conditions.

• The Corporation's allowance for loan losses may not be adequate to cover actual losses.

The Corporation maintains an allowance for loan losses to provide for loan defaults and non-performance. The allowance for loan losses represents management's estimate of probable losses inherent in the Corporation's loan portfolio. The Corporation's allowance consists of three components: probable losses estimated from individual reviews of specific loans, probable losses estimated from historical loss rates, and probable losses resulting from economic, environmental, qualitative or other deterioration above and beyond what is reflected in the first two components of the allowance. The process for determining the adequacy of the allowance for loan losses is critical to the Corporation's financial results. It requires management to make difficult, subjective and complex judgments, as a result of the need to make estimates about the effect of matters that are uncertain. Therefore, the allowance for loan losses, considering current factors at the time, including economic conditions and ongoing internal and external examination processes, will increase or decrease as deemed necessary to ensure the allowance for loan losses remains adequate. In addition, the allowance as a percentage of charge offs and nonperforming loans will change at different points in time based on credit performance, loan mix and collateral values.

In connection with recent economic developments, many financial institutions, including the Corporation, have experienced unusual and significant declines in the performance of their loan portfolios, and the values of real estate collateral supporting many loans have declined. If current trends in the housing and real estate markets continue, it is likely that loan delinquencies and credit losses may increase. Although the Corporation believes its underwriting and loan review procedures are appropriate for the various kinds of loans it makes, the Corporation's results of operations and financial condition will be adversely affected in the event the quality of its loan portfolio deteriorates.

• The Corporation may suffer losses in its loan portfolio despite its underwriting practices.

The Corporation seeks to mitigate the risks inherent in its loan portfolio by adhering to specific underwriting practices. The Corporation's strategy for credit risk management includes conservative credit policies and underwriting criteria for all loans, as well as an overall credit limit for each customer significantly below legal lending limits. The strategy also emphasizes diversification on a regional geographic, industry and customer level, regular credit quality reviews and management reviews of large credit exposures and loans experiencing deterioration of credit quality. There is a continuous review of the loan portfolio, including an internally administered loan "watch" list and an independent loan review. The evaluation takes into consideration identified credit problems, as well as the possibility of losses inherent in the loan portfolio that are not specifically identified. Although the Corporation believes that its underwriting criteria are appropriate for the various kinds of loans it makes, the Corporation may incur losses on loans due to the factors previously discussed.

The Corporation faces operational risks because the nature of the financial services business involves a high volume of transactions.

The Corporation operates in diverse markets and relies on the ability of its employees and systems to process a high number of transactions. Operational risk is the risk of loss resulting from the Corporation's operations, including, but not limited to, the risk of fraud by employees or persons outside of the Corporation, the execution of unauthorized transactions by employees, errors relating to transaction processing and technology, breaches of the internal control system and compliance requirements and business continuation and disaster recovery. 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. In the event of a breakdown in the internal control system, improper operation of systems or improper employee actions, the Corporation could suffer financial loss, face regulatory action and suffer damage to its reputation.

▲ A natural disaster could harm the Corporation's business.

Natural disasters could harm the Corporation's operations directly through interference with communications, as well as through the destruction of facilities and operational, financial and management information systems. These events could prevent the Corporation from gathering deposits, originating loans and processing and controlling its flow of business.

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PART I: ITEM 1A. AND ITEM 1B.

¶The Corporation faces systems failure risks as well as security risks, including “hacking” and “identity theft”.

The computer systems and network infrastructure the Corporation uses could be vulnerable to unforeseen problems. The Corporation’s operations are dependent upon the ability to protect computer equipment against damage from fire, power loss or telecommunication failure. Any damage or failure that causes an interruption in operations could adversely affect the business and financial results. In addition, computer systems and network infrastructure present security risks, and could be susceptible to hacking or identity theft.

¶The Corporation relies on dividends from its subsidiaries for its liquidity needs.

The Corporation is a separate and distinct legal entity from its bank and non-bank subsidiaries. The Corporation receives substantially all of its cash from dividends paid by its subsidiaries. These dividends are the principal source of funds to pay dividends on the Corporation’s stock and interest and principal on its debt. Various federal and state laws and regulations limit the amount of dividends that the bank subsidiaries may pay to the Corporation.

¶The Corporation’s reported financial results depend on management’s selection of accounting methods and certain assumptions and estimates.

The Corporation’s accounting policies and methods are fundamental to how it records and reports its financial condition and results of operations. The Corporation’s management must exercise judgment in selecting and applying many of these accounting policies and methods, so they comply with Generally Accepted Accounting Principles and reflect management’s judgment of the most appropriate manner to report the Corporation’s financial condition and results. In some cases, management must select the accounting policy or method to apply from two or more alternatives, any of which might be reasonable under the circumstances yet might result in the Corporation’s reporting materially different results than would have been reported under a different alternative. Certain accounting policies are critical to presenting the Corporation’s financial condition and results, and require management to make difficult, subjective or complex judgments about matters that are uncertain. Materially different amounts could be reported under different conditions or using different assumptions or estimates. These critical accounting policies include: the allowance for loan losses; the valuation of investment securities; the valuation of goodwill and intangible assets; and pension accounting. Because of the uncertainty of estimates involved in these matters, the Corporation may be required to do one or more of the following: significantly increase the allowance for loan losses and/or sustain loan losses that are significantly higher than the reserve provided; recognize significant provision for impairment of its investment securities; recognize significant impairment on its goodwill and intangible assets; or significantly increase its pension liability. As part of its function of assisting the Corporation’s Board of Directors in discharging its responsibility of ensuring all types of risk to the organization are properly being managed, mitigated and monitored by management, the Audit Committee of the Board of Directors oversees management’s accounting policies and methods. For more information, refer to “CRITICAL ACCOUNTING POLICIES” under Item 7 Part II of Management’s Discussion and Analysis of Financial Condition and Results of Operations of this Annual Report on Form 10-K.

- A write-down of all or part of the Corporation’s goodwill could materially reduce its net income and net worth.

At December 31, 2012, the Corporation had goodwill of \$141,375,000 recorded on its consolidated balance sheet. Under ASC 340-20, Other Assets and Deferred Costs, the Corporation is required to evaluate goodwill for impairment on an annual basis, as well as on an interim basis, if events or changes indicate that the asset may be impaired. An impairment loss must be recognized for any excess of carrying value over the fair value of goodwill. The fair value is

determined based on internal valuations using management's assumptions of future growth rates, future attrition, discount rates, multiples of earnings or other relevant factors. The resulting estimated fair value could result in material write-downs of goodwill and recording of impairment losses. Such a write-down could materially reduce the Corporation's net income and overall net worth. The Corporation also cannot predict the occurrence of certain future events that might adversely affect the fair value of goodwill. Such events include, but are not limited to, strategic decisions made in response to economic and competitive conditions, the effect of the economic environment on the Corporation's customer base, or a material negative change in its relationship with significant customers.

Changes in accounting standards could materially impact the Corporation's financial statements.

From time to time, the Financial Accounting Standards Board changes the financial accounting and reporting standards that govern the preparation of the Corporation's financial statements. These changes can be hard to predict and can materially impact how the Corporation records and reports its financial condition and results of operations. In some cases, the Corporation could be required to apply a new or revised standard retroactively; resulting in the restating of prior period financial statements.

Significant legal actions could subject the Corporation to substantial uninsured liabilities.

The Corporation is from time to time subject to claims related to its operations. These claims and legal actions, including supervisory actions by the Corporation's regulators, could involve large monetary claims and significant defense costs. To protect itself from the cost of these claims, the Corporation maintains insurance coverage in amounts and with deductibles that it believes are appropriate for its operations. However, the Corporation's insurance coverage may not cover all claims against the Corporation or continue to be available to the Corporation at a reasonable cost. As a result, the Corporation may be exposed to substantial uninsured liabilities, which could adversely affect the Corporation's results of operations and financial condition

Negative publicity could damage the Corporation's reputation and adversely impact its business and financial results.

Reputation risk, or the risk to the Corporation's earnings and capital from negative publicity, is inherent in the Corporation's business. Negative publicity can result from the Corporation's actual or alleged conduct in any number of activities, including lending practices, corporate governance and acquisitions, and actions taken by government regulators and community organizations in response to those activities. Negative publicity can adversely affect the Corporation's ability to keep and attract customers and can expose the Corporation to litigation and regulatory action. Although the Corporation takes steps to minimize reputation risk in dealing with customers and other constituencies, the Corporation is inherently exposed to this risk.

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PART I: ITEM 1A. AND ITEM 1B.

• Acquisitions may not produce revenue enhancements or cost savings at levels or within timeframes originally anticipated and may result in unforeseen integration difficulties.

The Corporation regularly explores opportunities to acquire banks, financial institutions, or other financial services businesses or assets. The Corporation cannot predict the number, size or timing of acquisitions. Difficulty in integrating an acquired business or company may cause the Corporation not to realize expected revenue increases, cost savings, increases in geographic or product presence, and/or other projected benefits from the acquisition. The integration could result in higher than expected deposit attrition (run-off), loss of key employees, disruption of the Corporation's business or the business of the acquired company, or otherwise adversely affect the Corporation's ability to maintain relationships with customers and employees or achieve the anticipated benefits of the acquisition. Also, the negative effect of any divestitures required by regulatory authorities in acquisitions or business combinations may be greater than expected.

• The Corporation may not be able to pay dividends in the future in accordance with past practice.

The Corporation has traditionally paid a quarterly dividend to common stockholders. The payment of dividends is subject to legal and regulatory restrictions. Any payment of dividends in the future will depend, in large part, on the Corporation's earnings, capital requirements, financial condition and other factors considered relevant by the Corporation's Board of Directors.

• The Corporation's stock price can be volatile.

The Corporation's stock price can fluctuate widely in response to a variety of factors, including: actual or anticipated variations in the Corporation's quarterly operating results; recommendations by securities analysts; significant acquisitions or business combinations; strategic partnerships, joint ventures or capital commitments; operating and stock price performance of other companies that investors deem comparable to the Corporation; new technology used or services offered by the Corporation's competitors; news reports relating to trends, concerns and other issues in the banking and financial services industry, and changes in government regulations. General market fluctuations, industry factors and general economic and political conditions and events, including terrorist attacks, economic slowdowns or recessions, interest rate changes, credit loss trends or currency fluctuations, could also cause the Corporation's stock price to decrease, regardless of the Corporation's operating results.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

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PART I: ITEM 2., ITEM 3. AND ITEM 4.

ITEM 2. PROPERTIES.

The headquarters of the Corporation and the Bank is located at 200 East Jackson Street, Muncie, Indiana. The building is owned by the Bank.

The Bank conducts business through numerous facilities owned and leased. Of the seventy-six banking offices operated by the Bank, fifty-four are owned and twenty-two are leased from non-affiliated third parties.

None of the properties owned by the Corporation are subject to any major encumbrances. The net investment of the Corporation and subsidiaries in real estate and equipment at December 31, 2012 was \$52,749,000.

ITEM 3. LEGAL PROCEEDINGS.

There is no pending legal proceeding, other than ordinary routine litigation incidental to the business of the Corporation or its subsidiaries, of a material nature to which the Corporation or its subsidiaries is a party or of which any of their properties are subject. Further, there is no material legal proceeding in which any director, officer, principal shareholder, or affiliate of the Corporation, or any associate of any such director, officer or principal shareholder, is a party, or has a material interest, adverse to the Corporation or any of its subsidiaries.

None of the routine legal proceedings, individually or in the aggregate, in which the Corporation or its affiliates are involved are expected to have a material adverse impact on the financial position or the results of operations of the Corporation.

ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.



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SUPPLEMENTAL INFORMATION

SUPPLEMENTAL INFORMATION - EXECUTIVE OFFICERS OF THE REGISTRANT

The names, ages, and positions with the Corporation and the Bank of all executive officers of the Corporation and all persons chosen to become executive officers are listed below. The officers are elected by the Board of Directors of the Corporation for a term of one year or until the election of their successors. There are no arrangements between any officer and any other person pursuant to which he or she was selected as an officer.

Michael C. Rechin, 54, President and Chief Executive Officer, Corporation  
Chief Executive Officer of the Corporation since April 2007; Chief Operating Officer of the Corporation from November 2005 to April 2007; Executive Vice President, Corporate Banking National City Bank from 1995 to November 2005.

Mark K. Hardwick, 42, Executive Vice President and Chief Financial Officer, Corporation  
Executive Vice President and Chief Financial Officer of the Corporation since December 2005; Senior Vice President and Chief Financial Officer of the Corporation from April 2002 to December 2005; Corporate Controller of the Corporation from November 1997 to April 2002.

Michael J. Stewart, 47, Executive Vice President and Chief Banking Officer, Corporation  
Executive Vice President and Chief Banking Officer of the Corporation since February 2008; Executive Vice President from December 2006 to February 2008 for National City Corp; Executive Vice President and Chief Credit Officer for National City Bank of Indiana from December 2002 to December 2006.

Robert R. Connors, 63, Senior Vice President, Chief Information Officer, Corporation  
Senior Vice President and Chief Information Officer of the Corporation since January 2006; Senior Vice President of Operations and Technology of the Corporation from August 2002 to January 2006.

Kimberly J. Ellington, 53, Senior Vice President and Director of Human Resources, Corporation  
Senior Vice President and Director of Human Resources of the Corporation since 2004; Vice President and Director of Human Resources of the Corporation from 1999 to 2004.

Jeffrey B. Lorentson, 49, Senior Vice President and Chief Risk Officer, Corporation  
Senior Vice President and Chief Risk Officer of the Corporation since June 2007; Corporate Controller of First Indiana Bank from June 2006 to June 2007; First Vice President and Corporate Controller of the Corporation from 2003 to 2006; Vice President and Corporate Controller of the Corporation from 2002 to 2003.

John J. Martin, 46, Senior Vice President and Chief Credit Officer, Corporation  
Senior Vice President and Chief Credit Officer of the Corporation since June 2009; First Vice President and Deputy Chief Credit Officer of the Corporation from July 2008 to June 2009; First Vice President and Senior Manager of Lending Process of the Corporation from January 2008 to July 2008; Senior Vice President and Regional Senior Credit Officer of National City Bank from May 2000 to December 2007.

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## PART II: ITEM 5. AND ITEM 6.

## PART II

## ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

## PERFORMANCE GRAPH

The following graph compares the cumulative 5-year total return to shareholders on First Merchants Corporation's common stock relative to the cumulative total returns of the Russell 2000 index and the SNL Bank \$1B - \$5B index. The graph assumes that the value of the investment in the Corporation's common stock and in each of the indexes (including reinvestment of dividends) was \$100 on December 31, 2007 and tracks it through December 31, 2012.

Index	Period Ending					
	12/31/2007	12/31/2008	12/31/2009	12/31/2010	12/31/2011	12/31/2012
First Merchants Corporation	100.00	106.04	30.07	45.08	43.31	76.47
Russell 2000	100.00	66.21	84.20	106.82	102.36	119.09
SNL Bank \$1B-\$5B	100.00	82.94	59.45	67.39	61.46	75.78

The stock price performance included in this graph is not necessarily indicative of future stock price performance.

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## PART II: ITEM 5. AND ITEM 6.

## STOCK INFORMATION

Quarter	Price Per Share				Dividends Declared <sup>(1)</sup>	
	HIGH	LOW	HIGH	LOW	2012	2011
First Quarter	2012	2011	2012	2011	2012	2011
First Quarter	\$12.41	\$9.45	\$8.48	\$7.87	\$0.01	\$0.01
Second Quarter	12.90	9.70	10.97	7.90	0.03	0.01
Third Quarter	15.78	9.40	12.29	6.70	0.03	0.01
Fourth Quarter	15.40	9.04	12.53	6.63	0.03	0.01

Numbers rounded to nearest cent when applicable.

The table above lists per share prices and dividend payments during 2012 and 2011. Prices are as reported by the National Association of Securities Dealers Automated Quotation – Global Select Market System.

## COMMON STOCK LISTING

First Merchants Corporation common stock is traded over-the-counter on the NASDAQ Global Select Market System. Quotations are carried in many daily papers. The NASDAQ symbol is FRME (Cusip #320817-10-9). At the close of business on February 28, 2013, the number of shares outstanding was 28,695,887. There were 2,945 stockholders of record on that date.

## PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASES

There were no purchases of the Corporation's common stock by or on behalf of the Corporation during the quarter ended December 31, 2012.

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(1) The “DIVIDEND LIMITATIONS” section of “BUSINESS” included as Item 1 of this Annual Report on Form 10-K, the “CAPITAL” and “LIQUIDITY” sections of “Management's Discussion & Analysis of Financial Condition and Results of Operations” included as Item 7 of this Annual Report on Form 10-K and Note 14. STOCKHOLDERS' EQUITY to the Notes to Consolidated Financial Statements included as Item 8 of this Annual Report on Form 10-K include discussions regarding dividend restrictions.

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## PART II: ITEM 5. AND ITEM 6.

## EQUITY COMPENSATION PLAN INFORMATION

The following table provides information about the Corporation's common stock that may be issued under equity compensation plans as of December 31, 2012.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercised price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensations plans (excluding securities reflected in first column)	
Equity Compensation Plans Approved by Stockholders	906,636	\$ 21.58	692,189	(1)
Equity Compensation Plans Not Approved by Stockholders <sup>(2)</sup>			398,331	
Total	906,636	\$ 21.58	1,090,520	(1)

## ITEM 6. SELECTED FINANCIAL DATA.

The selected financial data is presented within the "FIVE – YEAR SUMMARY OF SELECTED FINANCIAL DATA" on page 3 of this Annual Report on Form 10-K.

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(1) This number does not include shares remaining available for future issuance under the 2009 Long-term Equity Incentive Plan, which was approved by the Corporation's shareholders at the 2009 annual meeting. The aggregate number of shares that are available for grants under that Plan in any calendar year is equal to the sum of: (a) 1 percent of the number of common shares of the Corporation outstanding as of the last day of the preceding calendar year; plus (b) the number of shares that were available for grants, but not granted, under the Plan in any previous year; but in no event will the number of shares available for grants in any calendar year exceed 1.5 percent of the number of common shares of the Corporation outstanding as of the last day of the preceding calendar year. The 2009 Long-term Equity Incentive Plan will expire in 2019.

(2) The only plan reflected above that was not approved by the Corporation's stockholders relates to certain First Merchants Corporation Stock Option Agreements ("Agreements"). These Agreements provided for non-qualified stock options of the common stock of the Corporation, awarded between 1995 and 2002 to each director of First Merchants Bank, National Association ("First Merchants") who, on the date of the grants: (a) were serving as a director of First Merchants; (b) were not an employee of the Corporation, First Merchants, or any of the Corporation's other affiliated banks or the non-bank subsidiaries; and (c) were not serving as a director of the Corporation. The exercise price of the shares was equal to the fair market value of the shares upon the grant of the option. Options became 100 percent vested when granted and are fully exercisable six months after the date of the grant, for a period of ten years.

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PART II: ITEM 7. AND ITEM 7A. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

CRITICAL ACCOUNTING POLICIES

Generally accepted accounting principles require management to apply significant judgment to certain accounting, reporting and disclosure matters. Management must use assumptions and estimates to apply those principles where actual measurement is not possible or practical. For a complete discussion of the Corporation's significant accounting policies, see Note 1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES in the Notes to Consolidated Financial Statements included as Item 8 of this Annual Report on Form 10-K for additional detail.

RESULTS OF OPERATIONS – 2012

Net income available to stockholders was \$40.6 million, or \$1.41 per fully diluted common share, an increase of \$31.6 million compared to \$9.0 million, or \$0.34 per fully diluted common share in 2011.

On February 10, 2012, the Bank assumed substantially all the deposits and certain other liabilities and acquired certain assets of SCB Bank, from the FDIC as the receiver for SCB Bank. This transaction generated a pre-tax gain of \$9.1 million, or \$0.21 per common share after tax. Details of this transaction are included in NOTE 2. PURCHASE AND ASSUMPTION, included within the Notes to Consolidated Financial Statements included as Item 8 of this Annual Report on Form 10-K.

In 2011, an after-tax loss of \$12.3 million, or \$0.47 per share, was recorded due to the accounting treatment for the extinguishment of trust preferred securities. The extinguishment of the trust preferred securities was done in conjunction with the redemption of 69,600 shares of the Corporation's fixed rate cumulative perpetual preferred stock, under the Capital Purchase Program, for \$69.6 million, the issuance of 90,783 shares of the Corporation's senior non-cumulative perpetual preferred stock, through the Small Business Lending Fund, for \$90.8 million, and the issuance of 2,822,000 shares of the Corporation's common stock in exchange for gross proceeds of \$21.2 million. The details are discussed within Note 14. STOCKHOLDERS' EQUITY of the Notes to Consolidated Financial Statements included as Item 8 of this Annual Report on Form 10-K.

As of December 31, 2012, total assets equaled \$4.3 billion, an increase of \$131.7 million from December 31, 2011. Loans and investments, the Corporation's primary earning assets, totaled \$3.8 billion, up slightly from the prior year's total of \$3.7 billion. While investments decreased \$72.0 million, loans and loans held for sale increased \$193.2 million. The Bank acquired \$93.8 million in loans as a result of the SCB transaction. Additional details of these changes are included within the "EARNING ASSETS" section of Management's Discussion and Analysis of Financial Condition and Results of Operations included as Item 7 of this Annual Report on Form 10-K.

The Corporation's allowance for loan losses totaled \$69.4 million as of year end 2012. The allowance provides 129.9 percent coverage of all non-accrual loans and 2.37 percent of total loans. Details of the Allowance for Loan and Lease Losses and non-performing loans are discussed within the "LOAN QUALITY" and "PROVISION/ALLOWANCE FOR LOAN LOSSES" sections of Management's Discussion and Analysis of Financial Condition and Results of Operations included as Item 7 of this Annual Report on Form 10-K.

Taxes, both current and deferred, decreased in 2012 by \$5.6 million. This change is primarily driven from decreases in the deferred tax assets associated with the deductibility of the provision for loan losses and pensions and other employee benefits, the utilization of federal tax credit carryforwards, and the increase in the deferred tax liability associated with the gain on the FDIC modified whole bank transaction. Details of the change is discussed within the "INCOME TAX" section of Management's Discussion and Analysis of Financial Condition and Results of Operations included as Item 7 of this Annual Report on Form 10-K.

Deposits increased \$211.7 million from December 31, 2011. As part of the SCB transaction, the Bank assumed deposits of \$125.9 million. The Bank also completed repayment of \$79.0 million of Senior Notes (the "Notes") that matured on March 30, 2012. The Notes were originally issued by the Bank on March 31, 2009 and were guaranteed by the FDIC under its Temporary Liquidity Guarantee program. Additionally, on August 22, 2012, the Corporation exercised its option to redeem the \$4,124,000 subordinated debenture associated with the CNBC Statutory Trust I. The redemption price was 104.59. The debenture had carried a fixed interest rate of 10.2 percent. Additional details of the Corporation's borrowings are discussed in NOTE 10. BORROWINGS of the Notes to Consolidated Financial Statements included as Item 8 of this Annual Report on Form 10-K.

The Corporation was able to maintain all regulatory capital ratios in excess of the regulatory definition of "well-capitalized" as discussed in the "CAPITAL" section of Management's Discussion and Analysis of Financial Condition and Results of Operations included as Item 7 of this Annual Report on Form 10-K.



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## PART II: ITEM 7. AND ITEM 7A. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## Net Interest Income

Net interest income is the primary source of the Corporation's earnings. Net interest margin is a function of net interest income and the level of average earning assets. The following table presents the Corporation's interest income, interest expense, and net interest income as a percent of average earning assets for the three-year period ending in 2012.

(Dollars in Thousands)	2012	2011	2010	
Net Interest Income	\$152,336	\$143,355	\$143,569	
FTE Adjustment	\$5,745	\$5,759	\$5,865	
Net Interest Income on a Fully Taxable Equivalent Basis	\$158,081	\$149,114	\$149,434	
Average Earning Assets	\$3,833,174	\$3,744,027	\$3,862,493	
Interest Income (FTE) as a Percent of Average Earning Assets	4.74	% 4.99	% 5.32	%
Interest Expense as a Percent of Average Earning Assets	0.62	% 1.01	% 1.45	%
Net Interest Income (FTE) as a Percent of Average Earning Assets	4.12	% 3.98	% 3.87	%

In 2012, asset yields decreased 25 basis points on a fully taxable equivalent basis (FTE) and interest cost decreased 39 basis points, resulting in an 14 basis point increase in the interest margin compared to 2011. An increase in earning assets, primarily due to a larger loan portfolio as a result of the SCB Bank transaction, as discussed in NOTE 2 Purchase and Assumption, in the Notes to Consolidated Financial Statements included as Item 8 of this Annual Report on form 10-K, resulted in a positive volume variance of \$7,754,000 (FTE). In addition, a low interest rate environment produced a positive rate variance of \$1,227,000 (FTE), resulting in a net increase of \$8,981,000 in net interest income.

In 2011, asset yields decreased 33 basis points on a fully taxable equivalent basis (FTE) and interest cost decreased 44 basis points, resulting in an 11 basis point increase in the net interest margin compared to 2010. A decrease in earning assets, primarily due to a smaller loan portfolio and a decline in interest-bearing liabilities, produced a negative volume variance of \$2,439,000 (FTE). Furthermore, a declining interest rate environment produced a positive rate variance of \$2,225,000 (FTE), resulting in a net decrease of \$214,000 in net interest income.

Average earning assets include the average balance of securities classified as available for sale, computed based on the average of the historical amortized cost balances without the effects of the fair value adjustment. In addition, annualized amounts are computed utilizing a 30/360 day basis.

## Non-Interest Income

Non-interest income increased \$15,182,000 or 30.9 percent in 2012 compared to 2011. The largest item contributing to the increase was a gross purchase gain of \$9,124,000 recognized from the purchase of certain assets and assumption of certain liabilities of SCB Bank. Details of this transaction are included within Note 2. PURCHASE AND ASSUMPTION of the Notes to Consolidated Financial Statements included as Item 8 of this Annual Report on Form 10-K.

Additionally, significant increases were realized in gains on the sale of mortgage loans, earnings on cash surrender value of life insurance and interchange from electronic card transactions of \$3,210,000, \$822,000, and \$810,000 respectively.

### Non-Interest Expenses

Non-interest expenses increased \$1,177,000 or 0.9 percent in 2012 compared to 2011. Salaries and employee benefits increased by \$4,663,000. Base salaries were down \$81,000 while commissions and incentives were up \$2,861,000 over prior year. Employees benefits were \$1,752,000 higher in 2012 than 2011 primarily as a result of employee retirement plans and employee health insurance increases of \$909,000 and 596,000 respectively. Additionally, other expenses were \$2,050,000 higher than 2011 due primarily to expenses associated with the integration of the Shelbyville transaction.

The increases in salary and employee benefits and other expenses was offset by year over year declines in other real estate owned and credit-related expenses of \$2,436,000, FDIC expenses of \$2,022,000, and amortization of core deposit intangibles of \$1,621,000.

### Income Tax Expense

Income tax expense in 2012 was \$15,867,000 on pre-tax income of \$60,989,000, or 26.0 percent. For the same period in 2011, the income tax expense was \$8,655,000 on pre-tax income of \$33,907,000. Additional details are discussed within the "INCOME TAXES" section of the Management's Discussion and Analysis of Financial Condition and Results of Operations included as Item 7 of this Annual Report on Form 10-K.

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RESULTS OF OPERATIONS – 2011

As of December 31, 2011, total assets equaled \$4.2 billion, an increase of \$2.2 billion from December 31, 2010. Loans and investments, the Corporation's primary earning assets, totaled \$3.7 billion, consistent with the prior year's total of \$3.7 billion. While loans decreased \$126 million, investment securities increased \$120 million. Excess liquidity mainly created by the decline in the loan portfolio was used to increase the investment securities portfolio. Details of these changes are included within the "EARNING ASSETS" section of Management's Discussion and Analysis of Financial Condition and Results of Operations included as Item 7 of this Annual Report on Form 10-K.

The Allowance for Loan and Lease Losses declined by \$12.1 million during 2011, as the credit quality of the Corporation's loan portfolio improved throughout the year. Details of the Allowance for Loan and Lease Losses and non-performing loans are discussed within the "LOAN QUALITY" and "PROVISION/ALLOWANCE FOR LOAN LOSSES" sections of Management's Discussion and Analysis of Financial Condition and Results of Operations included as Item 7 of this Annual Report on Form 10-K.

In 2011, the Cash Surrender Value of Life Insurance increased by \$27.6 million. This increase is due to purchases of \$25 million in new policies in 2011 plus increases in the value of the existing policies.

Taxes, both current and deferred, decreased in 2011 by \$9.2 million. The decrease is primarily due to the receipt of \$3 million in refunds and timing differences associated with the deductibility of the provision for loan losses and the utilization of federal net operating loss carryforwards. Additionally, the deferred tax liability associated with the net unrealized gain on securities available for sale increased. Partially offsetting these changes was an increase in the deferred tax asset associated with pensions and other employee benefits. Details of the change is discussed within the "INCOME TAX" section of Management's Discussion and Analysis of Financial Condition and Results of Operations included as Item 7 of this Annual Report on Form 10-K.

The Corporation was able to maintain all regulatory capital ratios in excess of the regulatory definition of "well-capitalized" as discussed in the "CAPITAL" section of Management's Discussion and Analysis of Financial Condition and Results of Operations included as Item 7 of this Annual Report on Form 10-K.

Net income available to stockholders was \$9 million, or \$0.34 per fully diluted common share, a decrease of \$2.7 million from 2010. Income before income taxes increased by \$30.6 million, primarily due to a decrease in the Provision for Loan Losses of \$23.9 million. Additionally, losses and dividends related to preferred stock transactions totaled \$16.2 million in 2011 versus gains and dividends of \$4.8 million in 2010. The details are discussed within Note 14. STOCKHOLDERS' EQUITY of the Notes to Consolidated Financial Statements included as Item 8 of this Annual Report on Form 10-K.

The Corporation's allowance for loan losses totaled \$70.9 million as of year end 2011. The allowance provides 101.9 percent coverage of all non-accrual loans and 2.6 percent of total loans. Provision expense for the year declined from \$46.5 million in 2010 to \$22.6 million in 2011 as net charge offs also declined during the year from \$55.6 million in 2010 to \$34.7 million in 2011. Additional details are discussed within the "PROVISION/ALLOWANCE FOR LOAN LOSSES" section of Management's Discussion and Analysis of Financial Condition and Results of Operations included as Item 7 of this Annual Report on Form 10-K.

Net Interest Income

Net interest income is the primary source of the Corporation's earnings. Net interest margin is a function of net interest income and the level of average earning assets. The following table presents the Corporation's interest income, interest expense, and net interest income as a percent of average earning assets for the three-year period ending in 2011.

(Dollars in Thousands)	2011	2010	2009		
Net Interest Income	\$143,355	\$143,569	\$153,346		
FTE Adjustment	\$5,759	\$5,865	\$5,722		
Net Interest Income on a Fully Taxable Equivalent Basis	\$149,114	\$149,434	\$159,068		
Average Earning Assets	\$3,744,027	\$3,862,493	\$4,245,134		
Interest Income (FTE) as a Percent of Average Earning Assets	4.99	% 5.32	% 5.56	%	
Interest Expense as a Percent of Average Earning Assets	1.01	% 1.45	% 1.82	%	
Net Interest Income (FTE) as a Percent of Average Earning Assets	3.98	% 3.87	% 3.74	%	

In 2011, asset yields decreased 33 basis points on a fully taxable equivalent basis (FTE) and interest cost decreased 44 basis points, resulting in an 11 basis point increase in the interest margin compared to 2010. A decrease in earning assets, primarily due to a smaller loan portfolio and a decline in interest-bearing liabilities, produced a negative volume variance of \$2,439,000 (FTE). Furthermore, a declining interest rate environment produced a positive rate variance of \$2,225,000 (FTE), resulting in a net decrease of \$214,000 in net interest income.

In 2010, asset yields decreased 24 basis points (FTE) and interest cost decreased 37 basis points, resulting in a 13 basis point increase in the interest margin compared to 2009. A decrease in earning assets, primarily due to a smaller loan portfolio and a decline in interest-bearing liabilities, produced a negative volume variance of \$6,519,000 (FTE). In addition, a declining interest rate environment produced a negative rate variance of \$3,258,000 (FTE), resulting in a net decrease of \$9,777,000 in net interest income.

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PART II: ITEM 7. AND ITEM 7A. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Average earning assets include the average balance of securities classified as available for sale, computed based on the average of the historical amortized cost balances without the effects of the fair value adjustment. In addition, annualized amounts are computed utilizing a 30/360 day basis.

Non-Interest Income

Non-interest income increased \$576,000 or 1.2 percent in 2011 compared to 2010. Increases were realized in gains on the sale of mortgage loans, investment commissions, earnings on cash surrender value of life insurance and interchange from electronic card transactions were \$612,000, \$511,000, \$498,000 and \$453,000 respectively. Additionally, fee income from origination of loan level hedges increased \$523,000 from 2011 to 2010. Offsetting these increases was a decrease of \$1,311,000 in service charges on deposit accounts due to a decrease in the volume of customer overdrafts and returned items. Likewise, insurance commissions were \$565,000 lower in 2011 than 2010.

Non-Interest Expenses

Non-interest expenses decreased \$6.4 million or 4.5 percent in 2011 compared to 2010. Salaries and employee benefits increased by \$1,482,000 and represented the only material increase. Base salaries were down \$741,000 while commissions and incentives were up \$2,697,000 over prior year. The net increase in salaries was offset by year over year declines in FDIC expenses of \$2,590,000, credit related expenses of \$1,822,000 and amortization of core deposit intangibles of \$1,173,000.

Income Tax Expense

Income tax expense in 2011 was \$8,655,000 on pre-tax income of \$33,907,000, or 25.5 percent. For the same period in 2010, the income tax benefit was \$3,590,000 on pre-tax income of \$3,319,000. Additional details are discussed within the "INCOME TAXES" section of the Management's Discussion and Analysis of Financial Condition and Results of Operations included as Item 7 of this Annual Report on Form 10-K.

CAPITAL

To be categorized as well capitalized, the Bank must maintain a minimum total capital to risk-weighted assets, Tier I capital to risk-weighted assets and Tier I capital to average assets of 10 percent, 6 percent and 5 percent, respectively. The Corporation's regulatory capital exceeded the regulatory "well capitalized" standard at December 31, 2012. See additional information on the Corporation's and Bank's capital ratios in Note 15. REGULATORY CAPITAL, in the Notes to Consolidated Financial Statements included as Item 8 of this Annual Report on Form 10-K.

Tier I regulatory capital consists primarily of total stockholders' equity and subordinated debentures issued to business trusts categorized as qualifying borrowings, less non-qualifying intangible assets and unrealized net securities gains or losses. The Corporation's Tier I capital to average assets ratio was 11.03 percent and 10.17 percent at December 31, 2012 and 2011, respectively.

At December 31, 2012, the Corporation had a Tier I risk-based capital ratio of 14.15 percent and total risk-based capital ratio of 16.34 percent, compared to 13.92 percent and 16.54 percent, respectively, at December 31, 2011. Regulatory capital guidelines require a Tier I risk-based capital ratio of at least 4 percent and a total risk-based

capital ratio of at least 8 percent.

On June 30, 2010, the Corporation completed an exchange of 46,400 shares of the Corporation's Series A Preferred Stock held by the Treasury for \$46,400,000 in aggregate principal amount of trust preferred securities issued through the Corporation's wholly owned subsidiary trust, First Merchants Capital Trust III. The trust preferred securities qualified as Tier 1 capital, subject to the 25 percent aggregate limitation on Tier 1 capital for these and similar securities. After the completed exchange, the Treasury continued to hold 69,600 shares of Series A Preferred Stock along with a warrant to purchase up to 991,453 shares of the Corporation's common stock ("the Warrant"), which was also issued pursuant to the Troubled Asset Relief Program ("TARP").

On September 9, 2011, the Corporation entered into securities purchase agreements with two investors, pursuant to which the Corporation sold an aggregate of 2,822,000 shares of its common stock in exchange for gross proceeds of approximately \$21.2 million. The purchase price for each share of common stock was \$7.50. The common stock was issued in a direct private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended, and Rule 506 of Regulation D promulgated thereunder.

On September 22, 2011, the Corporation entered into a Securities Purchase Agreement with the Treasury, pursuant to which the Corporation issued 90,782.94 shares of the Corporation's Senior Non-Cumulative Perpetual Preferred Stock, Series B (the "Series B Preferred Stock"), having a liquidation amount per share equal to \$1,000, for a total purchase price of \$90,782,940. The Purchase Agreement was entered into, and the Series B Preferred Stock was issued, pursuant to the SBLF program, a \$30 billion fund established under the Small Business Jobs Act of 2010, that encourages lending to small businesses by providing capital to qualified community banks with assets of less than \$10 billion.

Also on September 22, 2011, the Corporation entered into and consummated two letter agreements with the Treasury, pursuant to which the Corporation redeemed, out of the proceeds of the issuance of the Series B Preferred Stock in the amount of \$90,782,940 and cash of \$25,813,171 (of which \$21,165,000 was raised through the private placement of the Corporation's common stock on September 9, 2011) for an aggregate redemption price of \$116,596,111, including accrued but unpaid dividends to the date of redemption: (i) the remaining 69,600 shares of the Corporation's Series A Preferred Stock, and (ii) all 46,400 Capital Securities held by the Treasury.

The Series B Preferred Stock is entitled to receive non-cumulative dividends, payable quarterly, on each January 1, April 1, July 1 and October 1, beginning October 1, 2011. The Purchase Agreement defines the dividend rate as a percentage of the liquidation amount, and can fluctuate on a quarterly basis during the first ten quarters during which the Series B Preferred Stock is outstanding, based upon changes in the level of Qualified Small Business Lending ("QSBL") by the Bank.

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The Series B Preferred Stock is non-voting, except in limited circumstances. In the event that the Corporation misses five dividend payments, whether or not consecutive, the holder of the Series B Preferred Stock will have the right, but not the obligation, to appoint a representative as an observer on the Corporation's Board of Directors. In the event that the Corporation misses six dividend payments, whether or not consecutive, and if the then outstanding aggregate liquidation amount of the Series B Preferred Stock is at least \$25,000,000, then the holder of the Series B Preferred Stock will have the right to designate two directors to the Board of Directors of the Corporation.

The Series B Preferred Stock may be redeemed at any time at the Corporation's option, at a redemption price of 100 percent of the liquidation amount plus accrued but unpaid dividends to the date of redemption for the current period, subject to the approval of its federal banking regulator. On January 3, 2013, the Corporation redeemed 22,695.94 shares of the Series B Preferred Stock. The details are discussed within Note 23. SUBSEQUENT EVENTS, to the Notes to Consolidated Financial Statements included as Item 8 of this Annual Report on Form 10-K.

On November 23, 2011, the Corporation repurchased the Warrant to purchase 991,453 shares of the Corporation's common stock at an exercise price of \$17.55 per share with an expiration date of February 20, 2019 held by the Treasury. The Corporation was the successful bidder in a private auction for the Warrant conducted by the Treasury with a winning bid of \$367,500. See Note 14. STOCKHOLDERS' EQUITY, to the Notes to Consolidated Financial Statements included as Item 8 of this Annual Report on Form 10-K for additional information.

Management believes that all of the above capital ratios are meaningful measurements for evaluating the safety and soundness of the Corporation. Additionally, management believes the following table is meaningful when considering performance measures of the Corporation. The table below details and reconciles tangible earnings per share, return on tangible capital and tangible assets to traditional GAAP measures.

(Dollars in Thousands, Except Per Share Amounts)	December 31, 2012	December 31, 2011		
Average Goodwill	\$ 141,362	\$ 141,357		
Average Core Deposit Intangible (CDI)	8,719	10,655		
Average Deferred Tax on CDI	(2,192 )	(2,458 )		
Intangible Adjustment	\$ 147,889	\$ 149,554		
Average Stockholders' Equity (GAAP capital)	\$ 535,506	\$ 478,440		
Average Cumulative Preferred Stock	(125 )	(125 )		
Average Preferred Stock Issued under the Capital Purchase Program		(49,216 )		
Average Non-Cumulative Preferred Stock Issued under the Small Business Lending Fund	(90,783 )	(24,965 )		
Intangible Adjustment	(147,889 )	(149,554 )		
Average Tangible Capital	\$ 296,709	\$ 254,580		
Average Assets	\$ 4,245,863	\$ 4,143,850		
Intangible Adjustment	(147,889 )	(149,554 )		
Average Tangible Assets	\$ 4,097,974	\$ 3,994,296		
Net Income available to Common Stockholders	\$ 40,583	\$ 9,013		
CDI amortization, net of tax	1,081	2,112		
Tangible Net Income (Loss) available to Common Stockholders	\$ 41,664	\$ 11,125		
Diluted Earnings Per Share	\$ 1.41	\$ 0.34		
Diluted Tangible Earnings Per Share	\$ 1.44	\$ 0.42		
Return on Average GAAP Capital	7.58	%	1.88	%

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Return on Average Tangible Capital	14.04	%	4.37	%
Return on Average Assets	0.96	%	0.22	%
Return on Average Tangible Assets	1.02	%	0.28	%

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PART II: ITEM 7. AND ITEM 7A. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

LOAN QUALITY

The Corporation's primary lending focus is small business and middle market commercial, residential real estate, auto and small consumer lending, which results in portfolio diversification. Commercial loans are individually underwritten and judgmentally risk rated. They are periodically monitored and prompt corrective actions are taken on deteriorating loans. Retail loans are typically underwritten with statistical decision-making tools and are managed throughout their life cycle on a portfolio basis.

At December 31, 2012, non-performing loans totaled \$66,080,000, a decrease of \$17,820,000 from December 31, 2011. Loans 90 days past due, other than non-accrual and renegotiated loans, increased by \$1,457,000 during the same period. The amount of non-accrual loans totaled \$53,999,000 at December 31, 2012. The quality and amount of non-performing loans may increase or decrease going forward due to portfolio growth, routine problem loan recognition and resolution through collections, sales or charge offs. The performance of any loan can be affected by external factors, such as economic conditions, or internal factors, such as actions of a borrower's management. The Corporation's coverage ratio of allowance for loan losses to non-accrual loans increased from 101.9 percent at December 31, 2011, to 129.9 percent at December 31, 2012. See additional information in the "PROVISION/ALLOWANCE FOR LOAN LOSSES" section of Management's Discussion and Analysis of Financial Condition and Results of Operations included as Item 7 of this Annual Report on Form 10-K.

Impaired loans include all commercial non-accrual loans and renegotiated loans as well as substandard, doubtful and loss grade loans that were still accruing but deemed impaired according to guidance set forth in ASC 310. Also included in impaired loans are accruing commercial loans that are contractually past due 90 days or more. Furthermore, at December 31, 2012, the Corporation included loans accounted for under SOP 03-3 in the impaired loan total. A loan is deemed impaired when, based on current information or events, it is probable that all amounts due of principal and interest according to the contractual terms of the loan agreement will not be collected. At December 31, 2012, commercial impaired loans totaled \$79,179,000. A specific allowance for losses was not deemed necessary for a subset of impaired loans totaling \$67,333,000, but a specific allowance of \$4,243,000 was recorded for the remaining balance of \$11,846,000 and is included in the Corporation's allowance for loan losses at December 31, 2012. The average balance of the total aforementioned impaired loans for 2012 was \$88,614,000.

In connection with economic developments during the past several years, many financial institutions have experienced deterioration in the performance of their loan portfolios. The values of real estate collateral supporting many loans declined, one result of which was increased charge offs. While the Corporation's non-performing and impaired loan totals have shown improvement, further deterioration of housing and real estate values may result in continued elevated levels of loan delinquencies and credit losses. Although the Corporation believes its underwriting and loan review procedures are appropriate for the various kinds of loans it makes, its results of operations and its financial condition could be adversely affected in the event the quality of its loan portfolio deteriorates.

In 2012, total net charge offs were \$20,066,000, a decrease of \$14,643,000 from 2011 and down \$35,571,000 from 2010. The Corporation incurred two commercial loan charge offs over \$1 million in 2012 totaling \$3,686,000, or 18.4 percent, of total net charge offs for the year. The largest charge off equaling \$1,994,000, was incurred on a commercial and industrial loan. Five large recoveries totaling \$3,146,000 were recognized during the year. Commercial and farm real estate accounted for \$8,399,000, or 41.9 percent of total net charge offs, compared to \$20,312,000 and 58.5 percent in 2011. In 2009, new home construction weakened, home values declined, and construction and land development continued to decline, all of which resulted in a deterioration in values and subsequently charge offs of loans to builders and developers. While some stabilization was evident in 2010 and 2011,

charge offs continued at a historically elevated level as the overall weak economic conditions continued to impact the loan portfolio.

The table below represents loan loss experience for the years indicated.

(Dollars in Thousands)	2012	2011	2010		
Allowance for Loan Losses:					
Balance at January 1	\$70,898	\$82,977	\$92,131		
Charge Offs	27,272	48,473	67,572		
Recoveries	7,206	13,764	11,935		
Net Charge Offs	20,066	34,709	55,637		
Provision for Loan Losses	18,534	22,630	46,483		
Balance at December 31	\$69,366	\$70,898	\$82,977		
Ratio of Net Charge Offs During the Period to Average Loans Outstanding During the Period	0.71	% 1.26	% 1.82	%	
Ratio of Allowance to Non-Accrual Loans	129.90	% 101.88	% 91.60	%	

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## PART II: ITEM 7. AND ITEM 7A. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The distribution of the net charge offs for the years indicated is provided in the following table.

(Dollars in Thousands)	December 31, 2012	December 31, 2011	December 31, 2010
Net Charge Offs:			
Commercial and industrial loans	\$6,133	\$1,043	\$15,091
Agricultural production financing and other farm loans	(42	) (45	) 991
Real estate loans			
Construction	271	6,684	4,550
Commercial and farmland	8,399	20,312	26,853
Residential	3,052	3,871	6,098
Home Equity	1,310	2,360	512
Individuals loans for household and other personal expenditures	435	499	1,488
Lease financing receivables, net of unearned income	32	(7	) 54
Other Loans	476	(8	)
Total Net Charge Offs	\$20,066	\$34,709	\$55,637

Commercial construction and land development loans were \$98,639,000 at December 31, 2012, a decrease of \$16,859,000 from December 31, 2011. Construction and land development loans represent 3.4 percent of loans. Management continues to closely monitor this segment of the portfolio, as well as being selective with additional exposure to this industry.

At December 31, 2012, non-performing assets, which includes non-accrual loans, renegotiated loans, and other real estate owned, plus loans 90-days delinquent, totaled \$81,380,000; a decrease of \$19,389,000 from December 31, 2011 as noted in the table below. Renegotiated loans decreased \$1,627,000 but the focus on commercial and consumer loan workouts continued during 2012. Other real estate owned decreased \$3,026,000 from December 31, 2011. Current appraisals are obtained to determine value as management continues to aggressively market these real estate assets.

The following table summarizes the non-accrual loans, renegotiated loans, other real estate owned, loans contractually past due 90 days or more other than non-accruing loans, and impaired loans for the Corporation.

(Dollars in Thousands)	December 31, 2012	December 31, 2011
Non-Performing Assets:		
Non-accrual loans	\$53,399	\$69,592
Renegotiated loans	12,681	14,308
Non-performing loans (NPL)	66,080	83,900
Other real estate owned	13,263	16,289
Non-performing assets (NPA)	79,343	100,189
90+ days delinquent and still accruing	2,037	580
NPAs & 90+ days delinquent	\$81,380	\$100,769
Impaired Loans (includes substandard, doubtful and loss)	\$79,179	\$79,775

The composition of the non-performing assets and 90-day delinquent loans is detailed in the following table.

(Dollars in Thousands)	December 31, 2012	December 31, 2011
Non Performing Assets and 90+ Days Delinquent:		
Commercial and industrial loans	\$13,690	\$13,725
Agricultural production financing and other loans to farmers		
Real estate loans		
Construction	12,378	17,784
Commercial and farm land	34,999	46,985
Residential	16,620	18,398
Home Equity	3,198	3,142
Lease Financing	301	
Individual's loans for household and other personal expenditures	190	162
Other loans	4	573
Non performing assets plus 90+ days delinquent	\$81,380	\$100,769

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PROVISION/ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is maintained through the provision for loan losses, which is a charge against earnings. The provision for loan losses in 2012, 2011 and 2010 were \$18,534,000, \$22,630,000 and \$46,483,000, respectively, showing a significant decline in each year.

The amount actually provided for loan losses in any period may be greater than or less than net loan losses, based on management's judgment as to the appropriate level of the allowance for loan losses. The determination of the provision in any period is based on management's continuing review and evaluation of the loan portfolio, and its judgment as to the impact of current economic conditions on the portfolio.

The amount provided for loan losses and the determination of the adequacy of the allowance are based on a continuous review of the loan portfolio, including an internally administered loan "watch" list and an independent loan review. The evaluation takes into consideration identified credit problems, as well as the possibility of losses inherent in the loan portfolio that are not specifically identified. See the "CRITICAL ACCOUNTING POLICIES" section of Management's Discussion and Analysis of Financial Condition and Results of Operations included as Item 7 of this Annual Report on Form 10-K.

Management believes that the allowance for loan losses is adequate to cover probable incurred losses inherent in the loan portfolio at December 31, 2012. The process for determining the adequacy of the allowance for loan losses is critical to the Corporation's financial results. It requires management to make difficult, subjective and complex judgments, as estimates about the effect of uncertain matters are needed. The allowance for loan losses considers current factors, including economic conditions and ongoing internal and external examination processes and will increase or decrease as deemed necessary to ensure the allowance for loan losses remains adequate. In addition, the allowance as a percentage of charge offs and nonperforming loans will change at different points in time based on credit performance, loan mix and collateral values.

At December 31, 2012, the allowance for loan losses was \$69,366,000 a decrease of \$1,532,000 from year-end 2011. As a percent of loans, the allowance decreased to 2.4 percent at December 31, 2012 from 2.6 percent at December 31, 2011. During 2012, the allowance decreased by \$3,695,000 in specific reserves against impaired loans and by \$2,163,000 in the ASC 450, Contingencies, allocation for loans not deemed impaired.

The allowance as a percent of loans decreased from year end 2011 despite the year over year increase in loans, reflecting the impact of the stabilizing economic environment on the Corporation's loan portfolio, resulting in fewer charge offs and lower specific reserves. Loans are generally secured by specific items of collateral, including real property and business assets. Allowable methods for determining the amount of impairment include estimating fair value using the fair value of the collateral for collateral dependent loans. If the impaired loan is identified as collateral dependent, then the fair value method of measuring the amount of impairment is utilized. This method requires obtaining a current independent appraisal of the collateral and applying a discount factor to the value. The fair value of real estate is generally determined based on appraisals by qualified licensed appraisers. The appraisers typically determine the value of the real estate by utilizing an income or market valuation approach. Updated "as is" or "liquidation value" appraisals are obtained as individual circumstances and or market conditions warrant. Partially charged off loans measured for impairment based on their collateral value are generally not returned to performing status subsequent to receiving updated appraisals or restructure of the loan. If an appraisal is not available, the fair value may be determined by using a cash flow analysis. Fair value on other collateral such as business assets is typically ascertained by assessing, either singularly or some combination of, asset appraisals, accounts receivable aging reports, inventory

listings and or customer financial statements. Both appraised values and values based on borrower's financial information are discounted as considered appropriate based on age and quality of the information and current market conditions.

Loans deemed impaired according to guidance set forth in ASC 310 are evaluated during problem loan meetings held within each reporting period by a special assets management team. Loan collateral and customer financial information are reviewed and the level of impairment is assessed to determine appropriate and accurate reserve and or charge off amounts. Loans or portions of loans are charged off when they are considered uncollectible and of such little value that their continuance as an asset is not warranted. It is the Corporation's policy to recognize losses promptly to prevent overstatement of assets, earnings and capital.

The following table summarizes loan loss reserves by loan segment for the periods ended December 31, 2012 and December 31, 2011.

		December 31, 2012					
(Dollars in Thousands)	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total	
Allowance Balances:							
Individually evaluated for impairment	\$1,628	\$2,565		\$50		\$4,243	
Collectively evaluated for impairment	24,285	24,138	\$2,593	14,107		65,123	
Total Allowance for Loan Losses	\$25,913	\$26,703	\$2,593	\$14,157		\$69,366	
		December 31, 2011					
(Dollars in Thousands)	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total	
Allowance Balances:							
Individually evaluated for impairment	\$4,701	\$2,504		\$733		\$7,938	
Collectively evaluated for impairment	13,030	35,415	\$2,902	11,610	\$3	62,960	
Total Allowance for Loan Losses	\$17,731	\$37,919	\$2,902	\$12,343	\$3	\$70,898	

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PART II: ITEM 7. AND ITEM 7A. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The historical loss allocation for loans not deemed impaired according to ASC 310 is the product of the volume of loans within the non-impaired criticized and non-criticized risk grade classifications, each segmented by call code, and the historical loss factor for each respective classification and call code segment. The historical loss factors are based upon actual loss experience within each risk and call code classification. The historical look back period for non-criticized loans is the most recent rolling-four-quarter average and aligns with the look back period for non-impaired criticized loans. Each of the rolling-four-quarter periods used to obtain the average, includes all charge offs for the previous twelve-month period; therefore, the historical look back period goes back seven quarters. The resulting allocation is more reflective of current conditions. Criticized loans are grouped based on the risk grade assigned to the loan. Loans with a special mention grade are assigned a loss factor and loans with a classified grade, but not impaired, are assigned a separate loss factor. The loss factor computation for this allocation includes a segmented historical loss migration analysis of non-impaired loans, by risk grade, to charge off. Given the credit improvement in the loan portfolio during 2012 and the resulting decreases in both non-impaired criticized loans and net charge offs, the historical loss component adjusted downward in 2012.

In addition to the specific reserves and historical loss components of the allowance, consideration is given to various environmental factors to help ensure that losses inherent in the portfolio are reflected in the allowance for loan losses. The environmental component adjusts the historical loss allocations for commercial and consumer loans to reflect relevant current conditions that, in management's opinion, have an impact on loss recognition. Environmental factors that management reviews in the analysis include: National and local economic trends and conditions; trends in growth in the loan portfolio and growth in higher risk areas; levels of, and trends in, delinquencies and non-accruals; experience and depth of lending management and staff; adequacy of, and adherence to, lending policies and procedures including those for underwriting; industry concentrations of credit; and adequacy of risk identification systems and controls through the internal loan review and internal audit processes. Each environmental factor receives an individual qualitative allocation that, in management's opinion, reflects losses inherent in the portfolio that are not reflected in the historical loss components of the allowance. As the economic environment has seen improvement during the period, management believes losses inherent in the portfolio may not be immediately apparent for specific identification thus the environmental allocations increased to ensure the adequacy of the allowance. At December 31, 2012, the allocation related to environmental considerations totaled \$42,461,000, an increase of \$11,328,000 from December 31, 2011.

The Corporation's primary market areas for lending are central Indiana and Butler and Franklin counties in Ohio. When evaluating the adequacy of the allowance, consideration is given to this regional geographic concentration and the closely associated effect changing economic conditions have on the Corporation's customers. In management's opinion, the allowance for loan losses at December 31, 2012 is reflective of both the banking environment within the Corporation's footprint and the Corporation's recent loan and loss trends.

GOODWILL

During the deteriorating economic conditions in the last few years, the financial markets have continued to reflect lower valuations for the stocks of financial institutions, when compared to historic valuation metrics, largely driven by both the constriction in available credit and the losses suffered. Additionally, many bank stocks with geographic exposure in certain markets, including Indiana and Ohio, have been depressed. The Corporation's stock activity, as well as the price, has been adversely impacted by the economic conditions affecting the banking industry since 2009. Management has concluded that the 2012 trading value of the stock price is not indicative or reflective of fair value (per ASC 820, Fair Value Measurements and Disclosures) as the Corporation's minimal free float driven by large index fund positions, coupled with meaningful long-term retail holdings, has created unusual volatility in the

stock price given modest fundamental changes in demand and appears to be impacting the price as well.

The two-step goodwill impairment test is used to identify potential goodwill impairment and measure the amount of impairment loss to be recognized, if any. The first step compares the fair value of a reporting unit with its carrying value. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired and the second step of the test is not necessary. If the carrying amount of a reporting unit exceeds its fair value, the second step is performed to measure impairment loss, if any. Under the second step, the fair value is allocated to all of the assets and liabilities of the reporting unit to determine an implied goodwill value. This allocation is similar to a purchase price allocation performed in purchase accounting. If the implied goodwill value of a reporting unit is less than the carrying amount of that goodwill, an impairment loss is recognized in an amount equal to that excess.

The Corporation used an independent, outside firm to help determine the fair value of the Corporation, as of October 1, 2012, for purposes of the first step of the impairment test. The Discounted Earnings method (an “Income Approach”) as well as the Guideline Publicly Traded Company Method and the Transaction Method (both Market Approaches that apply market multiples to various financial metrics to derive value) were used and weighted to form the conclusion of fair value. The Discounted Earnings method was given primary weight in the fair value analysis.

The Discounted Earnings method was based primarily on: 1) management projections derived from expected balance sheet and income statement assumptions, based on current economic conditions, which show signs of improvements; 2) present value factors based on an implied market cost of equity, and; 3) historic (long-term) price-to-earnings multiples for comparable companies. Determining the Corporation’s fair value using the Discounted Earnings method involves a significant amount of judgment. The methodology is largely based on unobservable level three inputs. The test results are dependent upon attaining actual financial results consistent with the forecasts and assumptions used in the valuation model. The Discounted Earnings method relied on a terminal Price/Earnings (“P/E”) multiple. The P/E multiple used to determine terminal value was notably lower than the historic P/E multiple observed for the Corporation, the peer group, and the NASDAQ community banking index (“ABAQ”). Based on the results of the step one analysis, the fair value exceeded the Corporation’s carrying value; therefore, it was concluded goodwill is not impaired.

Additionally, a sensitivity analysis was performed on the Discounted Earnings methodology by testing a range of the following metrics: 1) implied market cost of equity; and 2) historic (long-term) price-to-earnings multiples for comparable companies. Based on the sensitivity testing, at the low-end of the sensitivity test range (for both metrics), fair value of the Corporation exceeded its carrying value. For reasons that include but are not limited to the aforementioned, management believes the Corporation’s recently traded stock price is not indicative of fair value.



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PART II: ITEM 7. AND ITEM 7A. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

LIQUIDITY

Liquidity management is the process by which the Corporation ensures that adequate liquid funds are available for the holding company and its subsidiaries. These funds are necessary in order to meet financial commitments on a timely basis. These commitments include withdrawals by depositors, funding credit obligations to borrowers, paying dividends to stockholders, paying operating expenses, funding capital expenditures, and maintaining deposit reserve requirements. Liquidity is monitored and closely managed by the asset/liability committee.

The Corporation's liquidity is dependent upon the receipt of dividends from the Bank, which are subject to certain regulatory limitations and access to other funding sources. Liquidity of the Bank is derived primarily from core deposit growth, principal payments received on loans, the sale and maturity of investment securities, net cash provided by operating activities, and access to other funding sources.

The most stable source of liability-funded liquidity for both the long-term and short-term is deposit growth and retention in the core deposit base. In addition, Federal Home Loan Bank ("FHLB") advances are utilized as a funding source. At December 31, 2012, total borrowings from the FHLB were \$94,238,000. The Bank has pledged certain mortgage loans and investments to the FHLB. The total available remaining borrowing capacity from the FHLB at December 31, 2012 was \$217,275,000.

On March 30, 2012, the Bank completed repayment of \$79,000,000 of Senior Notes (the "Notes") that had matured. The Notes, which were originally issued by the Bank on March 31, 2009, were guaranteed by the FDIC under its Temporary Liquidity Guarantee Program ("TLGP").

On August 22, 2012, the Corporation exercised its option to redeem the \$4,124,000 subordinated debenture associated with the CNBC Statutory Trust I. The redemption price premium was 104.59. The debenture carried a fixed interest rate of 10.2 percent.

For further discussion, see Note 10. BORROWINGS, in the Notes to Consolidated Financial Statements included as Item 8 of this Annual Report on Form 10-K.

The principal source of asset-funded liquidity is investment securities classified as available for sale, the market values of which totaled \$513,343,000 at December 31, 2012, a decrease of \$5,148,000, or 1.0 percent, from December 31, 2011. Securities classified as held to maturity that are maturing within a short period of time can also be a source of liquidity. Securities classified as held to maturity and that are maturing in one year or less totaled \$2,590,000 at December 31, 2012. In addition, other types of assets such as cash and due from banks, federal funds sold and securities purchased under agreements to resell, and loans and interest-bearing deposits with other banks maturing within one year are sources of liquidity.

The Corporation currently has a \$55 million credit facility with Bank of America, N.A. comprised of (a) a term loan in the principal amount of \$5 million (the "Term Loan") and (b) a subordinated debenture in the principal amount of \$50 million (the "Subordinated Debt"). Pursuant to the terms of the underlying Loan Agreement (the "Loan Agreement"), the Term Loan and the Subordinated Debt each mature on February 15, 2015. The Term Loan is secured by a pledge of all of the issued and outstanding shares of the Bank.

The Loan Agreement contains certain customary representations and warranties and financial and negative covenants. A breach of any of these covenants could result in a default under the Loan Agreement. At December 31,

2012, the Corporation was in compliance with these financial covenants.

The Loan Agreement provides that upon an event of default as the result of the Corporation's failure to comply with a financial covenant, Bank of America may (a) declare the \$5 million outstanding principal amount of the Term Loan immediately due and payable, (b) exercise all of its rights and remedies at law, in equity and/or pursuant to any or all collateral documents, including foreclosing on the collateral if payment of the Term Loan is not made in full, and (c) add a default rate of 3 percent per annum to the Term Loan. Because the Subordinated Debt is treated as Tier 2 capital for regulatory capital purposes, the Loan Agreement does not provide Bank of America with any right of acceleration or other remedies with regard to the Subordinated Debt upon an event of default caused by the Corporation's breach of a financial covenant. As of December 31, 2011, the Corporation failed to meet the minimum return on average total assets covenant of at least 0.75 percent. Bank of America chose to apply the default rate through March 31, 2012, but not to accelerate the Term Loan based on the Corporation's failure to meet these financial covenants. As of March 31, 2012, the Corporation was no longer in default due to breach of a financial covenant; therefore, the default rate of 3 percent per annum was no longer applied to the Term Loan.

In the normal course of business, the Bank is a party to a number of other off-balance sheet activities that contain credit, market and operational risk that are not reflected in whole or in part in the consolidated financial statements. Such activities include: traditional off-balance sheet credit-related financial instruments, commitments under operating leases and long-term debt.

The Bank provides customers with off-balance sheet credit support through loan commitments and standby letters of credit. Summarized credit-related financial instruments at December 31, 2012 are as follows:

(Dollars in Thousands)	December 31, 2012
Amounts of Commitments:	
Loan Commitments to Extend Credit	\$873,455
Standby Letters of Credit	21,734
	\$895,189

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Since many of the commitments are expected to expire unused or be only partially used, the total amount of unused commitments in the preceding table does not necessarily represent future cash requirements.

In addition to owned banking facilities, the Corporation has entered into a number of long-term leasing arrangements to support ongoing activities. The required payments under such commitments and borrowings at December 31, 2012 are as follows:

(Dollars in Thousands)	2013	2014	2015	2016	2017	2018 and after	Total
Operating Leases	\$2,284	\$2,025	\$1,852	\$1,441	\$865	\$1,428	\$9,895
Federal Funds Purchased	18,862						18,862
Securities Sold Under Repurchase Agreements	131,828	10,000					141,828
Federal Home Loan Bank Advances	1,619	26,506	30,986	28,933	2,731	3,463	94,238
Subordinated Debentures and Term Loans	459		55,000			56,702	112,161
Total	\$155,052	\$38,531	\$87,838	\$30,374	\$3,596	\$61,593	\$376,984

## INTEREST SENSITIVITY AND DISCLOSURES ABOUT MARKET RISK

Asset/Liability Management has been an important factor in the Corporation's ability to record consistent earnings growth through periods of interest rate volatility and product deregulation. Management and the Board of Directors monitor the Corporation's liquidity and interest sensitivity positions at regular meetings to review how changes in interest rates may affect earnings. Decisions regarding investment and the pricing of loan and deposit products are made after analysis of reports designed to measure liquidity, rate sensitivity, the Corporation's exposure to changes in net interest income given various rate scenarios and the economic and competitive environments.

It is the objective of the Corporation to monitor and manage risk exposure to net interest income caused by changes in interest rates. It is the goal of the Corporation's Asset/Liability function to provide optimum and stable net interest income. To accomplish this, management uses two asset liability tools. GAP/Interest Rate Sensitivity Reports and Net Interest Income Simulation Modeling are constructed, presented and monitored quarterly. Management believes that the Corporation's liquidity and interest sensitivity position at December 31, 2012, remained adequate to meet the Corporation's primary goal of achieving optimum interest margins while avoiding undue interest rate risk. The following table presents the Corporation's interest rate sensitivity analysis as of December 31, 2012.

(Dollars in Thousands)	December 31, 2012				Total
	1-180 Days	181-365 Days	1-5 Years	Beyond 5 Years	
Rate-Sensitive Assets:					
Interest-bearing Deposits	\$38,443				\$38,443
Investment Securities	84,259	\$67,597	\$326,387	\$396,120	874,363
Loans	1,737,624	326,405	679,648	111,466	2,855,143
Federal Reserve and Federal Home Loan Bank Stock			32,785		32,785
Total Rate-sensitive Assets	\$1,860,326	\$394,002	\$1,038,820	\$507,586	\$3,800,734
Rate-Sensitive Liabilities:					

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Interest-bearing Deposits	\$1,379,731	\$295,668	\$711,507	\$157,880	\$2,544,786
Federal Funds Purchased	18,862				18,862
Securities Sold Under Repurchase Agreements	131,828		10,000		141,828
Federal Home Loan Bank Advances	2,469	1,323	88,016	2,430	94,238
Subordinated Debentures and Term Loans	111,702			459	112,161
Total Rate-sensitive Liabilities	\$1,644,592	\$296,991	\$809,523	\$160,769	\$2,911,875
Interest Rate Sensitivity Gap by Period	\$215,734	\$97,011	\$229,297	\$346,817	
Cumulative Rate Sensitivity Gap	\$215,734	\$312,745	\$542,042	\$888,859	
Cumulative Rate Sensitivity Gap Ratio					
at December 31, 2012	113.1	% 116.1	% 119.7	% 130.5	%
at December 31, 2011	98.2	% 99.0	% 112.0	% 124.0	%

The Corporation had a cumulative positive gap of \$312,745,000 in the one-year horizon at December 31, 2012 or 7.26 percent of total assets.

The Corporation places its greatest credence in net interest income simulation modeling. The above GAP/Interest Rate Sensitivity Report is believed by the Corporation's management to have two major shortfalls. The GAP/Interest Rate Sensitivity Report fails to precisely gauge how often an interest rate sensitive product reprices, nor is it able to measure the magnitude of potential future rate movements.

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## PART II: ITEM 7. AND ITEM 7A. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Net interest income simulation modeling, or earnings-at-risk, measures the sensitivity of net interest income to various interest rate movements. The Corporation's asset liability process monitors simulated net interest income under three separate interest rate scenarios; base, rising and falling. Estimated net interest income for each scenario is calculated over a twelve-month horizon. The immediate and parallel changes to the base case scenario used in the model are presented below. The interest rate scenarios are used for analytical purposes and do not necessarily represent management's view of future market movements. Rather, these are intended to provide a measure of the degree of volatility interest rate movements may introduce into the earnings of the Corporation.

The base scenario is highly dependent on numerous assumptions embedded in the model, including assumptions related to future interest rates. While the base sensitivity analysis incorporates management's best estimate of interest rate and balance sheet dynamics under various market rate movements, the actual behavior and resulting earnings impact will likely differ from that projected. For certain assets, the base simulation model captures the expected prepayment behavior under changing interest rate environments. Assumptions and methodologies regarding the interest rate or balance behavior of indeterminate maturity products, such as savings, money market, NOW and demand deposits, reflect management's best estimate of expected future behavior.

The comparative rising 200 basis points and falling 100 basis points scenarios below, as of December 31, 2012, assume further interest rate changes in addition to the base simulation discussed above. These changes are immediate and parallel changes to the base case scenario. In the current rate environment, many driver rates are at or near historical lows, thus total rate movements (beginning point minus ending point) to each of the various driver rates utilized by management have the following results:

	At December 31, 2012	
	RISING (200 Basis Points)	FALLING (100 Basis Points)
Driver Rates		
Prime	200	0
Federal Funds	200	0
One-Year CMT	200	(8)
Three-Year CMT	200	(3)
Five-Year CMT	200	(10)
CD's	200	(25)
FHLB	200	(5)

Results for the base, rising 200 basis points, and falling 100 basis points interest rate scenarios are listed below based upon the Corporation's rate sensitive assets and liabilities at December 31, 2012. The net interest income shown represents cumulative net interest income over a twelve-month time horizon. Balance sheet assumptions used for the base scenario are the same for the rising and falling simulations.

	At December 31, 2012		
(Dollars in Thousands)	Base	RISING (200 Basis Points)	FALLING (100 Basis Points)
Net Interest Income	\$145,846	\$153,621	\$144,122
Variance from Base		\$7,775	\$(1,724)
Percent of Change from Base		5.33	% (1.18)

The comparative rising 200 basis points and falling 100 basis points scenarios below, as of December 31, 2011, assume further interest rate changes in addition to the base simulation discussed above. These changes are immediate and parallel changes to the base case scenario. In addition, total rate movements (beginning point minus ending point) to each of the various driver rates utilized by management in the base simulation are as follows:

	At December 31, 2011	
	RISING (200 Basis Points)	FALLING (100 Basis Points)
Driver Rates		
Prime	200	0
Federal Funds	200	0
One-Year CMT	200	(2)
Three-Year CMT	200	(6)
Five-Year CMT	200	0
CD's	200	(42)
FHLB	200	0

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## PART II: ITEM 7. AND ITEM 7A. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results for the base, rising 200 basis points, and falling 100 basis points interest rate scenarios are listed below. The net interest income shown represents cumulative net interest income over a twelve-month time horizon. Balance sheet assumptions used for the base scenario are the same for the rising and falling simulations.

(Dollars in Thousands)	At December 31, 2011		
	Base	RISING (200 Basis Points)	FALLING (100 Basis Points)
Net Interest Income	\$142,706	\$146,352	\$140,332
Variance from Base		\$3,646	\$(2,374)
Percent of Change from Base		2.55	% (1.66)

## EARNING ASSETS

The following table presents the earning asset mix as of December 31, 2012, and December 31, 2011. Earnings assets increased by \$108,300,000. Interest-bearing time deposits decreased \$14,408,000. Investments decreased by approximately \$72,037,000, while loans and loans held for sale increased by \$193,230,000. The four largest loan segments that experienced increases were commercial and industrial, commercial and farm land, construction and home equity. Decreases were experienced mainly in individual's loans and residential segments.

Effective February 10, 2012, the Bank assumed substantially all the deposits and certain other liabilities and acquired certain assets of SCB Bank, from the FDIC as the receiver of SCB Bank. The two most significant earning assets acquired were loans of \$93,800,000 and investment securities of approximately \$18,900,000. Detail of this transaction are included in NOTE 2. PURCHASE AND ASSUMPTION, included within the Notes to Consolidated Financial Statements included as Item 8 of this Annual Report on Form 10-K.

(Dollars in Thousands)	December 31, 2012	December 31, 2011
Interest-bearing Time Deposits	\$38,443	\$52,851
Investment Securities Available for Sale	513,343	518,491
Investment Securities Held to Maturity	361,020	427,909
Mortgage Loans Held for Sale	22,300	17,864
Loans	2,902,209	2,713,415
Federal Reserve and Federal Home Loan Bank Stock	32,785	31,270
	\$3,870,100	\$3,761,800

## DEPOSITS AND BORROWINGS

The table below reflects the level of deposits and borrowed funds (federal funds purchased, repurchase agreements; FHLB advances; subordinated debentures and term loans) based on year-end levels at December 31, 2012 and 2011.

(Dollars in Thousands)	December 31, 2012	December 31, 2011
------------------------	-------------------------	-------------------------

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Deposits	\$3,346,383	\$3,134,655
Federal Funds Purchased	18,862	
Securities Sold Under Repurchase Agreements	141,828	156,305
Federal Home Loan Bank Advances	94,238	138,095
Subordinated Debentures and Term Loans	112,161	194,974
	\$3,713,472	\$3,624,029

The Corporation has leveraged its capital position with FHLB advances, as well as repurchase agreements, which are pledged against acquired investment securities as collateral for the borrowings. Further discussion regarding FHLB advances is included in Management's Discussion and Analysis of Financial Condition and Results of Operations under the heading "LIQUIDITY". Additionally, the interest rate risk is included as part of the Corporation's interest simulation discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations included as Item 7 of this Annual Report on Form 10-K under the heading "INTEREST SENSITIVITY AND DISCLOSURES ABOUT MARKET RISK".



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INCOME TAXES

Income tax expense totaled \$15,867,000 for 2012 compared to \$8,655,000 for 2011. The Corporation's federal statutory income tax rate is 35 percent and its state tax rate varies from 0 to 8.5 percent depending on the state in which the subsidiary company is domiciled. The Corporation's effective tax rate is lower than the blended effective statutory federal and state rates primarily due to the Corporation's income on tax-exempt securities and loans, income generated by the subsidiaries domiciled in a state with no state or local income tax, income tax credits generated from investments in affordable housing projects, tax-exempt earnings from bank-owned life insurance contracts and reduced state taxes, resulting from the effect of state income apportionment. The reconciliation of federal statutory to actual tax expense is shown in Note 19, INCOME TAX, in the Notes to Consolidated Financial Statements included as Item 8 of this Annual Report on Form 10-K.

The Corporation's tax asset, deferred and receivable decreased from \$36,424,000 at December 31, 2011 to \$30,867,000 at December 31, 2012. In addition, the Corporation's net deferred tax asset has decreased from \$31,858,000 at December 31, 2011 to \$26,122,000 at December 31, 2012. This change is primarily driven from decreases in the deferred tax assets associated with the deductibility of the provision for loan losses and pensions and other employee benefits, the utilization of federal tax credit carryforwards, and the increase in the deferred tax liability associated with the gain on the FDIC modified whole bank transaction.

The Corporation has recorded a valuation allowance of \$13,859,000 related to deferred state taxes as it does not anticipate having future state taxable income sufficient to fully utilize the deferred state tax asset. This is primarily due to the Corporation's current tax structure as noted above.

INFLATION

Changing prices of goods, services and capital affect the financial position of every business enterprise. The level of market interest rates and the price of funds loaned or borrowed fluctuate due to changes in the rate of inflation and various other factors, including government monetary policy.

Fluctuating interest rates affect the Corporation's net interest income and loan volume. As the inflation rate increases, the purchasing power of the dollar decreases. Those holding fixed-rate monetary assets incur a loss, while those holding fixed-rate monetary liabilities enjoy a gain. The nature of a financial holding company's operations is such that there will generally be an excess of monetary assets over monetary liabilities, and, thus, a financial holding company will tend to suffer from an increase in the rate of inflation and benefit from a decrease

OTHER

The Securities and Exchange Commission maintains a website that contains reports, proxy and information statements and other information regarding registrants that file electronically with the Commission, including the Corporation, and that address is [www.sec.gov](http://www.sec.gov).

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

The quantitative and qualitative disclosures about market risk information are presented in the "INTEREST SENSITIVITY AND DISCLOSURES ABOUT MARKET RISK" section of Management's Discussion and Analysis of Financial Condition and Results of Operations included as Item 7 of this Annual Report on Form 10-K.



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PART II: ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

Report of Independent Registered Public Accounting Firm

Audit Committee, Board of Directors and Stockholders  
First Merchants Corporation  
Muncie, Indiana

We have audited the accompanying consolidated balance sheets of First Merchants Corporation (Corporation) as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2012. The Corporation's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements 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. Our audits 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. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of First Merchants Corporation as of December 31, 2012 and 2011, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2012, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), First Merchants Corporation's internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 15, 2013, expressed an unqualified opinion on the effectiveness of the Corporation's internal control over financial reporting.

BKD, LLP  
Indianapolis, Indiana  
March 15, 2013

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## CONSOLIDATED BALANCE SHEETS

	December 31, 2012	December 31, 2011
(Dollars in Thousands, Except Share Data)		
<b>ASSETS</b>		
Cash and cash equivalents	\$101,460	\$73,312
Interest-bearing time deposits	38,443	52,851
Investment securities available for sale	513,343	518,491
Investment securities held to maturity (fair value of \$378,174 and \$442,469)	361,020	427,909
Mortgage loans held for sale	22,300	17,864
Loans	2,902,209	2,713,415
Less: Allowance for loan losses	(69,366 )	(70,898 )
Net loans	2,832,843	2,642,517
Premises and equipment	52,749	51,013
Federal Reserve and Federal Home Loan Bank stock	32,785	31,270
Interest receivable	16,367	17,723
Core deposit intangibles	8,154	9,114
Goodwill	141,375	141,357
Cash surrender value of life insurance	125,397	124,329
Other real estate owned	13,263	16,289
Tax asset, deferred and receivable	30,867	36,424
Other assets	14,455	12,613
<b>TOTAL ASSETS</b>	<b>\$4,304,821</b>	<b>\$4,173,076</b>
<b>LIABILITIES</b>		
Deposits:		
Noninterest-bearing	\$801,597	\$646,508
Interest-bearing	2,544,786	2,488,147
Total Deposits	3,346,383	3,134,655
Borrowings:		
Federal funds purchased	18,862	
Securities sold under repurchase agreements	141,828	156,305
Federal Home Loan Bank advances	94,238	138,095
Subordinated debentures and term loans	112,161	194,974
Total Borrowings	367,089	489,374
Interest payable	1,841	2,925
Other liabilities	37,272	31,655
Total Liabilities	3,752,585	3,658,609
<b>COMMITMENTS AND CONTINGENT LIABILITIES</b>		
<b>STOCKHOLDERS' EQUITY</b>		
Preferred Stock, no-par value, \$1,000 liquidation value:		
Authorized - 500,000 shares		
Senior Non-Cumulative Perpetual Preferred Stock, Series B		
Issued and outstanding - 90,782.94 shares	90,783	90,783
Cumulative Preferred Stock, \$1,000 par value, \$1,000 liquidation value:		
Authorized - 600 shares		

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Issued and outstanding - 125 shares	125	125
Common Stock, \$.125 stated value:		
Authorized - 50,000,000 shares		
Issued and outstanding - 28,692,616 and 28,559,707 shares	3,587	3,570
Additional paid-in capital	256,843	254,874
Retained earnings	206,397	168,717
Accumulated other comprehensive loss	(5,499 )	(3,602 )
Total Stockholders' Equity	552,236	514,467
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$4,304,821</b>	<b>\$4,173,076</b>

See notes to consolidated financial statements.

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## CONSOLIDATED STATEMENTS OF INCOME

(Dollars in Thousands, Except Share Data)	December 31, 2012	December 31, 2011	December 31, 2010
<b>INTEREST INCOME</b>			
Loans receivable:			
Taxable	\$ 146,745	\$ 149,716	\$ 174,070
Tax-exempt	480	528	515
Investment securities:			
Taxable	17,027	19,230	12,957
Tax-exempt	10,189	10,167	10,377
Federal funds sold		3	26
Deposits with financial institutions	100	282	381
Federal Reserve and Federal Home Loan Bank stock	1,408	1,319	1,252
<b>Total Interest Income</b>	<b>175,949</b>	<b>181,245</b>	<b>199,578</b>
<b>INTEREST EXPENSE</b>			
Deposits	14,800	22,281	39,876
Federal funds purchased	69	25	5
Securities sold under repurchase agreements	907	1,511	1,712
Federal Home Loan Bank advances	2,624	4,181	5,368
Subordinated debentures, revolving credit lines and term loans	5,213	9,892	9,048
<b>Total Interest Expense</b>	<b>23,613</b>	<b>37,890</b>	<b>56,009</b>
<b>NET INTEREST INCOME</b>	<b>152,336</b>	<b>143,355</b>	<b>143,569</b>
Provision for loan losses	18,534	22,630	46,483
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>133,802</b>	<b>120,725</b>	<b>97,086</b>
<b>OTHER INCOME</b>			
Service charges on deposit accounts	11,587	11,972	13,283
Fiduciary activities	7,891	7,650	7,692
Other customer fees	11,233	10,024	8,990
Commission income	6,224	5,660	6,225
Earnings on cash surrender value of life insurance	3,418	2,596	2,098
Net gains and fees on sales of loans	10,628	7,418	6,806
Net realized gains on sales of available for sale securities	2,389	2,439	3,406
Other-than-temporary impairment on available for sale securities		(2,788	) (3,049
Portion of loss recognized in other comprehensive income before taxes		2,388	1,505
Net impairment losses recognized in earnings		(400	) (1,544
Gain on FDIC modified whole bank transaction	9,124		
Other income	1,808	1,761	1,588
<b>Total Other Income</b>	<b>64,302</b>	<b>49,120</b>	<b>48,544</b>
<b>OTHER EXPENSES</b>			
Salaries and employee benefits	79,398	74,735	73,253
Net occupancy	10,186	10,118	9,935
Equipment	7,201	6,794	7,323
Marketing	2,158	2,002	1,970

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Outside data processing fees	5,656	5,671	5,093
Printing and office supplies	1,169	1,242	1,259
Core deposit amortization	1,927	3,548	4,721
FDIC assessments	3,509	5,531	8,121
Other real estate owned and credit-related expenses	8,178	10,614	12,436
Other expenses	17,733	15,683	18,200
Total Other Expenses	137,115	135,938	142,311
INCOME BEFORE INCOME TAX	60,989	33,907	3,319
Income tax expense (benefit)	15,867	8,655	(3,590 )
NET INCOME	45,122	25,252	6,909
Gain on exchange of preferred stock for trust preferred debt			11,353
Loss on CPP unamortized discount		(1,401 )	(1,301 )
Loss on extinguishment of trust preferred securities		(10,857 )	
Preferred stock dividends and discount accretion	(4,539 )	(3,981 )	(5,239 )
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS	\$40,583	\$9,013	\$11,722
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS PER SHARE:			
Basic	\$1.42	\$0.34	\$0.48
Diluted	\$1.41	\$0.34	\$0.48

See notes to consolidated financial statements.

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## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in Thousands)	December 31, 2012	December 31, 2011	December 31, 2010
Net income	\$45,122	\$25,252	\$6,909
Other comprehensive income (loss) net of tax:			
Unrealized holding gain (loss) on securities available for sale arising during the period, net of tax of \$654, \$10,658, and \$106	1,214	19,793	(197 )
Unrealized loss on securities transferred to held-to-maturity, net of tax of \$2,864		(5,315 )	
Unrealized gain (loss) on securities available for sale for which a portion of an other than temporary impairment has been recognized in income, net of tax of \$56, \$86, and \$539	(104 )	160	(1,001 )
Unrealized gain (loss) on cash flow hedges arising during the period, net of tax of \$514, \$1,146, and \$155	(952 )	(2,129 )	288
Reclassification adjustment for net gains included in net income net of tax of \$759, \$714, and \$652	(1,413 )	(1,326 )	(1,210 )
Defined Benefit Pension Plans, net of tax of \$346, \$2,492, and \$526			
Net Gain (Loss) Arising During Period	(577 )	(5,722 )	156
Prior Service Cost Arising During Period		26	583
Amortization of Prior Service Cost	(65 )	1,068	50
	(1,897 )	6,555	(1,331 )
Comprehensive income	\$43,225	\$31,807	\$5,578

The following table represents the components of accumulated other comprehensive income (loss):

(Dollars in Thousands)	December 31, 2012	December 31, 2011
Net unrealized gain on securities available for sale	\$ 17,904	\$ 18,244
Net unrealized loss on securities available for sale for which a portion of an other-than-temporary impairment has been recognized in income	(3,272 )	(3,168 )
Net unrealized loss on cash flow hedges	(2,652 )	(1,841 )
Defined benefit plans	(17,479 )	(16,837 )
	\$ (5,499 )	\$ (3,602 )

See notes to consolidated financial statements.





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## CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(Dollars in Thousands, Except Share Data)	Preferred		Common Stock			Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount	Shares	Amount					
Balances, December 31, 2009	116,125	\$112,498	21,227,741	\$2,653	\$206,600	\$150,860	\$ (8,826 )	\$463,785	
Comprehensive Income									
Net Income						6,909		6,909	
Other Comprehensive Income, net of tax							(1,331 )	(1,331 )	
Cash Dividends on Common Stock (\$.04 per Share)						(989 )		(989 )	
Cash Dividends on Preferred Stock under Capital Purchase Program						(5,366 )		(5,366 )	
Cumulative Preferred Stock Converted to Trust	(46,400 )	(46,400 )						(46,400 )	
Preferred Securities Gain on Exchange of Preferred Stock for Trust						11,353		11,353	
Preferred Debt Loss on Capital Purchase Program Unamortized Discount		1,301				(1,301 )			
Accretion of Discount on Preferred Stock		606				(606 )			
Private Stock Issuance			4,200,000	525	23,625			24,150	
Tax Benefit (Loss) from Stock Options Exercised					(50 )			(50 )	
Share-based Compensation			49,833	6	1,744			1,750	
Stock Issued Under Employee Benefit Plans			97,966	12	570			582	
Stock Issued Under Dividend Reinvestment and Stock Purchase Plan			11,545	2	89			91	
Stock Redeemed			(12,834 )	(1 )	(75 )			(76 )	
Balances, December 31, 2010	69,725	\$68,005	25,574,251	\$3,197	\$232,503	\$160,860	\$ (10,157 )	\$454,408	
Comprehensive Income									
Net Income						25,252	6,555	25,252 6,555	

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Other Comprehensive Income, net of tax				
Cash Dividends on Common Stock (\$.04 per Share)			(1,067 )	(1,067 )
Cash Dividends on Preferred Stock under Capital Purchase Program			(3,662 )	(3,662 )
Accretion of Discount on Preferred Stock	319		(319 )	
Loss on Capital Purchase Program Unamortized Discount	1,401		(1,401 )	
Repurchase of Capital Purchase Program Warrants			(368 )	(368 )
Loss on Extinguishment of Trust Preferred Securities Equity Adjustment Related to First Merchants Reinsurance Co. LTD			(10,857 )	(10,857 )
Preferred Stock Redeemed under Capital Purchase Program	(69,600 )	(69,600 )		(69,600 )
Preferred Stock issued under the Small Business Lending Fund	90,783	90,783		90,783
Private Stock Issuance		2,822,000	353	20,812