

FIRST MERCHANTS CORP
Form 10-Q
November 06, 2015

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

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

For the quarterly period ended September 30, 2015
OR
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the Transition Period from _____ to _____

Commission File Number 0-17071

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

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

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

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

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

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

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

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

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

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

As of October 30, 2015, there were 37,874,522 outstanding common shares of the registrant.

1

Table of Contents

TABLE OF CONTENTS

FIRST MERCHANTS CORPORATION

<u>Part I. Financial Information</u>		Page No.
Item 1.	<u>Financial Statements:</u>	
	<u>Consolidated Condensed Balance Sheets</u>	<u>3</u>
	<u>Consolidated Condensed Statements of Income</u>	<u>4</u>
	<u>Consolidated Condensed Statements of Comprehensive Income</u>	<u>5</u>
	<u>Consolidated Condensed Statement of Stockholders' Equity</u>	<u>6</u>
	<u>Consolidated Condensed Statements of Cash Flows</u>	<u>7</u>
	<u>Notes to Consolidated Condensed Financial Statements</u>	<u>8</u>
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>43</u>
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>55</u>
Item 4.	<u>Controls and Procedures</u>	<u>56</u>
 <u>Part II. Other Information</u>		
Item 1.	<u>Legal Proceedings</u>	<u>57</u>
Item 1A.	<u>Risk Factors</u>	<u>57</u>
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>57</u>
Item 3.	<u>Defaults Upon Senior Securities</u>	<u>57</u>
Item 4.	<u>Mine Safety Disclosures</u>	<u>57</u>
Item 5.	<u>Other Information</u>	<u>57</u>
Item 6.	<u>Exhibits</u>	<u>58</u>
	<u>Signatures</u>	<u>59</u>
	<u>Index to Exhibits</u>	<u>60</u>

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

CONSOLIDATED CONDENSED BALANCE SHEETS

	September 30, 2015 (Unaudited)	December 31, 2014
ASSETS		
Cash and cash equivalents	\$84,677	\$118,616
Interest-bearing time deposits	27,111	47,520
Investment securities available for sale	597,839	549,543
Investment securities held to maturity (fair value of \$627,848 and \$647,723)	610,954	631,088
Loans held for sale	1,943	7,235
Loans, net of allowance for loan losses of \$62,861 and \$63,964	4,258,854	3,860,901
Premises and equipment	83,457	77,691
Federal Reserve and Federal Home Loan Bank stock	34,498	41,353
Interest receivable	22,048	19,984
Core deposit intangibles	14,127	16,031
Goodwill	205,376	202,724
Cash surrender value of life insurance	171,530	169,424
Other real estate owned	14,809	19,293
Tax asset, deferred and receivable	38,339	41,960
Other assets	24,235	20,764
TOTAL ASSETS	\$6,189,797	\$5,824,127
LIABILITIES		
Deposits:		
Noninterest-bearing	\$1,110,905	\$1,070,859
Interest-bearing	3,703,684	3,569,835
Total Deposits	4,814,589	4,640,694
Borrowings:		
Federal funds purchased	52,896	15,381
Securities sold under repurchase agreements	153,822	124,539
Federal Home Loan Bank advances	237,856	145,264
Subordinated debentures and term loans	121,936	126,810
Total Borrowings	566,510	411,994
Interest payable	3,710	3,201
Other liabilities	38,004	41,411
Total Liabilities	5,422,813	5,097,300
COMMITMENTS AND CONTINGENT LIABILITIES		
STOCKHOLDERS' EQUITY		
Cumulative Preferred Stock, \$1,000 par value, \$1,000 liquidation value:		
Authorized - 600 shares		
Issued and outstanding - 125 shares	125	125
Common Stock, \$.125 stated value:		
Authorized - 50,000,000 shares		
Issued and outstanding - 37,873,921 and 37,669,948 shares	4,734	4,709
Additional paid-in capital	433,577	431,220

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Retained earnings	332,162	292,403	
Accumulated other comprehensive loss	(3,614) (1,630)
Total Stockholders' Equity	766,984	726,827	
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$6,189,797	\$5,824,127	

See notes to consolidated condensed financial statements.

3

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

CONSOLIDATED CONDENSED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
INTEREST INCOME				
Loans receivable:				
Taxable	\$46,037	\$43,981	\$134,908	\$128,329
Tax exempt	1,190	61	2,174	180
Investment securities:				
Taxable	4,374	5,046	13,522	14,902
Tax exempt	4,412	3,683	12,478	10,691
Deposits with financial institutions	25	18	93	76
Federal Reserve and Federal Home Loan Bank stock	500	501	1,509	1,648
Total Interest Income	56,538	53,290	164,684	155,826
INTEREST EXPENSE				
Deposits	3,715	2,853	10,917	8,276
Federal funds purchased	27	102	69	174
Securities sold under repurchase agreements	96	74	264	457
Federal Home Loan Bank advances	711	734	2,108	2,092
Subordinated debentures and term loans	1,666	1,661	4,996	4,950
Total Interest Expense	6,215	5,424	18,354	15,949
NET INTEREST INCOME	50,323	47,866	146,330	139,877
Provision for loan losses		1,600	417	1,600
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	50,323	46,266	145,913	138,277
OTHER INCOME				
Service charges on deposit accounts	4,445	4,119	12,083	11,768
Fiduciary activities	2,242	2,152	7,058	6,724
Other customer fees	4,156	3,991	12,425	11,773
Commission income	4	1,723	4,147	5,877
Earnings on cash surrender value of life insurance	710	1,524	2,097	2,925
Net gains and fees on sales of loans	1,905	1,458	5,175	3,340
Net realized gains on sales of available for sale securities	1,115	910	2,047	2,335
Gain on sale of insurance subsidiary			8,265	
Other income	2,322	2,535	4,467	5,283
Total Other Income	16,899	18,412	57,764	50,025
OTHER EXPENSES				
Salaries and employee benefits	25,137	24,173	76,112	72,904
Net occupancy	3,726	3,401	11,019	10,543
Equipment	2,698	2,187	8,104	7,022
Marketing	847	1,070	2,578	2,628
Outside data processing fees	1,992	1,853	5,477	5,723

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Printing and office supplies	343	350	1,010	1,201
Core deposit amortization	693	592	2,143	1,776
FDIC assessments	958	920	2,716	2,843
Other real estate owned and foreclosure expenses	1,835	2,618	4,436	6,988
Professional and other outside services	1,686	1,573	6,311	4,483
Other expenses	3,683	3,839	11,317	10,804
Total Other Expenses	43,598	42,576	131,223	126,915
INCOME BEFORE INCOME TAX	23,624	22,102	72,454	61,387
Income tax expense	6,557	5,980	21,247	16,485
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS	\$17,067	\$16,122	\$51,207	\$44,902
Per Share Data:				
Basic Net Income Available to Common Stockholders	\$0.46	\$0.45	\$1.36	\$1.25
Diluted Net Income Available to Common Stockholders	\$0.45	\$0.45	\$1.35	\$1.24
Cash Dividends Paid	\$0.11	\$0.08	\$0.30	\$0.21
Average Diluted Shares Outstanding (in thousands)	38,118	36,329	38,054	36,295

See notes to consolidated condensed financial statements.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Net income	\$17,067	\$16,122	\$51,207	\$44,902
Other comprehensive income net of tax:				
Unrealized holding gain on securities available for sale arising during the period, net of tax of \$2,439, \$152, \$63 and \$6,105	4,530	283	117	11,338
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 \$916		(1)		1,701
Unrealized gain (loss) on cash flow hedges arising during the period, net of tax of \$627, \$10, \$792 and \$885	(1,164)	18	(1,468)	(1,645)
Reclassification adjustment for losses included in net income, net of tax of \$263, \$194, \$340 and \$450	(490)	(360)	(633)	(834)
	2,876	(60)	(1,984)	10,560
Comprehensive income	\$19,943	\$16,062	\$49,223	\$55,462

See notes to consolidated condensed financial statements.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

CONSOLIDATED CONDENSED STATEMENT OF STOCKHOLDERS' EQUITY

(Unaudited)

	Preferred		Common Stock		Additional		Accumulated Other Comprehensive		Total
	Shares	Amount	Shares	Amount	Paid in Capital	Retained Earnings	Loss		
Balances, December 31, 2014	125	\$ 125	37,669,948	\$ 4,709	\$ 431,220	\$ 292,403	\$ (1,630)	\$ 726,827	
Comprehensive income									
Net income						51,207		51,207	
Other comprehensive income, net of tax							(1,984)	(1,984)	
Cash dividends on common stock (\$.30 per share)						(11,448)		(11,448)	
Share-based compensation			145,697	18	1,669			1,687	
Stock issued under employee benefit plans			17,228	2	349			351	
Stock issued under dividend reinvestment and stock purchase plan			19,647	2	485			487	
Stock options exercised			90,566	11	1,481			1,492	
Stock redeemed			(69,165)	(8)	(1,627)			(1,635)	
Balances, September 30, 2015	125	\$ 125	37,873,921	\$ 4,734	\$ 433,577	\$ 332,162	\$ (3,614)	\$ 766,984	

See notes to consolidated condensed financial statements.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the Nine Months Ended	
	September 30, 2015	September 30, 2014
Cash Flow From Operating Activities:		
Net income	\$51,207	\$44,902
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	417	1,600
Depreciation and amortization	4,707	4,505
Change in deferred taxes	19,282	17,026
Share-based compensation	1,687	1,611
Tax benefit from stock options exercised	(70	) (60
Loans originated for sale	(286,414	) (149,001
Proceeds from sales of loans	291,706	147,909
Gain on sale of insurance subsidiary	(8,265)
Gain on cancellation of subordinated debentures	(1,250)
Gains on sales of securities available for sale	(2,047	) (2,335
Change in interest receivable	(1,772	) (783
Change in interest payable	480	2,048
Other adjustments	(15,618	) (15,009
Net cash provided by operating activities	\$54,050	\$52,413
Cash Flows from Investing Activities:		
Net change in interest-bearing deposits	\$21,331	\$30,898
Purchases of:		
Securities available for sale	(166,645	) (114,563
Securities held to maturity	(55,415	) (114,821
Proceeds from sales of securities available for sale	70,114	47,722
Proceeds from maturities of:		
Securities available for sale	47,664	47,096
Securities held to maturity	69,629	51,029
Change in Federal Reserve and Federal Home Loan Bank stock	7,710	(4,137
Net change in loans	(296,602	) (159,559
Net cash and cash equivalents paid in acquisition	(12,004)
Net cash received from sale of insurance subsidiary	15,155	
Proceeds from the sale of other real estate owned	8,294	11,860
Other adjustments	1,264	7,367
Net cash used in investing activities	\$(289,505	) \$(197,108
Cash Flows from Financing Activities:		
Net change in :		
Demand and savings deposits	\$106,597	\$(47,610
Certificates of deposit and other time deposits	(38,028	) 126,265
Borrowings	414,197	386,643
Repayment of borrowings	(270,497	) (348,357
Cash dividends on common stock	(11,448	) (7,650

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Stock issued under employee benefit plans	351	376
Stock issued under dividend reinvestment and stock purchase plans	487	380
Stock options exercised	1,422	450
Tax benefit from stock options exercised	70	60
Stock redeemed	(1,635	) (1,059
Net cash provided by financing activities	\$201,516	\$109,498
Net Change in Cash and Cash Equivalents	(33,939	) (35,197
Cash and Cash Equivalents, January 1	118,616	109,434
Cash and Cash Equivalents, September 30	\$84,677	\$74,237
Additional cash flow information:		
Interest paid	\$17,845	\$13,901
Income tax paid	\$15,000	\$4,409
Loans transferred to other real estate owned	\$3,244	\$3,807
Fixed assets transferred to other real estate owned	\$1,166	\$297
Non-cash investing activities using trade date accounting	\$3,332	\$6,502

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

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

See notes to consolidated condensed financial statements.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

NOTE 1

GENERAL

Financial Statement Preparation

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

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

NOTE 2

ACQUISITIONS AND DIVESTITURES

Consummation of Merger

Ameriana Bancorp

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

regulatory approvals and other customary closing conditions, the parties anticipate completing the Ameriana Merger in the fourth quarter of 2015.

Acquisitions

C Financial Corporation

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

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

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

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

Community Bancshares, Inc.

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

Under the acquisition method of accounting, the total purchase price is allocated to net tangible and intangible assets based on their current estimated fair values on the date of the acquisition. Based on preliminary valuations of the fair value of tangible and intangible assets acquired and liabilities assumed, which are based on assumptions that are subject to change, the purchase price for the Community acquisition is detailed in the following table. Prior to the end

of the one year measurement period for finalizing the purchase price allocation, if information becomes available which would indicate adjustments are required to the purchase price allocation, such adjustments will be included in the purchase price allocation retrospectively.

	Fair Value	
Cash and cash equivalents	\$4,124	
Interest-bearing time deposits	16,526	
Investment Securities, available for sale	76,807	
Loans	145,064	
Premises and equipment	3,610	
Federal Home Loan Bank stock	1,950	
Interest receivable	767	
Cash surrender value of life insurance	3,266	
Other real estate owned	6,662	
Taxes, deferred and receivable	3,348	
Other assets	167	
Deposits	(228,424)
Interest payable	(98)
Other liabilities	(3,014)
Net tangible assets acquired	30,755	
Core deposit intangible	4,658	
Goodwill	13,776	
Purchase price	\$49,189	

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

Pro Forma Financial Information

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

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

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

Subsidiary Divestiture

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

NOTE 3

INVESTMENT SECURITIES

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at September 30, 2015				
U.S. Government-sponsored agency securities	\$100	\$5		\$105
State and municipal	289,998	11,617	\$497	301,118
U.S. Government-sponsored mortgage-backed securities	287,317	7,635	73	294,879
Corporate obligations	31			31
Equity securities	1,706			1,706
Total available for sale	579,152	19,257	570	597,839
Held to maturity at September 30, 2015				
State and municipal	218,794	5,707	166	224,335
U.S. Government-sponsored mortgage-backed securities	392,160	11,566	213	403,513
Total held to maturity	610,954	17,273	379	627,848
Total Investment Securities	\$1,190,106	\$36,530	\$949	\$1,225,687

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

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

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Maturity Distribution at September 30, 2015:				
Due in one year or less	\$3,661	\$3,715	\$5,521	\$5,533
Due after one through five years	13,265	13,854	24,076	25,086
Due after five through ten years	51,070	53,347	81,286	83,355
Due after ten years	222,133	230,338	107,911	110,361
	\$290,129	\$301,254	\$218,794	\$224,335
U.S. Government-sponsored mortgage-backed securities	287,317	294,879	392,160	403,513
Equity securities	1,706	1,706		
Total Investment Securities	\$579,152	\$597,839	\$610,954	\$627,848

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

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

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

The carrying value of securities pledged as collateral, to secure public deposits and for other purposes, was \$646,124,000 at September 30, 2015, and \$449,408,000 at December 31, 2014.

The book value of securities sold under agreements to repurchase amounted to \$149,014,000 at September 30, 2015, and \$120,027,000 at December 31, 2014.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Sales and Redemptions of Available for Sale Securities:				
Gross gains	\$1,115	\$910	\$2,147	\$2,335
Gross losses			100	
Other-than-temporary impairment losses				

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

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Temporarily Impaired Available for Sale Securities at September 30, 2015						
State and municipal	\$36,702	\$ 497			\$36,702	\$ 497
U.S. Government-sponsored mortgage-backed securities	6,482	8	\$2,125	\$ 65	8,607	73
Total Temporarily Impaired Available for Sale Securities	43,184	505	2,125	65	45,309	570
Temporarily Impaired Held to Maturity Securities at September 30, 2015						
State and municipal	13,711	144	1,716	22	15,427	166
U.S. Government-sponsored mortgage-backed securities	20,752	40	13,491	173	34,243	213
Total Temporarily Impaired Held to Maturity Securities	34,463	184	15,207	195	49,670	379
Total Temporarily Impaired Investment Securities	\$77,647	\$ 689	\$17,332	\$ 260	\$94,979	\$ 949
	Less than 12 Months		12 Months or Longer		Total	

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

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

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

	September 30, 2015	December 31, 2014	
Investments reported at less than historical cost:			
Historical cost	\$ 95,928	\$ 73,249	
Fair value	\$ 94,979	\$ 72,390	
Percent of the Corporation's available for sale and held to maturity portfolio	7.9	% 6.1	%

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

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

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

State and Municipal

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

U.S. Government-Sponsored Mortgage-Backed Securities

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

Credit Losses Recognized on Investments

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

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

Credit losses on debt securities held:

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

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

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

NOTE 4

LOANS AND ALLOWANCE

The Corporation's primary lending focus is small business and middle market commercial, commercial real estate, residential real estate and consumer lending, which results in portfolio diversification. The following tables show the composition of the loan portfolio, the allowance for loan losses and certain credit quality elements, all excluding loans held for sale. Loans held for sale as of September 30, 2015, and December 31, 2014, were \$1,943,000 and \$7,235,000, respectively.

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

	September 30, 2015	December 31, 2014
Commercial and industrial loans	\$999,195	\$896,688
Agricultural production financing and other loans to farmers	91,354	104,927
Real estate loans:		
Construction	298,250	207,221
Commercial and farmland	1,695,703	1,672,661
Residential	677,767	647,315
Home Equity	318,949	286,529
Individuals' loans for household and other personal expenditures	71,893	73,400
Lease financing receivables, net of unearned income	614	1,106
Other commercial loans	167,990	35,018
Loans	\$4,321,715	\$3,924,865
Allowance for loan losses	(62,861)	(63,964)
Net Loans	\$4,258,854	\$3,860,901

At September 30, 2015, Other commercial loans totaled \$167,990,000, an increase of \$132,972,000 from December 31, 2014. This increase was primarily a result of organic growth in the obligations of the state and political subdivisions sector of the portfolio.

Allowance, Credit Quality and Loan Portfolio

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

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

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

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

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

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

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

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

	Three Months Ended September 30, 2015					Total
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	
Allowance for loan losses:						
Balances, July 1	\$31,479	\$15,828	\$2,927	\$12,311	\$5	\$62,550
Provision for losses	3,202	(2,966)	(102)	(132)	(2))
Recoveries on loans	281	1,510	67	513		2,371
Loans charged off	(1,026)	(386)	(169)	(479)	)	(2,060)
Balances, September 30, 2015	\$33,936	\$13,986	\$2,723	\$12,213	\$3	\$62,861

	Nine Months Ended September 30, 2015					Total
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	
Allowance for loan losses:						
Balances, January 1	\$28,824	\$19,327	\$2,658	\$13,152	\$3	\$63,964

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Provision for losses	6,226	(6,364	) 225	330		417
Recoveries on loans	1,168	2,069	246	1,392		4,875
Loans charged off	(2,282	) (1,046	) (406	) (2,661	)	(6,395
Balances, September 30, 2015	\$33,936	\$13,986	\$2,723	\$12,213	\$3	\$62,861

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

	Three Months Ended September 30, 2014					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance for loan losses:						
Balances, July 1	\$28,614	\$22,582	\$2,243	\$14,928		\$68,367
Provision for losses	1,385	528	113	(424)	\$(2)	1,600
Recoveries on loans	1,987	1,215	86	431	3	3,722
Loans charged off	(4,444)	(2,707)	(214)	(728)		(8,093)
Balances, September 30, 2014	\$27,542	\$21,618	\$2,228	\$14,207	\$1	\$65,596

	Nine Months Ended September 30, 2014					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance for loan losses:						
Balances, January 1	\$27,176	\$23,102	\$2,515	\$15,077		\$67,870
Provision for losses	1,736	(177)	(39)	100	\$(20)	1,600
Recoveries on loans	4,485	2,356	303	1,360	23	8,527
Loans charged off	(5,855)	(3,663)	(551)	(2,330)	(2)	(12,401)
Balances, September 30, 2014	\$27,542	\$21,618	\$2,228	\$14,207	\$1	\$65,596

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

	September 30, 2015					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance Balances:						
Individually evaluated for impairment	\$1,268	\$304		\$73		\$1,645
Collectively evaluated for impairment	32,668	13,480	\$2,723	12,031	\$3	60,905
Loans Acquired with Deteriorated Credit Quality		202		109		311
Total Allowance for Loan Losses	\$33,936	\$13,986	\$2,723	\$12,213	\$3	\$62,861
Loan Balances:						
Individually evaluated for impairment	\$8,192	\$19,466		\$4,867		\$32,525
Collectively evaluated for impairment	1,243,032	1,924,902	\$71,893	986,759	\$614	4,227,200
Loans Acquired with Deteriorated Credit Quality	7,315	49,585		5,090		61,990
Loans	\$1,258,539	\$1,993,953	\$71,893	\$996,716	\$614	\$4,321,715

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

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

Commercial

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

Commercial real estate

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

Residential and Consumer

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

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

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

	September 30, 2015	December 31, 2014
Commercial and industrial loans	\$4,460	\$7,048
Agriculture production financing and other loans to farmers	1,210	5,800
Real estate Loans:		
Construction	745	1,439
Commercial and farmland	13,506	19,350
Residential	10,749	12,933
Home Equity	1,783	1,988
Individuals' loans for household and other personal expenditures	144	231
Total	\$32,597	\$48,789

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

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

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

	September 30, 2015		
	Unpaid Principal Balance	Recorded Investment	Related Allowance
Impaired loans with no related allowance:			
Commercial and industrial loans	\$22,117	\$11,580	
Agriculture production financing and other loans to farmers	669	663	
Real estate Loans:			
Construction	5,559	2,708	
Commercial and farmland	85,001	63,620	
Residential	12,737	8,795	
Home equity	250	194	
Other commercial loans	23		
Total	\$126,356	\$87,560	
Impaired loans with related allowance:			
Commercial and industrial loans	\$3,058	\$2,716	\$1,234
Agriculture production financing and other loans to farmers	547	547	34
Real estate Loans:			
Commercial and farmland	2,707	2,441	506
Residential	721	622	182
Total	\$7,033	\$6,326	\$1,956
Total Impaired Loans	\$133,389	\$93,886	\$1,956
	December 31, 2014		
	Unpaid Principal Balance	Recorded Investment	Related Allowance
Impaired loans with no related allowance:			
Commercial and industrial loans	\$35,514	\$18,029	
Agriculture production financing and other loans to farmers	26	22	
Real estate Loans:			
Construction	12,956	9,318	
Commercial and farmland	95,856	68,187	
Residential	10,591	6,839	
Home equity	3,590	398	
Other commercial loans	30		
Total	\$158,563	\$102,793	
Impaired loans with related allowance:			

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Commercial and industrial loans	\$1,766	\$1,684	\$1,055
Agriculture production financing and other loans to farmers	6,777	5,777	400
Real estate Loans:			
Commercial and farmland	7,159	4,971	1,120
Residential	1,001	998	194
Total	\$16,703	\$13,430	\$2,769
Total Impaired Loans	\$175,266	\$116,223	\$2,769

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2015	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Impaired loans with no related allowance:				
Commercial and industrial loans	\$11,863	\$137	\$12,676	\$368
Agriculture production financing and other loans to farmers	675		699	
Real estate Loans:				
Construction	2,855	41	3,407	123
Commercial and farmland	64,186	932	65,310	2,661
Residential	9,028	47	9,272	177
Home equity	194		197	
Total	\$88,801	\$1,157	\$91,561	\$3,329
Impaired loans with related allowance:				
Commercial and industrial loans	\$2,731	\$10	\$2,774	\$29
Agriculture production financing and other loans to farmers	547		547	
Real estate Loans:				
Commercial and farmland	2,459		2,613	
Residential	625		626	
Total	\$6,362	\$10	\$6,560	\$29
Total Impaired Loans	\$95,163	\$1,167	\$98,121	\$3,358

	Three Months Ended September 30, 2014		Nine Months Ended September 30, 2014	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Impaired loans with no related allowance:				
Commercial and industrial loans	\$13,406	\$86	\$13,820	\$263
Agriculture production financing and other loans to farmers	25		27	

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Real estate Loans:				
Construction	8,026	112	8,197	331
Commercial and farmland	61,356	895	62,367	2,663
Residential	3,018	40	3,164	93
Home equity	118		147	
Total	\$85,949	\$1,133	\$87,722	\$3,350
Impaired loans with related allowance:				
Commercial and industrial loans	\$1,814	\$10	\$1,864	\$30
Agriculture production financing and other loans to farmers	10,645		10,645	
Real estate Loans:				
Commercial and farmland	4,484		4,528	23
Residential	1,460		1,460	
Total	\$18,403	\$10	\$18,497	\$53
Total Impaired Loans	\$104,352	\$1,143	\$106,219	\$3,403

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

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

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

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

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

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

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

•

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

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

	September 30, 2015							
	Commercial Pass	Commercial Special Mention	Commercial Substandard	Commercial Doubtful	Commercial Loss	Consumer Performing	Consumer Non-Performing	Total
Commercial and industrial loans	\$927,042	\$ 30,679	\$ 41,444		\$ 30			\$999,195
Agriculture production financing and other loans to farmers	73,793	4,750	12,811					91,354
Real estate Loans:								
Construction	280,673	1,151	1,230			\$ 15,114	\$ 82	298,250
Commercial and farmland	1,588,797	40,199	66,705				2	1,695,703
Residential	168,287	2,265	11,325			490,657	5,233	677,767
Home equity	7,195	16	484			309,403	1,851	318,949
Individuals' loans for household and other personal expenditures						71,691	202	71,893
Lease financing receivables, net of unearned income	520		94					614
Other commercial loans	167,990							167,990
Loans	\$3,214,297	\$ 79,060	\$ 134,093		\$ 30	\$ 886,865	\$ 7,370	\$4,321,715

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

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

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

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

	September 30, 2015						Total Past Due & Non-Accrual	Total
	Current	30-59 Days Past Due	60-89 Days Past Due	Loans > 90 Days And Accruing	Non-Accrual			
Commercial and industrial loans	\$992,529	\$1,106	\$1,035	\$65	\$ 4,460	\$ 6,666	\$999,195	
Agriculture production financing and other loans to farmers	86,997	2,647	500		1,210	4,357	91,354	
Real estate Loans:								
Construction	296,978	504	23		745	1,272	298,250	
Commercial and farmland	1,673,750	5,935	1,426	1,086	13,506	21,953	1,695,703	
Residential	661,884	3,128	1,531	475	10,749	15,883	677,767	
Home equity	315,250	793	861	262	1,783	3,699	318,949	
Individuals' loans for household and other personal expenditures	71,375	284	31	59	144	518	71,893	
Lease financing receivables, net of unearned income	614						614	
Other commercial loans	167,990						167,990	
Loans	\$4,267,367	\$14,397	\$5,407	\$1,947	\$ 32,597	\$ 54,348	\$4,321,715	
	December 31, 2014							
	Current	30-59 Days Past Due	60-89 Days Past Due	Loans > 90 Days And Accruing	Non-Accrual	Total Past Due & Non-Accrual	Total	
Commercial and industrial loans	\$882,596	\$4,006	\$53	\$2,985	\$ 7,048	\$ 14,092	\$896,688	
Agriculture production financing and other loans to farmers	98,236	891			5,800	6,691	104,927	
Real estate Loans:								
Construction	204,683	1,017	82		1,439	2,538	207,221	
Commercial and farmland	1,642,016	9,846	778	671	19,350	30,645	1,672,661	
Residential	626,821	4,876	1,831	854	12,933	20,494	647,315	
Home equity	282,828	1,213	352	148	1,988	3,701	286,529	
Individuals' loans for household and other personal expenditures	72,853	258	53	5	231	547	73,400	
Lease financing receivables, net of unearned income	1,106						1,106	
Other commercial loans	35,018						35,018	

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

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

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

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

	Three Months Ended September 30, 2015			Nine Months Ended September 30, 2015		
	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans
Commercial and industrial loans	\$363	\$ 218	2	\$4,111	\$ 2,115	7
Real estate Loans:						
Construction				79	80	1
Commercial and farmland	744	744	1	1,281	3,025	3
Residential	11	13	1	55	908	4
Home Equity	239	242	1	239	242	1
Total	\$1,357	\$ 1,217	5	\$5,765	\$ 6,370	16

	Three Months Ended September 30, 2014			Nine Months Ended September 30, 2014		
	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans
Real estate Loans:						
Commercial and farmland				\$259	\$ 259	1
Residential	\$256	\$ 245	5	448	428	7
Home Equity	229	247	7	314	343	10
Individuals' loans for household and other personal expenditures				26	26	2
Total	\$485	\$ 492	12	\$1,047	\$ 1,056	20

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

	Three Months Ended September 30, 2015			Total Modification
	Term Modification	Rate Modification	Combination	
Commercial and industrial loans	\$138		\$75	\$213
Real estate Loans:				
Commercial and farmland			744	744
Residential		\$13		13
Home Equity		242		242

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Total	\$138	\$255	\$819	\$1,212
-------	-------	-------	-------	---------

	Nine Months Ended September 30, 2015			
	Term Modification	Rate Modification	Combination	Total Modification
Commercial and industrial loans	\$806		\$1,080	\$1,886
Real estate Loans:				
Commercial and farmland	1,337		1,004	2,341
Residential	850	\$59		909
Home Equity		242		242
Total	\$2,993	\$301	\$2,084	\$5,378

23

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

	Three Months Ended September 30, 2014			Total Modification
	Term Modification	Rate Modification	Combination	
Real estate Loans:				
Residential			\$241	\$241
Home Equity			245	245
Total			\$486	\$486

	Nine Months Ended September 30, 2014			Total Modification
	Term Modification	Rate Modification	Combination	
Real estate Loans:				
Commercial and farmland	\$283			\$283
Residential		\$60	\$361	421
Home Equity		95	245	340
Individuals' loans for household and other personal expenditures			24	24
Total	\$283	\$155	\$630	\$1,068

Loans secured by commercial and farm real estate made up 47 percent of the post-modification balance of troubled debt restructured loans made in the nine months ended September 30, 2015.

The following tables show troubled debt restructures that occurred during the twelve months ended September 30, 2015 and September 30, 2014, that subsequently defaulted during the period indicated and remained in default at period end. For purposes of this discussion, a loan is considered in default if it is 30 or more days past due.

	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2015	
	Number of Loans	Recorded Balance	Number of Loans	Recorded Balance
Real estate Loans:				
Residential	1	\$21	1	\$21
Total	1	\$21	1	\$21

	Three Months Ended September 30, 2014		Nine Months Ended September 30, 2014	
	Number of Loans	Recorded Balance	Number of Loans	Recorded Balance
Real estate Loans:				

Residential	1	\$71	1	\$71
Total	1	\$71	1	\$71

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

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

NOTE 5

ACCOUNTING FOR CERTAIN LOANS ACQUIRED IN A PURCHASE

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

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

	September 30, 2015				Total
	C Financial	Community	CFS	SCB	
Commercial and industrial loans	\$ 109	\$6,628	\$55,927	\$5,008	\$67,672
Agricultural production financing and other loans to farmers		2,024		1,456	3,480
Real estate loans:					
Construction	6,209	8,959	1,660		16,828
Commercial and farmland	28,094	56,148	207,197	13,981	305,420
Residential	58,096	23,465	122,369	6,449	210,379
Home Equity	9,861	8,147	34,404	13,799	66,211
Individuals' loans for household and other personal expenditures	12	577	531	56	1,176
Other commercial loans			73		73
Total	\$ 102,381	\$ 105,948	\$ 422,161	\$ 40,749	\$ 671,239
Carrying Amount	\$ 100,001	\$ 99,467	\$ 401,497	\$ 35,617	\$ 636,582
Allowance		109	202		311
Carrying Amount Net of Allowance	\$ 100,001	\$ 99,358	\$ 401,295	\$ 35,617	\$ 636,271

December 31, 2014

Community	CFS	SCB	Total
-----------	-----	-----	-------

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Commercial and industrial loans	\$8,168	\$64,897	\$6,059	\$79,124
Agricultural production financing and other loans to farmers	1,100		893	1,993
Real estate loans:				
Construction	19,063	9,113		28,176
Commercial and farmland	74,600	251,002	15,593	341,195
Residential	28,863	144,396	7,384	180,643
Home Equity	9,881	39,244	15,758	64,883
Individuals' loans for household and other personal expenditures	1,314	922	121	2,357
Other commercial loans		86		86
Total	\$142,989	\$509,660	\$45,808	\$698,457
Carrying Amount	\$134,198	\$484,949	\$39,324	\$658,471
Allowance		650		650
Carrying Amount Net of Allowance	\$134,198	\$484,299	\$39,324	\$657,821

The outstanding balance and related carrying amount of loans acquired and accounted for under ASC 310-30 as of September 30, 2015 were \$82.9 million and \$62.0 million, respectively. Additionally, the outstanding balance and related carrying amount of those loans as of December 31, 2014 were \$99.0 million and \$73.1 million, respectively.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

	Three Months Ended September 30, 2015				
	C Financial	Community	CFS	SCB	Total
Beginning balance	\$133	\$1,818	\$1,732	\$758	\$4,441
Additions					
Accretion	(8	) (139	) (1,058	) (285	) (1,490
Reclassification from nonaccretable		21	704	235	960
Disposals		(140	) (3	)	(143
Ending balance	\$125	\$1,560	\$1,375	\$708	\$3,768

	Nine Months Ended September 30, 2015				
	C Financial	Community	CFS	SCB	Total
Beginning balance		\$2,122	\$2,400	\$868	\$5,390
Additions	\$145				145
Accretion	(20	) (671	) (2,977	) (774	) (4,442
Reclassification from nonaccretable		249	1,963	614	2,826
Disposals		(140	) (11	)	(151
Ending balance	\$125	\$1,560	\$1,375	\$708	\$3,768

	Three Months Ended September 30, 2014		
	CFS	SCB	Total
Beginning balance	\$3,488	\$1,170	\$4,658
Additions			
Accretion	(2,156	) (518	) (2,674
Reclassification from nonaccretable	1,428	311	1,739
Disposals	(136	) (35	) (171
Ending balance	\$2,624	\$928	\$3,552

	Nine Months Ended September 30, 2014		
	CFS	SCB	Total
Beginning balance	\$4,164	\$1,388	\$5,552
Additions			
Accretion	(3,699	) (920	) (4,619
Reclassification from nonaccretable	2,330	495	2,825
Disposals	(171	) (35	) (206

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Ending balance	\$2,624	\$928	\$3,552
----------------	---------	-------	---------

The following table presents loans acquired, as of their respective acquisition dates, during the periods ended September 30, 2015 and 2014, for which it was probable that all contractually required payments would not be collected:

	C Financial - 2015	Community - 2014
Contractually required payments receivable at acquisition date	2,632	26,032
Nonaccretable difference	393	3,498
Expected cash flows at acquisition date	2,239	22,534
Accretable difference	145	2,234
Basis in loans at acquisition date	2,094	20,300

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

NOTE 6

GOODWILL

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

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

NOTE 7

CORE DEPOSIT AND OTHER INTANGIBLES

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

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

	September 30, 2015	September 30, 2014
Gross Carrying Amount	\$58,360	\$53,702
Core deposit and other intangibles acquired	981	
Accumulated amortization	(44,472	) (41,659
Core deposit and other intangibles reduction	(742)
Core deposit and other intangibles	\$14,127	\$12,043

Estimated future amortization expense is summarized as follows:

	Amortization Expense
2015	\$693
2016	2,734
2017	2,697

2018	1,584
2019	1,356
After 2019	5,063
	\$ 14,127

NOTE 8

DERIVATIVE FINANCIAL INSTRUMENTS

Risk Management Objective of Using Derivatives

The Corporation is exposed to certain risks arising from both its business operations and economic conditions. The Corporation principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Corporation manages economic risks, including interest rate, liquidity, and credit risk, primarily by managing the amount, sources, and duration of its assets and liabilities and through the use of derivative financial instruments. Specifically, the Corporation enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Corporation's derivative financial instruments are used to manage differences in the amount, timing, and duration of the Corporation's known or expected cash payments principally related to certain variable-rate liabilities. The Corporation also has derivatives that are a result of a service the Corporation provides to certain qualifying customers, and, therefore, are not used to manage interest rate risk in the Corporation's assets or liabilities. The Corporation manages a matched book with respect to its derivative instruments offered as a part of this service to its customers in order to minimize its net risk exposure resulting from such transactions.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

Cash Flow Hedges of Interest Rate Risk

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

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

Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest payments are made on the Corporation's variable-rate liabilities. During the next twelve months, the Corporation expects to reclassify \$1,345,000 from accumulated other comprehensive income to interest expense.

Non-designated Hedges

The Corporation does not use derivatives for trading or speculative purposes. Derivatives not designated as hedges are not speculative and result from a service the Corporation provides to certain customers. The Corporation executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. Those interest rate swaps are simultaneously hedged by offsetting interest rate swaps that the Corporation executes with a third party, such that the Corporation minimizes its net risk exposure resulting from such transactions. As the interest rate swaps associated with this program do not meet the strict hedge accounting requirements, changes in the fair value of both the customer swaps and the offsetting swaps are recognized directly in earnings. As of September 30, 2015, the notional amount of customer-facing swaps was approximately \$175,435,000. This amount is offset with third party counterparties, as described above.

Fair Values of Derivative Instruments on the Balance Sheet

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

	Asset Derivatives				Liability Derivatives			
	September 30, 2015		December 31, 2014		September 30, 2015		December 31, 2014	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments:								
Interest rate contracts	Other Assets	\$39	Other Assets	\$137	Other Liabilities	\$3,822	Other Liabilities	\$2,650
Derivatives not designated as hedging instruments:								
Interest rate contracts	Other Assets	\$6,505	Other Assets	\$3,730	Other Liabilities	\$6,801	Other Liabilities	\$3,887

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

Effect of Derivative Instruments on the Income Statement

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

Derivatives Not Designated as Hedging Instruments under FASB ASC 815-10	Location of Gain (Loss) Recognized Income on Derivative	Amount of Gain (Loss) Recognized Income on Derivative	
		Three Months Ended	Three Months Ended
		September 30, 2015	September 30, 2014
Interest rate contracts	Other income	\$(194	) \$43

Derivatives Not Designated as Hedging Instruments under FASB ASC 815-10	Location of Gain (Loss) Recognized Income on Derivative	Amount of Gain (Loss) Recognized Income on Derivative	
		Nine Months Ended	Nine Months Ended
		September 30, 2015	September 30, 2014
Interest rate contracts	Other income	\$(139	) \$31

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

Derivatives in Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in Other Comprehensive Income on Derivative (Effective Portion)			
	Three Months Ended		Nine Months ended	
	September 30, 2015	September 30, 2014	September 30, 2015	September 30, 2014
Interest Rate Products	\$(1,791	) \$28	\$(2,260	) \$(2,530

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

Location of Loss Reclassified from Accumulated Other Comprehensive Income (Effective Portion)	Amount of Gain (Loss) Reclassified from Other Comprehensive Income into Income (Effective Portion)			
	Three Months Ended		Nine Months ended	
	September 30, 2015	September 30, 2014	September 30, 2015	September 30, 2014

Interest Expense	\$ (362)	\$ (356)	\$ (1,074)	(1,051)
------------------	---------	---	---------	---	-----------	---	--------	---

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

Credit-risk-related Contingent Features

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

The Corporation also has agreements with certain of its derivative counterparties that contain a provision where if the Corporation defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, the Corporation could also be declared in default on its derivative obligations. As of September 30, 2015, the termination value of derivatives in a net liability position related to these agreements was \$10,893,000. As of September 30, 2015, the Corporation had minimum collateral posting thresholds with certain of its derivative counterparties and had posted collateral of \$10,681,000. If the Corporation had breached any of these provisions at September 30, 2015, it could have been required to settle its obligations under the agreements at their termination value.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

NOTE 9

DISCLOSURES ABOUT FAIR VALUE OF ASSETS AND LIABILITIES

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

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

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

Recurring Measurements

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

Available for Sale Investment Securities

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

Third party vendors compile prices from various sources and may apply such techniques as matrix pricing to determine the value of identical or similar investment securities classified within Level 2. Matrix pricing is a mathematical technique widely used in the banking industry to value investment securities without relying exclusively on quoted prices for specific investment securities but rather relying on the investment securities' relationship to other benchmark quoted investment securities. Any investment security not valued based upon the methods above are considered Level 3.

Interest Rate Derivative Agreements

See information regarding the Corporation's interest rate derivative products in NOTE 8. DERIVATIVE FINANCIAL INSTRUMENTS, included within the Notes to Consolidated Condensed Financial Statements of this Quarterly Report on Form 10-Q.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

September 30, 2015	Fair Value	Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available for sale securities:				
U.S. Government-sponsored agency securities	\$105		\$105	
State and municipal	301,118		295,257	\$5,861
U.S. Government-sponsored mortgage-backed securities	294,879		294,879	
Corporate obligations	31			31
Equity securities	1,706		1,702	4
Interest rate swap asset	6,505		6,505	
Interest rate cap	39		39	
Interest rate swap liability	10,623		10,623	

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

Level 3 Reconciliation

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

	Available for Sale Securities			
	Three Months Ended September 30, 2015	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2015	Nine Months Ended September 30, 2014
Balance at beginning of the period	\$6,028	\$7,533	\$6,646	\$9,977
Total realized and unrealized gains and losses:				
Included in net income				
Included in other comprehensive income	24	68	165	2,960
Purchases, issuances and settlements				
Transfers in/(out) of Level 3				
Principal payments	(156	) (114	) (915	) (5,450
Ending balance	\$5,896	\$7,487	\$5,896	\$7,487

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

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

Transfers Between Levels

There were no transfers between Levels 1, 2 and 3 for the three and nine months ended September 30, 2015 and 2014.

Nonrecurring Measurements

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

		Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2015				
Impaired loans (collateral dependent)	\$8,816			\$8,816
Other real estate owned	5,621			5,621

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

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

Impaired Loans (collateral dependent)

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

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

Other Real Estate Owned

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

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

Unobservable (Level 3) Inputs

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

September 30, 2015	Fair Value	Valuation Technique	Unobservable Inputs	Range (Weighted-Average)
State and municipal securities	\$5,861	Discounted cash flow	Maturity/Call date Blend of US Muni BQ curve Discount rate	1 month to 15 yrs A- to BBB- .90% - 5%
Corporate obligations and Equity securities	\$35	Discounted cash flow	Risk free rate plus Premium for illiquidity	3 month LIBOR plus 200bps
Impaired loans (collateral dependent)	\$8,816	Collateral based measurements	Discount to reflect current market conditions and ultimate collectability	0% - 50% (1%)
Other real estate owned	\$5,621	Appraisals	Discount to reflect current market conditions	0% - 20% (2%)
December 31, 2014	Fair Value	Valuation Technique	Unobservable Inputs	Range (Weighted-Average)
State and municipal securities	\$6,611	Discounted cash flow	Maturity/Call date Blend of US Muni BQ curve Discount rate	1 month to 15 yrs A- to BBB- .90% - 5%
Corporate obligations and Equity securities	\$35	Discounted cash flow	Risk free rate plus Premium for illiquidity	3 month LIBOR plus 200bps
Impaired loans (collateral dependent)	\$17,134	Collateral based measurements	Discount to reflect current market conditions and ultimate collectability	0% - 50% (3%)
Other real estate owned	\$5,155	Appraisals	Discount to reflect current market conditions	0% - 20% (7%)

Sensitivity of Significant Unobservable Inputs

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

State and Municipal Securities, Corporate Obligations and Equity Securities

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

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

Fair Value of Financial Instruments

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

	Carrying Amount	September 30, 2015		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash and cash equivalents	\$84,677	\$84,677		
Interest-bearing time deposits	27,111	27,111		
Investment securities available for sale	597,839		\$591,943	\$5,896
Investment securities held to maturity	610,954		599,054	28,794
Loans held for sale	1,943		1,943	
Loans	4,258,854			4,199,947
Federal Reserve Bank and Federal Home Loan Bank stock	34,498		34,498	
Interest rate swap and cap asset	6,544		6,544	
Interest receivable	22,048		22,048	
Liabilities:				
Deposits	\$4,814,589	\$3,705,092	\$1,097,905	
Borrowings:				
Federal funds purchased	52,896		52,896	
Securities sold under repurchase agreements	153,822		153,822	
Federal Home Loan Bank advances	237,856		239,629	
Subordinated debentures and term loans	121,936		97,873	
Interest rate swap liability	10,623		10,623	
Interest payable	3,710		3,710	
	Carrying Amount	December 31, 2014		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash and cash equivalents	\$118,616	\$118,616		
Interest-bearing time deposits	47,520	47,520		

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

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

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

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

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

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

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

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

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

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

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

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

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

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

NOTE 10

TRANSFERS ACCOUNTED FOR AS SECURED BORROWINGS

The collateral pledged for all repurchase agreements that are accounted for as secured borrowings as of September 30, 2015 were:

	Remaining Contractual Maturity of the Agreements				Total
	Overnight and Continuous	Up to 30 Days	30-90 Days	Greater Than 90 Days	
U.S. Government-sponsored mortgage-backed securities	\$126,043	\$1,333	\$18,888	\$7,558	\$153,822

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

NOTE 11

ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

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

	Accumulated Other Comprehensive Income (Loss)				Total
	Unrealized Gains (Losses) on Securities Available for Sale	Unrealized Gains (Losses) on Securities Available for Sale which a Portion of Other-Than-Temporary Impairment has been Recognized in Income	Unrealized Gains (Losses) on Cash Flow Hedges	Unrealized Gains (Losses) on Defined Benefit Plans	
Balance at December 31, 2014	\$14,098		\$ (2,182)	\$ (13,546)	\$ (1,630)
Other comprehensive income before reclassifications	117		(1,468)		(1,351)
Amounts reclassified from accumulated other comprehensive income	(1,331)		698		(633)
Period change	(1,214)	—	(770)	—	(1,984)
Balance at September 30, 2015	\$12,884	\$ —	\$ (2,952)	\$ (13,546)	\$ (3,614)
Balance at December 31, 2013	\$1,566	\$ (1,847)	\$ (501)	\$ (5,628)	\$ (6,410)
Other comprehensive income before reclassifications	11,338	1,701	(1,645)		11,394
Amounts reclassified from accumulated other comprehensive income	(1,518)		684		(834)
Period change	9,820	1,701	(961)	—	10,560
Balance at September 30, 2014	\$11,386	\$ (146)	\$ (1,462)	\$ (5,628)	\$ 4,150

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

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

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Details about Accumulated Other Comprehensive Income (Loss) Components	September 30,		Affected Line Item in the Statements of Income
	2015	2014	
Unrealized gains (losses) on available for sale securities ⁽¹⁾			
Realized securities gains (losses) reclassified into income	\$1,115	\$910	Other income - net realized gains on sales of available for sale securities
Related income tax expense	(390)	(318)	Income tax expense
	\$725	\$592	
Unrealized gains (losses) on cash flow hedges ⁽²⁾			
Interest rate contracts	\$(362)	\$(356)	Interest expense - subordinated debentures and term loans
Related income tax benefit	127	124	Income tax expense
	\$(235)	\$(232)	
Total reclassifications for the period, net of tax	\$490	\$360	

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

Details about Accumulated Other Comprehensive Income (Loss) Components	Amount Reclassified from Accumulated Other Comprehensive Income (Loss) For the Nine Months Ended September 30,		Affected Line Item in the Statements of Income
	2015	2014	
Unrealized gains (losses) on available for sale securities ⁽¹⁾			
Realized securities gains reclassified into income	\$2,047	\$2,335	Other income - net realized gains on sales of available for sale securities
Related income tax expense	(716)	(817)	Income tax expense
	\$1,331	\$1,518	
Unrealized gains (losses) on cash flow hedges ⁽²⁾			
Interest rate contracts	\$(1,074)	\$(1,051)	Interest expense - subordinated debentures and term loans
Related income tax benefit	376	367	Income tax expense
	\$(698)	\$(684)	
Total reclassifications for the period, net of tax	\$633	\$834	

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

⁽²⁾ For additional detail related to unrealized gains (losses) on cash flow hedges and related amounts reclassified from accumulated other comprehensive income see NOTE 8. DERIVATIVE FINANCIAL INSTRUMENTS.

NOTE 12

SHARE-BASED COMPENSATION

Stock options and restricted stock awards ("RSAs") have been issued to directors, officers and other management employees under the Corporation's 1999 Long-term Equity Incentive Plan and the 2009 Long-term Equity Incentive Plan. The stock options, which have a ten year life, become 100 percent vested ranging from six months to two years and are fully exercisable when vested. Option exercise prices equal the Corporation's common stock closing price on NASDAQ on the date of grant. RSAs issued to employees and non-employee directors provide for the issuance of shares of the Corporation's common stock at no cost to the holder and generally vest after three years. The RSAs vest

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

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

Compensation expense related to unvested share-based awards is recorded by recognizing the unamortized grant date fair value of these awards over the remaining service periods of those awards, with no change in historical reported fair values and earnings. Awards are valued at fair value in accordance with provisions of share-based compensation guidance and are recognized on a straight-line basis over the service periods of each award. To complete the exercise of vested stock options, RSA's and ESPP options, the Corporation generally issues new shares from its authorized but unissued share pool. Share-based compensation for the three and nine months ended September 30, 2015 was \$556,000 and \$1,687,000, respectively, compared to \$552,000 and \$1,611,000, respectively, for the three and nine months ended September 30, 2014. Share-based compensation has been recognized as a component of salaries and benefits expense in the accompanying CONSOLIDATED CONDENSED STATEMENTS OF INCOME.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

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

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Stock and ESPP Options				
Pre-tax compensation expense	\$23	\$81	\$78	\$156
Income tax expense (benefit)	5	(21)	) 4	(26)
Stock and ESPP option expense, net of income taxes	\$28	\$60	\$82	\$130
Restricted Stock Awards				
Pre-tax compensation expense	\$533	\$471	\$1,609	\$1,455
Income tax benefit	(187)	) (165)	) (552)	) (509)
Restricted stock awards expense, net of income taxes	\$346	\$306	\$1,057	\$946
Total Share-Based Compensation				
Pre-tax compensation expense	\$556	\$552	\$1,687	\$1,611
Income tax benefit	(182)	) (186)	) (548)	) (535)
Total share-based compensation expense, net of income taxes	\$374	\$366	\$1,139	\$1,076

As of September 30, 2015, unrecognized compensation expense related to RSAs was \$3,488,000 and is expected to be recognized over a weighted-average period of 1.41 years. The Corporation did not have any unrecognized compensation expense related to stock options as of September 30, 2015.

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

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

	Number of Shares	Weighted-Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2015	737,931	\$ 20.99		
Granted	—			
Exercised	(90,566)	\$ 15.70		
Canceled	(189,853)	\$ 26.00		
Outstanding September 30, 2015	457,512	\$ 19.96	3.31	2,976,604
Vested and Expected to Vest at September 30, 2015	457,512	\$ 19.96	3.31	2,976,604
Exercisable at September 30, 2015	457,512	\$ 19.96	3.31	2,976,604

There were no options granted during the nine months ended September 30, 2015. The weighted-average grant date fair value was \$8.13 for stock options granted during the nine months ended September 30, 2014.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Corporation's closing stock price on the last trading day of the first nine months of 2015 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their stock options on September 30, 2015. The amount of aggregate intrinsic value will change based on the fair market value of the Corporation's common stock. The aggregate intrinsic value of stock options exercised during the nine months ended September 30, 2015 and 2014 was \$812,000 and \$388,000, respectively. Cash receipts of stock options exercised during this same period were \$1,422,000 and \$450,000, respectively.

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

	Number of Shares	Weighted-Average Grant Date Fair Value
Unvested RSAs at January 1, 2015	385,450	\$15.65
Granted	111,124	\$23.16
Vested	(145,697	) \$11.81
Forfeited	(5,742	) \$17.95
Unvested RSAs at September 30, 2015	345,135	\$19.65

The grant date fair value of ESPP options was estimated at the beginning of the July 1, 2015 quarterly offering period of approximately \$23,000. The ESPP options vested during the three months ending September 30, 2015, leaving no unrecognized compensation expense related to unvested ESPP options at September 30, 2015.

NOTE 13

Income Tax

	Three Months Ended September 30,		Nine Months Ended September 30,		
	2015	2014	2015	2014	
Income Tax Expense :					
Currently Payable:					
Federal	\$(5,723) \$(969) \$1,965	\$(541)
Deferred:					
Federal	12,149	6,812	18,899	16,644	
State	131	137	383	382	
Total Income Tax Expense	\$6,557	\$5,980	\$21,247	\$16,485	
Reconciliation of Federal Statutory to Actual Tax Expense:					
Federal statutory income tax at 35%	\$8,268	\$7,736	\$25,359	\$21,486	
Tax-exempt interest income	(1,949) (1,310) (5,116) (3,805)
Basis difference on sale of insurance subsidiary			2,252		

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Stock compensation	8	8	26	29
Earnings on life insurance	(249	) (534	) (734	) (1,024)
Tax credits	(145	) (158	) (437	) (753)
Other	624	238	(103	) 552
Actual Tax Expense	\$6,557	\$5,980	\$21,247	\$16,485

39

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

NOTE 14

Net Income Per Share

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

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

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

	Three Months Ended September 30, 2015			2014		
	Net Income	Weighted-Average Shares	Per Share Amount	Net Income	Weighted-Average Shares	Per Share Amount
Net income available to common stockholders	17,067	37,850,827	\$0.46	16,122	36,054,867	\$0.45
Effect of dilutive stock options and warrants		267,372			274,114	
Diluted net income per share	\$17,067	38,118,199	\$0.45	\$16,122	36,328,981	\$0.45
	Nine Months Ended September 30, 2015			2014		
	Net Income	Weighted-Average Shares	Per Share Amount	Net Income	Weighted-Average Shares	Per Share Amount
Net income available to common stockholders	51,207	37,785,236	\$1.36	44,902	36,013,049	\$1.25
Effect of dilutive stock options and warrants		268,750			282,337	
Diluted net income per share	\$51,207	38,053,986	\$1.35	\$44,902	36,295,386	\$1.24

Stock options to purchase 225,180 and 531,872 shares for the three months ended September 30, 2015 and 2014, respectively, were not included in the earnings per share calculation because the exercise price exceeded the average market price.

Stock options to purchase 335,550 and 569,061 shares for the nine months ended September 30, 2015 and 2014, respectively, were not included in the earnings per share calculation because the exercise price exceeded the average market price.

NOTE 15

IMPACT OF ACCOUNTING CHANGES

FASB ASU 2015-09, Financial Services-Insurance (Topic 944): Disclosures about Short-Duration Contracts
In May 2015, FASB issued 2015-09, Disclosures about Short-Duration Contracts. This update increases the transparency of significant estimates made in measuring the liability for unpaid claims and claim adjustment expenses, improve comparability through consistently disclosed information, and provide financial statements users with information to facilitate analysis of the amount, timing, and uncertainty of cash flows arising from contracts issued by insurance entities and the development of loss reserve estimates. The amendments in this update are effective for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016. Adoption of this ASU is not expected to have a significant effect on the Corporation's consolidated financial statements.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

FASB Accounting Standards Update No. 2015-15, Interest-Imputation of Interest (Subtopic 835-30), Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements

The FASB has issued Accounting Standards Update (ASU) No. 2015-15, Interest - Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit

Arrangements - Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting.

This ASU adds SEC paragraphs pursuant to the SEC Staff Announcement at the June 18, 2015, Emerging Issues Task Force meeting about the presentation and subsequent measurement of debt issuance costs associated with line-of-credit arrangements.

In April 2015, the FASB issued ASU No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, which requires the presentation of debt issuance costs related to a recognized debt liability as a direct deduction from the carrying amount of that debt liability. ASU 2015-03 does not address presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements.

Given the absence of authoritative guidance within ASU 2015-03 for debt issuance costs related to line-of-credit arrangements, the SEC staff would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. Adoption of this ASU is not expected to have a significant effect on the Corporation's consolidated financial statements.

FASB Accounting Standards Update No. 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments

In September 2015, FASB issued Accounting Standards Update (ASU) No. 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments. To simplify the accounting for adjustments made to provisional amounts recognized in a business combination, the amendments eliminate the requirement to retrospectively account for those adjustments.

U.S. GAAP currently requires that during the measurement period, the acquirer retrospectively adjust the provisional amounts recognized at the acquisition date with a corresponding adjustment to goodwill. Those adjustments are required when new information is obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the amounts initially recognized or would have resulted in the recognition of additional assets or liabilities. The acquirer also must revise comparative information for prior periods presented in financial statements as needed, including revising depreciation, amortization, or other income effects as a result of changes made to provisional amounts.

The amendments require that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The amendments require that the acquirer record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date.

The amendments require an entity to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date.

For public business entities, the amendments are effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. The amendments should be applied prospectively to adjustments to provisional amounts that occur after the

effective date with earlier application permitted for financial statements that have not been issued.

The only disclosures required at transition should be the nature of and reason for the change in accounting principle. An entity should disclose that information in the first annual period of adoption and in the interim periods within the first annual period if there is a measurement-period adjustment during the first annual period in which the changes are effective. The Corporation is evaluating the effect of this ASU on its consolidated financial statements.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

NOTE 16

GENERAL LITIGATION AND REGULATORY EXAMINATIONS

On July 8, 2015, a purported shareholder of Ameriana Bancorp filed a putative class action lawsuit captioned Shiva Stein, individually and on behalf of other similarly situated vs. Ameriana Bancorp et al., Cause No. 49D10-1507-PL-022566 in the Marion County, Indiana Superior Court 10 against Ameriana Bancorp, its Board of Directors and First Merchants Corporation. Plaintiff amended the complaint on September 23, 2015. The amended complaint alleges direct and derivative claims for breach of fiduciary duties by the members of the Board of Directors regarding the proposed Merger and claims against First Merchants Corporation for allegedly aiding and abetting those alleged breaches. The plaintiff seeks (1) class certification, (2) to enjoin the merger, (3) a declaration that the Merger Agreement is unlawful and unenforceable, (4) an order directing the members of Ameriana Bancorp's Board of Directors to commence a new sales process, (5) an order rescinding the Merger Agreement, and (6) compensatory damages, expert fees, attorneys' fees, and costs in an unspecified amount. At this early stage of the litigation, it is not possible to assess the probability of a material adverse outcome or reasonably estimate any potential financial impact of the lawsuit on Ameriana Bancorp. Ameriana Bancorp, its Board of Directors and First Merchants Corporation believe the claims against them are without merit and intend to contest the matter vigorously.

On September 22, 2015, a purported shareholder of Ameriana Bancorp filed a putative class action lawsuit captioned Darrell F. Ewing v. Ameriana, et al., No. 1:15-CV-01491 in U.S. District Court in the Southern District of Indiana against Ameriana Bancorp, its Board of Directors and First Merchants Corporation. The complaint generally alleges various claims of federal securities law violations and that the Directors of Ameriana Bancorp breached their fiduciary duties by providing materially inadequate disclosures and material disclosure omissions with respect to the proposed Merger. The plaintiff seeks (1) class certification, (2) to enjoin the Merger or, in the event the Merger is completed before entry of an injunction, to rescind the Merger or be awarded an unspecified amount of rescissory damages, (3) compensatory damages in an unspecified amount, and (4) costs and expenses, including attorneys' and expert fees. At this early stage of the litigation, it is not possible to assess the probability of a material adverse outcome or reasonably estimate any potential financial impact of the lawsuit on Ameriana Bancorp. Ameriana Bancorp, its Board of Directors and First Merchants Corporation believe the claims against them are without merit and intend to contest the matter vigorously.

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

Table of Contents

PART I: FINANCIAL INFORMATION

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

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

FORWARD-LOOKING STATEMENTS

From time to time, we include forward-looking statements in our oral and written communication. We may include forward-looking statements in filings with the Securities and Exchange Commission, such as this Quarterly Report on Form 10-Q, in other written materials and in oral statements made by senior management to analysts, investors, representatives of the media and others. We intend these forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and we are including this statement for purposes of these safe harbor provisions. Forward-looking statements can often be identified by the use of words like "believe", "continue", "pattern", "estimate", "project", "intend", "anticipate", "expect" and 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 our goals, intentions and expectations;
- statements regarding our business plan and growth strategies;
- statements regarding the asset quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

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

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

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

CRITICAL ACCOUNTING POLICIES

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

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

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

BUSINESS SUMMARY

First Merchants Corporation (the “Corporation”) is a financial holding company headquartered in Muncie, Indiana and was organized in September 1982. The Corporation’s Common Stock is traded on NASDAQ’s Global Select Market System under the symbol FRME. The Corporation has one full-service bank charter, First Merchants Bank, National Association (the “Bank”), which opened for business in Muncie, Indiana, in March 1893. The Bank also operates Lafayette Bank and Trust, Commerce National Bank and First Merchants Trust Company as divisions of First Merchants Bank, National Association. The Bank includes 107 banking locations in twenty-six Indiana, two Illinois and two Ohio counties. In addition to its branch network, the Corporation’s delivery channels include ATMs, check cards, remote deposit capture, interactive voice response systems and internet technology. The Corporation’s business activities are currently limited to one significant business segment, which is community banking.

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

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

Table of Contents

PART I: FINANCIAL INFORMATION

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

RESULTS OF OPERATIONS

Executive Summary

First Merchants Corporation reported net income available to common stockholders of \$17.1 million for the three months ended September 30, 2015, an increase of \$945,000, compared to net income available to common stockholders of \$16.1 million for the three months ended September 30, 2014. Diluted earnings per share for the three months ended September 30, 2015 and 2014 totaled \$0.45 per share. Net income available to common stockholders was \$51.2 million for the nine months ended September 30, 2015, an increase of \$6.3 million, compared to net income available to common stockholders of \$44.9 million for the nine months ended September 30, 2014. Diluted earnings per share for the nine months ended September 30, 2015 totaled \$1.35 per share, an increase of 8.9 percent, compared to \$1.24 per diluted share for the same period of 2014.

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

As of September 30, 2015, total assets equaled \$6.2 billion, an increase of \$365.7 million from December 31, 2014. The Corporation's loan portfolio increased \$392.7 million, with the largest increases in Other Commercial and Commercial and Industrial loans. The Corporation acquired \$141.7 million in assets as a result of the C Financial acquisition, of which, loans accounted for \$110.6 million. Additional details of the changes in the Corporation's loans and other earning assets are discussed within NOTE 4. LOANS AND ALLOWANCE, included within the Notes to Consolidated Condensed Financial Statements, and the "EARNING ASSETS" section of Management's Discussion and Analysis of Financial Condition and Results of Operations of this Quarterly Report on Form 10-Q.

The Corporation's allowance for loan losses totaled \$62.9 million as of September 30, 2015. The allowance provided 192.8 percent coverage of all non-accrual loans and 1.45 percent of total loans. The Corporation did not expense a provision for loan losses during the third quarter of 2015 and had net recoveries during the period of \$311,000. Non-performing loans declined \$14.4 million, or 28.3 percent, from December 31, 2014. During the same period of 2014, the Corporation had provision expense of \$1.6 million and net charge offs during the period of \$4.4 million. Additional details are discussed within the "LOAN QUALITY/PROVISION FOR LOAN LOSSES" section of Management's Discussion and Analysis of Financial Condition and Results of Operations of this Quarterly Report on Form 10-Q.

As of September 30, 2015, total deposits equaled \$4.8 billion, an increase of \$173.9 million from December 31, 2014. The Corporation acquired \$105.3 million in deposits as a result of the C Financial acquisition. The largest increases were in demand and savings deposits, which accounted for \$181.9 million of the overall increase. This increase was offset by decreases in other certificates and time deposits and brokered deposits of \$23.7 million and \$10.6 million, respectively, compared to December 31, 2014.

Total borrowings increased \$154.5 million as of September 30, 2015 compared to December 31, 2014 as Federal Home Loan Bank advances and Federal Funds purchased increased \$92.6 million and \$37.5 million, respectively. The Corporation acquired \$19.0 million of Federal Home Loan Bank advances as a result of the C Financial acquisition. Additionally, during the third quarter the Corporation canceled \$5 million of subordinated debentures, resulting in a

gain of \$1.3 million.

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

NET INTEREST INCOME

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

For the periods presented, the increases in net interest income and average earning assets were primarily driven by the acquisitions of Community in November 2014 and C Financial in April 2015. As a result of the acquisitions, the Corporation recognized fair value accretion, which is included in interest income, of \$2,012,000 and \$3,484,000, respectively, for the three months ended September 30, 2015 and 2014. Net interest margin for the third quarter of 2015 decreased to 3.85 percent compared to the third quarter of 2014 at 3.98 percent, while average earning assets increased by \$527,000. Asset yields decreased 11 basis points FTE and interest costs increased 2 basis point, resulting in a 13 basis points FTE decrease in net interest margin as compared to the same period in 2014.

Table of Contents

PART I: FINANCIAL INFORMATION

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

Net interest margin for the nine months ended September 30, 2015 decreased to 3.82 percent compared to the nine months ended September 30, 2014 at 3.95 percent, while average earning assets increased by \$472 million. Asset yields decreased 11 basis points FTE and interest costs increased 2 basis points, resulting in a 13 basis points FTE decrease in net interest margin as compared to the same period in 2014. Interest income included \$6,340,000 and \$7,426,000 of fair value accretion for the nine months ended September 30, 2015 and 2014, respectively.

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

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

(Dollars in Thousands)	Three Months Ended September 30, 2015			September 30, 2014		
	Average Balance	Interest Income / Expense	Average Rate	Average Balance	Interest Income / Expense	Average Rate
Assets:						
Interest-bearing time deposits	\$34,343	\$25	0.29 %	\$28,549	\$18	0.25 %
Federal Reserve and Federal Home Loan Bank stock	34,627	500	5.78	43,127	501	4.65
Investment Securities: ⁽¹⁾						
Taxable	692,583	4,374	2.53	776,270	5,046	2.60
Tax-Exempt ⁽²⁾	503,174	6,787	5.40	409,241	5,665	5.54
Total Investment Securities	1,195,757	11,161	3.73	1,185,511	10,711	3.61
Loans held for sale	2,163	125	23.12	9,393	152	6.47
Loans: ⁽³⁾						
Commercial	3,247,336	36,582	4.51	2,905,920	34,344	4.73
Real Estate Mortgage	447,733	4,803	4.29	455,714	5,025	4.41
Installment	403,399	4,526	4.49	369,797	4,460	4.82
Tax-Exempt ⁽²⁾	172,844	1,832	4.24	12,866	94	2.92
Total Loans	4,273,475	47,868	4.48	3,753,690	44,075	4.70
Total Earning Assets	5,538,202	59,554	4.30	5,010,877	55,305	4.41
Net unrealized gain on securities available for sale	10,379			11,247		
Allowance for loan losses	(62,521)			(68,123)		
Cash and cash equivalents	93,542			74,773		
Premises and equipment	84,880			74,696		
Other assets	489,467			475,234		
Total Assets	\$6,153,949			\$5,578,704		
Liabilities:						
Interest-bearing deposits:						
Interest-bearing NOW deposits	\$1,112,161	\$359	0.13 %	\$1,059,163	\$279	0.11 %

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Money market deposits	837,963	448	0.21	736,339	372	0.20
Savings deposits	628,020	155	0.10	528,746	154	0.12
Certificates and other time deposits	1,122,964	2,753	0.98	1,032,274	2,048	0.79
Total Interest-bearing Deposits	3,701,108	3,715	0.40	3,356,522	2,853	0.34
Borrowings	523,814	2,500	1.91	572,923	2,571	1.80
Total Interest-bearing Liabilities	4,224,922	6,215	0.59	3,929,445	5,424	0.55
Noninterest-bearing deposits	1,123,575			932,266		
Other liabilities	46,308			37,687		
Total Liabilities	5,394,805			4,899,398		
Stockholders' Equity	759,144			679,306		
Total Liabilities and Stockholders' Equity	\$6,153,949	6,215	0.45	\$5,578,704	5,424	0.43
Net Interest Income		\$53,339			\$49,881	
Net Interest Margin			3.85 %			3.98 %

(1) Average balance of securities is computed based on the average of the historical amortized cost balances without the effects of the fair value adjustments. Annualized amounts are computed utilizing a 30/360 day basis.

(2) Tax-exempt securities and loans are presented on a fully taxable equivalent basis, using a marginal tax rate of 35 percent for 2015 and 2014. These totals equal \$3,016 and \$2,015 for the three months ended September 30, 2015 and 2014, respectively.

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

Table of Contents

PART I: FINANCIAL INFORMATION

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

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

(Dollars in Thousands)	Nine Months Ended September 30, 2015			September 30, 2014		
	Average Balance	Interest Income / Expense	Average Rate	Average Balance	Interest Income / Expense	Average Rate
Assets:						
Interest-bearing time deposits	\$50,327	\$93	0.25 %	\$43,906	\$76	0.23 %
Federal Reserve and Federal Home Loan Bank stock	38,367	1,509	5.24	41,657	1,648	5.27
Investment Securities: ⁽¹⁾						
Taxable	708,328	13,522	2.55	761,924	14,902	2.61
Tax-Exempt ⁽²⁾	474,004	19,197	5.40	389,682	16,447	5.63
Total Investment Securities	1,182,332	32,719	3.69	1,151,606	31,349	3.63
Loans held for sale	4,364	380	11.61	6,653	322	6.45
Loans: ⁽³⁾						
Commercial	3,161,385	106,412	4.49	2,893,922	99,685	4.59
Real Estate Mortgage	454,288	14,614	4.29	417,899	14,650	4.67
Installment	397,981	13,502	4.52	353,134	13,672	5.16
Tax-Exempt ⁽²⁾	103,931	3,344	4.29	12,328	277	3.00
Total Loans	4,121,949	138,252	4.47	3,683,936	128,606	4.65
Total Earning Assets	5,392,975	172,573	4.27 %	4,921,105	161,679	4.38 %
Net unrealized gain on securities available for sale	12,463			7,929		
Allowance for loan losses	(62,940)			(68,703)		
Cash and cash equivalents	96,671			83,259		
Premises and equipment	82,342			74,732		
Other assets	491,542			481,959		
Total Assets	\$6,013,053			\$5,500,281		
Liabilities:						
Interest-bearing deposits:						
Interest-bearing NOW deposits	\$1,077,463	\$894	0.11 %	\$1,061,762	\$827	0.10 %
Money market deposits	838,552	1,305	0.21	755,097	1,136	0.20
Savings deposits	604,436	481	0.11	527,147	461	0.12
Certificates and other time deposits	1,132,497	8,237	0.97	1,021,044	5,852	0.76
Total Interest-bearing Deposits	3,652,948	10,917	0.40	3,365,050	8,276	0.33
Borrowings	478,030	7,437	2.07	508,992	7,673	2.01
Total Interest-bearing Liabilities	4,130,978	18,354	0.59	3,874,042	15,949	0.55
Noninterest-bearing deposits	1,090,158			925,107		
Other liabilities	45,215			38,724		
Total Liabilities	5,266,351			4,837,873		
Stockholders' Equity	746,702			662,408		
Total Liabilities and Stockholders' Equity	\$6,013,053	18,354	0.45	\$5,500,281	15,949	0.43

Net Interest Income	\$154,219		\$145,730
Net Interest Margin		3.82 %	3.95 %

(1) Average balance of securities is computed based on the average of the historical amortized cost balances without the effects of the fair value adjustments. Annualized amounts are computed utilizing a 30/360 day basis.

(2) Tax-exempt securities and loans are presented on a fully taxable equivalent basis, using a marginal tax rate of 35 percent for 2015 and 2014. These totals equal \$7,889 and \$5,853 for the nine months ended September 30, 2015 and 2014, respectively.

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

Table of Contents

PART I: FINANCIAL INFORMATION

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

NON-INTEREST INCOME

Non-interest income decreased \$1.5 million, or 8.2 percent, in the third quarter of 2015, compared to the third quarter of 2014. In June 2015, the Corporation sold all of its stock in First Merchants Insurance Services, resulting in no insurance commission income in the third quarter of 2015. This transaction accounted for a \$1.7 million decline in commission income compared to the third quarter of 2014. In November 2014, the Corporation acquired Community, and in April 2015, the Corporation acquired C Financial. Each of the acquisitions contributed to a larger customer base, which resulted in an increase in gains on the sale of mortgage loans and service charge income of \$447,000 and \$326,000, respectively, for the three months ended September 30, 2015 when compared to the same period in 2014. Additional details of the divestiture and acquisitions can be found in NOTE 2. ACQUISITIONS AND DIVESTITURES, included within the Notes to Consolidated Condensed Financial Statements of this Quarterly Report on Form 10-Q.

In August 2015, the Corporation completed the cancellation of \$5 million of subordinated debentures at a gain of \$1.3 million. This gain was offset by a decline in gains on the sale of other real estate owned of \$1.7 million from the third quarter of 2014. Additionally, earnings on cash surrender value of life insurance declined \$814,000 from the prior quarter of 2014 due to a death benefit from Bank Owned Life Insurance of \$846,000 in the third quarter of 2014.

During the first nine months of 2015, non-interest income increased \$7.7 million, or 15.5 percent, over the same period in 2014. The sale of First Merchants Insurance Services created an \$8.3 million gain, but was offset by a \$1.7 million decline in insurance commission income from 2014. The larger customer base from the Community and C Financial acquisitions contributed to increases in the gains on the sale of mortgage loans, other customer fees and fiduciary activities of \$1.8 million, \$652,000 and \$334,000, respectively.

In August 2015, the Corporation completed the cancellation of \$5 million of subordinated debentures at a gain of \$1.3 million. This gain was offset by a decline in gains on the sale of other real estate owned of \$2.7 million from the same period in 2014. In addition, earnings on cash surrender value of life insurance declined \$828,000 from the prior year due to a death benefit from Bank Owned Life Insurance of \$846,000 during the nine months ended September 30, 2014.

NON-INTEREST EXPENSE

Non-interest expense increased \$1.0 million, or 2.4 percent, in the third quarter of 2015, compared to the third quarter of 2014. The largest increase was in salaries and employee benefits which increased \$964,000, or 4.0 percent. This was primarily driven by the addition of personnel from the acquisitions of Community and C Financial. Additionally, the Corporation had an increase in equipment and net occupancy expenses of \$511,000 and \$325,000, respectively, due to the addition of Community and C Financial core system expenses and banking centers. These increases were offset by a decrease of \$783,000 in other real estate owned and foreclosure expenses as asset quality trends continue to improve from the same period last year.

During the first nine months of 2015, non-interest expense increased \$4.3 million, or 3.4 percent, when compared to the first nine months of 2014. Salaries and employee benefits increased \$3.2 million, or 4.4 percent, over the same period last year due to the addition of personnel from the acquisitions of Community and C Financial. The Corporation also experienced an increase of \$1.8 million in professional and other outside services, primarily acquisition and divestiture expenses, which consisted of legal and investment banker expenses of \$1.0 million and

contract termination expenses related to the C Financial acquisition of \$719,000. Equipment and net occupancy expenses increased \$1.1 million and \$476,000, respectively, due to running Community's and C Financial's core systems prior to integration and additional banking centers. These increases were offset by a decrease of \$2.6 million in other real estate owned and foreclosure expenses as asset quality trends continue to improve over the prior year.

INCOME TAXES

Income tax expense for the third quarter of 2015 was \$6,557,000 on pre-tax net income of \$23,624,000. For the same period in 2014, income tax expense was \$5,980,000 on pre-tax net income of \$22,102,000.

Income tax expense for the nine months ended September 30, 2015 was \$21,247,000 on pre-tax net income of \$72,454,000. For the same period in 2014, income tax expense was \$16,485,000 on pre-tax net income of \$61,387,000.

The increase in the effective tax rate in the nine months ended September 30, 2015, when compared to the same period of 2014, was primarily a result of a permanent book-to-tax basis difference associated with the gain on sale of FMIG. Details of the FMIG sale and tax effect are included in NOTE 2. ACQUISITIONS AND DIVESTITURES and NOTE 13. INCOME TAX, included within the Notes to Consolidated Condensed Financial Statements of this Quarterly Report on Form 10-Q

Taxes, both current and deferred, decreased in the first nine months of 2015 by \$3,621,000. The decline in the net asset was primarily due to decreases in the deferred tax assets associated with the accounting for loans, federal net operating loss carryforwards, deferred and incentive compensation, and allowance for loan losses of \$1,705,000, \$1,246,000, \$1,132,000 and \$629,000, respectively. The deferred tax asset decreases were partially offset by a decline in the deferred tax liability associated with the accounting for unrealized gains on available for sale securities of \$653,000.

Table of Contents

PART I: FINANCIAL INFORMATION

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

CAPITAL

Capital adequacy is an important indicator of financial stability and performance. The Corporation and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies and are assigned to a capital category. The assigned capital category is largely determined by four ratios that are calculated according to the regulations: total risk-based capital, tier 1 risk-based capital, common equity tier 1 capital, and tier 1 leverage ratios. The ratios are intended to measure capital relative to assets and credit risk associated with those assets and off-balance sheet exposures of the entity. The capital category assigned to an entity can also be affected by qualitative judgments made by regulatory agencies about the risk inherent in the entity's activities that are not part of the calculated ratios.

There are five capital categories defined in the regulations, ranging from well capitalized to critically undercapitalized. Classification of a bank in any of the undercapitalized categories can result in actions by regulators that could have a material effect on a bank's operations. Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total and tier 1 capital to risk-weighted assets, and of tier 1 capital to average assets, or leverage ratio, all of which are calculated as defined in the regulations. Banks with lower capital levels are deemed to be undercapitalized, significantly undercapitalized or critically undercapitalized, depending on their actual levels. The appropriate federal regulatory agency may also downgrade a bank to the next lower capital category upon a determination that the bank is in an unsafe or unsound practice. Banks are required to monitor closely their capital levels and to notify their appropriate regulatory agency of any basis for a change in capital category.

Basel III was effective for the Corporation on January 1, 2015. Basel III requires the Corporation and the Bank to maintain minimum amounts and ratio of common equity tier 1 capital to risk weighted assets, as defined in the regulation. Under the new Basel III rules, in order to avoid limitations on capital distributions, including dividends, the Corporation must hold a capital conservation buffer above the adequately capitalized common equity tier 1 capital to risk-weighted assets ratio. The capital conservation buffer is being phased in from zero percent to 2.50 percent by 2019. Under Basel III, the Corporation and Bank elected to opt-out of including accumulated other comprehensive income in regulatory capital. Regulatory capital ratios at September 30, 2015, were calculated under Basel III while regulatory capital ratios at December 31, 2014, were calculated under Basel I.

As of September 30, 2015, the Bank met all capital adequacy requirements to be considered well capitalized. There is no threshold for well capitalized status for bank holding companies. The Corporation's and Bank's actual and required capital ratios as of September 30, 2015 and December 31, 2014 were as follows:

	September 30, 2015		Prompt Corrective Action Thresholds			
	Actual Amount	Ratio	Adequately Capitalized Amount	Ratio	Well Capitalized Amount	Ratio
(Dollars in Thousands)						
Total risk-based capital to risk-weighted assets						
First Merchants Corporation	\$736,001	14.85	% \$396,539	8.00	% N/A	N/A
First Merchants Bank	693,917	13.90	399,318	8.00	\$499,147	10.00 %
Tier 1 capital to risk-weighted assets						
First Merchants Corporation	\$608,989	12.29	% \$297,404	6.00	% N/A	N/A

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

First Merchants Bank	631,496	12.65		299,488	6.00	\$ 399,318	8.00	%
Common equity tier 1 capital to risk-weighted assets								
First Merchants Corporation	\$ 560,580	11.31	%	\$ 223,053	4.50	% N/A	N/A	
First Merchants Bank	631,496	12.65		224,616	4.50	\$ 324,446	6.50	%
Tier 1 capital to average assets								
First Merchants Corporation	\$ 608,989	10.25	%	\$ 237,626	4.00	% N/A	N/A	
First Merchants Bank	631,496	10.66		237,045	4.00	\$ 296,306	5.00	%

December 31, 2014

(Dollars in Thousands)	Actual Amount	Ratio	Prompt Corrective Action Thresholds					
			Adequately Capitalized		Well Capitalized			
			Amount	Ratio	Amount	Ratio		
Total risk-based capital to risk-weighted assets								
First Merchants Corporation	\$ 685.507	15.34	%	\$ 357,581	8.00	% N/A	N/A	
First Merchants Bank	653.169	14.64		356,884	8.00	\$ 446,105	10.00	%
Tier 1 capital to risk weighted assets								
First Merchants Corporation	\$ 564,535	12.63	%	\$ 178,791	4.00	% N/A	N/A	
First Merchants Bank	597,305	13.39		178,442	4.00	\$ 267,663	6.00	%
Tier 1 capital to average assets								
First Merchants Corporation	\$ 564,535	10.15	%	\$ 222,533	4.00	% N/A	N/A	
First Merchants Bank	597,305	10.56		226,339	4.00	\$ 282,923	5.00	%

Table of Contents

PART I: FINANCIAL INFORMATION

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

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.

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 tables are also meaningful when considering performance measures of the Corporation.

The Corporation had a strong capital position as evidenced by the tangible common equity to tangible assets ratio of 9.25 percent at September 30, 2015, and 9.16 percent at December 31, 2014.

(Dollars in Thousands, Except Per Share Amounts)	Tangible Common Equity to Tangible Assets (non-GAAP)			
	September 30, 2015		December 31, 2014	
Total Stockholders' Equity (GAAP)	\$766,984		\$726,827	
Less: Cumulative preferred stock (GAAP)	(125	)	(125)
Less: Intangible assets, net of tax (GAAP)	(214,115	)	(212,669)
Tangible common equity (non-GAAP)	\$552,744		\$514,033	
Total assets (GAAP)	\$6,189,797		\$5,824,127	
Less: Intangible assets, net of tax (GAAP)	(214,115	)	(212,669)
Tangible assets (non-GAAP)	\$5,975,682		5,611,458	
Tangible common equity to tangible assets (non-GAAP)	9.25	%	9.16	%

The following table details and reconciles tangible earnings per share, return on tangible capital and tangible assets to traditional GAAP measures for the three and nine months ended September 30, 2015 and 2014.

(Dollars in Thousands, Except Per Share Amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Average goodwill (GAAP)	\$205,375	\$188,947	\$206,115	\$188,961
Average core deposit intangible (GAAP)	14,447	12,323	15,221	12,922
Average deferred tax on CDI (GAAP)	(5,494	) (4,735	) (5,724	) (4,819
Intangible adjustment (non-GAAP)	\$214,328	\$196,535	\$215,612	\$197,064
Average stockholders' equity (GAAP)	\$759,144	\$679,306	\$746,702	\$662,408
Average cumulative preferred stock (GAAP)	(125	) (125	) (125	) (125
Intangible adjustment (non-GAAP)	(214,328	) (196,535	) (215,612	) (197,064
Average tangible capital (non-GAAP)	\$544,691	\$482,646	\$530,965	\$465,219
Average assets (GAAP)	\$6,153,949	\$5,578,704	\$6,013,053	\$5,500,281
Intangible adjustment (non-GAAP)	(214,328	) (196,535	) (215,613	) (197,064
Average tangible assets (non-GAAP)	\$5,939,621	\$5,382,169	\$5,797,440	\$5,303,217
Net income available to common stockholders (GAAP)	\$17,067	\$16,122	\$51,207	\$44,902
CDI amortization, net of tax (GAAP)	436	336	1,284	1,009
Tangible net income available to common stockholders (non-GAAP)	\$17,503	\$16,458	\$52,491	\$45,911

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Per Share Data:

Diluted net income available to common stockholders (GAAP)	\$0.45	\$0.45	\$1.35	\$1.24
Diluted tangible net income available to common stockholders (non-GAAP)	\$0.46	\$0.45	\$1.39	\$1.26

Ratios:

Return on average GAAP capital (ROE)	8.99	% 9.49	% 9.14	% 9.04	%
Return on average tangible capital	12.85	% 13.64	% 13.18	% 13.16	%
Return on average assets (ROA)	1.11	% 1.16	% 1.14	% 1.09	%
Return on average tangible assets	1.18	% 1.22	% 1.21	% 1.15	%

Return on average tangible capital is tangible net income available to common stockholders (annualized) expressed as a percentage of average tangible capital. Return on average tangible assets is tangible net income available to common stockholders (annualized) expressed as a percentage of average tangible assets.

Table of Contents

PART I: FINANCIAL INFORMATION

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

LOAN QUALITY/PROVISION FOR LOAN LOSSES

The Corporation's primary lending focus is small business and middle market commercial, commercial real estate, residential real estate 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.

Loan Quality

The quality and amount of non-performing loans may increase or decrease going forward as a result of acquisitions, organic portfolio growth, 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 specific to a particular borrower, such as the actions of a customer's management.

At September 30, 2015, non performing loans totaled \$36,420,000, a decrease of \$14,361,000 from the December 31, 2014 balance of \$50,781,000. Non-accrual loans decreased \$16,192,000 to \$32,597,000, from the December 31, 2014 balance of \$48,789,000. The Corporation's coverage ratio of allowance for loan losses to non-accrual loans increased from 131.1 percent at December 31, 2014 to 192.8 percent at September 30, 2015. See additional information regarding the allowance for loan losses in the "Provision for Loan Losses" section of Management's Discussion and Analysis of Financial Condition and Results of Operations included as ITEM 2 of this Quarterly Report on Form 10-Q.

Accruing loans delinquent 90 or more days of \$1,947,000 at September 30, 2015 decreased \$2,716,000 from the December 31, 2014 balance of \$4,663,000. Commercial and industrial loans 90+ days delinquent and accruing were \$65,000 at September 30, 2015, compared to the December 31, 2014 balance of \$2,985,000.

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

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 substantially within the contractual terms of the note. At September 30, 2015, commercial impaired loans totaled \$93,886,000 a decrease of \$22,337,000 from the December 31, 2014 balance of \$116,223,000. At September 30, 2015, a specific allowance for losses was not deemed necessary for commercial impaired loans totaling \$87,560,000 as there was no identified loss on these credits. A specific allowance of \$1,956,000 was recorded for the remaining balance of these impaired loans totaling \$6,326,000 and is included in the Corporation's allowance for loan losses.

The following table details the Corporation's non-performing assets plus loans 90-days or more delinquent, and notes total commercial impaired loans for the periods indicated.

(Dollars in Thousands)	September 30, 2015	December 31, 2014
------------------------	-----------------------	----------------------

Non-Performing Assets:		
Non-accrual loans	\$32,597	\$48,789
Renegotiated loans	3,823	1,992
Non-performing loans (NPL)	36,420	50,781
Other real estate owned	14,809	19,293
Non-performing assets (NPA)	51,229	70,074
90+ days delinquent and still accruing	1,947	4,663
Non-performing assets plus 90+ days delinquent	\$53,176	\$74,737
Impaired Loans	\$93,886	\$116,223

The composition of non-performing assets plus loans 90-days or more delinquent is reflected in the following table for the periods indicated.

(Dollars in Thousands)	September 30, 2015	December 31, 2014
Non-Performing Assets and 90+ Days Delinquent:		
Commercial and industrial loans	\$5,479	\$10,033
Agricultural production financing and other loans to farmers	1,210	5,800
Real estate loans:		
Construction	7,885	8,363
Commercial and farmland	22,713	30,400
Residential	13,213	17,079
Home Equity	2,473	2,802
Individuals' loans for household and other personal expenditures	203	260
Non-performing assets plus 90+ days delinquent	\$53,176	\$74,737

Table of Contents

PART I: FINANCIAL INFORMATION

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

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 financial condition could be adversely affected in the event the quality of its loan portfolio declines. Deterioration in the economic environment including residential and commercial real estate values may result in increased levels of loan delinquencies and credit losses.

Provision for Loan Losses

The allowance for loan losses is maintained through the provision for loan losses, which is a charge against earnings. 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 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 ongoing 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.

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

At September 30, 2015, the allowance for loan losses was \$62,861,000, a decrease of \$1,103,000 from December 31, 2014. As a percent of loans, the allowance was 1.45 percent at September 30, 2015, compared to 1.63 percent at December 31, 2014. The provision for loan losses for the nine months ended September 30, 2015 was \$417,000. The provision for loan losses for the nine months ended September 30, 2014 was \$1,600,000. Specific reserves on impaired loans decreased \$813,000 from \$2,769,000 at December 31, 2014, to \$1,956,000 at September 30, 2015.

Net charge offs for the nine months ended September 30, 2015, were \$1,520,000. Comparatively, the same period in 2014 had net charge offs of \$3,874,000. For the nine months ended September 30, 2015, there were two charge offs greater than \$500,000 totaling \$1,635,000 and one recovery totaling \$931,000. The distribution of the net charge offs or recoveries for the three and nine months ended September 30, 2015 and 2014 are reflected in the following table:

(Dollars in Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net Charge Offs (Recoveries):				
Commercial and industrial loans	\$ 738	\$ 2,465	\$ 355	\$ 1,412
Agricultural production financing and other loans to farmers	9	(5	) 769	(22
Real estate loans:				
Construction	63	(5	) 102	(379
Commercial and farmland	(1,187	) 1,497	(1,125	) 1,686
Residential	53	277	842	736
Home Equity	(87	) 20	427	234
Individuals' loans for household and other personal expenditures	102	128	160	248
Lease financing receivables, net of unearned income		(3	)	(21
Other commercial loans	(2	) (3	) (10	) (20

Total Net Charge Offs	\$(311)	\$4,371	\$1,520	\$3,874
-----------------------	--------	---	---------	---------	---------

Management continually evaluates the commercial loan portfolio by including consideration of specific borrower cash flow analysis and estimated collateral values, types and amounts on non-performing loans, past and anticipated loan loss experience, changes in the composition of the loan portfolio, and the current condition and amount of loans outstanding. 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.

LIQUIDITY

Liquidity management is the process by which the Bank ensures 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 our receipt of dividends from the Bank, which is 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.

Table of Contents

PART I: FINANCIAL INFORMATION

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

The principal source of asset-funded liquidity is investment securities classified as available for sale, the market values of which totaled \$597,839,000 at September 30, 2015, an increase of \$48,296,000, or 8.8 percent, from December 31, 2014. Securities classified as held to maturity that are maturing within a short period of time, which totaled \$5,521,000 at September 30, 2015, can also be a source of liquidity. In addition, other types of assets such as cash and due from banks, federal funds sold, and securities purchased under agreements to resell, loans and interest-bearing deposits with other banks maturing within one year are sources of liquidity.

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 funding sources. At September 30, 2015, total borrowings from the FHLB were \$237,856,000. The Bank has pledged certain mortgage loans and investments to the FHLB. The total available remaining borrowing capacity from the FHLB at September 30, 2015, was \$404,726,000.

On November 1, 2013, the Corporation completed the private issuance and sale to four institutional investors of an aggregate of \$70 million of debt comprised of (a) 5.00 percent Fixed-to-Floating Rate Senior Notes due 2028 in the aggregate principal amount of \$5 million (the "Senior Debt") and (b) 6.75 percent Fixed-to-Floating Rate Subordinated Notes due 2028 in the aggregate principal amount of \$65 million (the "Subordinated Debt"). The Senior Debt agreement contains certain customary representations and warranties and financial and negative covenants. As of September 30, 2015, the Corporation was in compliance with these covenants.

On April 11, 2014, the Corporation entered into a line of credit agreement with U.S. Bank, N.A. with a maximum borrowing capacity of \$20 million. As of September 30, 2015, there was no outstanding balance on the line of credit. Interest is payable quarterly based on one-month LIBOR plus 2.00 percent. The line of credit has a quarterly facility fee of 0.25 percent on the unused balance. The line of credit agreement contains certain customary representations and warranties and financial and negative covenants. As of September 30, 2015, the Corporation was in compliance with these covenants. The line of credit was scheduled to mature on April 10, 2015; however, on April 9, 2015 the agreement was renewed with a maturity date of April 8, 2016.

Additionally, on August 10, 2015, the Corporation completed the cancellation of \$5 million of subordinated debentures at a gain of \$1.3 million. As of September 30, 2015, \$51.7 million of subordinated debentures remain outstanding with a maturity date of September 15, 2037.

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 our 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 and commercial letters of credit. Summarized credit-related financial instruments at September 30, 2015, are as follows:

(Dollars in Thousands)	September 30, 2015
Amounts of commitments:	
Loan commitments to extend credit	\$ 1,608,243
Standby and commercial letters of credit	41,343

\$1,649,586

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 September 30, 2015, are as follows:

(Dollars in Thousands)	Remaining 2015	2016	2017	2018	2019	2020	2021 and after	Total
Operating leases	\$789	\$2,713	\$1,964	\$1,030	\$822	\$659	\$3,965	\$11,942
Federal funds purchased	52,896							52,896
Securities sold under repurchase agreements	153,822							153,822
Federal Home Loan Bank advances	67,024	46,597	17,246	26,851	13,828	31,310	35,000	237,856
Subordinated debentures and term loans	234						121,702	121,936
Total	\$274,765	\$49,310	\$19,210	\$27,881	\$14,650	\$31,969	\$160,667	\$578,452

Table of Contents

PART I: FINANCIAL INFORMATION

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

INTEREST SENSITIVITY AND DISCLOSURE 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.

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 12-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 September 30, 2015, 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:

	September 30, 2015	
	RISING (200 Basis Points)	FALLING (100 Basis Points)
Driver Rates		
Prime	200	—
Federal funds	200	—
One-year CMT	200	(25)
Three-year CMT	200	(64)
Five-year CMT	200	(81)
CD's	200	(21)

FHLB advances 200 (55)

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 September 30, 2015. The net interest income shown represents cumulative net interest income over a 12-month time horizon. Balance sheet assumptions used for the base scenario are the same for the rising and falling simulations.

(Dollars in Thousands)	September 30, 2015		
	Base	RISING (200 Basis Points)	FALLING (100 Basis Points)
Net interest income	\$ 188,544	\$ 200,448	\$ 183,409
Variance from base		\$ 11,904	\$(5,135)
Percent of change from base		6.3	% (2.7)%

Table of Contents

PART I: FINANCIAL INFORMATION

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

The comparative rising 200 basis points and falling 100 basis points scenarios below, as of December 31, 2014, 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:

Driver Rates	December 31, 2014	
	RISING (200 Basis Points)	FALLING (100 Basis Points)
Prime	200	—
Federal funds	200	—
One-year CMT	200	(15)
Three-year CMT	200	(83)
Five-year CMT	200	(100)
CD's	200	(23)
FHLB advances	200	(43)

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 12-month time horizon. Balance sheet assumptions used for the base scenario are the same for the rising and falling simulations.

(Dollars in Thousands)	December 31, 2014		
	Base	RISING (200 Basis Points)	FALLING (100 Basis Points)
Net interest income	\$ 180,175	\$ 192,164	\$ 175,118
Variance from base		\$ 11,989	\$(5,057)
Percent of change from base		6.7	% (2.8)%

EARNING ASSETS

The following table presents the earning asset mix as of September 30, 2015, and December 31, 2014. Earning assets increased by \$392,456,000 during the nine months ended September 30, 2015. Interest-bearing time deposits decreased \$20,409,000, while investment securities increased by approximately \$28,162,000. Loans and loans held for sale increased by \$391,558,000, of which \$110,625,000 was a result of the C Financial acquisition on April 17, 2015. Additional details of the transaction can be found in NOTE 2. ACQUISITIONS AND DIVESTITURES, included within the Notes to Consolidated Condensed Financial Statements of this Quarterly Report on Form 10-Q. The three loan classes experiencing the largest increase from December 31, 2014, were other commercial loans, commercial and industrial loans and real estate construction. These increases were primarily offset by a decrease in agricultural production financing.

(Dollars in Thousands)	September 30, 2015	December 31, 2014
Interest-bearing time deposits	\$27,111	\$47,520
Investment securities available for sale	597,839	549,543

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Investment securities held to maturity	610,954	631,088
Mortgage loans held for sale	1,943	7,235
Loans	4,321,715	3,924,865
Federal Reserve and Federal Home Loan Bank stock	34,498	41,353
Total	\$5,594,060	\$5,201,604

OTHER

The Securities and Exchange Commission maintains a web site 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 (<http://www.sec.gov>).

Table of Contents

PART I: FINANCIAL INFORMATION

ITEM 3. QUANTITATIVE AND QUALITATIVE
DISCLOSURES ABOUT MARKET RISK

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required under this item is included as part of Management's Discussion and Analysis of Financial Condition and Results of Operations, under the headings "LIQUIDITY" and "INTEREST SENSITIVITY AND DISCLOSURE ABOUT MARKET RISK".

55

Table of Contents

PART I: FINANCIAL INFORMATION

ITEM 4. CONTROLS AND PROCEDURES

ITEM 4. CONTROLS AND PROCEDURES

At the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934 are recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There have been no changes in the Corporation's internal control over financial reporting identified in connection with the evaluation discussed above that occurred during the Corporation's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

Table of Contents

PART II: OTHER INFORMATION

ITEM 1., ITEM 1A., ITEM 2., ITEM 3., ITEM 4. AND ITEM 5.

(table dollar amounts in thousands, except share data)

ITEM 1. LEGAL PROCEEDINGS

On July 8, 2015, a purported shareholder of Ameriana Bancorp filed a putative class action lawsuit captioned Shiva Stein, individually and on behalf of other similarly situated vs. Ameriana Bancorp et al., Cause No. 49D10-1507-PL-022566 in the Marion County, Indiana Superior Court 10 against Ameriana Bancorp, its Board of Directors and First Merchants Corporation. Plaintiff amended the complaint on September 23, 2015. The amended complaint alleges direct and derivative claims for breach of fiduciary duties by the members of the Board of Directors regarding the proposed Merger and claims against First Merchants Corporation for allegedly aiding and abetting those alleged breaches. The plaintiff seeks (1) class certification, (2) to enjoin the merger, (3) a declaration that the Merger Agreement is unlawful and unenforceable, (4) an order directing the members of Ameriana Bancorp's Board of Directors to commence a new sales process, (5) an order rescinding the Merger Agreement, and (6) compensatory damages, expert fees, attorneys' fees, and costs in an unspecified amount. At this early stage of the litigation, it is not possible to assess the probability of a material adverse outcome or reasonably estimate any potential financial impact of the lawsuit on Ameriana Bancorp. Ameriana Bancorp, its Board of Directors and First Merchants Corporation believe the claims against them are without merit and intend to contest the matter vigorously.

On September 22, 2015, a purported shareholder of Ameriana Bancorp filed a putative class action lawsuit captioned Darrell F. Ewing v. Ameriana, et al., No. 1:15-CV-01491 in U.S. District Court in the Southern District of Indiana against Ameriana Bancorp, its Board of Directors and First Merchants Corporation. The complaint generally alleges various claims of federal securities law violations and that the Directors of Ameriana Bancorp breached their fiduciary duties by providing materially inadequate disclosures and material disclosure omissions with respect to the proposed Merger. The plaintiff seeks (1) class certification, (2) to enjoin the Merger or, in the event the Merger is completed before entry of an injunction, to rescind the Merger or be awarded an unspecified amount of rescissory damages, (3) compensatory damages in an unspecified amount, and (4) costs and expenses, including attorneys' and expert fees. At this early stage of the litigation, it is not possible to assess the probability of a material adverse outcome or reasonably estimate any potential financial impact of the lawsuit on Ameriana Bancorp. Ameriana Bancorp, its Board of Directors and First Merchants Corporation believe the claims against them are without merit and intend to contest the matter vigorously.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors previously disclosed in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2014,

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

a. None

b. None

c. Issuer Purchases of Equity Securities

The following table presents information relating to our purchases of equity securities during the three months ended September 30, 2015, as follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as part of Publicly announced Plans or Programs	Maximum Number of Shares that may yet be Purchased Under the Plans or Programs
July, 2015	8,116	\$26.08		
August, 2015	6,653	\$26.45		
September, 2015				

The shares were purchased in connection with the exercise of certain outstanding stock options or restricted stock.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable

ITEM 5. OTHER INFORMATION

a. None

b. None

Table of Contents

PART II: OTHER INFORMATION

ITEM 6. EXHIBITS

ITEM 6. EXHIBITS

Exhibit No: Description of Exhibits:

2.1	Agreement and Plan of Reorganization and Merger between First Merchants Corporation and Ameriana Bancorp dated as of June 26, 2015 (Incorporated by reference to registrant's Form 8-K filed on June 29, 2015)
3.1	First Merchants Corporation Articles of Incorporation, as amended (Incorporated by reference to registrant's Form 10-Q filed on November 9, 2011)
3.2	Bylaws of First Merchants Corporation dated October 28, 2009 (Incorporated by reference to registrant's Form 10-Q filed on November 9, 2009)
4.1	First Merchants Corporation Amended and Restated Declaration of Trust of First Merchants Capital Trust II dated as of July 2, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007)
4.2	Indenture dated as of July 2, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007)
4.3	Guarantee Agreement dated as of July 2, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007)
4.4	Form of Capital Securities Certification of First Merchants Capital Trust II (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007)
4.5	First Merchants Corporation Dividend Reinvestment and Stock Purchase Plan (Incorporated by reference to registrant's Post-Effective Amendment No. 1 to Form S-3 filed on August 21, 2009)
4.6	Upon request, the registrant agrees to furnish supplementally to the Commission a copy of the instruments defining the rights of holders of its (a) 5.00% Fixed-to-Floating Rate Senior Notes due 2028 in the aggregate principal amount of \$5 million and (b) 6.75% Fixed-to-Floating Rate Subordinated Notes due 2028 in aggregate principal amount of \$65 million.
10.1	Voting Agreement dated June 26, 2015, by and among First Merchants Corporation and certain shareholders of Ameriana Bancorp (Incorporated by reference to registrant's Form 8-K filed on June 29, 2015)
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes - Oxley Act of 2002 (1)
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes - Oxley Act of 2002 (1)
32	Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (1)
101.INS	XBRL Instance Document (2)
101.SCH	XBRL Taxonomy Extension Schema Document (2)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document (2)
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document (2)
101.LAB	XBRL Taxonomy Extension Label Linkbase Document (2)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document (2)

(1) Filed herewith.

(2) Furnished herewith.

Table of Contents

PART II: OTHER INFORMATION

ITEM 6. EXHIBITS

SIGNATURES

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

First Merchants Corporation
(Registrant)

Date: November 6, 2015

by /s/ Michael C. Rechin
Michael C. Rechin
President and Chief Executive Officer
(Principal Executive Officer)

Date: November 6, 2015

by /s/ Mark K. Hardwick
Mark K. Hardwick
Executive Vice President and
Chief Financial Officer
(Principal Financial and Accounting Officer)

Table of Contents

PART II: OTHER INFORMATION

ITEM 6. EXHIBITS

INDEX TO EXHIBITS

Exhibit No: Description of Exhibits:

2.1	Agreement and Plan of Reorganization and Merger between First Merchants Corporation and Ameriana Bancorp dated as of June 26, 2015 (Incorporated by reference to registrant's Form 8-K filed on June 29, 2015)
3.1	First Merchants Corporation Articles of Incorporation, as amended (Incorporated by reference to registrant's Form 10-Q filed on November 9, 2011)
3.2	Bylaws of First Merchants Corporation dated October 28, 2009 (Incorporated by reference to registrant's Form 10-Q filed on November 9, 2009)
4.1	First Merchants Corporation Amended and Restated Declaration of Trust of First Merchants Capital Trust II dated as of July 2, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007)
4.2	Indenture dated as of July 2, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007)
4.3	Guarantee Agreement dated as of July 2, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007)
4.4	Form of Capital Securities Certification of First Merchants Capital Trust II (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007)
4.5	First Merchants Corporation Dividend Reinvestment and Stock Purchase Plan (Incorporated by reference to registrant's Post-Effective Amendment No. 1 to Form S-3 filed on August 21, 2009)
4.6	Upon request, the registrant agrees to furnish supplementally to the Commission a copy of the instruments defining the rights of holders of its (a) 5.00% Fixed-to-Floating Rate Senior Notes due 2028 in the aggregate principal amount of \$5 million and (b) 6.75% Fixed-to-Floating Rate Subordinated Notes due 2028 in aggregate principal amount of \$65 million.
10.1	Voting Agreement dated June 26, 2015, by and among First Merchants Corporation and certain shareholders of Ameriana Bancorp (Incorporated by reference to registrant's Form 8-K filed on June 29, 2015)
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes - Oxley Act of 2002 (1)
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes - Oxley Act of 2002 (1)
32	Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (1)
101.INS	XBRL Instance Document (2)
101.SCH	XBRL Taxonomy Extension Schema Document (2)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document (2)
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document (2)
101.LAB	XBRL Taxonomy Extension Label Linkbase Document (2)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document (2)

(1) Filed herewith.

(2) Furnished herewith.

