FIRST MERCHANTS CORP
Form 10-Q
August 09, 2016

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

---

[x] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2016
OR
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the Transition Period from _______ to _______

Commission File Number 0-17071

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

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

200 East Jackson 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 [X] 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 [X] No [ ]

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 [X] 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 [X]

As of July 29, 2016, there were 40,774,224 outstanding common shares of the registrant.

Table of Contents

TABLE OF CONTENTS

FIRST MERCHANTS CORPORATION

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

CONSOLIDATED CONDENSED BALANCE SHEETS

	June 30, 2016 (Unaudited)	December 31, 2015
ASSETS		
Cash and cash equivalents	$ 120,471	$ 102,170
Interest-bearing time deposits	62,533	32,315
Investment securities available for sale	658,829	658,400
Investment securities held to maturity (fair value of $665,066 and $632,380)	638,972	618,599
Loans held for sale	18,854	9,894
Loans, net of allowance for loan losses of $62,186 and $62,453	4,729,243	4,631,369
Premises and equipment	95,170	97,648
Federal Reserve and Federal Home Loan Bank stock	18,096	37,633
Interest receivable	23,351	24,415
Core deposit intangibles	16,821	16,635
Goodwill	244,000	243,129
Cash surrender value of life insurance	201,417	200,539
Other real estate owned	13,219	17,257
Tax asset, deferred and receivable	32,547	46,977
Other assets	32,895	24,023
TOTAL ASSETS	$ 6,906,418	$ 6,761,003
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 1,253,747	$ 1,266,027
Interest-bearing	4,153,807	4,023,620
Total Deposits	5,407,554	5,289,647
Borrowings:		
Federal funds purchased	20,000	49,721
Securities sold under repurchase agreements	140,777	155,325
Federal Home Loan Bank advances	268,579	235,652
Subordinated debentures and term loans	127,678	127,846
Total Borrowings	557,034	568,544
Interest payable	3,051	3,092
Other liabilities	51,229	49,211
Total Liabilities	6,018,868	5,910,494
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 - 40,772,896 and 40,664,259 shares	5,097	5,083
Additional paid-in capital	505,725	504,530

Retained earnings	369,568	342,133
Accumulated other comprehensive income (loss)	7,035	(1,362)
Total Stockholders' Equity	887,550	850,509
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 6,906,418	$ 6,761,003

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 INCOME

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
INTEREST INCOME				
Loans receivable:				
Taxable	$52,099	$45,320	$102,588	$88,871
Tax exempt	1,465	736	2,780	984
Investment securities:				
Taxable	4,202	4,425	8,530	9,148
Tax exempt	4,583	4,231	9,092	8,066
Deposits with financial institutions	122	31	228	68
Federal Reserve and Federal Home Loan Bank stock	233	459	713	1,009
Total Interest Income	62,704	55,202	123,931	108,146
INTEREST EXPENSE				
Deposits	4,039	3,686	8,102	7,202
Federal funds purchased	7	19	35	42
Securities sold under repurchase agreements	92	90	192	168
Federal Home Loan Bank advances	818	706	1,614	1,397
Subordinated debentures and term loans	1,786	1,670	3,571	3,330
Total Interest Expense	6,742	6,171	13,514	12,139
NET INTEREST INCOME	55,962	49,031	110,417	96,007
Provision for loan losses	790	417	1,340	417
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	55,172	48,614	109,077	95,590
OTHER INCOME				
Service charges on deposit accounts	4,416	4,090	8,561	7,638
Fiduciary activities	2,376	2,309	4,870	4,816
Other customer fees	4,695	4,602	9,754	8,269
Commission income		1,815		4,143
Earnings on cash surrender value of life insurance	1,297	640	2,773	1,387
Net gains and fees on sales of loans	1,717	1,781	3,177	3,270
Net realized gains (losses) on sales of available for sale securities	706	(93)	1,703	932
Gain on sale of insurance subsidiary		8,265		8,265
Other income	1,178	697	1,384	785
Total Other Income	16,385	24,106	32,222	39,505
OTHER EXPENSES				
Salaries and employee benefits	25,570	26,434	52,907	50,975
Net occupancy	4,059	3,503	8,081	7,293
Equipment	3,243	2,840	6,481	5,406
Marketing	851	951	1,588	1,731
Outside data processing fees	2,025	1,768	4,094	3,485

Printing and office supplies	369	303	733	667
Core deposit amortization	977	729	1,955	1,450
FDIC assessments	1,002	895	1,952	1,758
Other real estate owned and foreclosure expenses	915	845	1,666	1,241
Professional and other outside services	1,478	3,134	3,640	4,625
Other expenses	4,346	4,494	8,213	7,634
Total Other Expenses	44,835	45,896	91,310	86,265
INCOME BEFORE INCOME TAX	26,722	26,824	49,989	48,830
Income tax expense	6,716	8,856	12,290	14,690
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS	$20,006	$17,968	$37,699	$34,140
Per Share Data:				
Basic Net Income Available to Common Stockholders	$0.50	$0.47	$0.93	$0.90
Diluted Net Income Available to Common Stockholders	$0.49	$0.47	$0.92	$0.90
Cash Dividends Paid	$0.14	$0.11	$0.25	$0.19
Average Diluted Shares Outstanding (in thousands)	40,969	38,043	40,941	38,022

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 June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net income	$20,006	$17,968	$37,699	$34,140
Other comprehensive income net of tax:				
Unrealized holding gain (loss) on securities available for sale arising during the period, net of tax of $3,096, $2,904, $5,861 and $2,376	5,750	(5,393)	10,885	(4,413)
Unrealized gain (loss) on cash flow hedges arising during the period, net of tax of $284, $282, $969 and $165	(529)	525	(1,798)	(304)
Reclassification adjustment for net losses (gains) included in net income, net of tax of $136, $158, $371 and $77	(252)	293	(690)	(143)
	4,969	(4,575)	8,397	(4,860)
Comprehensive income	$24,975	$13,393	$46,096	$29,280

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	
	Shares	Amount	Shares	Amount	Paid in Capital	Retained Earnings	Comprehensive Income (Loss)	Total
Balances, December 31, 2015	125	$ 125	40,664,259	$5,083	$504,530	$342,133	$ (1,362)	$850,509
Comprehensive income								
Net income						37,699		37,699
Other comprehensive income, net of tax							8,397	8,397
Cash dividends on common stock ($.25 per share)						(10,264)		(10,264)
Share-based compensation			106,290	13	1,222			1,235
Stock issued under employee benefit plans			10,536	1	215			216
Stock issued under dividend reinvestment and stock purchase plan			15,703	2	382			384
Stock options exercised			13,828	2	212			214
Stock redeemed			(37,720)	(4)	(836)			(840)
Balances, June 30, 2016	125	$ 125	40,772,896	$5,097	$505,725	$369,568	$ 7,035	$887,550

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)

	Six Months Ended	
	June 30, 2016	June 30, 2015
Cash Flow From Operating Activities:		
Net income	$37,699	$34,140
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,340	417
Depreciation and amortization	3,604	3,123
Change in deferred taxes	5,571	2,341
Share-based compensation	1,235	1,130
Tax benefit from stock options exercised	(3)	(35)
Loans originated for sale	(199,281)	(176,552)
Proceeds from sales of loans	190,321	175,492
Gain on sale of insurance subsidiary		(8,265)
Gains on sales of securities available for sale	(1,703)	(932)
Change in interest receivable	1,064	396
Change in interest payable	(41)	(19)
Other adjustments	(5,237)	5,170
Net cash provided by operating activities	34,569	36,406
Cash Flows from Investing Activities:		
Net change in interest-bearing deposits	(30,218)	21,773
Purchases of:		
Securities available for sale	(96,873)	(101,627)
Securities held to maturity	(76,395)	(55,415)
Proceeds from sales of securities available for sale	85,081	42,117
Proceeds from maturities of:		
Securities available for sale	32,286	31,917
Securities held to maturity	54,810	44,035
Change in Federal Reserve and Federal Home Loan Bank stock	19,537	7,578
Net change in loans	(102,735)	(213,356)
Net cash and cash equivalents paid in acquisition		(12,004)
Net cash received from sale of insurance subsidiary		15,155
Proceeds from the sale of other real estate owned	4,633	4,444
Other adjustments	(1,671)	1,464
Net cash used in investing activities	(111,545)	(213,919)
Cash Flows from Financing Activities:		
Net change in :		
Demand and savings deposits	173,705	51,914
Certificates of deposit and other time deposits	(56,969)	(8,357)
Borrowings	279,518	200,467
Repayment of borrowings	(290,687)	(71,916)
Cash dividends on common stock	(10,264)	(7,246)

Stock issued under employee benefit plans	216	231
Stock issued under dividend reinvestment and stock purchase plans	384	310
Stock options exercised	211	619
Tax benefit from stock options exercised	3	35
Stock redeemed	(840)	(1,232)
Net cash provided by financing activities	95,277	164,825
Net Change in Cash and Cash Equivalents	18,301	(12,688)
Cash and Cash Equivalents, January 1	102,170	118,616
Cash and Cash Equivalents, June 30	$120,471	$105,928
Additional cash flow information:		
Interest paid	$13,555	$12,129
Income tax paid	$3,155	$3,000
Loans transferred to other real estate owned	$320	$3,360
Fixed assets transferred to other real estate owned	$360	$1,003
Non-cash investing activities using trade date accounting	$4,414	$1,887
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, 2015, 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, 2015 filed with the Securities and Exchange Commission. The results of operations for the three and six months ended June 30, 2016, 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

Acquisition - Ameriana Bancorp, Inc.

On December 31, 2015, the Corporation acquired 100 percent of Ameriana Bancorp, Inc. ("Ameriana"). Ameriana merged with and into the Corporation (the "Ameriana Merger") whereupon the separate corporate existence of Ameriana ceased and the Corporation survived. Immediately following the Ameriana Merger, Ameriana Bank, an Indiana bank and wholly-owned subsidiary of Ameriana, 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. Ameriana was headquartered in New Castle, Indiana and had 13 banking centers serving central and east central Indiana. Pursuant to the merger agreement, each Ameriana shareholder received 0.9037 shares of the Corporation's common stock for each outstanding share of Ameriana common stock held. The Corporation issued approximately 2.8 million shares of common stock, which was valued at approximately $70.4 million. The Corporation engaged in this transaction with the expectation that it would be accretive and expand the existing footprint in central and east central Indiana. Goodwill resulted from this transaction due to the expected 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 Ameriana acquisition is detailed in the following table. If prior to the end of the one year measurement period for finalizing the purchase price allocation, 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	$4,068
Interest-bearing time deposits	8,790
Investment securities	61,754
Loans	316,929
Premises and equipment	13,946
Federal Home Loan Bank stock	2,693
Other real estate owned	5,613
Interest receivable	1,306
Cash surrender value of life insurance	28,188
Other assets	6,713
Deposits	(383,718)
Interest payable	(24)
Federal Home Loan Bank Advances	(24,884)
Subordinated debentures	(5,487)
Other liabilities	(9,451)
Net tangible assets acquired	26,436
Core deposit intangible	5,342
Goodwill	38,624
Purchase price	$70,402

8

(table dollar amounts in thousands, except share data)

Of the total purchase price, $5,342,000 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.

Acquisition - 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 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 were expected. The purchase price of the C Financial acquisition was allocated as follows:

	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 over a 15 year period for tax purposes as the transaction was considered a taxable exchange.

Subsidiary Divestiture - First Merchants Insurance Services, Inc.

On June 12, 2015, the Corporation sold all of its stock in First Merchants Insurance Services, Inc., an Indiana corporation ("FMIG"), to USI Insurance Services LLC, a Delaware limited liability company. 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.

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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 June 30, 2016				
U.S. Government-sponsored agency securities	$100	$ 2		$102
State and municipal	329,042	24,438		353,480
U.S. Government-sponsored mortgage-backed securities	292,822	8,469	$ 20	301,271
Corporate obligations	31			31
Equity securities	3,882	63		3,945
Total available for sale	625,877	32,972	20	658,829
Held to maturity at June 30, 2016				
Federal agencies	28,980	34	5	29,009
State and municipal	207,731	11,621		219,352
U.S. Government-sponsored mortgage-backed securities	402,261	14,444		416,705
Total held to maturity	638,972	26,099	5	665,066
Total Investment Securities	$1,264,849	$ 59,071	$ 25	$1,323,895

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at December 31, 2015				
U.S. Government-sponsored agency securities	$100	$ 4		$104
State and municipal	291,730	14,241	$ 60	305,911
U.S. Government-sponsored mortgage-backed securities	342,550	4,234	518	346,266
Corporate obligations	31			31
Equity securities	3,912			3,912
Certificates of deposit	2,176			2,176
Total available for sale	640,499	18,479	578	658,400
Held to maturity at December 31, 2015				
State and municipal	219,767	6,982	15	226,734
U.S. Government-sponsored mortgage-backed securities	398,832	7,601	787	405,646
Total held to maturity	618,599	14,583	802	632,380
Total Investment Securities	$1,259,098	$ 33,062	$ 1,380	$1,290,780

The amortized cost and fair value of available for sale and held to maturity securities at June 30, 2016 and December 31, 2015, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Maturity Distribution at June 30, 2016:				
Due in one year or less	$3,065	$3,086	$2,500	$2,532
Due after one through five years	19,909	21,060	42,528	44,205
Due after five through ten years	60,972	64,871	82,937	85,365
Due after ten years	245,227	264,596	108,746	116,259
	$329,173	$353,613	$236,711	$248,361
U.S. Government-sponsored mortgage-backed securities	292,822	301,271	402,261	416,705
Equity securities	3,882	3,945		
Total Investment Securities	$625,877	$658,829	$638,972	$665,066

Table of Contents
PART I. FINANCIAL INFORMATION
ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(table dollar amounts in thousands, except share data)
(Unaudited)

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Maturity Distribution at December 31, 2015				
Due in one year or less	$4,658	$4,704	$4,144	$4,148
Due after one through five years	13,725	14,295	28,054	29,175
Due after five through ten years	52,878	55,375	81,483	83,646
Due after ten years	220,600	231,672	106,086	109,765
	$291,861	$306,046	$219,767	$226,734
U.S. Government-sponsored mortgage-backed securities	342,550	346,266	398,832	405,646
Equity securities	3,912	3,912		
Certificates of deposit	2,176	2,176		
Total Investment Securities	$640,499	$658,400	$618,599	$632,380

The carrying value of securities pledged as collateral, to secure borrowings and for other purposes, was $607,799,000 at June 30, 2016, and $637,358,000 at December 31, 2015.

The book value of securities sold under agreements to repurchase amounted to $135,855,000 at June 30, 2016, and $153,789,000 at December 31, 2015.

Gross gains on the sales and redemptions of available for sale securities for the three and six months ended June 30, 2016 and 2015 are shown below.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Sales and Redemptions of Available for Sale Securities:				
Gross gains	$706	$ 7	$1,703	$1,032
Gross losses		100		100

The following table shows investment securities with unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2016, and December 31, 2015:

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses

Temporarily Impaired Available for Sale Securities at June 30, 2016						
U.S. Government-sponsored mortgage-backed securities	4,007	$ 15	$1,053	$ 5	5,060	$ 20
Total Temporarily Impaired Available for Sale Securities	4,007	15	1,053	5	5,060	20
Temporarily Impaired Held to Maturity Securities at June 30, 2016						
Federal agencies	4,995	5			4,995	5
Total Temporarily Impaired Held to Maturity Securities	4,995	5			4,995	5
Total Temporarily Impaired Investment Securities	$9,002	$ 20	$1,053	$ 5	$10,055	$ 25

	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 December 31, 2015						
State and municipal	$7,558	$ 60			$7,558	$ 60
U.S. Government-sponsored mortgage-backed securities	83,396	445	$2,101	$ 73	85,497	518
Total Temporarily Impaired Available for Sale Securities	90,954	505	2,101	73	93,055	578
Temporarily Impaired Held to Maturity Securities at December 31, 2015						
State and municipal			1,982	15	1,982	15
U.S. Government-sponsored mortgage-backed securities	69,641	519	12,906	268	82,547	787
Total Temporarily Impaired Held to Maturity Securities	69,641	519	14,888	283	84,529	802
Total Temporarily Impaired Investment Securities	$160,595	$ 1,024	$16,989	$ 356	$177,584	$ 1,380

Table of Contents
PART I. FINANCIAL INFORMATION
ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(table dollar amounts in thousands, except share data)
(Unaudited)

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

	June 30, 2016	December 31, 2015
Investments reported at less than historical cost:		
Historical cost	$10,081	$178,964
Fair value	$10,055	$177,584
Percent of the Corporation's available for sale and held to maturity portfolio	0.8 %	13.9 %

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 impairment is identified.

The Corporation’s management has evaluated all securities with unrealized losses for other-than temporary impairment as of June 30, 2016. 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 losses resulting from the sale of certain securities has proven the data to be accurate over time. The 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.

U.S. Government-Sponsored Mortgage-Backed Securities

The unrealized losses on the Corporation’s investments in securities of U.S. Government-sponsored mortgage-backed securities were caused by changes in interest rates and not credit quality. 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 investments and more likely than not the Corporation won't be required to sell the investments before recovery of its lower amortized cost basis, which may be maturity. The Corporation does not consider the investment securities to be other-than-temporarily impaired at June 30, 2016.

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 2016	Accumulated Credit Losses in 2015
Credit losses on debt securities held:		
Balance, January 1	$ —	$ 500
Reductions for previous other-than-temporary losses realized on securities sold during the year	—	(500)
Balance, June 30	$ —	$ —

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

Table of Contents
PART I. FINANCIAL INFORMATION
ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(table dollar amounts in thousands, except share data)
(Unaudited)

NOTE 4

LOANS AND ALLOWANCE

The Corporation's primary lending focus is small business and middle market commercial, commercial real estate, residential real estate and consumer, which results in portfolio diversification. The following tables show the composition of the loan portfolio, the allowance for loan losses and certain credit quality aspects, all excluding loans held for sale. Loans held for sale as of June 30, 2016, and December 31, 2015, were $18,854,000 and $9,894,000, respectively.

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

	June 30, 2016	December 31, 2015
Commercial and industrial loans	$1,084,890	$1,057,075
Agricultural production financing and other loans to farmers	95,131	97,711
Real estate loans:		
Construction	352,980	366,704
Commercial and farmland	1,869,703	1,802,921
Residential	758,870	786,105
Home Equity	374,159	348,613
Individuals' loans for household and other personal expenditures	75,205	74,717
Lease financing receivables, net of unearned income	388	588
Other commercial loans	180,103	159,388
Loans	$4,791,429	$4,693,822
Allowance for loan losses	(62,186)	(62,453)
Net Loans	$4,729,243	$4,631,369

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 adequate to cover probable losses inherent in the loan portfolio at June 30, 2016. 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 it 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, portfolio mix and collateral values.

The allowance for loan losses is maintained through the provision for loan losses, which is a charge against earnings. The allowance is increased by provision expense and decreased by charge offs less recoveries. All charge offs are approved by the Bank's senior loan officers or loan committees, depending on the amount of the charge off. The Bank charges off a loan when a determination is made that all or a portion of the loan is uncollectible. 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 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.

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.

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 risk grades to charge off.

Table of Contents
PART I. FINANCIAL INFORMATION
ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(table dollar amounts in thousands, except share data)
(Unaudited)

In addition to the specific reserves and historical loss components of the allowance, consideration is given to various environmental factors to ensure that losses inherent in the portfolio are reflected in the allowance for loan losses. The environmental component adjusts the historical loss allocations for non-impaired 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.

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 included in the allowance to the extent a specific impairment is identified that exceeds the fair value adjustment on an impaired loan or the historical loss and environmental factor analysis indicates losses inherent in a purchased portfolio exceeds the fair value adjustment on the portion of the purchased portfolio not deemed impaired.

The following tables summarize changes in the allowance for loan losses by loan segment for the three and six months ended June 30, 2016, and June 30, 2015:

	Three Months Ended June 30, 2016					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance for loan losses:						
Balances, April 1	$26,264	$ 22,317	$ 2,647	$ 10,856	$ 2	$62,086
Provision for losses	400	200	44	146		790
Recoveries on loans	683	276	107	273		1,339
Loans charged off	(1,026)	(513)	(114)	(376)		(2,029)
Balances, June 30, 2016	$26,321	$ 22,280	$ 2,684	$ 10,899	$ 2	$62,186

	Six Months Ended June 30, 2016					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance for loan losses:						
Balances, January 1	$26,478	$ 22,145	$ 2,689	$ 11,139	$ 2	$62,453
Provision for losses	539	414	77	310		1,340
Recoveries on loans	975	1,228	185	585		2,973
Loans charged off	(1,671)	(1,507)	(267)	(1,135)		(4,580)
Balances, June 30, 2016	$26,321	$ 22,280	$ 2,684	$ 10,899	$ 2	$62,186

	Three Months Ended June 30, 2015					
	Commercial		Consumer	Residential		Total

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

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

Table of Contents
PART I. FINANCIAL INFORMATION
ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(table dollar amounts in thousands, except share data)
(Unaudited)

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

	June 30, 2016					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance Balances:						
Individually evaluated for impairment	$1,573	$276		$69		$1,918
Collectively evaluated for impairment	24,748	21,824	$2,684	10,808	$ 2	60,066
Loans Acquired with Deteriorated Credit Quality		180		22		202
Total Allowance for Loan Losses	$26,321	$22,280	$2,684	$10,899	$ 2	$62,186
Loan Balances:						
Individually evaluated for impairment	$7,841	$21,118		$3,462		$32,421
Collectively evaluated for impairment	1,345,826	2,155,077	$75,205	1,126,707	$ 388	4,703,203
Loans Acquired with Deteriorated Credit Quality	6,457	46,488		2,860		55,805
Loans	$1,360,124	$2,222,683	$75,205	$1,133,029	$ 388	$4,791,429

	December 31, 2015					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance Balances:						
Individually evaluated for impairment	$1,277	$243		$169		$1,689
Collectively evaluated for impairment	25,201	21,753	$2,689	10,966	$ 2	60,611
Loans Acquired with Deteriorated Credit Quality		149		4		153
Total Allowance for Loan Losses	$26,478	$22,145	$2,689	$11,139	$ 2	$62,453
Loan Balances:						
Individually evaluated for impairment	$7,877	$16,670		$4,020		$28,567
Collectively evaluated for impairment	1,298,988	2,096,089	$74,717	1,125,316	$ 588	4,595,698
Loans Acquired with Deteriorated Credit Quality	7,309	56,866		5,382		69,557
Loans	$1,314,174	$2,169,625	$74,717	$1,134,718	$ 588	$4,693,822

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 typically 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.

Table of Contents
PART I. FINANCIAL INFORMATION
ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(table dollar amounts in thousands, except share data)
(Unaudited)

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. Uncollected interest previously recorded, but not deemed collectible, is reversed and charged against current income. Payments subsequently received on non-accrual loans are applied to principal. A loan is returned to accrual status when principal and interest are no longer past due and collectability is probable, typically after a minimum of six consecutive months of performance. Payments received on impaired accruing or delinquent loans are applied to interest income as accrued.

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

	June 30, 2016	December 31, 2015
Commercial and industrial loans	$3,413	$ 4,634
Agriculture production financing and other loans to farmers	1,471	827
Real estate Loans:		
Construction	721	736
Commercial and farmland	15,541	11,277
Residential	9,952	11,818
Home Equity	2,345	1,952
Individuals' loans for household and other personal expenditures	122	145
Total	$33,565	$ 31,389

Commercial impaired loans include non-accrual loans, loans accounted for under ASC 310-30, and loans risk graded as substandard, doubtful and loss that were still accruing but deemed impaired according to the 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.

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

	June 30, 2016		
	Unpaid Principal	Recorded Investment	Related Allowance

	Balance		
Impaired loans with no related allowance:			
Commercial and industrial loans	$19,322	$ 10,183	
Agriculture production financing and other loans to farmers	709	701	
Real estate Loans:			
Construction	8,089	4,091	
Commercial and farmland	83,028	61,319	
Residential	8,650	5,016	
Home equity	176	139	
Other commercial loans	16		
Total	$119,990	$ 81,449	
Impaired loans with related allowance:			
Commercial and industrial loans	$2,491	$ 2,114	$ 1,007
Agriculture production financing and other loans to farmers	1,331	1,301	566
Real estate Loans:			
Commercial and farmland	2,145	1,978	456
Residential	877	801	91
Total	$6,844	$ 6,194	$ 2,120
Total Impaired Loans	$126,834	$ 87,643	$ 2,120

Table of Contents
PART I. FINANCIAL INFORMATION
ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(table dollar amounts in thousands, except share data)
(Unaudited)

	December 31, 2015		
	Unpaid Principal Balance	Recorded Investment	Related Allowance
Impaired loans with no related allowance:			
Commercial and industrial loans	$22,151	$ 11,669	
Agriculture production financing and other loans to farmers	370	361	
Real estate Loans:			
Construction	4,551	2,336	
Commercial and farmland	95,930	69,024	
Residential	11,262	7,338	
Home equity	297	247	
Other commercial loans	20		
Total	$134,581	$ 90,975	
Impaired loans with related allowance:			
Commercial and industrial loans	$3,043	$ 2,690	$ 1,247
Agriculture production financing and other loans to farmers	466	466	30
Real estate Loans:			
Commercial and farmland	2,144	1,933	392
Residential	2,300	1,463	173
Total	$7,953	$ 6,552	$ 1,842
Total Impaired Loans	$142,534	$ 97,527	$ 1,842

	Three Months Ended June 30, 2016		Six Months Ended June 30, 2016	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Impaired loans with no related allowance:				
Commercial and industrial loans	$10,372	$ 128	$10,307	$ 231
Agriculture production financing and other loans to farmers	834	2	882	2
Real estate Loans:				
Construction	4,085	74	4,074	147
Commercial and farmland	62,173	861	63,136	1,706
Residential	5,069	54	5,390	107
Home equity	138		139	
Total	$82,671	$ 1,119	$83,928	$ 2,193
Impaired loans with related allowance:				
Commercial and industrial loans	$2,120	$ 9	$2,129	$ 19
Agriculture production financing and other loans to farmers	1,321		1,405	
Real estate Loans:				
Commercial and farmland	1,986		2,008	
Residential	840		860	

Total	$6,267	$ 9	$6,402	$ 19
Total Impaired Loans	$88,938	$ 1,128	$90,330	$ 2,212

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

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 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.

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:
  - 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,
  - 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,
  - loans have a distinct possibility that the Corporation will sustain some loss if deficiencies are not corrected,
  - unusual courses of action are needed to maintain a high probability of repayment,
  - the borrower is not generating enough cash flow to repay loan principal; however, it continues to make interest payments,
  - the Corporation is forced into a subordinated or unsecured position due to flaws in documentation,
  - loans have been restructured so that payment schedules, terms and collateral represent concessions to the borrower when compared to the normal loan terms,
  - the Corporation is seriously contemplating foreclosure or legal action due to the apparent deterioration of the loan, and
  - 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 not 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.

18

Table of Contents
PART I. FINANCIAL INFORMATION
ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(table dollar amounts in thousands, except share data)
(Unaudited)

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

June 30, 2016	
Commercial Pass	Commercial Special Mention