FIRST MERCHANTS CORP
Form 10-Q
August 09, 2007

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, 2007

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)

(765) 747-1500

(Registrant's telephone number, including area code)

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.
(Check one):

Large accelerated filer [ ]   Accelerated filer [X]   Non-accelerated filer [ ]

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 27, 2007, there were 18,434,596 outstanding common shares, without par value, of the registrant.

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PART I. FINANCIAL INFORMATION
Item 1. FINANCIAL STATEMENTS
CONSOLIDATED CONDENSED BALANCE SHEETS
(Dollars in thousands, except per share amounts)

	June 30, 2007	December 31, 2006
	(Unaudited)	
ASSETS:		
Cash and due from banks	$ 80,921	$ 89,957
Interest-bearing deposits....................................	8,898	11,284
Investment securities available for sale	470,388	455,933
Investment securities held to maturity	8,893	9,284
Mortgage loans held for sale.................................	2,842	5,413
Loans, net of allowance for loan losses of $27,608 and $26,540.	2,778,460	2,666,061
Premises and equipment	44,126	42,393
Federal Reserve and Federal Home Loan Bank stock..............	23,822	23,691
Interest receivable	21,615	24,345
Core deposit intangibles	13,888	15,470
Goodwill	123,168	123,168
Cash surrender value of life insurance.......................	69,111	64,213
Other assets	23,383	23,658
Total assets	$ 3,669,515	$ 3,554,870
LIABILITIES:		
Deposits:		
Noninterest-bearing	$ 362,083	$ 362,058
Interest-bearing	2,357,518	2,388,480
Total deposits	2,719,601	2,750,538
Borrowings:		
Federal funds purchased	125,650	56,150
Securities sold under repurchase agreements	91,038	42,750
Federal Home Loan Bank Advances	268,680	242,408
Subordinated debentures, revolving credit lines and term loans	102,206	99,456
Total borrowings	587,574	440,764
Interest payable	10,417	9,326
Other liabilities..	24,543	26,917
Total liabilities	3,342,135	3,227,545

COMMITMENTS AND CONTINGENT LIABILITIES		
STOCKHOLDERS' EQUITY:		
Preferred stock, no-par value:		
Authorized and unissued - 500,000 shares		
Common Stock, $.125 stated value:		
Authorized --- 50,000,000 shares		
Issued and outstanding - 18,285,359 and 18,439,843 shares....	2,286	2,305
Additional paid-in capital	143,317	146,460
Retained earnings	193,460	187,965
Accumulated other comprehensive loss	(11,683)	(9,405)
Total stockholders' equity	327,380	327,325
Total liabilities and stockholders' equity	$ 3,669,515	$ 3,554,870

See notes to consolidated condensed financial statements.

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CONSOLIDATED CONDENSED STATEMENTS OF INCOME
(Dollars in thousands, except per share amounts)
(Unaudited)

	Three Months Ended June 30,		Six M
	2007	2006	200
Interest Income:			
Loans receivable			
Taxable	$51,204	$45,658	$100,8
Tax exempt	249	231	4
Investment securities			
Taxable	3,394	3,082	6,6
Tax exempt	1,651	1,613	3,3
Federal funds sold	91	11	
Deposits with financial institutions	120	132	2
Federal Reserve and Federal Home Loan Bank stock	299	320	6
Total interest income	57,008	51,047	112,2
Interest expense:			
Deposits	22,390	16,914	44,1
Borrowings	7,003	6,367	13,3
Total interest expense	29,393	23,281	57,5
Net Interest Income	27,615	27,766	54,6
Provision for loan losses	1,648	1,729	3,2

Net Interest Income After Provision for Loan Losses	25,967	26,037	51,4
Other Income:			
Net realized loss on sales of available-for-sale securities..		(9)	
Other income	9,766	8,420	19,5
Total other income	9,766	8,411	19,5
Other expenses:			
Salaries and benefits	14,796	13,543	29,5
Write-off of unamortized underwriting expenses	1,771		1,7
Other expenses	11,172	10,351	20,6
Total other expenses	27,739	23,894	51,9
Income before income tax	7,994	10,554	19,0
Income tax expense	1,786	3,263	5,1
Net Income	$ 6,208	$ 7,291	$13,9
Per share:			
Basic	$ .34	$ .39	$ .7
Diluted	.34	.39	.7
Dividends	.23	.23	.4

See notes to consolidated condensed financial statements.

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CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in thousands)

(Unaudited)

	Three Months E June 30	
	2007	
Net Income..	$ 6,208	$
Other comprehensive income (loss), net of tax:		
Unrealized losses on securities available for sale:		
Unrealized holding losses arising during the period, net of income tax benefit of $1,493, $1,631, $1,195 and $2,035	(2,773)	(
Unrealized losses on cash flow hedge assets:		
Unrealized losses arising during the period, net of income tax benefit of $221, $0, $179 and $0	(331)	
Unrealized gain on pension minumum funding liability:		
Unrealized loss arising during the period, net of income tax expense of $(140), $0, $(140) and $0	210	

Reclassification adjustment for losses included in net income, net of income tax expense of $0, $(4), $0 and $0		
	(2,894)	(
Comprehensive income	$ 3,314	$

See notes to consolidated condensed financial statements.

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CONSOLIDATED CONDENSED STATEMENTS OF STOCKHOLDERS' EQUITY
(Dollars in thousands)
(Unaudited)

	2007	2006
Balances, January 1	$ 327,325	$ 313,396
Net income	13,979	14,800
Cash dividends on common stock	(8,435)	(8,449)
Cash dividends on restricted stock awards	(48)	(26)
Other comprehensive loss, net of tax...........................	(2,278)	(3,052)
Stock issued under dividend reinvestment and stock purchase plan	593	592
Stock options exercised	370	755
Tax benefit from stock options exercised	89	78
Stock redeemed	(4,956)	(5,442)
Share-based compensation	741	352
Balances, June 30	$ 327,380	$ 313,004

See notes to consolidated condensed financial statements.

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CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	Si
	2007
Cash Flows From Operating Activities:	
Net income	$ 13,
Adjustments to reconcile net income to net cash provided by operating activities	
Provision for loan losses	3,
Depreciation and amortization	2,
Share-based compensation	
Tax benefits from stock options exercised	
Mortgage loans originated for sale	(58,
Proceeds from sales of mortgage loans	60,
Change in interest receivable	2,
Change in interest payable	1,
Other adjustments	(
Net cash provided by operating activities	$ 26,
Cash Flows From Investing Activities:	
Net change in interest-bearing deposits	$ 2,
Purchases of	
Securities available for sale	(49,
Proceeds from maturities of	
Securities available for sale	31,
Securities held to maturity	
Purchase of Federal Reserve and	
Federal Home Loan Bank Stock	(
Purchase of bank owned life insurance	(3,
Net change in loans	(115,
Other adjustments	(4,
Net cash used by investing activities	$ (139,
Cash Flows From Financing Activities:	
Net change in	
Demand and savings deposits	$ (40,
Certificates of deposit and other time deposits	9,
Borrowings	192,
Repayment of borrowings	(45,
Cash dividends on common stock	(8,
Cash dividends on restricted stock awards	
Stock issued under dividend reinvestment and stock purchase plans	
Stock options exercised	
Tax benefit from stock options exercised	
Stock redeemed	(4,
Net cash provided by financing activities	103,
Net Change in Cash and Cash Equivalents	(9,

Cash and Cash Equivalents, January 1		89,
Cash and Cash Equivalents, June 30	$	80,
Additional cash flows information:		
Interest paid	$	58,
Income tax paid		6,

See notes to consolidated condensed financial statements.

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Table dollars in thousands)
(Unaudited)

NOTE 1. General

Financial Statement Preparation

The significant accounting policies followed by First Merchants Corporation ("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, 2006 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 Form 10-K annual report filed with the Securities and Exchange Commission. The results of operations for the three and six months ended June 30, 2007 are not necessarily indicative of the results to be expected for the year.

Change in an Accounting Principle

The Corporation or one of its subsidiaries files income tax returns in the U.S. federal and Indiana jurisdictions. With few exceptions, the Corporation is no longer subject to U.S. federal, state and local examinations by tax authorities for years before 2003.

The Corporation adopted the provisions of the Financial Accounting Standards Board (FASB) Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109, on January 1, 2007. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. As a result of the implementation of FIN 48, the Corporation did not identify any uncertain tax positions that it believes should be recognized in the financial statements.

(Table dollars in thousands)

NOTE 2. Share-Based Compensation

Stock options and restricted stock awards ("RSAs") have been issued to directors, officers and other management employees under the Corporation's 1994 Stock Option Plan and The 1999 Long-term Equity Incentive Plan. The stock options, which have a ten year life, become 100 percent vested ranging from three 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 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.

The Corporation's 2004 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 annual offerings financed by payroll deductions. The price of the stock to be paid by the employees may not be less than 85 percent of the lesser of the fair market value of the Corporation's common stock at the beginning or at the end of the offering period. Common stock purchases are made annually and are paid through advance payroll deductions of up to 20 percent of eligible compensation.

SFAS 123(R) requires the Corporation to begin recording compensation expense in 2006 related to unvested share-based awards outstanding as of December 31, 2005, 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 granted after December 31, 2005 are valued at fair value in accordance with provisions of SFAS 123(R) and are recognized on a straight-line basis over the service periods of each award. To complete the exercise of vested stock options, RSA's and ESPP options, the Corporation generally issues new shares from its authorized but unissued share pool. Share-based compensation for the three and six months ended June 30, 2007 totaled $490,000 and $741,000, respectively, compared to $158,000 and $352,000 for the three and six months ended June 30, 2006, respectively. Share-based compensation has been recognized as a component of salaries and benefits expense in the accompanying Consolidated Condensed Statements of Income.

NOTE 2. Share-Based Compensation continued

The estimated fair value of the stock options granted during 2007 and in prior years was calculated using a Black Scholes option pricing model. The following summarizes the assumptions used in the 2007 Black Scholes model:

Risk-free interest rate	4.67%
Expected price volatility	29.76%
Dividend yield	3.64%
Forfeiture rate	5.00%
Weighted-average expected life, until exercise	5.99 years

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 zero-coupon 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.

(Table dollars in thousands)

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. SFAS 123(R) 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 5 percent for the six months ended June 30, 2007, based on historical experience. In the Corporation's pro forma disclosures required under SFAS 123(R) for the periods prior to fiscal 2006, the Corporation accounted for forfeitures as they occurred.

NOTE 2. Share-Based Compensation continued

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

	Three Months Ended June 30, 2007	Three Months Ended June 30, 2006
Stock and ESPP Options:		
Pre-tax compensation expense	$ 174	$ 116
Income tax benefit	(9)	(8)
Stock and ESPP option expense, net of income taxes	$ 165	$ 108
Restricted Stock Awards:		
Pre-tax compensation expense	$ 316	$ 42
Income tax benefit	(110)	(37)
Restricted stock awards expense, net of income taxes	$ 206	$ 5
Total Share-Based Compensation:		
Pre-tax compensation expense	$ 490	$ 158
Income tax benefit	(119)	(45)

Total share-based compensation expense, net of income taxes	$ 371	$ 113

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(Table dollars in thousands)
(Unaudited)

NOTE 2. Share-Based Compensation continued

As of June 30, 2007, unrecognized compensation expense related to stock options, and RSAs totaling $408,000 and $1,676,000, respectively, is expected to be recognized over weighted-average periods of 1.05 and 2.15 years, respectively.

Stock option activity under the Corporation's stock option plans as of June 30, 2007 and changes during the six months ended June 30, 2007 were as follows:

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in Years)
Outstanding at January 1, 2007	1,067,247	$ 23.87	
Granted	65,550	26.31	
Exercised	(24,098)	18.14	
Cancelled	(14,689)	25.74	
Outstanding at June 30, 2007	1,094,010	$ 24.12	5.63
Vested and Expected to Vest at June 30, 2007	1,081,482	$ 24.10	5.59
Exercisable at June 30, 2007	964,460	$ 23.90	5.17

The weighted-average grant date fair value, as calculated using the Black-Scholes option pricing model, was $6.45 for stock options granted during the six months ended June 30, 2007.

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Corporation's closing stock price on the last trading day of the first six months of 2007 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their stock options on June 30, 2007. 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 first six months of 2007 was $163,000. Exercise of options during this same period resulted in cash receipts of $288,000. The Corporation recognized a tax benefit of approximately $89,000 in the first six months of 2007, related to the exercise of employee stock options and has been recorded as an increase to additional paid-in capital.

(Table dollars in thousands)

The following table summarizes information on unvested restricted stock awards outstanding as of June 30, 2007:

	Number of Shares	Weighted-Average Grant-Date Fair Value
Unvested RSAs at January 1, 2007	55,000	$ 27.83
Granted	54,925	26.26
Forfeited	(2,900)	25.70
Vested	(6,566)	25.50
Unvested RSAs at June 30, 2007	100,459	$ 27.18

NOTE 2. Share-Based Compensation continued

The grant date fair value of ESPP options was estimated at the beginning of the July 1, 2006 offering period and approximates $198,000. The ESPP options vests during the twelve month period ending June 30, 2007.

NOTE 3. Investment Securities

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at June 30, 2007				
U.S. Treasury	$ 1,502	$	(5)	$ 1,497
U.S. Government-sponsored agency securities	84,660		$(1,166)	83,494
State and municipal	165,294	1,052	(1,378)	164,968
Mortgage-backed securities	208,291	75	(5,462)	202,904
Corporate Obligations	11,796		(57)	11,739
Marketable equity securities	6,063		(277)	5,786
Total available for sale	477,606	1,127	(8,345)	470,388
Held to maturity at June 30, 2007				
State and municipal	8,877	215	(344)	8,748
Mortgage-backed securities	16			16
Total held to maturity	8,893	215	(344)	8,764
Total investment securities	$486,499	$ 1,342	$ (8,689)	$479,152

The Corporation has the intent and ability to hold the securities with unrealized losses to the earlier of recovery or maturity. If the Corporation is unable to make this assertation at any reporting period, the Corporation will take the necessary actions to recognize the unrealized loss in the appropriate period's income statement.

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at December 31, 2006				
U.S. Treasury	$ 1,502	$ 1		$ 1,503
U.S. Government-sponsored agency securities	87,193	69	$(1,284)	85,978
State and municipal	168,262	2,251	(892)	169,621
Mortgage-backed securities	195,228	600	(3,983)	191,845
Marketable equity securities	7,296		(310)	6,986
Total available for sale	459,481	2,921	(6,469)	455,933
Held to maturity at December 31, 2006				
State and municipal	9,266	432	(200)	9,498
Mortgage-backed securities	18			18
Total held to maturity	9,284	432	(200)	9,516
Total investment securities	$468,765	$ 3,353	$ (6,669)	$465,449

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Table dollars in thousands)
(Unaudited)

NOTE 4. Loans and Allowance

	June 30, 2007
Loans:	
Commercial and industrial loans	$ 590,345
Agricultural production financing and other loans to farmers	103,713
Real estate loans:	
Construction	172,247

Commercial and farmland	895,301
Residential	768,392
Individuals' loans for household and other personal expenditures	206,435
Tax-exempt loans	23,181
Lease financing receivables, net of unearned income	7,906
Other loans	38,548
	2,806,068
Allowance for loan losses	(27,608)
Total Loans	$ 2,778,460

	Six Mont June 2007
Allowance for loan losses:	
Balances, January 1	$ 26,540
Provision for losses	3,247
Recoveries on loans	527
Loans charged off	(2,706)
Balances, June 30	$ 27,608

Information on nonaccruing, contractually past due 90 days or more other than nonaccruing and restructured loans is summarized below:	June 30, 2007	December 31, 2006
Non-accrual loans	$ 30,820	$ 17,926
Loans contractually past due 90 days or more other than nonaccruing	5,203	2,870
Restructured loans	58	84
Total	$ 36,081	$ 20,880

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Table dollars in thousands)
(Unaudited)

NOTE 5. 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-captial when share-based awards are exercised, are assumed to be used to repurchase common stock in the current period.

	Three Months Ended June 30, 2007			
	Income	Weighted-Average Shares	Per Share Amount	Income
Basic net income per share:				
Net income available to common stockholders.................	$ 6,208	18,290,918	$ .34	$ 7,29
Effect of dilutive stock options........		77,595		
Diluted net income per share:				
Net income available to common stockholders and assumed conversions.............	$ 6,208	18,368,513	$ .34	$ 7,29

Options to purchase 714,716 and 659,659 shares for the three months ended June 30, 2007 and 2006 were not included in the earnings per share calculation because the exercise price exceeded the average market price.

	Six Months Ended June 30, 2007			
	Income	Weighted-Average Shares	Per Share Amount	Income
Basic net income per share:				
Net income available to common stockholders.................	$ 13,979	18,350,606	$ .76	$ 14,80
Effect of dilutive stock options........		81,800		
Diluted net income per share:				
Net income available to common stockholders and assumed conversions.............	$ 13,979	18,432,406	$ .76	$ 14,80

Options to purchase 692,836 and 572,616 shares for the six months ended June 30, 2007 and 2006 were not included in the earnings per share calculation because the exercise price exceeded the average market price.

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Table dollars in thousands)
(Unaudited)

Note 6. Defined Benefit Pension Costs

The Corporation has defined benefit pension plans covering substantially all employees. The plans provide benefits that are based on the employees' compensation and years of service. The Corporation uses an actuarial calculation to determine pension plan costs.

The following represents the pension cost for the three and six months ended June 30, 2007 and 2006.

	Three Months Ended June 30,		Si
	2007	2006	20
Pension Cost			
Service cost...	$ 123	$ 131	$
Interest cost	717	683	1,
Expected return on plan assets	(785)	(728)	(1,
Amortization of prior service cost.....................	1	1	
Amortization of the net loss...........................	104	87	
Total Pension Cost................................	$ 160	$ 174	$

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(Table dollars in thousands)
(Unaudited)

Note 7. Impact of Accounting Changes

In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156 (SFAS No. 156), Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, which requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable and permits the entities to elect either fair value measurement with changes in fair value reflected in earnings or the amortization and impairment requirements of SFAS No. 140 for subsequent measurement. The subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value eliminates the necessity for entities that manage the risks inherent in servicing assets and servicing liabilities with derivatives to qualify for hedge accounting treatment and eliminates the characterization of declines in fair value as impairments or direct write-downs. SFAS No. 156 is effective for the Corporation beginning January 1, 2007. We have evaluated the requirements of SFAS No. 156 and determined that it did not have a material effect on our financial condition or results of operations.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting standards, and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not expect that the adoption of SFAS No. 157 will have a material impact on our financial condition or results of operations.

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of SFAS No. 109, Accounting for Income Taxes (Interpretation No. 48). Interpretation No. 48 clarifies the accounting for uncertainty in income taxes in financial statements and prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. Interpretation No. 48 is effective for the Corporation beginning January 1, 2007. We have evaluated the requirements of Interpretation No. 48 and determined that it did not have a material effect on our financial condition or results of operations.

In September 2006, the SEC Staff issued Staff Accounting Bulletin ("SAB") No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements, which addresses how the effects of prior year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements. SAB No. 108 will require registrants to quantify misstatements using both the balance sheet and income-statement approaches and to evaluate whether either approach results in quantifying an error that is material in light of relevant quantitative and qualitative factors. When the effect of initial adoption is determined to be material, SAB No. 108 allows registrants to record that effect as a cumulative effect adjustment to beginning retained earnings. The requirements are effective for the Corporation beginning January 1, 2007. We have evaluated the requirements of SAB No. 108 and determined that it did not have a material effect on our financial condition or results of operations.

In September 2006, the Emerging Issues Task Force Issue 06-4 (EITF 06-4), Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements, was ratified. EITF 06-4 addresses accounting for separate agreements which split life insurance policy benefits between an employer and employee. The Issue requires the employer to recognize a liability for future benefits payable to the employee under these agreements. The effects of applying EITF 06-4 must be recognized through either a change in accounting principle through an adjustment to equity or through the retrospective application to all prior periods. For calendar year companies, EITF 06-4 is effective beginning January 1, 2008. Early adoption is permitted as of January 1, 2007. We do not expect the adoption of EITF 06-4 to have a material effect on our consolidated financial statements.

On February 15, 2007, the FASB issued its Statement No. 159, The Fair Value

Option for Financial Assets and Financial Liabilities-Including an Amendment of FASB Statement No. 115. FAS 159 permits entities to elect to report most financial assets and liabilities at their fair value with changes in fair value included in net income. The fair value option may be applied on an instrument-by-instrument or instrument class-by-class basis. The option is not available for deposits withdrawable on demand, pension plan assets and obligations, leases, instruments classified as stockholders' equity, investments in consolidated subsidiaries and variable interest entities and certain insurance policies. The new standard is effective at the beginning of the Company's fiscal year beginning January 1, 2008, and early application may be elected in certain circumstances. The Company is currently evaluating the effect of adoption of this Statement on its financial condition and results of operations.

Note 8. Subordinated Debentures

During the second quarter, First Merchants Corporation (the "Corporation") called its subordinated debentures payable to First Merchants Capital Trust I. The aggregate redemption price was the principal amount of $54,832,000 plus any accrued but unpaid interest at a rate of 8.75 percent. The redemption of the debentures was immediately followed by the redemption by First Merchants Capital Trust I of its outstanding common and preferred securities at their $25 liquidation value, plus any accrued but unpaid distributions.

In order to finance the redemption, the Corporation completed the issuance and sale of $55,000,000 in aggregate liquidation amount of Fixed/Floating Rate Capital Securities (the "Capital Securities") issued by the Corporation's newly formed subsidiary, First Merchants Capital Trust II, a Delaware Statutory Trust (the "Trust") in a trust preferred transaction. The Trust simultaneously issued 1,702 shares of the Trust's common securities (the "Common Securities") to the Corporation for the purchase price of $1,702,000, which constitutes all of the issued and outstanding common securities of the Trust. The Trust used the proceeds from the sale of the Capital Securities and the Common Securities to purchase $56,702,000 in aggregate principal amount of Fixed/Floating Rate Junior Subordinated Deferrable Interest Debentures issued by the Corporation (the "Debentures"). The net proceeds to the Corporation from the sale of the Debentures will be used by the Corporation to finance the redemption discussed above.

The Capital Securities and the Debentures will mature on September 15, 2037. Distributions on the Capital Securities are cumulative and will be payable quarterly at a fixed annual rate of 6.495% for the period from the date of issuance through September 15, 2012, and, thereafter, at an annual floating rate equal to three-month LIBOR plus 1.56%, reset quarterly. The Capital Securities are redeemable at any time after September 15, 2012 at par and without penalty, and may be redeemed earlier following the occurrence of specified Special Events. In each case, the right of the Corporation to redeem the related Debentures, and thereby to cause the redemption of the Capital Securities, will be subject to the Corporation's receipt of prior approval from the Federal Reserve, if then required under applicable capital guidelines or policies of the Federal Reserve. The Corporation has the ability to defer interest payments on the Capital Securities for up to 20 consecutive quarterly periods (5 years), provided that there is no event of default. Interest on the Capital Securities will continue to accrue during the extension period, and all accrued principal and interest must be paid at the end of each extension period. During a deferral period, the Corporation may not, except in certain limited circumstances, (i) declare or pay any dividends or distributions on, or redeem, purchase, acquire, or make a liquidation payment with respect to, any of the Corporation's capital stock or (ii) make any payment of principal of or interest or premium, if any, on or repay, repurchase or redeem any debt securities of the Corporation that rank pari passu in all respects with or junior in interest to the Debentures.

The Debentures were issued pursuant to an Indenture, (the "Indenture") between the Corporation as issuer and Wilmington Trust Company as trustee. The terms of the Debentures are substantially the same as the terms of the Capital Securities. The interest paid by Corporation on the Debentures will be used by the Trust to pay the quarterly distributions on the Capital Securities.

Note 8. Subordinated Debentures continued

The terms of the Capital Securities are governed by an Amended and Restated Declaration of Trust, (the "Trust Agreement") among the Corporation as sponsor, Wilmington Trust Company, as institutional trustee and Delaware trustee and the administrators named therein.

Under the terms of the Capital Securities, an event of default generally occurs upon the Corporation's failure to make required payments when due, its declaration of bankruptcy, or breach of certain covenants made in connection with the issuance of the Debentures, among other things.

In connection with the placement of the Capital Securities, the Corporation entered into a Guarantee Agreement with Wilmington Trust Company as guarantee trustee, (the "Guarantee Agreement"), for the purpose of guaranteeing the payment, after the expiration of any cure period, of any amounts to be paid by the Trust under the terms of the Capital Securities. The obligations of the Corporation under the Guarantee Agreement constitute unsecured obligations of the Corporation and rank subordinate and junior to all senior debt of the Corporation. The Guarantee Agreement shall terminate upon the full payment of the redemption price for the Capital Securities or full payment of the Debenture upon liquidation of the Trust.

The placement of the Securities was conducted pursuant to a Placement Agreement, (the "Placement Agreement"), among the Corporation, the Trust and FTN Financial Capital Markets and Keefe, Bruyette & Woods, Inc., as placement agents.

The preceding description is qualified in its entirety by reference to the terms of the Trust Agreement, the Indenture, the Guarantee Agreement, the form of Capital Securities Certificate and the Placement Agreement which are filed as exhibits to this Form 10Q.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

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FORWARD-LOOKING STATEMENTS

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

* 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.

FIRST MERCHANTS CORPORATION

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations continued

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 these 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 the Corporation's Annual Report on Form 10-K for the year ended December 31, 2006. Certain policies are considered critical because they are highly dependent upon subjective or complex judgments, assumptions and estimates. Changes in such estimates may have a significant impact on the financial statements. We have reviewed the application of these policies with the Audit Committee of our Board of Directors.

We believe there have been no significant changes during the six months ended June 30, 2007 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 the Corporation's Annual Report on Form 10-K for the year ended December 31, 2006.

BUSINESS SUMMARY

The Corporation is a diversified financial holding company headquartered in Muncie, Indiana. Since its organization in 1982, the Corporation has grown to include 66 banking center locations in 17 Indiana and 3 Ohio counties. In addition to its branch network, the Corporation's delivery channels include ATMs, check cards, interactive voice response systems and internet technology.

The Corporation's business activities are currently limited to one significant business segment, which is community banking. As of June 30, 2007, the Corporation's financial service affiliates included four nationally chartered banks: First Merchants Bank, National Association, First Merchants Bank of Central Indiana, National Association, Lafayette Bank and Trust Company, National Association and Commerce National Bank. The banks provide commercial and retail banking services. In addition, the Corporation's trust company, multi-line insurance company and a title company provide trust asset management services, retail and commercial insurance agency services and title services, respectively.

Management believes that its vision, mission, culture statement and core values produce profitable growth for stockholders. Management believes it is important to maintain a strong control environment as we continue to grow our businesses. Credit policies are maintained and continue to produce sound asset quality. Interest rate and market risks inherent in our asset and liability balances are managed within prudent ranges, while ensuring adequate liquidity and funding.

We believe it is important to maintain a well controlled environment as we continue to grow our businesses. Sound credit policies are maintained and interest rate and market risks inherent in our asset and liability balances are managed within prudent ranges, while ensuring adequate liquidity and funding. Our stockholder value has continued to increase due to customer satisfaction and the balanced way we manage our business risk.

RESULTS OF OPERATIONS

Net income for the three months ended June 30, 2007, equaled $6,208,000, compared to $7,291,000 in the same period of 2006. Diluted earnings per share were $.34, a decrease of 12.8 percent from the $.39 reported for the second quarter 2006. Net income for the six months ended June 30, 2007, equaled $13,979,000, compared to $14,800,000 during the same period in 2006. Diluted earnings per share were $.76 a 5 percent decrease from the $.80 reported in 2006. The decrease in earnings per share for the second quarter as well as the six months ended June 30, 2007, is primarily a result of the $1.1 million after tax write-off of the unamortized underwriting fees associated with First Merchants Capital Trust I subordinated debentures. For further discussion see Note 8 in the Notes to Consolidated Condensed Financial Statements and the discussion in Managements discussion and Analysis of Financial Condition under the heading "NET INTEREST MARGIN".

Annualized returns on average assets and average stockholders' equity for the three months ended June 30, 2007, were .69 percent and 7.53 percent, respectively, compared with .88 percent and 9.20 percent for the same period of 2006.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations continued

CAPITAL

Our regulatory capital continues to exceed regulatory "well capitalized" standards. 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. Our Tier I capital to average assets ratio was 7.5 percent at June 30, 2007 and 7.4 percent at year end 2006. In addition, at June 30, 2007, we had a Tier I risk-based capital ratio of 9.0 percent and total risk-based capital ratio of 10.9 percent. Regulatory capital guidelines require a Tier I risk-based capital ratio of 4.0 percent and a total risk-based capital ratio of 8.0 percent.

Our tangible capital ratio, defined as total stockholders' equity less intangibles net of tax to total assets less intangibles net of tax, equaled 5.5 percent as of June 30, 2007, and 5.7 percent at December 31, 2006.

We believe that all of the above capital ratios are meaningful measurements for evaluating our safety and soundness. Additionally, we believe the following table is also meaningful when considering our performance measures. The table details and reconciles tangible earnings per share, return on tangible capital and tangible assets to traditional GAAP measures.

(Dollars in thousands)	June 30, 2007	December 31, 2006
Average Goodwill	$ 123,168	$ 121,831
Average Core Deposit Intangible (CDI)	14,654	16,103
Average Deferred Tax on CDI	(3,850)	(4,994)

Intangible Adjustment	$ 133,972	$ 132,940
Average Stockholders' Equity (GAAP Capital)	$ 328,987	$ 319,519
Intangible Adjustment	(133,972)	(132,940)
Average Tangible Capital	$ 195,015	$ 186,579
Average Assets	$ 3,561,773	$ 3,371,386
Intangible Adjustment	(133,972)	(132,940)
Average Tangible Assets	$ 3,427,801	$ 3,328,446
Net Income	$ 13,979	$ 30,198
CDI Amortization, net of tax	960	1,920
Tangible Net Income	$ 14,939	$ 32,118
Diluted Earnings per Share	$ .76	$ 1.64
Diluted Tangible Earnings per Share	$ .81	$ 1.75
Return on Average GAAP Capital	8.50%	9.45%
Return on Average Tangible Capital	15.32%	17.21%
Return on Average Assets	.78%	.90%
Return on Average Tangible Assets	.87%	.99%

ASSET QUALITY/PROVISION FOR LOAN LOSSES

Our primary business focus is middle market commercial and residential real estate, auto and small consumer lending, which results in portfolio diversification. We ensure that appropriate methods to understand and underwrite risk are utilized. 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.

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 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.

At June 30, 2007, non-performing loans totaled $36,081,000, an increase of $15,201,000 from December 31, 2006, as noted in Note 4. Loans and Allowance, included within the Notes to Consolidated Condensed Financial Statements of this Form 10-Q. An increase of $6.4 million in the first quarter of 2007 was primarily due to three loan relationships. Two of these loans are well secured by commercial real estate and the other is well secured by residential property.

The increase of $8.8 million in the second quarter of 2007 was primarily due to two loan relationships secured by real estate developments, one commercial and one residential.

At June 30, 2007, impaired loans totaled $80,128,000, an increase of $19,808,000 from December 31, 2006. At June 30, 2007, an allowance for losses was not deemed necessary for impaired loans totaling $54,317,000, but an allowance of $6,003,000 was recorded for the remaining balance of impaired loans of $25,811,000 and is included in our allowance for loan losses.

At June 30, 2007, the allowance for loan losses was $27,608,000, an increase of $1,068,000 from year end 2006. As a percent of loans, the allowance was .98 percent at June 30, 2007 and .99 percent at December 31, 2006.

The provision for loan losses for the first six months of 2007 was $3,247,000, a decrease of $208,000 from $3,455,000 for the same period in 2006.

LIQUIDITY

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

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

The most stable source of liability-funded liquidity for both the long-term and short-term is deposit growth and retention in the core deposit base. In addition, the Corporation utilizes advances from the Federal Home Loan Bank. ("FHLB") and a revolving line of credit with LaSalle Bank, N.A. as funding sources. At June 30, 2007, total borrowings from the FHLB were $268,680,000. Our bank subsidiaries have pledged certain mortgage loans and certain investments to the FHLB. The total available remaining borrowing capacity from the FHLB at June 30, 2007, was $74,828,000. At June 30, 2007, the revolving line of credit with LaSalle Bank, N.A. had a balance of $13,250,000 and a remaining borrowing capacity of $6,750,000.

The principal source of asset-funded liquidity is investment securities classified as available-for-sale, the market values of which totaled $470,388,000 at June 30, 2007, an increase of $14,255,000 or 3.2 percent over December 31, 2006. Securities classified as held-to-maturity that are maturing within a short period of time can also be a source of liquidity. Securities classified as held-to-maturity and that are maturing in one year or less totaled $135,000 at June 30, 2007. In addition, other types of assets such as cash and due from banks, federal funds sold and securities purchased under agreements to resell, and loans and interest-bearing deposits with other banks maturing within one year are sources of liquidity.

In the normal course of business, the Corporation 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 banks provide customers with off-balance sheet credit support through loan commitments and standby letters of credit. Summarized credit-related financial instruments at June 30, 2007 are as follows:

(Dollars in thousands)	At June 30, 2007
Amounts of commitments:	
Loan commitments to extend credit	$ 698,048
Standby letters of credit	23,101
	$ 721,149

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 our ongoing activities. The required payments under such commitments and long-term debt at June 30, 2007 are as follows:

(Dollars in thousands)	2007 remaining	2008	2009	2010	2011	2012 and after	
Operating leases	$ 966	$ 1,671	$ 1,338	$ 1,154	$ 965	$ 752	$
Borrowings	308,015	75,233	27,358	46,108	18,949	111,911	5
Total	$308,981	$ 76,904	$ 28,696	$ 47,262	$ 19,914	$112,663	$5

INTEREST SENSITIVITY AND DISCLOSURES ABOUT MARKET RISK

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

It is our objective to monitor and manage risk exposure to net interest income caused by changes in interest rates. It is the goal of our Asset Liability function to provide optimum and stable net interest income. To accomplish this, we use two asset liability tools. GAP/Interest Rate Sensitivity Reports and Net Interest Income Simulation Modeling are both constructed, presented, and monitored quarterly.

We believe that our liquidity and interest sensitivity position at June 30, 2007, remained adequate to meet our primary goal of achieving optimum interest margins while avoiding undue interest rate risk.

Net interest income simulation modeling, or earnings-at-risk, measures the sensitivity of net interest income to various interest rate movements. Our 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 our view of future market movements. Rather, these are intended to provide a measure of the degree of volatility interest rate movements may introduce into our earnings.

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 our 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 mortgage-related 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, e.g., savings, money market, NOW and demand deposits, reflect our best estimate of expected future behavior.

The comparative rising and falling scenarios for the period ended May 31, 2008 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 us in the base simulation for the period ended May 31, 2008 are as follows:

Driver Rates	RISING	FALLING
Prime	200 Basis Points	(200) Basis Points
Federal Funds	200	(200)
One-Year CMT	200	(200)
Three-Year CMT	200	(200)
Five-Year CMT	200	(200)
CD's	200	(200)
FHLB Advances	200	(200)

Results for the base, rising and falling interest rate scenarios are listed below, based upon our rate sensitive assets and liabilities at May 31, 2007. 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.

BASE	RISING	FALLING

	(Dollars in thousands)		
Net Interest Income	$112,123	$106,430	$119,651
Variance from base		$ (5,693)	$ 7,528
Percent of change from base		(5.10)%	6.70%

The comparative rising and falling scenarios for the period ended December 31, 2007 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 us in the base simulation for the period ended December 31, 2007 are as follows:

Driver Rates	RISING	FALLING
Prime	200 Basis Points	(200) Basis Points
Federal Funds	200	(200)
One-Year CMT	200	(200)
Two-Year CMT	200	(200)
Three-Year CMT	200	(200)
Five-Year CMT	200	(200)
CD's	200	(191)
FHLB Advances	200	(200)

Results for the base, rising and falling interest rate scenarios are listed below, based upon our rate sensitive assets and liabilities at November 30, 2006. 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.

	BASE	RISING	FALLING
	(Dollars in thousands)		
Net Interest Income	$109,090	$108,036	$108,429
Variance from base		$ (1,054)	$ (631)
Percent of change from base		(.96)%	(.58)%

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EARNING ASSETS

The following table presents the earning asset mix as of June 30, 2007, and December 31, 2006.

Earning assets increased by $123,000,000 in the six months ended June 30, 2007. Loans increased by $111,000,000 and investments increased by $14,000,000. The three largest loan increases include commercial and industrial of $53,000,000, commercial real estate loans of $34,000,000 and residential real estate of $16,000,000.

EARNING ASSETS (Dollars in thousands)	June 30, 2007	December 2006
Interest-bearing time deposits	$ 8,898	$11,28
Investment securities available for sale	470,388	455,93
Investment securities held to maturity	8,893	9,28
Mortgage loans held for sale	2,842	5,41
Loans	2,806,068	2,692,60
Federal Reserve and Federal Home Loan Bank stock	23,822	23,69
Total	$3,320,911	$3,198,20

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NET INTEREST INCOME

Net Interest Income is the primary source of our earnings. It is a function of net interest margin and the level of average earning assets. The table below presents our asset yields, interest expense, and net interest income as a percent of average earning assets for the six months ended June 30, 2007 and 2006.

During the six months ended June 30, 2007, asset yields increased 29 basis points (FTE) and interest costs increased 62 basis points, resulting in a 33 basis point (FTE) decrease in net interest income as compared to the same period in 2006.

	Three Months Ended June 30,		Six Month June
(Dollars in Thousands)	2007	2006	2007
Annualized Net Interest Income......................	$ 110,459	$ 111,062	$ 109,380
Annualized FTE Adjustment...........................	$ 4,093	$ 3,969	$ 4,052
Annualized Net Interest Income On a Fully Taxable Equivalent Basis................	$ 114,552	$ 115,031	$ 113,432
Average Earning Assets..............................	$3,275,760	$3,029,988	$3,242,966
Interest Income (FTE) as a Percent of Average Earning Assets..........................	7.09%	6.87%	7.05%

Interest Expense as a Percent of Average Earning Assets..........................	3.59%	3.07%	3.55%
Net Interest Income (FTE) as a Percent of Average Earning Assets..........................	3.50%	3.80%	3.50%

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

HEDGING ACTIVITIES

On August 1, 2006, the Corporation purchased three prime-based interest rate floor agreements with an aggregate notional amount of $250 million and strike rates ranging from 6% to 7%. The combined purchase price of approximately $550,000 will be amortized on an allocated fair value basis over the three-year term of the agreements. During the quarter, the fair value of the floors increased by $62,000 to $490,000. No ineffectiveness was required to be recognized. The Corporation's objective in using interest rate floors is to add stability to interest income by reducing its exposure to decreases in cash flows on its prime-based loans. An interest rate floor agreement involves the receipt of cash payments when the underlying interest rate falls below the floor strike rate over the life of the agreement without exchange of the underlying principal (notional) amount. The interest rate floors are designated as cash flow hedges and will be accounted for in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended.

OTHER INCOME

Total other income in the second quarter of 2007 was $1,355,000 or 16.1 percent higher than the same period of 2006.

Four items primarily account for the change:

1. Service charges in the second quarter of 2007 were $320,000 higher than the same period in 2006 due to mid-year fee increases in 2006.

2. Earnings on bank-owned life insurance increased $350,000 from the same period in 2006 due to the purchase of $21,500,000 in additional policies in 2006 and 2007.

3. Insurance commissions increased $323,000 due to the purchase of an insurance agency in late 2006.

4. Trust fees increased $308,000 as a result of increased trust business.

Other income for the first six months of 2007 was $2,562,000 or 15.06 percent higher than the same period in 2006.

Four items primarily account for the change:

1. Service charges increased $777,000 from the same period in 2006 due to

a mid-year fee increase in 2006.

2. Earnings on bank-owned life insurance increased $612,000 from the same period in 2006 due to the purchase of $21,500,000 in additional policies in 2006 and 2007.

3. Insurance commissions increased $457,000 due to the purchase of an insurance agency in late 2006.

4. Trust fees increased $393,000 as a result of increased trust business.

OTHER EXPENSES

Total other expenses in the second quarter of 2007 were $3,845,000 or 16.1 percent higher than the same period in 2006.

Three items primarily account for the change:

1. Salary and employee benefit expenses were $1,071,000 higher in the second quarter of 2007, as compared to the same period in 2006 due to staff additions and normal annual increases. Approximately $332,000 of the increase is due to increases in share-based compensation expense.

2. Other expenses increased $535,000 primarily due to integration expenses related to bank combinations and name changes.

3. In the second quarter, the Corporation wrote off $1.8 million in unamortized underwriting fees associated with First Merchants Capital Trust I subordinated debentures.

Total other expenses for the first six months of 2007 were $4,251,000 or 8.9 percent higher than the same period in 2006:

Three items primarily account for the change:

1. Salary and employee benefit expenses were $1,249,000 higher in the same period in 2006 due to staff additions and normal annual increases. Approximately, $389,000 of the increase is due to increases in share-based compensation expense.

2. Other expenses increased $601,000 primarily due to integration expenses related to bank combinations and name changes.

3. In the second quarter, the Corporation wrote off $1.8 million in unamortized underwriting fees associated with First Merchants Capital Trust I subordinated debentures.

INCOME TAXES

Income tax expense, for the six months ended June 30, 2007, decreased by $1,325,000 from the same period in 2006. The effective tax rate was 26.7 and 30.3 percent for the 2007 and 2006 periods.

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 us, and that address is (http://www.sec.gov).

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 DISCLOSURES ABOUT MARKET RISK".

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 our internal controls over financial reporting identified in connection with the evaluation referenced above that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

FIRST MERCHANTS CORPORATION
FORM 10-Q
PART II. OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 1.A. Risk Factors

There have been no material changes from the risk factors previously disclosed in the Corporation's December 31, 2006 Annual Report on Form 10-K.

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 quarter ended June 30, 2007, as follows(1):

PERIOD	TOTAL NUMBER OF SHARES PURCHASED	AVERAGE PRICE PAID PER SHARE	TOTAL NUMBER OF SHARES PURCHASED AS PART OF PUBLICLY ANNOUNCED PLANS OR PROGRAMS	MA APPROX OF SH BE THE
04/01/07 - 04/30/07	0	0	0	
05/01/07 - 05/31/07	63,010(2)	$24.17	0	
06/01/07 - 06/30/07	1,417(1)	$24.05	0	

(1) These shares were purchased in connection with the exercise of certain outstanding stock options.

(2) On January 23, 2007, the Corporation's Board authorized management to repurchase up to 250,000 shares of the Corporation's Common Stock. This authorization was not publicly announced and expires January 22, 2008. The 60,000 referenced shares were purchased in open market transactions pursuant to this authorization. There were 48,000 remaining shares that may yet be purchased pursuant to such authorizations as of June 30, 2007. 3,010 of these shares were purchased in connection with the exercise of certain outstanding stock options.

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

a. The Annual Meeting of Shareholders of the Corporation was held on April 24, 2007.

b. No response is required.

c. The following matters were voted on by shareholders:

i) Election of Directors - The following directors were elected for a term of three years.

	Vote Count	
	Vote For	Vote Against
Michael L. Cox	13,905,020	1,188,814
Charles E. Schalliol	14,555,205	538,630
Terry L. Walker	14,555,610	538,225

ii) Ratification of the appointment of Independent Public Accounting Firm - BKD, LLP, Indianapolis, Indiana: Votes For - 14,888,856, Votes Against - 84,378, Votes Abstained - 120,600.

d. Not applicable.

Item 5. Other Information

a. None

b. None

FIRST MERCHANTS CORPORATION

FORM 10-Q

PART II. OTHER INFORMATION

Item 6. Exhibits

Exhibit No.:	Description of Exhibit:	Form 10-Q Page No.:
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 2, 2007)	
4.2	Indenture dated as of July 2, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 2, 2007)	
4.3	Guarantee Agreement dated as of July 2, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 2, 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 2, 2007)	
10.1	Placement Agreement dated June 29, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 2, 2007)	
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes - Oxley Act of 2002	34
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes - Oxley Act of 2002	35
32	Certifications Pursuant to	36

18 U.S.C. Section 1350, as
Adopted Pursuant to Section
906 of the Sarbanes-Oxley
Act of 2002

FIRST MERCHANTS CORPORATION

FORM 10-Q

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: August 9, 2007 — by /s/ Michael C. Rechin

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

Date: August 9, 2007 — by /s/ Mark K. Hardwick

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

FIRST MERCHANTS CORPORATION

FORM 10-Q

INDEX TO EXHIBITS

INDEX TO EXHIBITS

(a)3. Exhibits:

Exhibit No.:	Description of Exhibit:	Form 10-Q Page No.:
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 2, 2007)	
4.2	Indenture dated as of July 2, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 2, 2007)	
4.3	Guarantee Agreement dated as of July 2, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 2, 2007)	
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31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes - Oxley Act of 2002	35
32	Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	36

EXHIBIT-31.1

FIRST MERCHANTS CORPORATION

FORM 10-Q
CERTIFICATIONS PURSUANT TO
SECTION 302 OF
THE SARBANES-OXLEY ACT OF 2002

CERTIFICATION

I, Michael C. Rechin, President and Chief Executive Officer of First Merchants

Corporation, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of First Merchants Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in the Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report, based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2007 by /s/ Michael C. Rechin

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

EXHIBIT-31.2

FIRST MERCHANTS CORPORATION

FORM 10-Q
CERTIFICATIONS PURSUANT TO
SECTION 302 OF
THE SARBANES-OXLEY ACT OF 2002

CERTIFICATION

I, Mark K. Hardwick, Executive Vice President and Chief Financial Officer of First Merchants Corporation, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of First Merchants Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in the Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report, based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2007 by: /s/Mark K. Hardwick

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

EXHIBIT-32

CERTIFICATIONS PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report of First Merchants Corporation (the "Corporation") on Form 10-Q for the period ending June 30, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Michael C. Rechin, President and Chief Executive Officer of the Corporation, do hereby certify, in accordance with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o (d)); and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Corporation.

Date: August 9, 2007 by /s/ Michael C. Rechin

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

A signed copy of this written statement required by Section 906 has been provided to First Merchants Corporation and will be retained by First Merchants Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

In connection with the quarterly report of First Merchants Corporation (the "Corporation") on Form 10-Q for the period ending June 30, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Mark K. Hardwick, Executive Vice President and Chief Financial Officer of the Corporation, do hereby certify, in accordance with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o (d)); and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Corporation.

Date: August 9, 2007 by /s/ Mark K. Hardwick

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

A signed copy of this written statement required by Section 906 has been provided to First Merchants Corporation and will be retained by First Merchants Corporation and furnished to the Securities and Exchange Commission or its staff upon request.