

FIRST MERCHANTS CORP  
Form 10-Q  
May 06, 2015

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

---

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

For the quarterly period ended March 31, 2015  
OR  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-17071

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

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

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

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

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

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

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

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

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

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

As of April 30, 2015, there were 37,783,280 outstanding common shares of the registrant.

1

---

Table of Contents

## TABLE OF CONTENTS

## FIRST MERCHANTS CORPORATION

<u>Part I. Financial Information</u>		Page No.
Item 1.	<u>Financial Statements:</u>	
	<u>Consolidated Condensed Balance Sheets</u>	<u>3</u>
	<u>Consolidated Condensed Statements of Income</u>	<u>4</u>
	<u>Consolidated Condensed Statements of Comprehensive Income</u>	<u>5</u>
	<u>Consolidated Condensed Statement of Stockholders' Equity</u>	<u>6</u>
	<u>Consolidated Condensed Statements of Cash Flows</u>	<u>7</u>
	<u>Notes to Consolidated Condensed Financial Statements</u>	<u>8</u>
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>36</u>
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>47</u>
Item 4.	<u>Controls and Procedures</u>	<u>48</u>
<u>Part II. Other Information</u>		
Item 1.	<u>Legal Proceedings</u>	<u>49</u>
Item 1A.	<u>Risk Factors</u>	<u>49</u>
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>49</u>
Item 3.	<u>Defaults Upon Senior Securities</u>	<u>49</u>
Item 4.	<u>Mine Safety Disclosures</u>	<u>49</u>
Item 5.	<u>Other Information</u>	<u>49</u>
Item 6.	<u>Exhibits</u>	<u>50</u>
	<u>Signatures</u>	<u>51</u>
	<u>Index to Exhibits</u>	<u>52</u>

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

## CONSOLIDATED CONDENSED BALANCE SHEETS

	March 31, 2015 (Unaudited)	December 31, 2014
<b>ASSETS</b>		
Cash and cash equivalents	\$89,243	\$118,616
Interest-bearing time deposits	83,228	47,520
Investment securities available for sale	538,055	549,543
Investment securities held to maturity (fair value of \$670,611 and \$647,723)	651,418	631,088
Loans held for sale	6,392	7,235
Loans, net of allowance for loan losses of \$62,801 and \$63,964	3,902,731	3,860,901
Premises and equipment	77,468	77,691
Federal Reserve and Federal Home Loan Bank stock	41,273	41,353
Interest receivable	19,557	19,984
Core deposit intangibles	15,310	16,031
Goodwill	202,724	202,724
Cash surrender value of life insurance	170,172	169,424
Other real estate owned	19,073	19,293
Tax asset, deferred and receivable	38,695	41,960
Other assets	22,182	20,764
<b>TOTAL ASSETS</b>	<b>\$5,877,521</b>	<b>\$5,824,127</b>
<b>LIABILITIES</b>		
Deposits:		
Noninterest-bearing	\$1,100,397	\$1,070,859
Interest-bearing	3,547,678	3,569,835
<b>Total Deposits</b>	<b>4,648,075</b>	<b>4,640,694</b>
Borrowings:		
Federal funds purchased		15,381
Securities sold under repurchase agreements	134,023	124,539
Federal Home Loan Bank advances	166,326	145,264
Subordinated debentures and term loans	126,875	126,810
<b>Total Borrowings</b>	<b>427,224</b>	<b>411,994</b>
Interest payable	3,685	3,201
Other liabilities	58,879	41,411
<b>Total Liabilities</b>	<b>5,137,863</b>	<b>5,097,300</b>
<b>COMMITMENTS AND CONTINGENT LIABILITIES</b>		
<b>STOCKHOLDERS' EQUITY</b>		
Cumulative Preferred Stock, \$1,000 par value, \$1,000 liquidation value:		
Authorized - 600 shares		
Issued and outstanding - 125 shares	125	125
Common Stock, \$.125 stated value:		
Authorized - 50,000,000 shares		
Issued and outstanding - 37,781,488 and 37,669,948 shares	4,723	4,709
Additional paid-in capital	431,199	431,220

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Retained earnings	305,526	292,403
Accumulated other comprehensive loss	(1,915	) (1,630
Total Stockholders' Equity	739,658	726,827
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$5,877,521	\$5,824,127

See notes to consolidated condensed financial statements.

3

---

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

## CONSOLIDATED CONDENSED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended March 31,	
	2015	2014
INTEREST INCOME		
Loans receivable:		
Taxable	\$43,551	\$42,025
Tax exempt	248	61
Investment securities:		
Taxable	4,723	4,810
Tax exempt	3,835	3,438
Deposits with financial institutions	37	23
Federal Reserve and Federal Home Loan Bank stock	550	652
Total Interest Income	52,944	51,009
INTEREST EXPENSE		
Deposits	3,516	2,549
Federal funds purchased	23	49
Securities sold under repurchase agreements	78	196
Federal Home Loan Bank advances	691	682
Subordinated debentures and term loans	1,660	1,641
Total Interest Expense	5,968	5,117
NET INTEREST INCOME	46,976	45,892
Provision for loan losses		
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	46,976	45,892
OTHER INCOME		
Service charges on deposit accounts	3,548	3,551
Fiduciary activities	2,507	2,212
Other customer fees	3,667	3,733
Commission income	2,328	2,268
Earnings on cash surrender value of life insurance	747	748
Net gains and fees on sales of loans	1,489	723
Net realized gains on sales of available for sale securities	1,025	581
Other income	921	1,618
Total Other Income	16,232	15,434
OTHER EXPENSES		
Salaries and employee benefits	24,541	25,301
Net occupancy	3,790	3,938
Equipment	2,566	2,739
Marketing	780	769
Outside data processing fees	1,717	1,831
Printing and office supplies	364	458
Core deposit amortization	721	592

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

FDIC assessments	863	1,060
Other real estate owned and foreclosure expenses	1,229	1,757
Professional and other outside services	1,491	1,379
Other expenses	3,140	3,265
Total Other Expenses	41,202	43,089
INCOME BEFORE INCOME TAX	22,006	18,237
Income tax expense	5,834	4,617
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS	\$16,172	\$13,620
Per Share Data:		
Basic Net Income Available to Common Stockholders	\$0.43	\$0.38
Diluted Net Income Available to Common Stockholders	\$0.43	\$0.38
Cash Dividends Paid	\$0.08	\$0.05
Average Diluted Shares Outstanding (in thousands)	38,000	36,261

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 March 31,	
	2015	2014
Net income	\$16,172	\$13,620
Other comprehensive income net of tax:		
Unrealized holding gain on securities available for sale arising during the period, net of tax of \$528 and \$2,804	980	5,207
Unrealized gain on securities available for sale for which a portion of an other than temporary impairment has been recognized in income, net of tax of \$627		1,164
Unrealized loss on cash flow hedges arising during the period, net of tax of \$447 and \$443	(829)	(823)
Reclassification adjustment for losses included in net income, net of tax of \$235 and \$83	(436)	(154)
	(285)	5,394
Comprehensive income	\$15,887	\$19,014

See notes to consolidated condensed financial statements.



Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

## CONSOLIDATED CONDENSED STATEMENT OF STOCKHOLDERS' EQUITY

(Unaudited)

	Preferred		Common Stock		Additional		Accumulated Other Comprehensive	
	Shares	Amount	Shares	Amount	Paid in Capital	Retained Earnings	Income (Loss)	Total
Balances, December 31, 2014	125	\$ 125	37,669,948	\$ 4,709	\$ 431,220	\$ 292,403	\$ (1,630 )	\$ 726,827
Comprehensive income								
Net income						16,172		16,172
Other comprehensive income, net of tax							-(285 )	(285 )
Cash dividends on common stock (\$.08 per share)						(3,049 )		(3,049 )
Share-based compensation			126,531	16	501			517
Stock issued under employee benefit plans			6,678	1	128			129
Stock issued under dividend reinvestment and stock purchase plan			5,615	1	134			135
Stock options exercised			23,373	3	366			369
Stock redeemed			(50,657 )	(7 )	(1,150 )			(1,157 )
Balances, March 31, 2015	125	\$ 125	37,781,488	\$ 4,723	\$ 431,199	\$ 305,526	\$ (1,915 )	\$ 739,658

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)

	March 31,	
	2015	2014
Cash Flow From Operating Activities:		
Net income	\$ 16,172	\$ 13,620
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,534	1,493
Change in deferred taxes	5,804	6,136
Share-based compensation	517	505
Tax benefit from stock options exercised	(14	) (30
Loans originated for sale	(69,384	) (29,078
Proceeds from sales of loans	70,227	27,823
Gains on sales of securities available for sale	(1,025	) (581
Change in interest receivable	427	671
Change in interest payable	484	1,421
Other adjustments	(7,044	) (15,396
Net cash provided by operating activities	\$ 17,698	\$ 6,584
Cash Flows from Investing Activities:		
Net change in interest-bearing deposits	\$(35,708	) \$17,991
Purchases of:		
Securities available for sale	(20,193	) (84,844
Securities held to maturity	(39,542	) (67
Proceeds from sales of securities available for sale	38,198	9,053
Proceeds from maturities of:		
Securities available for sale	14,887	13,475
Securities held to maturity	18,685	14,548
Change in Federal Reserve and Federal Home Loan Bank stock	80	
Net change in loans	(43,939	) 15,089
Proceeds from the sale of other real estate owned	2,799	2,675
Other adjustments	(1,311	) (566
Net cash used in investing activities	\$(66,044	) \$(12,646
Cash Flows from Financing Activities:		
Net change in :		
Demand and savings deposits	\$(4,643	) \$(27,047
Certificates of deposit and other time deposits	12,024	78,758
Borrowings	59,484	150,000
Repayment of borrowings	(44,319	) (189,832
Cash dividends on common stock	(3,049	) (1,820
Stock issued under employee benefit plans	129	133
Stock issued under dividend reinvestment and stock purchase plans	135	96
Stock options exercised	355	273
Tax benefit from stock options exercised	14	30

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Stock redeemed	(1,157	) (1,043	)
Net cash provided by financing activities	\$18,973	\$9,548	
Net Change in Cash and Cash Equivalents	(29,373	) 3,486	
Cash and Cash Equivalents, January 1	118,616	109,434	
Cash and Cash Equivalents, March 31	\$89,243	\$112,920	
Additional cash flow information:			
Interest paid	\$5,484	\$3,696	
Income tax paid	\$500	\$1,200	
Loans transferred to other real estate owned	\$2,109	\$1,087	
Non-cash investing activities using trade date accounting	\$20,424	\$2,374	

See notes to consolidated condensed financial statements.

7

---

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)  
(Unaudited)

NOTE 1

GENERAL

Financial Statement Preparation

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

The consolidated condensed balance sheet of the Corporation as of December 31, 2014, has been derived from the audited consolidated balance sheet of the Corporation as of that date. Certain information and note disclosures normally included in the Corporation's annual financial statements, prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted. These consolidated condensed financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Corporation's Form 10-K annual report filed with the Securities and Exchange Commission. The results of operations for the three months ended March 31, 2015, are not necessarily indicative of the results to be expected for the year.

NOTE 2

BUSINESS COMBINATIONS

Community Bancshares, Inc.

On November 7, 2014, the Corporation acquired 100 percent of Community Bancshares, Inc. ("Community"). Community was headquartered in Noblesville, Indiana and had 10 full-service banking centers serving central Indiana. Pursuant to the merger agreement, each outstanding share of common stock of Community was converted into the right to receive either (a) 4.0926 shares of the Corporation's common stock, plus cash in lieu of fractional shares; or (b) \$85.94 in cash, based upon shareholder elections. The Corporation paid \$14.2 million in cash and issued approximately 1.6 million shares of common stock, valued at approximately \$35.0 million, for a total purchase price of approximately \$49.2 million.

The Corporation engaged in this transaction with the expectation that it would be accretive to income and expand the existing footprint in central Indiana. Goodwill resulted from this transaction due to the expected synergies from combining operations.

Under the acquisition method of accounting, the total purchase price is allocated to net tangible and intangible assets based on their current estimated fair values on the date of the acquisition. Based on preliminary valuations of the fair

value of tangible and intangible assets acquired and liabilities assumed, which are based on assumptions that are subject to change, the purchase price for the Community acquisition is detailed in the following table. Prior to the end of the one year measurement period for finalizing the purchase price allocation, if information becomes available which would indicate adjustments are required to the purchase price allocation, such adjustments will be included in the purchase price allocation retrospectively.

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

Of the total purchase price, \$4,658,000 has been allocated to a core deposit intangible that will be amortized over its estimated life of 10 years. The remaining purchase price has been allocated to goodwill, which is not deductible for tax purposes.

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

## Pro Forma Financial Information

The Corporation acquired CFS Bancorp ("CFS") on November 12, 2013 and Community on November 7, 2014. The results of operations of CFS and Community have been included in the Corporation's consolidated financial statements since the acquisition dates. The following schedule includes pro forma results for the periods ended December 31, 2014 and 2013 as if the CFS and Community acquisitions had occurred as of the beginning of the comparable prior annual reporting period.

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

The pro forma information includes adjustments for interest income on loans, amortization of intangibles arising from the transaction, interest expense on deposits acquired, premises expense for the banking centers acquired and the related income tax effects. The pro forma information for the year ended December 31, 2014 includes \$1.6 million of operating revenue from Community since the acquisition and approximately \$1.8 million, net of tax, of non-recurring expenses directly attributable to the Community acquisition. The pro forma information for the year ended December 31, 2013 includes \$4.9 million of operating revenue from CFS since the acquisition and approximately \$9.5 million, net of tax, of non-recurring expenses directly attributable to the CFS acquisition.

The pro forma financial information is presented for information purposes only and is not indicative of the results of operations that actually would have been achieved had the acquisition been consummated as of that time, nor is it intended to be a projection of future results.

## C Financial Corporation

The Corporation and C Financial Corporation ("C Financial") entered into an Agreement and Plan of Reorganization and Merger (the "Merger Agreement") on January 5, 2015. On April 17, 2015, the Corporation completed the merger with C Financial, pursuant to which, C Financial merged with and into the Corporation (the "Merger") whereupon the separate corporate existence of C Financial ceased and the Corporation survived. Immediately following the Merger, Cooper State Bank, an Ohio state bank and wholly-owned subsidiary of C Financial, merged with and into First Merchants Bank, National Association, a national bank and wholly-owned subsidiary of the Corporation, with First Merchants Bank, National Association continuing as the surviving bank. As part of the \$14.5 million merger, shareholders of C Financial received \$6.738 in cash for each share of C Financial common stock held. As a result of this merger, the Corporation (\$5.8 billion) and C Financial (\$138 million) have combined assets of approximately \$6.0 billion.

## NOTE 3

## INVESTMENT SECURITIES

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at March 31, 2015				
U.S. Government-sponsored agency securities	\$100	\$7		\$107
State and municipal	249,699	12,195	\$310	261,584
U.S. Government-sponsored mortgage-backed securities	265,740	8,949	62	274,627
Corporate obligations	31			31
Equity securities	1,706			1,706
Total available for sale	517,276	21,151	372	538,055
Held to maturity at March 31, 2015				
State and municipal	225,225	6,429	76	231,578
U.S. Government-sponsored mortgage-backed securities	426,193	12,988	148	439,033
Total held to maturity	651,418	19,417	224	670,611
Total Investment Securities	\$1,168,694	\$40,568	\$596	\$1,208,666

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

The amortized cost and fair value of available for sale securities and held to maturity securities at March 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 March 31, 2015:				
Due in one year or less	\$3,836	\$3,869	\$8,072	\$8,121
Due after one through five years	8,980	9,245	19,561	20,155
Due after five through ten years	50,220	52,853	86,271	88,851
Due after ten years	186,794	195,755	111,321	114,451
	\$249,830	\$261,722	\$225,225	\$231,578
U.S. Government-sponsored mortgage-backed securities	265,740	274,627	426,193	439,033
Equity securities	1,706	1,706		
Total Investment Securities	\$517,276	\$538,055	\$651,418	\$670,611

The carrying value of securities pledged as collateral, to secure public deposits and for other purposes, was \$458,131,000 at March 31, 2015, and \$449,408,000 at December 31, 2014.

The book value of securities sold under agreements to repurchase amounted to \$129,110,000 at March 31, 2015, and \$120,027,000 at December 31, 2014.



Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Gross gains on the sales and redemptions of available for sale securities for the three months ended March 31, 2015, and 2014 are shown below. There were no losses on the sale and redemption of available for sale securities, or other-than-temporary impairment losses recognized during the three months ended March 31, 2015, and 2014.

	Three Months Ended	
	March 31,	
	2015	2014
Sales and Redemptions of Available for Sale Securities:		
Gross gains	\$1,025	\$581

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Temporarily Impaired Available for Sale Securities at March 31, 2015						
State and municipal	\$23,922	\$ 310			\$23,922	\$ 310
U.S. Government-sponsored mortgage-backed securities	4,876	4	2,374	58	7,250	62
Total Temporarily Impaired Available for Sale Securities	28,798	314	2,374	58	31,172	372
Temporarily Impaired Held to Maturity Securities at March 31, 2015						
State and municipal	7,243	76			7,243	76
U.S. Government-sponsored mortgage-backed securities	4,963	42	11,626	106	16,589	148
Total Temporarily Impaired Held to Maturity Securities	12,206	118	11,626	106	23,832	224
Total Temporarily Impaired Investment Securities	\$41,004	\$ 432	\$ 14,000	\$ 164	\$55,004	\$ 596

	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, 2014						
State and municipal	1,256	7	\$9,850	\$ 116	\$11,106	\$ 123
U.S. Government-sponsored mortgage-backed securities	2,186	13	5,447	114	7,633	127
Total Temporarily Impaired Available for Sale Securities	3,442	20	15,297	230	18,739	250
Temporarily Impaired Held to Maturity Securities at December 31, 2014						
State and municipal	5,119	96	250		5,369	96
	9,791	82	38,491	430	48,282	512

U.S. Government-sponsored mortgage-backed securities

Total Temporarily Impaired Held to Maturity Securities	14,910	178	38,741	430	53,651	608
Total Temporarily Impaired Investment Securities	\$ 18,352	\$ 198	\$ 54,038	\$ 660	\$ 72,390	\$ 858

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

	March 31, 2015	December 31, 2014		
Investments reported at less than historical cost:				
Historical cost	\$55,599	\$73,249		
Fair value	\$55,004	\$72,390		
Percent of the Corporation's available for sale and held to maturity portfolio	4.6	% 6.1		%

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

The Corporation's management has evaluated all securities with unrealized losses for OTTI as of March 31, 2015. The evaluations are based on the nature of the securities, the extent and duration of the loss and the intent and ability of the Corporation to hold these securities either to maturity or through the expected recovery period.

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

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

## State and Municipal

The unrealized losses on the Corporation's investments in securities of state and political subdivisions were caused by changes in interest rates. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. The Corporation does not intend to sell the investment and it is not more likely than not that the Corporation will be required to sell the investment before recovery of its new, lower amortized cost basis, which may be maturity. The Corporation does not consider the investment securities to be other-than-temporarily impaired at March 31, 2015.

## U.S. Government-Sponsored Mortgage-Backed Securities

The unrealized losses on the Corporation's investment in U.S. Government-sponsored mortgage-backed securities were a result of changes in interest rates. The Corporation expects to recover the amortized cost basis over the term of the securities as the decline in market value is attributable to changes in interest rates and not credit quality. The Corporation does not intend to sell the investment and it is not more likely than not that the Corporation will be required to sell the investment before recovery of its new, lower amortized cost basis, which may be maturity. The Corporation does not consider the investment securities to be other-than-temporarily impaired at March 31, 2015.

## Corporate Obligations

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

## Credit Losses Recognized on Investments

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

	Accumulated Credit Losses in 2015	Accumulated Credit Losses in 2014
Credit losses on debt securities held:		
Balance, January 1	\$500	\$11,355
Reductions for previous other-than-temporary losses realized on securities sold during the year	(500	) (10,855
Balance, March 31	\$—	\$500

## NOTE 4

## LOANS AND ALLOWANCE

The Corporation's primary lending focus is small business and middle market commercial, commercial real estate, residential real estate and consumer lending, which results in portfolio diversification. The following tables show the composition of the loan portfolio, the allowance for loan losses and certain credit quality elements, all excluding loans held for sale. Loans held for sale as of March 31, 2015, and December 31, 2014, were \$6,392,000 and \$7,235,000, respectively.

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

	March 31, 2015	December 31, 2014
Commercial and industrial loans	\$938,937	\$896,688
Agricultural production financing and other loans to farmers	95,652	104,927
Real estate loans:		
Construction	237,036	207,221
Commercial and farmland	1,646,418	1,672,661
Residential	640,451	647,315
Home Equity	286,914	286,529
Individuals' loans for household and other personal expenditures	70,223	73,400
Lease financing receivables, net of unearned income	853	1,106
Other loans	49,048	35,018
Loans	\$3,965,532	\$3,924,865
Allowance for loan losses	(62,801)	(63,964)
Net Loans	\$3,902,731	\$3,860,901

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

Allowance, Credit Quality and Loan Portfolio

The Corporation maintains an allowance for loan losses to cover probable credit losses identified during its loan review process. Management believes the allowance for loan losses is appropriate to cover probable losses inherent in the loan portfolio at March 31, 2015. The process for determining the adequacy of the allowance for loan losses is critical to the Corporation's financial results. It requires management to make difficult, subjective and complex judgments, to estimate the effect of uncertain matters. The allowance for loan losses considers current factors, including economic conditions and ongoing internal and external examinations, and will increase or decrease as deemed necessary to ensure the allowance remains adequate. In addition, the allowance as a percentage of charge offs and nonperforming loans will change at different points in time based on credit performance, loan mix and collateral values.

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

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

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

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

historical loss migration analysis of criticized risk grades to charge off.

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

At March 31, 2015, the allowance for loan losses was \$62,801,000, a decrease of \$1,163,000 from the December 31, 2014 balance of \$63,964,000. Specific reserves on impaired loans increased \$2,762,000 to \$4,556,000, from \$1,794,000 at March 31, 2014. Net charge offs for the three months ended March 31, 2015, were \$1,163,000. Comparatively, the same period in 2014 had net recoveries of \$1,713,000. There was no provision for loan losses recognized for the three months ended March 31, 2015, and 2014. The determination of the provision for loan losses in any period is based on management's continuing review and evaluation of the loan portfolio, and its judgment as to the impact of current economic conditions on the portfolio.

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 changes in the allowance for loan losses by loan segment for the three months ended March 31, 2015, and March 31, 2014:

	Three Months Ended March 31, 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	1,834	(2,896)	) 527	534	1	
Recoveries on loans	450	412	78	132		1,072
Loans charged off	(1,101)	) (460)	) (125)	) (549)	)	(2,235)
Balances, March 31, 2015	\$30,007	\$16,383	\$3,138	\$13,269	\$4	\$62,801

	Three Months Ended March 31, 2014					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance for loan losses:						
Balances, January 1	\$27,176	\$23,102	\$2,515	\$15,077		\$67,870
Provision for losses	2,387	(1,257)	) (12)	) (1,098)	) \$(20)	)
Recoveries on loans	2,050	790	136	604	20	3,600
Loans charged off	(706)	) (277)	) (229)	) (675)	)	(1,887)
Balances, March 31, 2014	\$30,907	\$22,358	\$2,410	\$13,908		\$69,583

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

	March 31, 2015					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance Balances:						
Individually evaluated for impairment	\$2,700	\$1,017		\$359		\$4,076
Collectively evaluated for impairment	27,307	15,081	\$3,138	12,715	\$4	58,245
Loans Acquired with Deteriorated Credit Quality		285		195		480
Total Allowance for Loan Losses	\$30,007	\$16,383	\$3,138	\$13,269	\$4	\$62,801
Loan Balances:						
Individually evaluated for impairment	\$11,432	\$21,668		\$4,298		\$37,398
Collectively evaluated for impairment	1,063,822	1,806,864	\$70,223	918,527	\$853	3,860,289
Loans Acquired with Deteriorated Credit Quality	8,383	54,922		4,540		67,845



Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Loans	\$1,083,637	\$1,883,454	\$70,223	\$927,365	\$853	\$3,965,532
	December 31, 2014					
	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance Balances:						
Individually evaluated for impairment	\$1,455	\$470		\$194		\$2,119
Collectively evaluated for impairment	27,369	18,207	\$2,658	12,958	\$3	61,195
Loans Acquired with Deteriorated Credit Quality		650				650
Total Allowance for Loan Losses	\$28,824	\$19,327	\$2,658	\$13,152	\$3	\$63,964
Loan Balances:						
Individually evaluated for impairment	\$16,108	\$23,963		\$4,022		\$44,093
Collectively evaluated for impairment	1,011,122	1,796,797	\$73,400	925,282	\$1,106	3,807,707
Loans Acquired with Deteriorated Credit Quality	9,403	59,122		4,540		73,065
Loans	\$1,036,633	\$1,879,882	\$73,400	\$933,844	\$1,106	\$3,924,865

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

Commercial

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

Commercial real estate

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

Residential and Consumer

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

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

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

	March 31, 2015	December 31, 2014
Commercial and industrial loans	\$8,249	\$7,048
Agriculture production financing and other loans to farmers	1,978	5,800
Real estate Loans:		
Construction	1,585	1,439
Commercial and farmland	16,931	19,350
Residential	13,314	12,933
Home Equity	2,141	1,988
Individuals' loans for household and other personal expenditures	123	231
Total	\$44,321	\$48,789

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

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

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

	March 31, 2015		
	Unpaid Principal Balance	Recorded Investment	Related Allowance
Impaired loans with no related allowance:			
Commercial and industrial loans	\$27,308	\$13,460	
Agriculture production financing and other loans to farmers	307	302	
Real estate Loans:			
Construction	10,811	7,856	
Commercial and farmland	88,069	65,281	
Residential	9,792	6,273	
Home equity	546	474	
Other loans	28		
Total	\$136,861	\$93,646	
Impaired loans with related allowance:			
Commercial and industrial loans	\$4,434	\$4,376	\$2,461
Agriculture production financing and other loans to farmers	3,415	1,676	239
Real estate Loans:			
Commercial and farmland	3,171	3,093	1,302
Residential	1,876	1,759	554
Total	\$12,896	\$10,904	\$4,556
Total Impaired Loans	\$149,757	\$104,550	\$4,556

	December 31, 2014		
	Unpaid Principal Balance	Recorded Investment	Related Allowance
Impaired loans with no related allowance:			
Commercial and industrial loans	\$35,514	\$18,029	
Agriculture production financing and other loans to farmers	26	22	
Real estate Loans:			
Construction	12,956	9,318	
Commercial and farmland	95,856	68,187	
Residential	10,591	6,839	
Home equity	3,590	398	
Other loans	30		
Total	\$158,563	\$102,793	
Impaired loans with related allowance:			

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

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

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

	Three Months Ended March 31, 2015	
	Average Recorded Investment	Interest Income Recognized
Impaired loans with no related allowance:		
Commercial and industrial loans	\$16,150	\$139
Agriculture production financing and other loans to farmers	303	
Real estate Loans:		
Construction	8,542	104
Commercial and farmland	69,036	878
Residential	8,528	48
Home equity	533	3
Total	\$103,092	\$1,172
Impaired loans with related allowance:		
Commercial and industrial loans	\$4,379	\$10
Agriculture production financing and other loans to farmers	3,991	
Real estate Loans:		
Commercial and farmland	3,113	
Residential	1,761	
Total	\$13,244	\$10
Total Impaired Loans	\$116,336	\$1,182

	Three Months Ended March 31, 2014	
	Average Recorded Investment	Interest Income Recognized
Impaired loans with no related allowance:		
Commercial and industrial loans	\$16,377	\$21
Agriculture production financing and other loans to farmers	29	
Real estate Loans:		
Construction	10,440	28
Commercial and farmland	81,617	243
Residential	4,146	8
Home equity	144	
Other loans	6	
Total	\$112,759	\$300
Impaired loans with related allowance:		
Commercial and industrial loans	\$1,752	\$3
Real estate Loans:		
Commercial and farmland	4,398	1
Total	\$6,150	\$4
Total Impaired Loans	\$118,909	\$304

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

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

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

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

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

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

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

•



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

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

	March 31, 2015							
	Commercial Pass	Commercial Special Mention	Commercial Substandard	Commercial Doubtful	Commercial Loss	Consumer Performing	Consumer Non-Performing	Total
Commercial and industrial loans	\$867,157	\$ 28,888	\$ 41,023	\$ 1,869				\$938,937
Agriculture production financing and other loans to farmers	89,454	2,469	3,729					95,652
Real estate Loans:								
Construction	217,161	2,359	2,493			\$ 14,582	\$ 441	237,036
Commercial and farmland	1,521,989	48,219	76,208				2	1,646,418
Residential	149,021	4,232	10,845			466,806	9,547	640,451
Home equity	6,478	18	585			277,578	2,255	286,914
Individuals' loans for household and other personal expenditures						70,082	141	70,223
Lease financing receivables, net of unearned income	748		105					853
Other loans	49,048							49,048
Loans	\$2,901,056	\$ 86,185	\$ 134,988	\$ 1,869		\$ 829,048	\$ 12,386	\$3,965,532

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

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

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

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

	March 31, 2015						Total Past Due & Non-Accrual	Total
	Current	30-59 Days Past Due	60-89 Days Past Due	Loans > 90 Days And Accruing	Non-Accrual			
Commercial and industrial loans	\$927,244	\$2,057	\$1,166	\$221	\$ 8,249	\$ 11,693	\$938,937	
Agriculture production financing and other loans to farmers	93,349	325			1,978	2,303	95,652	
Real estate Loans:								
Construction	235,077	138		236	1,585	1,959	237,036	
Commercial and farmland	1,623,656	5,261	305	265	16,931	22,762	1,646,418	
Residential	623,394	2,446	761	536	13,314	17,057	640,451	
Home equity	282,344	1,734	316	379	2,141	4,570	286,914	
Individuals' loans for household and other personal expenditures	69,829	173	80	18	123	394	70,223	
Lease financing receivables, net of unearned income	675	178				178	853	
Other loans	49,048						49,048	
Loans	\$3,904,616	\$12,312	\$2,628	\$1,655	\$ 44,321	\$ 60,916	\$3,965,532	
	December 31, 2014							
	Current	30-59 Days Past Due	60-89 Days Past Due	Loans > 90 Days And Accruing	Non-Accrual	Total Past Due & Non-Accrual	Total	
Commercial and industrial loans	\$882,596	\$4,006	\$53	\$2,985	\$ 7,048	\$ 14,092	\$896,688	
Agriculture production financing and other loans to farmers	98,236	891			5,800	6,691	104,927	
Real estate Loans:								
Construction	204,683	1,017	82		1,439	2,538	207,221	
Commercial and farmland	1,642,016	9,846	778	671	19,350	30,645	1,672,661	
Residential	626,821	4,876	1,831	854	12,933	20,494	647,315	
Home equity	282,828	1,213	352	148	1,988	3,701	286,529	
Individuals' loans for household and other personal expenditures	72,853	258	53	5	231	547	73,400	
Lease financing receivables, net of unearned income	1,106						1,106	
Other loans	35,018						35,018	

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

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

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

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

	Three Months Ended March 31, 2015		
	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans
Commercial and industrial loans	\$2,362	\$ 1,361	4
Real estate Loans:			
Construction	79	80	1
Commercial and farmland		1,743	1
Residential	24	24	1
Total	\$2,465	\$ 3,208	7

	Three Months Ended March 31, 2014		
	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans
Real estate Loans:			
Residential	\$ 131	\$ 134	3
Individuals' loans for household and other personal expenditures	15	15	1
Total	\$ 146	\$ 149	4

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

	Three Months Ended March 31, 2015			
	Term Modification	Rate Modification	Combination	Total Modification
Commercial and industrial loans	\$253		\$1,079	\$1,332
Real estate Loans:				
Construction	2			2
Commercial and farmland	1,548			1,548
Residential		\$26		26
Total	\$1,803	\$26	\$1,079	\$2,908

	Three Months Ended March 31, 2014			
	Term Modification	Rate Modification	Combination	Total Modification

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Real estate Loans:			
Residential	\$ 134		\$ 134
Individuals loans for household and other personal expenditures		\$ 15	15
Total	\$ 134	\$ 15	\$ 149

Loans secured by commercial and farm real estate made up 54 percent of the post-modification balance of troubled debt restructured loans made in the three months ended March 31, 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)

The following tables summarize the troubled debt restructures that occurred during the three months ended March 31, 2015 and March 31, 2014, that subsequently defaulted during the period indicated and remained in default at period end. For purposes of this schedule, a loan is considered in default if it is 30 or more days past due.

	Three Months Ended March 31, 2015	
	Number of Loans	Recorded Balance
Real estate Loans:		
Home Equity	1	\$6
Total	1	\$6
	Three Months Ended March 31, 2014	
	Number of Loans	Recorded Balance
Commercial and industrial loans	1	\$146
Real estate Loans:		
Residential	1	57
Total	2	\$203

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

## NOTE 5

## ACCOUNTING FOR CERTAIN LOANS ACQUIRED IN A PURCHASE

The Bank acquired loans in a purchase during the years ended December 31, 2014, 2013 and 2012. The acquired loans detailed in the tables below are included in Note 4. LOANS AND ALLOWANCE, in the Notes to Consolidated Condensed Financial Statements of this Form 10-Q. As described in Note 4, loans purchased after December 31, 2008 are recorded at the acquisition date fair value, which could result in a fair value discount or premium. Purchased loans



with evidence of credit deterioration since origination and for which it is probable at the date of acquisition that the acquirer will not collect all contractually required principal and interest payments are accounted for under ASC 310-30, Loans Acquired with Deteriorated Credit Quality. The difference between contractually required payments and the cash flows expected to be collected at acquisition is referred to as the nonaccretable portion of the fair value discount or premium. The accretable portion of the fair value discount or premium is the difference between the expected cash flows and the net present value of expected cash flows, with such difference accreted into earnings over the term of the loans. All other loans not accounted for under ASC 310-30 are accounted for under ASC 310-20.

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

	March 31, 2015			December 31, 2014				
	Community	CFS	SCB	Total	Community	CFS	SCB	Total
Commercial and industrial loans	\$6,828	\$58,252	\$5,673	\$70,753	\$8,168	\$64,897	\$6,059	\$79,124
Agricultural production financing and other loans to farmers	737		877	1,614	1,100		893	1,993
Real estate loans:								
Construction	19,969	7,334		27,303	19,063	9,113		28,176
Commercial and farmland	69,421	232,436	14,666	316,523	74,600	251,002	15,593	341,195
Residential	28,048	137,457	6,868	172,373	28,863	144,396	7,384	180,643
Home Equity	9,324	37,439	14,843	61,606	9,881	39,244	15,758	64,883
Individuals' loans for household and other personal expenditures	1,056	779	95	1,930	1,314	922	121	2,357
Other Loans		84		84		86		86
Total	\$135,383	\$473,781	\$43,022	\$652,186	\$142,989	\$509,660	\$45,808	\$698,457
Carrying Amount	\$126,996	\$450,867	\$36,980	\$614,843	\$134,198	\$484,949	\$39,324	\$658,471
Allowance	195	285		480		650		650
Carrying Amount Net of Allowance	\$126,801	\$450,582	\$36,980	\$614,363	\$134,198	\$484,299	\$39,324	\$657,821

The balance of the allowance for loan losses for loans acquired and accounted for under ASC 310-30 was \$480,000 and \$650,000 at March 31, 2015 and December 31, 2014, respectively.

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

	Three Months Ended March 31, 2015			Three Months Ended March 31, 2014			
	Community	CFS	SCB	Total	CFS	SCB	Total
Beginning balance	\$2,122	\$2,400	\$868	\$5,390	\$4,164	\$1,388	\$5,552
Additions							
Accretion	(179)	(1,341)	(185)	(1,705)	(301)	(187)	(488)

Reclassification from nonaccretable	47	950	135	1,132	252	55	307
Disposals					(35 )		(35 )
Ending balance	\$ 1,990	\$ 2,009	\$ 818	\$ 4,817	\$ 4,080	\$ 1,256	\$ 5,336

## NOTE 6

## DERIVATIVE FINANCIAL INSTRUMENTS

## Risk Management Objective of Using Derivatives

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

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

Cash Flow Hedges of Interest Rate Risk

The Corporation's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish these objectives, the Corporation primarily uses interest rate swaps and interest rate caps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the payment of fixed amounts to a counterparty in exchange for the Corporation receiving variable payments over the life of the agreements without exchange of the underlying notional amount. Interest rate caps designated as cash flow hedges involve the receipt of variable amounts from a counterparty if interest rates rise above the strike rate on the contract in exchange for an up-front premium. As of March 31, 2015 and 2014, the Corporation had five interest rate swaps with a notional amount of \$56.0 million and one interest rate cap with a notional amount of \$13.0 million that were designated as cash flow hedges.

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. During 2015, \$26.0 million of the interest rate swaps and the \$13.0 million interest rate cap were used to hedge the variable cash outflows (LIBOR-based) associated with existing trust preferred securities when the outflows converted from a fixed rate to variable rate in September of 2012. In addition, the remaining \$30.0 million of interest rate swaps were used to hedge the variable cash outflows (LIBOR-based) associated with three Federal Home Loan Bank advances. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. During the three months ended March 31, 2015, and 2014, the Corporation did not recognize any ineffectiveness.

Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest payments are made on the Corporation's variable-rate liabilities. During the next twelve months, the Corporation expects to reclassify \$1,346,000 from accumulated other comprehensive income to interest expense.

Non-designated Hedges

The Corporation does not use derivatives for trading or speculative purposes. Derivatives not designated as hedges are not speculative and result from a service the Corporation provides to certain customers. The Corporation executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. Those interest rate swaps are simultaneously hedged by offsetting interest rate swaps that the Corporation executes with a third party, such that the Corporation minimizes its net risk exposure resulting from such transactions. As the interest rate swaps associated with this program do not meet the strict hedge accounting requirements, changes in the fair value of both the customer swaps and the offsetting swaps are recognized directly in earnings. As of March 31, 2015, the notional amount of customer-facing swaps was approximately \$137,186,000. This amount is offset with third party counterparties, as described above.

Fair Values of Derivative Instruments on the Balance Sheet

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

	Asset Derivatives				Liability Derivatives			
	March 31, 2015		December 31, 2014		March 31, 2015		December 31, 2014	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments:								
Interest rate contracts	Other Assets	\$87	Other Assets	\$137	Other Liabilities	\$3,547	Other Liabilities	\$2,650
Derivatives not designated as hedging instruments:								
Interest rate contracts	Other Assets	\$4,764	Other Assets	\$3,730	Other Liabilities	\$5,022	Other Liabilities	\$3,887

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

## Effect of Derivative Instruments on the Income Statement

The tables below present the effect of the Corporation's derivative financial instruments on the Income Statement for three months ended March 31, 2015, and 2014.

Derivatives Not Designated as Hedging Instruments under FASB ASC 815-10	Location of Gain (Loss) Recognized Income on Derivative	Amount of Gain (Loss)	Amount of Gain (Loss)
		Recognized Income on Derivative	Recognized Income on Derivative
		Three Months Ended March 31, 2015	Three Months Ended March 31, 2014
Interest rate contracts	Other income	\$(100	) \$19

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

Derivatives in Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in Other Comprehensive Income on Derivative (Effective Portion)	
	Three Months Ended March 31, 2015	March 31, 2014
Interest Rate Products	\$(1,276	) \$(1,266

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

Location of Loss Reclassified from Accumulated Other Comprehensive Income (Effective Portion)	Amount of Gain (Loss) Reclassified from Other Comprehensive Income into Income (Effective Portion)	
	Three Months Ended March 31, 2015	March 31, 2014
Interest Expense	\$(354	) \$(344

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

Credit-risk-related Contingent Features

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

The Corporation also has agreements with certain of its derivative counterparties that contain a provision where if the Corporation defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, the Corporation could also be declared in default on its derivative obligations. As of March 31, 2015, the termination value of derivatives in a net liability position related to these agreements was \$8,823,000. As of March 31, 2015, the Corporation had minimum collateral posting thresholds with certain of its derivative counterparties and had posted collateral of \$10,031,000. If the Corporation had breached any of these provisions at March 31, 2015, it could have been required to settle its obligations under the agreements at their termination value.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

NOTE 7

DISCLOSURES ABOUT FAIR VALUE OF ASSETS AND LIABILITIES

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

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

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

Recurring Measurements

Following is a description of the valuation methodologies and inputs used for instruments measured at fair value on a recurring basis and recognized in the accompanying Consolidated Condensed Balance Sheets, as well as the general classification of such instruments pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques as of March 31, 2015.



#### Available for Sale Investment Securities

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

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

#### Interest Rate Derivative Agreements

See information regarding the Corporation's interest rate derivative products in NOTE 6. DERIVATIVE FINANCIAL INSTRUMENTS, included within the Notes to Consolidated Condensed Financial Statements of this Form 10-Q.

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

March 31, 2015	Fair Value	Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available for sale securities:				
U.S. Government-sponsored agency securities	\$107		\$107	
State and municipal	261,584		255,421	\$6,163
U.S. Government-sponsored mortgage-backed securities	274,627		274,627	
Corporate obligations	31			31
Equity securities	1,706		1,702	4
Interest rate swap asset	4,764		4,764	
Interest rate cap	87		87	
Interest rate swap liability	8,569		8,569	

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

## Level 3 Reconciliation

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the Consolidated Condensed Balance Sheets using significant unobservable (Level 3) inputs for three months ended March 31, 2015, and 2014.

	Available for Sale Securities	
	Three Months Ended March 31, 2015	Three Months Ended March 31, 2014
Balance at beginning of the period	\$6,646	\$9,977
Total realized and unrealized gains and losses:		
Included in net income		
Included in other comprehensive income	91	2,058
Purchases, issuances and settlements		
Transfers in/(out) of Level 3		
Principal payments	(539	) (541
Ending balance	\$6,198	\$11,494

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

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

## Transfers Between Levels

There were no transfers between Levels 1, 2 and 3 for the three months ended March 31, 2015 and 2014.

## Nonrecurring Measurements

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

March 31, 2015	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans (collateral dependent)	\$7,485			\$7,485
Other real estate owned	\$663			\$663

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

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

## Impaired Loans (collateral dependent)

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

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

#### Other Real Estate Owned

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

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

## Unobservable (Level 3) Inputs

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

March 31, 2015	Fair Value	Valuation Technique	Unobservable Inputs	Range (Weighted-Average)
State and municipal securities	\$6,163	Discounted cash flow	Maturity/Call date Blend of US Muni BQ curve Discount rate	1 month to 15 yrs A- to BBB- .90% - 5%
Corporate obligations and Equity securities	\$35	Discounted cash flow	Risk free rate plus Premium for illiquidity	3 month LIBOR plus 200bps
Impaired loans (collateral dependent)	\$7,485	Collateral based measurements	Discount to reflect current market conditions and ultimate collectability	0% - 50% (4%)
Other real estate owned	\$663	Appraisals	Discount to reflect current market conditions	0% - 20% (1%)
December 31, 2014	Fair Value	Valuation Technique	Unobservable Inputs	Range (Weighted-Average)
State and municipal securities	\$6,611	Discounted cash flow	Maturity/Call date Blend of US Muni BQ curve Discount rate	1 month to 15 yrs A- to BBB- .90% - 5%
Corporate obligations and Equity securities	\$35	Discounted cash flow	Risk free rate plus Premium for illiquidity	3 month LIBOR plus 200bps
Impaired loans (collateral dependent)	\$17,134	Collateral based measurements	Discount to reflect current market conditions and ultimate collectability	0% - 50% (3%)
Other real estate owned	\$5,155	Appraisals	Discount to reflect current market conditions	0% - 20% (7%)

### Sensitivity of Significant Unobservable Inputs

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

#### State and Municipal Securities, Corporate Obligations and Equity Securities

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

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

## Fair Value of Financial Instruments

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

		March 31, 2015 (unaudited)		
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash and cash equivalents	\$89,243	\$89,243		
Interest-bearing time deposits	83,228	83,228		
Investment securities available for sale	538,055		\$531,857	\$6,198
Investment securities held to maturity	651,418		638,360	32,251
Loans held for sale	6,392		6,392	
Loans	3,902,731			3,867,719
Federal Reserve Bank and Federal Home Loan Bank stock	41,273		41,273	
Interest rate swap and cap asset	4,851		4,851	
Interest receivable	19,557		19,557	
Liabilities:				
Deposits	\$4,648,075	\$3,518,556	\$1,116,309	
Borrowings:				
Securities sold under repurchase agreements	134,023		134,035	
Federal Home Loan Bank advances	166,326		167,903	
Subordinated debentures and term loans	126,875		85,413	
Interest rate swap liability	8,569		8,569	
Interest payable	3,685		3,685	
		December 31, 2014		
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash and cash equivalents	\$118,616	\$118,616		
Interest-bearing time deposits	47,520	47,520		



Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

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

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

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

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

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

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

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

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

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

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

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

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

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

## NOTE 8

## ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table summarizes the changes in the balances of each component of accumulated other comprehensive income (loss), net of tax, as of March 31, 2015 and 2014:

	Accumulated Other Comprehensive Income (Loss)					Total
	Unrealized Gains (Losses) on Securities Available for Sale	Unrealized Gains (Losses) on Securities Available for Sale for which a Portion of Other-Than-Temporary Impairment has been Recognized in Income	Unrealized Gains (Losses) on Cash Flow Hedges	Unrealized Gains (Losses) on Defined Benefit Plans		
Balance at December 31, 2014	\$14,098		\$(2,182 )	\$(13,546 )		\$(1,630 )
Other comprehensive income before reclassifications	980		(829 )			151
Amounts reclassified from accumulated other comprehensive income	(666 )		230			(436 )
Period change	314	—	(599 )	—		(285 )
Balance at March 31, 2015	\$14,412	\$ —	\$(2,781 )	\$(13,546 )		\$(1,915 )
Balance at December 31, 2013	\$1,566	\$ (1,847 )	\$(501 )	\$(5,628 )		\$(6,410 )
Other comprehensive income before reclassifications	5,207	1,164	(823 )			5,548
Amounts reclassified from accumulated other comprehensive income	(378 )		224			(154 )
Period change	4,829	1,164	(599 )	—		5,394
Balance at March 31, 2014	\$6,395	\$ (683 )	\$(1,100 )	\$(5,628 )		\$(1,016 )

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

The following table presents the reclassification adjustments out of accumulated other comprehensive income (loss) that were included in net income in the Consolidated Condensed Statements of Income for the three months ended March 31, 2015 and 2014:

Details about Accumulated Other Comprehensive Income (Loss) Components	Amount Reclassified from Accumulated Other Comprehensive Income (Loss) For the Three Months Ended March 31,		Affected Line Item in the Statements of Income
	2015	2014	
Unrealized gains (losses) on available for sale securities <sup>(1)</sup>			
Realized securities gains reclassified into income	\$1,025	\$581	Other income - net realized gains on sales of available for sale securities
Related income tax expense	(359 )	(203 )	Income tax expense
	\$666	\$378	
Unrealized gains (losses) on cash flow hedges <sup>(2)</sup>			
Interest rate contracts	\$(354 )	\$(344 )	Interest expense - subordinated debentures and term loans
Related income tax benefit	124	120	Income tax expense
	\$(230 )	\$(224 )	
Total reclassifications for the period, net of tax	\$436	\$154	

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

<sup>(2)</sup> For additional detail related to unrealized gains (losses) on cash flow hedges and related amounts reclassified from accumulated other comprehensive income see NOTE 6. DERIVATIVE FINANCIAL INSTRUMENTS.

## NOTE 9

## SHARE-BASED COMPENSATION

Stock options and restricted stock awards ("RSAs") have been issued to directors, officers and other management employees under the Corporation's 1999 Long-term Equity Incentive Plan and the 2009 Long-term Equity Incentive Plan. The stock options, which have a ten year life, become 100 percent vested ranging from six months to two years and are fully exercisable when vested. Option exercise prices equal the Corporation's common stock closing price on NASDAQ on the date of grant. RSAs issued to employees and non-employee directors provide for the issuance of shares of the Corporation's common stock at no cost to the holder and generally vest after three years. The RSAs vest only if the employee is actively employed by the Corporation on the vesting date and, therefore, any unvested shares are forfeited. For non-employee directors, the RSAs vest only if the non-employee director remains as an active board member on the vesting date and, therefore, any unvested shares are forfeited. RSAs for employees and non-employee directors retired from the Corporation are either immediately vested at retirement or continue to vest after retirement, depending on the plan under which the shares were granted. Deferred stock units ("DSUs") can be credited to non-employee directors who have elected to defer payment of compensation under the Corporation's 2008 Equity Compensation Plan for Non-employee Directors. DSUs credited are equal to the restricted shares that the non-employee director would have received under the plan. As of March 31, 2015, there were no outstanding DSUs.

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

Compensation expense related to unvested share-based awards is recorded by recognizing the unamortized grant date fair value of these awards over the remaining service periods of those awards, with no change in historical reported fair values and earnings. Awards are valued at fair value in accordance with provisions of share-based compensation guidance and are recognized on a straight-line basis over the service periods of each award. To complete the exercise of vested stock options, RSA's and ESPP options, the Corporation generally issues new shares from its authorized but unissued share pool. Share-based compensation for the three months ended March 31, 2015 was \$517,000 compared to \$505,000 for the three months ended March 31, 2014. Share-based compensation has been recognized as a component of salaries and benefits expense in the accompanying CONSOLIDATED CONDENSED STATEMENTS OF INCOME.

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

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

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

Share-based compensation expense recognized in the CONSOLIDATED CONDENSED STATEMENTS OF INCOME is based on awards ultimately expected to vest and is reduced for estimated forfeitures. Share-based compensation guidance requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods, if actual forfeitures differ from those estimates. Pre-vesting forfeitures were estimated to be approximately 4.9 percent for the three months ended March 31, 2015, based on historical experience.

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

	Three Months Ended March 31,	
	2015	2014
Stock and ESPP Options		
Pre-tax compensation expense	\$27	\$44
Income tax expense (benefit)	(1	) (3
Stock and ESPP option expense, net of income taxes	\$26	\$41
Restricted Stock Awards		
Pre-tax compensation expense	\$490	\$461
Income tax benefit	(168	) (161
Restricted stock awards expense, net of income taxes	\$322	\$300
Total Share-Based Compensation		
Pre-tax compensation expense	\$517	\$505
Income tax benefit	(169	) (164
Total share-based compensation expense, net of income taxes	\$348	\$341

As of March 31, 2015, unrecognized compensation expense related to RSAs was \$4,400,000 and is expected to be recognized over a weighted-average period of 1.78 years. The Corporation did not have any unrecognized compensation expense related to stock options as of March 31, 2015.

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Stock option activity under the Corporation's stock option plans as of March 31, 2015 and changes during the three months ended March 31, 2015, were as follows:

	Number of Shares	Weighted-Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2015	737,931	\$ 20.99		
Granted				
Exercised	(23,373 )	\$ 15.17		
Canceled	(100 )	\$ 28.25		
Outstanding March 31, 2015	714,458	\$ 21.18	2.84	2,742,203
Vested and Expected to Vest at March 31, 2015	714,458	\$ 21.18	2.84	2,742,203
Exercisable at March 31, 2015	714,458	\$ 21.18	2.84	2,742,203

There were no options granted during the three months ended March 31, 2015 and March 31, 2014.

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 three months of 2015 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their stock options on March 31, 2015. The amount of aggregate intrinsic value will change based on the fair market value of the Corporation's common stock. The aggregate intrinsic value of stock options exercised during the three months ended March 31, 2015 and 2014 was \$188,000 and \$274,000, respectively. Cash receipts of stock options exercised during this same period were \$355,000 and \$273,000, respectively.

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

The following table summarizes information on unvested RSAs outstanding as of March 31, 2015:

	Number of Shares	Weighted-Average Grant Date Fair Value
Unvested RSAs at January 1, 2015	385,450	\$15.65
Granted	100,140	\$22.91
Vested	(126,531)	) \$11.40
Forfeited	(1,487)	) \$15.04
Unvested RSAs at March 31, 2015	357,572	\$19.19

The grant date fair value of ESPP options was estimated at the beginning of the January 1, 2015 quarterly offering period of approximately \$23,000. The ESPP options vested during the three months ending March 31, 2015, leaving no unrecognized compensation expense related to unvested ESPP options at March 31, 2015.

## NOTE 10

## Income Tax

	Three Months Ended March 31,	
	2015	2014
Income Tax Expense :		
Currently Payable:		
Federal	\$30	\$(1,519)
Deferred:		
Federal	5,669	6,026
State	135	110
Total Income Tax Expense	\$5,834	\$4,617
Reconciliation of Federal Statutory to Actual Tax Expense:		
Federal statutory income tax at 35%	\$7,702	\$6,383
Tax-exempt interest income	(1,429)	) (1,225)
Stock compensation	8	13
Earnings on life insurance	(262)	) (262)
Tax credits	(144)	) (298)
Other	(41)	) 6
Actual Tax Expense	\$5,834	\$4,617

## NOTE 11



Net Income Per Share

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

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

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

(Unaudited)

The following table reconciles basic and diluted net income per share for the three months ended March 31, 2015 and 2014.

	Three Months Ended March 31, 2015			2014		
	Net Income	Weighted-Average Shares	Per Share Amount	Net Income	Weighted-Average Shares	Per Share Amount
Basic net income per share	16,172	37,709,883	\$0.43	13,620	35,956,436	\$0.38
Effect of dilutive stock options and warrants		290,191			304,188	
Diluted net income per share	\$16,172	38,000,074	\$0.43	\$13,620	36,260,624	\$0.38

Stock options to purchase 367,576 and 648,182 shares for the three months ended March 31, 2015 and 2014, respectively, were not included in the earnings per share calculation because the exercise price exceeded the average market price.

## NOTE 12

## IMPACT OF ACCOUNTING CHANGES

## FASB Accounting Standards Update No. 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis

The FASB has issued an Accounting Standards Update (ASU) No. 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis, which is intended to improve targeted areas of consolidation guidance for legal entities such as limited partnerships, limited liability corporations, and securitization structures (collateralized debt obligations, collateralized loan obligations, and mortgage-backed security transactions). The ASU focuses on the consolidation evaluation for reporting organizations (public and private companies and not-for-profit organizations) that are required to evaluate whether they should consolidate certain legal entities. In addition to reducing the number of consolidation models from four to two, the new standard simplifies the FASB Accounting Standards Codification™ (Codification) and improves current GAAP by:

- Placing more emphasis on risk of loss when determining a controlling financial interest. A reporting organization may no longer have to consolidate a legal entity in certain circumstances based solely on its fee arrangement, when certain criteria are met.

- Reducing the frequency of the application of related-party guidance when determining a controlling financial interest in a variable interest entity (VIE).

- Changing consolidation conclusions for public and private companies in several industries that typically make use of limited partnerships or VIEs.

The ASU will be effective for periods beginning after December 15, 2015, for public companies. For private companies and not-for-profit organizations, the ASU will be effective for annual periods beginning after December 15, 2016; and for interim periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period. Adoption of this ASU is not expected to have a significant effect on the Corporation's consolidated financial statements.

NOTE 13

GENERAL LITIGATION AND REGULATORY EXAMINATIONS

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

35

---

Table of Contents

PART I: FINANCIAL INFORMATION

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

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

FORWARD-LOOKING STATEMENTS

From time to time, we include forward-looking statements in our oral and written communication. We may include forward-looking statements in filings with the Securities and Exchange Commission, such as this 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, future or conditional verbs such as "will", "would", "should", "could", "might", "can", "may", or similar expressions. These forward-looking statements include:

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

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

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

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

CRITICAL ACCOUNTING POLICIES

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

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

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

## BUSINESS SUMMARY

First Merchants Corporation (the “Corporation”) is a financial holding company headquartered in Muncie, Indiana and was organized in September 1982. The Corporation’s Common Stock is traded on NASDAQ’s Global Select Market System under the symbol FRME. The Corporation has one full-service bank charter, First Merchants Bank, National Association (the “Bank”), which opened for business in Muncie, Indiana, in March 1893. The Bank also operates Lafayette Bank and Trust, Commerce National Bank and First Merchants Trust Company as divisions of First Merchants Bank, National Association. The Bank includes 106 banking locations in twenty-six Indiana, two Illinois and two Ohio counties. In addition to its branch network, the Corporation’s delivery channels include ATMs, check cards, remote deposit capture, interactive voice response systems and internet technology. The Corporation’s business activities are currently limited to one significant business segment, which is community banking.

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

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

Table of Contents

PART I: FINANCIAL INFORMATION

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

RESULTS OF OPERATIONS

Executive Summary

First Merchants Corporation reported net income available to common stockholders of \$16.2 million for the three months ended March 31, 2015, an increase of \$2.6 million, compared to net income available to common stockholders of \$13.6 million for the three months ended March 31, 2014. Earnings per share for the three months ended March 31, 2015 totaled \$0.43 per share, an increase of \$0.05 per share, or 13.2%, over \$0.38 per share for the same period in 2014.

As of March 31, 2015, total assets equaled \$5.9 billion, an increase of \$53.4 million from December 31, 2014. The Corporation's loan portfolio increased \$40.7 million, with the largest increase in Commercial and Industrial loans. Additional details of the changes in the Corporation's loans and other earning assets are discussed within NOTE 4. LOANS AND ALLOWANCE, included within the Notes to Consolidated Condensed Financial Statements, and the "EARNING ASSETS" section of Management's Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-Q.

The Corporation's allowance for loan losses totaled \$62.8 million as of March 31, 2015. The allowance provided 141.7 percent coverage of all non-accrual loans and 1.58 percent of total loans. The Corporation did not expense a provision for loan losses during the first quarter of 2015 despite net charge-offs of \$1.2 million, primarily due a decline of \$5.1 million in non-performing loans, which now total \$45.6 million. During the same period of 2014, the Corporation did not expense a provision for loan losses and had net recoveries during the period of \$1.7 million. Additional details are discussed within the "LOAN QUALITY/PROVISION FOR LOAN LOSSES" section of Management's Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-Q.

Total deposits of \$4.6 billion increased from December 31, 2014 by \$7.4 million. The largest increase was in savings deposits, which increased \$25.7 million. This increase was offset by a decrease in demand deposits of \$30.4 million compared to December 31, 2014.

Total borrowings increased \$15.2 million from December 31, 2014 as Federal Home Loan Bank advances and securities sold under repurchase agreements increased \$21.1 million and \$9.5 million, respectively. These increases were offset by a decrease in Federal Funds purchased of \$15.4 million.

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

NET INTEREST INCOME

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

Net interest margin for the first quarter of 2015 decreased to 3.78 percent compared to the first quarter of 2014 at 3.97 percent, while earning assets increased by \$399,000. Asset yields decreased 16 basis points FTE and interest costs increased 3 basis points, resulting in a 19 basis points FTE decrease in net interest income as compared to the same period in 2014.

The increases in net interest income and average earning assets during the three months ended March 31, 2015 compared with the same period in 2014, were driven primarily due to the Corporation acquiring 100 percent of Community Bancshares, Inc. in November 2014. Due to this transaction, the Bank acquired all the assets, deposits and liabilities of Community Bank. Additional details can be found in NOTE 2. BUSINESS COMBINATION, included within the Notes to Consolidated Condensed Financial Statements of this Form 10-Q.

As a result of the acquisitions in prior periods, the Corporation recognized fair value accretion, which is included in interest income in the periods presented. Interest income included \$2,169,000 and \$1,769,000 of fair value accretion for the three months ended March 31, 2015 and 2014, respectively. Additional details of the Corporation's remaining loan fair value discount, accretable and nonaccretable yield related to acquisitions can be found in NOTE 5. ACCOUNTING FOR CERTAIN LOANS ACQUIRED IN A PURCHASE, included within the Notes to Consolidated Condensed Financial Statements of this Form 10-Q.

Table of Contents

## PART I: FINANCIAL INFORMATION

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

The following table presents the Corporation's average balance sheet, interest income/interest expense, and the average rate as a percent of average earning assets for the three months ended March 31, 2015, and 2014.

	For the Three Months Ended					
	March 31, 2015			March 31, 2014		
	Average Balance	Interest Income / Expense	Average Rate	Average Balance	Interest Income / Expense	Average Rate
Assets: <sup>(4)</sup>						
Interest-bearing time deposits	\$56,907	\$36	0.25 %	\$44,312	\$23	0.21 %
Federal Reserve and Federal Home Loan Bank stock	41,351	550	5.32	38,990	652	6.69
Investment Securities: <sup>(1)</sup>						
Taxable	736,378	4,723	2.57	736,682	4,810	2.61
Tax-Exempt <sup>(2)</sup>	433,531	5,899	5.44	369,597	5,289	5.72
Total Investment Securities	1,169,909	10,622	3.63	1,106,279	10,099	3.65
Loans held for sale	4,927	110	8.93	5,060	71	5.61
Loans: <sup>(3)</sup>						
Commercial	3,041,242	34,169	4.49	2,925,997	33,611	4.59
Real Estate Mortgage	459,794	4,849	4.22	346,318	3,989	4.61
Installment	394,063	4,424	4.49	326,357	4,353	5.34
Tax-Exempt <sup>(2)</sup>	36,788	382	4.15	12,352	94	3.04
Total Loans	3,936,814	43,934	4.46	3,616,084	42,118	4.66
Total Earning Assets	5,204,981	55,142	4.24	4,805,665	52,892	4.40
Net unrealized gain on securities available for sale	14,480			3,636		
Allowance for loan losses	(63,429 )			(68,806 )		
Cash and cash equivalents	98,791			95,255		
Premises and equipment	77,707			74,632		
Other assets	488,544			489,306		
Total Assets	\$5,821,074			\$5,399,688		
Liabilities: <sup>(4)</sup>						
Interest-bearing deposits:						
Interest-bearing NOW deposits	\$1,030,433	\$252	0.10 %	\$1,044,251	\$268	0.10 %
Money market deposits	823,761	412	0.20	752,738	367	0.20
Savings deposits	571,751	159	0.11	524,383	152	0.12
Certificates and other time deposits	1,126,098	2,693	0.96	978,673	1,762	0.72
Total Interest-bearing Deposits	3,552,043	3,516	0.40	3,300,045	2,549	0.31
Borrowings	437,864	2,452	2.24	493,578	2,568	2.08
Total Interest-bearing Liabilities	3,989,907	5,968	0.60	3,793,623	5,117	0.54
Noninterest-bearing deposits	1,053,095			915,636		
Other liabilities	43,561			45,530		
Total Liabilities	5,086,563			4,754,789		
Stockholders' Equity <sup>(4)</sup>	734,511			644,899		
Total Liabilities and Stockholders' Equity	\$5,821,074	5,968	0.46	\$5,399,688	5,117	0.43



Net Interest Income	\$49,174		\$47,775	
Net Interest Margin		3.78 %		3.97 %

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

(2) Tax-exempt securities and loans are presented on a fully taxable equivalent basis, using a marginal tax rate of 35 percent for 2015 and 2014. These totals equal \$2,198 and \$1,884 for the three months ended March 31, 2015 and 2014, respectively.

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

(4) Effective November 7, 2014, the Corporation acquired 100 percent of Community Bancshares, Inc. ("Community"). Community was headquartered in Noblesville, IN and had 10 banking centers serving central Indiana. Pursuant to the merger agreement, each outstanding share of common stock of Community was converted into the right to receive either (a) 4.0926 shares of First Merchants' common stock, plus cash in lieu of fractional shares; or (b) \$85.94 in cash, based upon shareholder elections. The Corporation paid \$14.2 million in cash and issued approximately 1.6 million shares of common stock, valued at \$35.0 million, for a total purchase price of approximately \$49.2 million. The details of the acquisition can be found in Note 2. BUSINESS COMBINATIONS, in the Notes to Consolidated Condensed Financial Statements on this Form 10-Q.

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. Annualized amounts are computed utilizing a 30/360 day basis.

Table of Contents

PART I: FINANCIAL INFORMATION

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

NON-INTEREST INCOME

Non-interest income increased \$798,000, or 5.2 percent in the first quarter of 2015, compared to the first quarter of 2014. In November 2014, the Corporation acquired 100 percent of Community Bancshares. The acquisition of Community added approximately \$324,000 to non-interest income in the first quarter of 2015 when compared with the same period in 2014. Additional details of this acquisition can be found in NOTE 2. BUSINESS COMBINATIONS, included within the Notes to Consolidated Condensed Financial Statements of this Form 10-Q.

Net gains on the sale of loans increased by \$766,000 during the three months ended March 31, 2015 compared with the same period in 2014. Additionally, the sale of investment securities resulted in net gains of \$1.0 million, a \$444,000 increase from the same period in 2014.

Offsetting these increases, was a \$596,000 decrease in other real estate owned gains during the first three months of 2015 when compared to the same period of 2014.

NON-INTEREST EXPENSE

Non-interest expense decreased \$1.9 million, or 4.4 percent in the first quarter of 2015, compared to the first quarter of 2014. The largest decrease was in salaries and employee benefits which declined \$760,000, or 3.0 percent from the same quarter last year. The primary driver of the decrease was a decline of \$708,000 in company contributions to employee health savings accounts when compared to the same period last year. In the first quarter of 2014, \$866,000 of one-time employee health savings account seeding was recognized. Additionally, other real estate owned expenses decreased by \$528,000 from the same quarter last year as expenses were moderate.

Additionally, the Corporation recognized \$549,000 of one-time expenses related to acquisitions and integrations during the first quarter of 2015. This was approximately \$859,000 less than the \$1.4 million of one-time acquisition and integration expenses recognized in the first quarter of 2014. Equipment expenses included approximately \$215,000 of expense due to running Community's core system prior to integration.

INCOME TAXES

Income tax expense for the three months ended March 31, 2015, was \$5,834,000 on pre-tax net income of \$22,006,000. For the same period in 2014, income tax expense was \$4,617,000 on pre-tax net income of \$18,237,000.

Taxes, both current and deferred, decreased in the first quarter of 2015 by \$3,265,000. The decline in the net asset was primarily due to decreases in the deferred tax assets associated with the accounting for deferred compensation and incentive compensation of \$1,076,000 and \$1,163,000, respectively.

Table of Contents

## PART I: FINANCIAL INFORMATION

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

## CAPITAL

Capital adequacy is an important indicator of financial stability and performance. The Corporation maintained a strong capital position as evidenced by the tangible common equity to tangible assets ratio of 9.31 percent at March 31, 2015, and 9.16 percent at December 31, 2014.

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

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

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

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

(Dollars in Thousands)	March 31, 2015		Prompt Corrective Action Thresholds				
	Actual Amount	Ratio	Adequately Capitalized Amount	Ratio	Well Capitalized Amount	Ratio	
Total risk-based capital to risk-weighted assets							
First Merchants Corporation	\$709,978	15.12	% \$375,606	8.00	% N/A	N/A	
First Merchants Bank	667,161	14.24	374,899	8.00	\$468,624	10.00	%

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Tier 1 capital to risk-weighted assets								
First Merchants Corporation	\$586,290	12.49	%	\$281,704	6.00	%	N/A	N/A
First Merchants Bank	608,531	12.99		281,175	6.00		\$374,899	8.00 %
Common equity tier 1 capital to risk-weighted assets								
First Merchants Corporation	\$533,844	11.37	%	\$211,278	4.50	%	N/A	N/A
First Merchants Bank	608,531	12.99		210,881	4.50		\$304,606	6.50 %
Tier 1 capital to average assets								
First Merchants Corporation	\$586,290	10.45	%	\$224,364	4.00	%	N/A	N/A
First Merchants Bank	608,531	10.87		223,888	4.00		\$279,859	5.00 %

December 31, 2014

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

Table of Contents

## PART I: FINANCIAL INFORMATION

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

Tier I regulatory capital consists primarily of total stockholders' equity and subordinated debentures issued to business trusts categorized as qualifying borrowings, less non-qualifying intangible assets and unrealized net securities gains or losses.

On November 7, 2014, the Corporation acquired 100 percent of Community. Pursuant to the merger agreement, each outstanding share of common stock of Community was converted into the right to receive either (a) 4.0926 shares of First Merchants' common stock, plus cash in lieu of fractional shares; or (b) \$85.94 in cash, based upon shareholder elections. The Corporation paid \$14.2 million in cash and issued approximately 1.6 million shares of common stock, valued at approximately \$35.0 million, for a total purchase price of approximately \$49.2 million.

Management believes that all of the above capital ratios are meaningful measurements for evaluating the safety and soundness of the Corporation. Additionally, management believes the following table is also meaningful when considering performance measures of the Corporation. The table details and reconciles tangible earnings per share, return on tangible capital and tangible assets to traditional GAAP measures for the three months ended March 31, 2015 and 2014.

(Dollars in Thousands, Except Per Share Amounts)	Three Months Ended March 31,		
	2015	2014	
Average goodwill	\$202,723	\$188,988	
Average core deposit intangible (CDI)	15,647	13,539	
Average deferred tax on CDI	(5,958)	(4,897)	)
Intangible adjustment	\$212,412	\$197,630	
Average stockholders' equity (GAAP capital)	\$734,511	\$644,899	
Average cumulative preferred stock	(125)	(125)	)
Intangible adjustment	(212,412)	(197,630)	)
Average tangible capital	\$521,974	\$447,144	
Average assets	\$5,821,074	\$5,399,688	
Intangible adjustment	(212,412)	(197,630)	)
Average tangible assets	\$5,608,662	\$5,202,058	
Net income available to common stockholders	\$16,172	\$13,620	
CDI amortization, net of tax	418	336	
Tangible net income available to common stockholders	\$16,590	\$13,956	
Per Share Data:			
Diluted net income available to common stockholders	\$0.43	\$0.38	
Diluted tangible net income available to common stockholders	\$0.44	\$0.38	
Ratios:			
Return on average GAAP capital (ROE)	8.81	% 8.45	%
Return on average tangible capital	12.71	% 12.49	%
Return on average assets (ROA)	1.11	% 1.01	%
Return on average tangible assets	1.18	% 1.07	%

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

common stockholders (annualized) expressed as a percentage of average tangible assets.

#### LOAN QUALITY/PROVISION FOR LOAN LOSSES

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

##### Loan Quality

The quality and amount of non-performing loans may increase or decrease going forward as a result of acquisitions, organic portfolio growth, problem loan recognition and resolution through collections, sales or charge offs. The performance of any loan can be affected by external factors such as economic conditions, or internal factors specific to a particular borrower, such as the actions of a customer's management.

At March 31, 2015, non performing loans totaled \$45,647,000, a decrease of \$5,134,000 from the December 31, 2014 balance of \$50,781,000. Non-accrual loans totaled \$44,321,000, and accounted for 87% percent of the decrease in non-performing loans from December 31, 2014. The Corporation's coverage ratio of allowance for loan losses to non-accrual loans increased from 131.1 percent at December 31, 2014 to 141.7 percent at March 31, 2015. See additional information regarding the allowance for loan losses in the "Provision for Loan Losses" section of Management's Discussion and Analysis of Financial Condition and Results of Operations included as ITEM 2 of this Form 10-Q.

Table of Contents

## PART I: FINANCIAL INFORMATION

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

Accruing loans delinquent 90 or more days of \$1,655,000 at March 31, 2015 decreased \$3,008,000 from the December 31, 2014 balance of \$4,663,000. Commercial and industrial loans 90+ days delinquent and accruing decreased \$2,764,000 from the December 31, 2014 balance of \$2,985,000 to \$221,000 at March 31, 2015.

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

A loan is deemed impaired when, based on current information or events, it is probable that all amounts due of principal and interest according to the contractual terms of the loan agreement will not be collected substantially within the contractual terms of the note. At March 31, 2015, commercial impaired loans totaled \$104,550,000 a decrease of \$11,673,000 from the balance of \$116,223,000 at December 31, 2014. At March 31, 2015, an allowance for losses was not deemed necessary for commercial impaired loans totaling \$93,646,000 as there was no identified loss on these credits. An allowance of \$4,556,000 was recorded for the remaining balance of these impaired loans totaling \$10,904,000 and is included in the Corporation's allowance for loan losses.

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

(Dollars in Thousands)	March 31, 2015	December 31, 2014
Non-Performing Assets:		
Non-accrual loans	\$44,321	\$48,789
Renegotiated loans	1,326	1,992
Non-performing loans (NPL)	45,647	50,781
Other real estate owned	19,073	19,293
Non-performing assets (NPA)	64,720	70,074
90+ days delinquent and still accruing	1,655	4,663
Non-performing assets plus 90+ days delinquent	\$66,375	\$74,737
Impaired Loans	\$104,550	\$116,223

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

(Dollars in Thousands)	March 31, 2015	December 31, 2014
Non-Performing Assets and 90+ Days Delinquent:		
Commercial and industrial loans	\$8,998	\$10,033
Agricultural production financing and other loans to farmers	1,978	5,800
Real estate loans:		
Construction	10,033	8,363
Commercial and farmland	26,803	30,400
Residential	15,605	17,079

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Home Equity	2,817	2,802
Individuals' loans for household and other personal expenditures	141	260
Non-performing assets plus 90+ days delinquent	\$66,375	\$74,737

Although the Corporation believes its underwriting and loan review procedures are appropriate for the various kinds of loans it makes, its results of operations and financial condition could be adversely affected in the event the quality of its loan portfolio declines. Deterioration in the economic environment including residential and commercial real estate values may result in increased levels of loan delinquencies and credit losses.



Table of Contents

## PART I: FINANCIAL INFORMATION

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

## Provision for Loan Losses

The allowance for loan losses is maintained through the provision for loan losses, which is a charge against earnings. The amount actually provided for loan losses in any period may be greater than or less than net loan losses, based on management's judgment as to the appropriate level of the allowance for loan losses. The amount provided for loan losses and the determination of the adequacy of the allowance are based on a continuous review of the loan portfolio, including an internally administered loan "watch" list and an ongoing loan review. The evaluation takes into consideration identified credit problems, as well as the possibility of losses inherent in the loan portfolio that are not specifically identified.

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

At March 31, 2015, the allowance for loan losses was \$62,801,000, a decrease of \$1,163,000 from December 31, 2014. As a percent of loans, the allowance was 1.58 percent at March 31, 2015, compared to 1.63 percent at December 31, 2014. There was no provision for loan losses for the three months ended March 31, 2015, equal to the same period in 2014. Specific reserves on impaired loans increased \$1,787,000 from \$2,769,000 at December 31, 2014, to \$4,556,000 at March 31, 2015.

Net charge offs for the three months ended March 31, 2015, were \$1,163,000. Comparatively, the same period in 2014 had net recoveries of \$1,713,000. Of the current period charge offs, one agricultural related charge off was greater than \$500,000. The distribution of the net charge offs or recoveries for the three months ended March 31, 2015 and March 31, 2014 are reflected in the following table:

(Dollars in Thousands)	Three Months Ended	
	March 31,	2014
Net Charge Offs (Recoveries):	2015	2014
Commercial and industrial loans	\$(76 )	\$(1,315 )
Agricultural production financing and other loans to farmers	731	(16 )
Real estate loans:		
Construction	4	(362 )
Commercial and farmland	44	(151 )
Residential	214	96
Home Equity	203	(25 )
Individuals' loans for household and other personal expenditures	47	93
Lease financing receivables, net of unearned income		(20 )
Other Loans	(4 )	(13 )
Total Net Charge Offs	\$1,163	\$(1,713 )

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

outstanding. The determination of the provision for loan losses in any period is based on management's continuing review and evaluation of the loan portfolio, and its judgment as to the impact of current economic conditions on the portfolio.

## LIQUIDITY

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

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

The principal source of asset-funded liquidity is investment securities classified as available for sale, the market values of which totaled \$538,055,000 at March 31, 2015, a decrease of \$11,488,000, or 2.1 percent, from December 31, 2014. 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 that are maturing in one year or less, totaled \$8,072,000 at March 31, 2015. In addition, other types of assets such as cash and due from banks, federal funds sold, and securities purchased under agreements to resell, loans and interest-bearing deposits with other banks maturing within one year are sources of liquidity.

Table of Contents

## PART I: FINANCIAL INFORMATION

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

The most stable source of liability-funded liquidity for both the long-term and short-term is deposit growth and retention in the core deposit base. In addition, Federal Home Loan Bank ("FHLB") advances are utilized as funding sources. At March 31, 2015, total borrowings from the FHLB were \$166,326,000. The Bank has pledged certain mortgage loans and investments to the FHLB. The total available remaining borrowing capacity from the FHLB at March 31, 2015, was \$375,171,000.

On November 1, 2013, the Corporation completed the private issuance and sale to four institutional investors of an aggregate of \$70 million of debt comprised of (a) 5.00 percent Fixed-to-Floating Rate Senior Notes due 2028 in the aggregate principal amount of \$5 million (the "Senior Debt") and (b) 6.75 percent Fixed-to-Floating Rate Subordinated Notes due 2028 in the aggregate principal amount of \$65 million (the "Subordinated Debt"). The Senior Debt agreement contains certain customary representations and warranties and financial and negative covenants. As of March 31, 2015, the Corporation was in compliance with these covenants.

Additionally, on April 11, 2014, the Corporation entered into a line of credit agreement with U.S. Bank, N.A. with a maximum borrowing capacity of \$20 million. As of March 31, 2015, there was no outstanding balance on the line of credit. Interest is payable quarterly based on one-month LIBOR plus 2.00 percent. The line of credit has a quarterly facility fee of 0.25 percent on the unused balance. The line of credit agreement contains certain customary representations and warranties and financial and negative covenants. As of March 31, 2015, the Corporation was in compliance with these covenants. The line of credit was schedule to mature on April 10, 2015; however, on April 9, 2015 the agreement was amended to have a maturity date of April 8, 2016.

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

The Bank provides customers with off-balance sheet credit support through loan commitments and standby and commercial letters of credit. Summarized credit-related financial instruments at March 31, 2015, are as follows:

(Dollars in Thousands)	March 31, 2015
Amounts of commitments:	
Loan commitments to extend credit	\$ 1,664,946
Standby and commercial letters of credit	44,928
	\$ 1,709,874

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

In addition to owned banking facilities, the Corporation has entered into a number of long-term leasing arrangements to support ongoing activities. The required payments under such commitments and borrowings at March 31, 2015, are as follows:

(Dollars in Thousands)	2016	2017	2018	2019	2020	Total
------------------------	------	------	------	------	------	-------

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

	Remaining 2015						2021 and after	
Operating leases	\$2,024	\$2,162	\$1,466	\$694	\$490	\$414	\$2,322	\$9,572
Securities sold under repurchase agreements	134,023							134,023
Federal Home Loan Bank advances	51,844	41,225	15,016	25,637	12,503	10,101	10,000	166,326
Subordinated debentures and term loans	173						126,702	126,875
Total	\$188,064	\$43,387	\$16,482	\$26,331	\$12,993	\$10,515	\$139,024	\$436,796

Table of Contents

## PART I: FINANCIAL INFORMATION

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

## INTEREST SENSITIVITY AND DISCLOSURE ABOUT MARKET RISK

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

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

Net interest income simulation modeling, or earnings-at-risk, measures the sensitivity of net interest income to various interest rate movements. The Corporation's asset liability process monitors simulated net interest income under three separate interest rate scenarios; base, rising and falling. Estimated net interest income for each scenario is calculated over a 12-month horizon. The immediate and parallel changes to the base case scenario used in the model are presented below. The interest rate scenarios are used for analytical purposes and do not necessarily represent management's view of future market movements. Rather, these are intended to provide a measure of the degree of volatility interest rate movements may introduce into the earnings of the Corporation.

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

The comparative rising 200 basis points and falling 100 basis points scenarios below, as of March 31, 2015, assume further interest rate changes in addition to the base simulation discussed above. These changes are immediate and parallel changes to the base case scenario. In the current rate environment, many driver rates are at or near historical lows, thus total rate movements (beginning point minus ending point) to each of the various driver rates utilized by management have the following results:

	March 31, 2015	
	RISING	FALLING
	(200 Basis Points)	(100 Basis Points)
Driver Rates		
Prime	200	—
Federal funds	200	—
One-year CMT	200	(5 )
Three-year CMT	200	(62 )
Five-year CMT	200	(1 )
CD's	200	(23 )

FHLB advances 200 (48 )

Results for the base, rising 200 basis points, and falling 100 basis points interest rate scenarios are listed below based upon the Corporation's rate sensitive assets and liabilities at March 31, 2015. The net interest income shown represents cumulative net interest income over a 12-month time horizon. Balance sheet assumptions used for the base scenario are the same for the rising and falling simulations.

(Dollars in Thousands)	March 31, 2015		
	Base	RISING (200 Basis Points)	FALLING (100 Basis Points)
Net interest income	\$179,646	\$194,266	\$176,145
Variance from base		\$14,620	\$(3,501 )
Percent of change from base		8.14	% (1.95 )%

Table of Contents

## PART I: FINANCIAL INFORMATION

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

The comparative rising 200 basis points and falling 100 basis points scenarios below, as of December 31, 2014, assume further interest rate changes in addition to the base simulation discussed above. These changes are immediate and parallel changes to the base case scenario. In addition, total rate movements (beginning point minus ending point) to each of the various driver rates utilized by management in the base simulation are as follows:

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

Results for the base, rising 200 basis points, and falling 100 basis points interest rate scenarios are listed below. The net interest income shown represents cumulative net interest income over a 12-month time horizon. Balance sheet assumptions used for the base scenario are the same for the rising and falling simulations.

(Dollars in Thousands)	December 31, 2014		
	Base	RISING (200 Basis Points)	FALLING (100 Basis Points)
Net interest income	\$ 180,175	\$ 192,164	\$ 175,118
Variance from base		\$ 11,989	\$(5,057 )
Percent of change from base		6.65	% (2.81 )%

## EARNING ASSETS

The following table presents the earning asset mix as of March 31, 2015, and December 31, 2014. Earning assets increased by \$84,294,000 during the three months ended March 31, 2015. Interest-bearing time deposits increased \$35,708,000, while investments increased by approximately \$8,842,000. Loans and loans held for sale increased by \$39,824,000. The three loan classes experiencing the largest increase from December 31, 2014, were commercial and industrial loans, real estate construction and other loans. These increases were offset primarily by decreases in three loan classes, which were real estate commercial and farmland, agriculture production financing and residential.

(Dollars in Thousands)	March 31, 2015	December 31, 2014
Interest-bearing time deposits	\$ 83,228	\$ 47,520
Investment securities available for sale	538,055	549,543
Investment securities held to maturity	651,418	631,088
Mortgage loans held for sale	6,392	7,235
Loans	3,965,532	3,924,865

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Federal Reserve and Federal Home Loan Bank stock	41,273	41,353
Total	\$5,285,898	\$5,201,604

OTHER

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



Table of Contents

PART I: FINANCIAL INFORMATION

ITEM 3. QUANTITATIVE AND QUALITATIVE  
DISCLOSURES ABOUT MARKET RISK

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

47

---

Table of Contents

PART I: FINANCIAL INFORMATION

ITEM 4. CONTROLS AND PROCEDURES

ITEM 4. CONTROLS AND PROCEDURES

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

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

Table of Contents

PART II: OTHER INFORMATION

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

(table dollar amounts in thousands, except share data)

ITEM 1. LEGAL PROCEEDINGS

None

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors previously disclosed in the Corporation's December 31, 2014, 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 three months ended March 31, 2015, as follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as part of Publicly announced Plans or Programs	Maximum Number of Shares that may yet be Purchased Under the Plans or Programs
January, 2015	183	\$21.84		
February, 2015	50,181	\$22.84		
March, 2015	293	\$22.92		

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

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable

ITEM 5. OTHER INFORMATION

a. None

b. None

49

---

Table of Contents

PART II: OTHER INFORMATION

ITEM 6. EXHIBITS

ITEM 6. EXHIBITS

Exhibit No: Description of Exhibits:

2.1	Agreement and Plan of Reorganization and Merger between First Merchants Corporation and C Financial Corporation dated as of January 5, 2015 (Incorporated by reference to registrant's Form 8-K filed on January 6, 2015)
3.1	First Merchants Corporation Articles of Incorporation, as amended (Incorporated by reference to registrant's Form 10-Q filed on November 9, 2011)
3.2	Bylaws of First Merchants Corporation dated October 28, 2009 (Incorporated by reference to registrant's Form 10-Q filed on November 9, 2009)
4.1	First Merchants Corporation Amended and Restated Declaration of Trust of First Merchants Capital Trust II dated as of July 2, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007)
4.2	Indenture dated as of July 2, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007)
4.3	Guarantee Agreement dated as of July 2, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007)
4.4	Form of Capital Securities Certification of First Merchants Capital Trust II (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007)
4.5	First Merchants Corporation Dividend Reinvestment and Stock Purchase Plan (Incorporated by reference to registrant's Post-Effective Amendment No. 1 to Form S-3 filed on August 21, 2009)
4.6	Upon request, the registrant agrees to furnish supplementally to the Commission a copy of the instruments defining the rights of holders of its (a) 5.00% Fixed-to-Floating Rate Senior Notes due 2028 in the aggregate principal amount of \$5 million and (b) 6.75% Fixed-to-Floating Rate Subordinated Notes due 2028 in aggregate principal amount of \$65 million.
10.1	Voting Agreement dated January 5, 2015, by and among First Merchants Corporation and certain shareholders of C Financial Corporation (Incorporated by reference to registrant's Form 8-K filed on January 6, 2015)
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes - Oxley Act of 2002 (1)
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes - Oxley Act of 2002 (1)
32	Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (1)
101.INS	XBRL Instance Document (2)
101.SCH	XBRL Taxonomy Extension Schema Document (2)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document (2)
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document (2)
101.LAB	XBRL Taxonomy Extension Label Linkbase Document (2)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document (2)

(1) Filed herewith.

(2) Furnished herewith.



Table of Contents

PART II: OTHER INFORMATION

ITEM 6. EXHIBITS

SIGNATURES

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

First Merchants Corporation  
(Registrant)

Date: May 6, 2015

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

Date: May 6, 2015

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

Table of Contents

PART II: OTHER INFORMATION

ITEM 6. EXHIBITS

INDEX TO EXHIBITS

Exhibit No: Description of Exhibits:

2.1	Agreement and Plan of Reorganization and Merger between First Merchants Corporation and C Financial Corporation dated as of January 5, 2015 (Incorporated by reference to registrant's Form 8-K filed on January 6, 2015)
3.1	First Merchants Corporation Articles of Incorporation, as amended (Incorporated by reference to registrant's Form 10-Q filed on November 9, 2011)
3.2	Bylaws of First Merchants Corporation dated October 28, 2009 (Incorporated by reference to registrant's Form 10-Q filed on November 9, 2009)
4.1	First Merchants Corporation Amended and Restated Declaration of Trust of First Merchants Capital Trust II dated as of July 2, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007)
4.2	Indenture dated as of July 2, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007)
4.3	Guarantee Agreement dated as of July 2, 2007 (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007)
4.4	Form of Capital Securities Certification of First Merchants Capital Trust II (Incorporated by reference to registrant's Form 8-K filed on July 3, 2007)
4.5	First Merchants Corporation Dividend Reinvestment and Stock Purchase Plan (Incorporated by reference to registrant's Post-Effective Amendment No. 1 to Form S-3 filed on August 21, 2009)
4.6	Upon request, the registrant agrees to furnish supplementally to the Commission a copy of the instruments defining the rights of holders of its (a) 5.00% Fixed-to-Floating Rate Senior Notes due 2028 in the aggregate principal amount of \$5 million and (b) 6.75% Fixed-to-Floating Rate Subordinated Notes due 2028 in aggregate principal amount of \$65 million.
10.1	Voting Agreement dated January 5, 2015, by and among First Merchants Corporation and certain shareholders of C Financial Corporation (Incorporated by reference to registrant's Form 8-K filed on January 6, 2015)
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes - Oxley Act of 2002 (1)
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes - Oxley Act of 2002 (1)
32	Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (1)
101.INS	XBRL Instance Document (2)
101.SCH	XBRL Taxonomy Extension Schema Document (2)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document (2)
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document (2)
101.LAB	XBRL Taxonomy Extension Label Linkbase Document (2)
101.PRE	XBRL Taxonomy Extension Presentation Linkebase Document (2)

(1) Filed herewith.

(2) Furnished herewith.



