

FIRST MERCHANTS CORP
Form 10-Q
August 09, 2012

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 June 30, 2012

OR

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

For the Transition Period from _____ to _____

Commission File Number 0-17071

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

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

200 East Jackson 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 definition 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 July 31, 2012, there were 28,650,646 outstanding common shares of the registrant.

FIRST MERCHANTS CORPORATION
FORM 10Q

	Page No.
<u>Part I. Financial Information</u>	
Item 1.	
	<u>Financial Statements:</u>
	<u>Consolidated Condensed Balance Sheets</u> 3
	<u>Consolidated Condensed Statements of Income</u> 4
	<u>Consolidated Condensed Statements of Comprehensive Income</u> 5
	<u>Consolidated Condensed Statement of Stockholders' Equity</u> 6
	<u>Consolidated Condensed Statements of Cash Flows</u> 7
	<u>Notes to Consolidated Condensed Financial Statements</u> 8
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> 40
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u> 51
Item 4.	<u>Controls and Procedures</u> 51
<u>Part II. Other Information</u>	
Item 1.	<u>Legal Proceedings</u> 52
Item 1.A.	<u>Risk Factors</u> 52
Item 2.	<u>Unregistered Sales of Equity Securities and use of Proceeds</u> 52
Item 3.	<u>Defaults Upon Senior Securities</u> 52
Item 4.	<u>Mine Safety Disclosures</u> 52
Item 5.	<u>Other Information</u> 52
Item 6.	<u>Exhibits</u> 53
	<u>Signatures</u> 54
	<u>Index to Exhibits</u> 55

FIRST MERCHANTS CORPORATION
FORM 10Q
PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
CONSOLIDATED CONDENSED BALANCE SHEETS
(Dollars in thousands)

	June 30, 2012 (Unaudited)	December 31, 2011
ASSETS		
Cash and cash equivalents	\$ 68,493	\$ 73,312
Interest-bearing time deposits	41,760	52,851
Investment securities available for sale	547,551	518,491
Investment securities held to maturity (fair value of \$413,247 and \$442,469)	396,770	427,909
Mortgage loans held for sale	15,278	17,864
Loans, net of allowance for loan losses of \$70,143 and \$70,898	2,727,491	2,642,517
Premises and equipment	51,335	51,013
Federal Reserve and Federal Home Loan Bank stock	33,033	31,270
Interest receivable	16,506	17,723
Core deposit intangibles	8,649	9,114
Goodwill	141,357	141,357
Cash surrender value of life insurance	124,018	124,329
Other real estate owned	14,183	16,289
Tax asset, deferred and receivable	32,003	36,424
Other assets	13,996	12,613
TOTAL ASSETS	\$ 4,232,423	\$ 4,173,076
LIABILITIES		
Deposits:		
Noninterest-bearing	\$ 684,101	\$ 646,508
Interest-bearing	2,604,797	2,488,147
Total Deposits	3,288,898	3,134,655
Borrowings:		
Federal funds purchased	652	
Securities sold under repurchase agreements	160,127	156,305
Federal Home Loan Bank advances	96,847	138,095
Subordinated debentures and term loans	115,951	194,974
Total Borrowings	373,577	489,374
Interest payable	2,168	2,925
Other liabilities	32,104	31,655
Total Liabilities	3,696,747	3,658,609
COMMITMENTS AND CONTINGENT LIABILITIES		
STOCKHOLDERS' EQUITY		
Preferred Stock, no-par value, \$1,000 liquidation value:		
Authorized - 500,000 shares		
Senior Non-Cumulative Perpetual Preferred Stock, Series B		
Issued and outstanding - 90,782.94 shares	90,783	90,783
Cumulative Preferred Stock, \$1,000 par value, \$1,000 liquidation value:		

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Authorized - 600 shares		
Issued and outstanding - 125 shares	125	125
Common Stock, \$.125 stated value:		
Authorized - 50,000,000 shares		
Issued and outstanding - 28,643,264 and 28,559,707 shares	3,580	3,570
Additional paid-in capital	255,632	254,874
Retained earnings	188,863	168,717
Accumulated other comprehensive loss	(3,307)	(3,602)
Total Stockholders' Equity	535,676	514,467
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 4,232,423	\$ 4,173,076

See notes to consolidated condensed financial statements.

FIRST MERCHANTS CORPORATION
FORM 10Q
CONSOLIDATED CONDENSED STATEMENTS OF INCOME
(Dollars in thousands, except per share amounts)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
INTEREST INCOME				
Loans receivable:				
Taxable	\$ 36,652	\$ 37,457	\$ 72,500	\$ 76,195
Tax exempt	123	247	240	349
Investment securities:				
Taxable	4,468	5,040	9,042	9,587
Tax exempt	2,551	2,535	5,113	5,088
Federal funds sold		1		3
Deposits with financial institutions	28	100	53	183
Federal Reserve and Federal Home Loan Bank stock	347	341	690	682
Total Interest Income	44,169	45,721	87,638	92,087
INTEREST EXPENSE				
Deposits	3,939	5,864	8,049	12,730
Federal funds purchased	12	3	24	6
Securities sold under repurchase agreements	197	386	492	764
Federal Home Loan Bank advances	637	977	1,631	1,978
Subordinated debentures and term loans	1,331	2,644	3,273	5,285
Total Interest Expense	6,116	9,874	13,469	20,763
NET INTEREST INCOME	38,053	35,847	74,169	71,324
Provision for loan losses	4,545	5,625	9,420	11,219
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	33,508	30,222	64,749	60,105
OTHER INCOME				
Service charges on deposit accounts	2,893	2,997	5,712	5,776
Fiduciary activities	1,938	1,929	3,921	3,965
Other customer fees	3,150	2,634	5,736	4,869
Commission income	1,485	1,024	3,152	2,912
Earnings on cash surrender value of life insurance	662	571	2,040	1,149
Net gains and fees on sales of loans	2,314	1,030	4,266	2,903
Net realized gains on sales of available for sale securities	502	825	1,291	1,288
Other-than-temporary impairment on available for sale securities				(2,775)
Portion of loss recognized in other comprehensive income before taxes				2,375
Net impairment losses recognized in earnings				(400)
Gain on FDIC modified whole bank transaction			9,124	
Other income	221	51	581	457
Total Other Income	13,165	11,061	35,823	22,919
OTHER EXPENSES				
Salaries and employee benefits	19,641	18,560	38,995	35,736

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Net occupancy	2,473	2,415	5,124	5,160
Equipment	1,656	1,677	3,461	3,460
Marketing	564	436	1,006	818
Outside data processing fees	1,506	1,458	2,882	2,903
Printing and office supplies	294	313	561	601
Core deposit amortization	480	1,101	949	2,202
FDIC assessments	862	1,451	1,979	3,555
Other real estate owned and credit-related expenses	2,122	2,843	4,308	6,038
Other expenses	4,582	4,145	8,943	7,807
Total Other Expenses	34,180	34,399	68,208	68,280
INCOME BEFORE INCOME TAX	12,493	6,884	32,364	14,744
Income tax expense	3,288	1,396	8,788	3,795
NET INCOME	9,205	5,488	23,576	10,949
Preferred stock dividends and discount accretion	(1,135)	(990)	(2,270)	(1,978)
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS	\$ 8,070	\$ 4,498	\$ 21,306	\$ 8,971

Per Share Data:

Basic Net Income Available to Common Stockholders	\$ 0.28	\$ 0.18	\$ 0.74	\$ 0.35
Diluted Net Income Available to Common Stockholders	\$ 0.28	\$ 0.18	\$ 0.74	\$ 0.35
Cash Dividends Paid	\$ 0.03	\$ 0.01	\$ 0.04	\$ 0.02
Average Diluted Shares Outstanding (in thousands)	28,815	25,783	28,782	25,773

See notes to consolidated condensed financial statements.

FIRST MERCHANTS CORPORATION
FORM 10Q
CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME
(Dollars in thousands)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net Income	\$ 9,205	\$ 5,488	\$ 23,576	\$ 10,949
Other comprehensive income net of tax:				
Unrealized holding gain on securities available for sale arising during the period, net of income tax of \$664, \$1,099, \$653, and \$3,674	1,232	2,041	1,212	6,823
Unrealized loss on securities available for sale for which a portion of an other than temporary impairment has been recognized in income, net of tax of \$24, \$0, \$31, and \$844	(44)		(58)	(1,568)
Unrealized loss on cash flow hedges arising during the period, net of income tax of \$567, \$217, \$404, and \$170	(1,053)	(403)	(750)	(316)
Amortization of items previously recorded in accumulated other comprehensive income (loss), net of income tax of \$113, \$11, \$393, and \$20	209	(20)	730	(38)
Reclassification adjustment for gains included in net income net of income tax expense of \$176, \$289, \$452, and \$311	(326)	(537)	(839)	(577)
	18	1,081	295	4,324
Comprehensive Income	\$ 9,223	\$ 6,569	\$ 23,871	\$ 15,273

The components of accumulated other comprehensive loss, net of tax, included in stockholders' equity, are as follows:

	June 30, 2012	December 31, 2011
Net unrealized gain on securities available for sale	\$ 18,617	\$ 18,244
Net unrealized loss on securities available for sale for which a portion of an other-than-temporary impairment has been recognized in income	(3,226)	(3,168)
Net unrealized loss on cash flow hedges	(2,590)	(1,841)
Defined benefit plans	(16,108)	(16,837)
	\$ (3,307)	\$ (3,602)

See notes to consolidated condensed financial statements.

FIRST MERCHANTS CORPORATION
FORM 10Q
CONSOLIDATED CONDENSED STATEMENT OF STOCKHOLDERS' EQUITY
(Dollars in thousands, except per share data)
(Unaudited)

	Preferred		Common Stock		Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
	Shares	Amount	Shares	Amount			(Loss)	
Balances, December 31, 2011	90,908	\$ 90,908	28,559,707	\$ 3,570	\$ 254,874	\$ 168,717	\$ (3,602)	\$ 514,467
Comprehensive Income								
Net Income						23,576		23,576
Other Comprehensive Income, net of tax							295	295
Cash Dividends on Common Stock (\$0.04 per share)						(1,160)		(1,160)
Cash Dividends on Preferred Stock under Small Business Lending Fund						(2,270)		(2,270)
Share-based Compensation			73,469	9	677			686
Stock Issued Under Employee Benefit Plans			23,495	3	222			225
Stock Issued Under Dividend Reinvestment and Stock Purchase Plan			7,625	1	86			87
Stock Redeemed			(21,032)	(3)	(227)			(230)
Balances, June 30, 2012	90,908	\$ 90,908	28,643,264	\$ 3,580	\$ 255,632	\$ 188,863	\$ (3,307)	\$ 535,676

See notes to consolidated condensed financial statements.

FIRST MERCHANTS CORPORATION
FORM 10Q
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	June 30,	
	2012	2011
Cash Flow From Operating Activities:		
Net income	\$ 23,576	\$ 10,949
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	9,420	11,219
Depreciation and amortization	2,348	2,571
Change in deferred taxes	7,452	4,697
Share-based compensation	686	718
Mortgage loans originated for sale	(177,645)	(106,979)
Proceeds from sales of mortgage loans	180,231	123,602
Gain on acquisition	(9,124)	
Gains on sales of securities available for sale	(1,291)	(1,288)
Recognized loss on other-than-temporary-impairment		400
Change in interest receivable	1,745	1,673
Change in interest payable	(1,124)	(661)
Other adjustments	1,297	10,553
Net cash provided by operating activities	\$ 37,571	\$ 57,454
Cash Flows from Investing Activities:		
Net change in interest-bearing deposits	\$ 23,004	\$ 49,351
Purchases of:		
Securities available for sale	(82,459)	(93,887)
Securities held to maturity	(566)	(75,971)
Proceeds from sales of securities available for sale	26,351	25,911
Proceeds from maturities of:		
Securities available for sale	47,379	22,237
Securities held to maturity	30,131	15,362
Change in Federal Reserve and Federal Home Loan Bank stock	(2)	2,500
Purchase of bank owned life insurance		(5,000)
Net change in loans	(4,579)	80,883
Net cash received from acquisition	17,200	
Proceeds from the sale of other real estate owned	3,437	5,349
Other adjustments	(1,216)	7,929
Net cash provided by investing activities	\$ 58,680	\$ 34,664
Cash Flows from Financing Activities:		
Net change in :		
Demand and savings deposits	\$ 93,510	\$ (12,918)
Certificates of deposit and other time deposits	(65,176)	(113,429)
Borrowings	31,755	62,351
Repayment of borrowings	(157,811)	(33,634)
Cash dividends on common stock	(1,160)	(518)
Cash dividends on preferred stock	(2,270)	(1,740)
Stock issued under dividend reinvestment and stock purchase plans	312	461

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Stock redeemed	(230)	(124)
Net cash used in financing activities	\$ (101,070)	\$ (99,551)
Net Change in Cash and Cash Equivalents	(4,819)	(7,433)
Cash and Cash Equivalents, January 1	73,312	58,307
Cash and Cash Equivalents, June 30	\$ 68,493	\$ 50,874

Additional cash flow information:

Interest paid	\$ 14,226	\$ 21,424
Income tax paid	\$ 3,988	\$ 2,977
Loans transferred to other real estate owned	\$ 3,199	\$ 3,814
Non-cash investing activities using trade date accounting	\$ 757	\$ 1,036

See notes to consolidated condensed financial statements.

FIRST MERCHANTS CORPORATION
FORM 10Q
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Table dollars in thousands)
(Unaudited)

NOTE 1. General

Financial Statement Preparation

The significant accounting policies followed by First Merchants Corporation (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, 2011, 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 six months ended June 30, 2012, are not necessarily indicative of the results to be expected for the year.

NOTE 2. Purchase and Assumption

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

Under the terms of the Agreement, the Bank acquired \$147.7 million in assets, including approximately \$11.9 million of cash and cash equivalents, \$18.9 million of marketable securities, \$1.8 million in Federal Home Loan Bank stock, \$113.0 million in loans and \$2.1 million of premises and other assets. The Bank assumed approximately \$135.7 million of liabilities, including approximately \$125.7 million in customer deposits, \$9.6 million of other borrowed money and \$402,000 in other liabilities. These balances are book balances and do not reflect the fair value adjustments which are shown on the following table. The acquisition did not include any loss sharing agreement with the FDIC.

The bid accepted by the FDIC included no deposit premium. The assets were acquired at a discount of \$29.0 million from book value. The FDIC made a payment of \$17.2 million to the Bank upon the final closing date balance sheet for SCB Bank that reflected the difference between the purchase price of the assets acquired and the value of the liabilities assumed.

The Bank engaged in this transaction with the expectation that it would be immediately accretive and add a new market area with a demographic profile consistent with many of the current Indiana markets served by the Bank.

FIRST MERCHANTS CORPORATION
FORM 10Q
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Table dollars in thousands)
(Unaudited)

NOTE 2. Purchase and Assumption continued

The transaction was accounted for under the acquisition method of accounting in accordance with the Business Combination topic of the FASB Accounting Standards Codification (“ASC 310-20 and 310-30”). The statement of net assets and liabilities acquired as of February 10, 2012, are presented below. The assets and liabilities of SCB were recorded at the respective acquisition date provisional fair values, and identifiable intangible assets were recorded at provisional fair value.

Assets		Liabilities	
Cash and due from banks (1)	\$ 29,113	Deposits:	
Investment securities, available for sale	18,896	Non-interest bearing	\$ 13,715
Federal Home Loan Bank stock	1,761	NOW accounts	14,746
Loans:		Savings and money market	25,843
Commercial	51,042	Certificate of deposit	71,605
Residential mortgage	11,181	Total Deposits	125,909
Installment	31,570		
Total Loans	93,793	Federal Home Loan Bank advances	10,286
		Other liabilities	804
Premises	1,516	Total Liabilities Assumed	\$ 136,999
Core deposit intangible	484		
Other assets	560	Net Gain on Acquisition	\$ 9,124
Total Assets Purchased	\$ 146,123		

(1) Includes \$17,200,000 cash received from the FDIC.

In many cases, the fair values of assets acquired and liabilities assumed were determined by estimating cash flows expected to result from those assets and liabilities and discounting them at appropriate market rates. The most significant category of assets for which this procedure was used was acquired loans. The Bank acquired the \$113.0 million loan portfolio at a fair value discount of \$19.2 million. The performing portion of the portfolio, \$86.3 million, had an estimated fair value of \$76.5 million. The excess of expected cash flows above the fair value of the performing portion of loans will be accreted to interest income over the remaining lives of the loans in accordance with ASC 310-20.

Certain loans for which specific credit-related deterioration has occurred since origination are recorded at fair value which is derived from calculating the present value of the amounts expected to be collected. Income recognition on these loans is based on reasonable expectation about the timing and amount of cash flows to be collected. Many of the acquired loans deemed impaired and considered collateral dependent, with the timing of a sale of loan collateral indeterminate, remain on non-accrual status and have no accretable yield.

In accordance with ASC 310-30 (formerly Statement of Position (“SOP”) 03-3 as of February 10, 2012, loans acquired during 2012 for which it was probable at acquisition that all contractually required payments would not be collected are as follows:

Edgar Filing: FIRST MERCHANTS CORP - Form 10-Q

Preliminary estimate of contractually required principal and interest at acquisition	\$	31,143
Preliminary estimate of contractual cash flows not expected to be collected (nonaccretable differences)		9,688
Preliminary estimate of expected cash flows at acquisition		21,455
Preliminary estimate of interest component of expected cash flows (accretable discount)		4,152
Preliminary estimate of fair value of acquired loans accounted for under ASC 310-30	\$	17,303

Pro-forma statements were determined to be impracticable due to the nature of the transaction as certain assets were not purchased.

FIRST MERCHANTS CORPORATION
FORM 10Q
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Table dollars in thousands)
(Unaudited)

NOTE 2. Purchase and Assumption continued

The carrying amount of these loans is included in the balance sheet amounts of loans receivable at June 30, 2012. The amounts of loans at June 30, 2012, are as follows:

	June 30, 2012
Commercial and industrial loans	\$ 12,126
Agricultural production finance and other loans to farmers	1,479
Real estate loans	
Construction	91
Commercial and farmland	29,611
Residential	34,151
Individuals' loans for household and other personal expenditures	1,152
Other loans	1,025
Total	\$ 79,635

Accretable yield, or income expected to be collected, is as follows:

	June 30, 2012
Beginning balance, February 10, 2012	\$ 9,774
Accretions	(726)
Ending balance, June 30, 2012	\$ 9,048

At June 30, 2012, specific reserves of \$563,000 were included in the allowance for loan losses.

FIRST MERCHANTS CORPORATION
FORM 10Q
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Table dollars in thousands)
(Unaudited)

NOTE 3. Investment Securities

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at June 30, 2012				
