

GERMAN AMERICAN BANCORP, INC.  
Form 10-Q  
May 09, 2014  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarterly Period  
Ended March 31, 2014

Commission File Number 001-15877

German American Bancorp, Inc.  
(Exact name of registrant as specified in its charter)  
Indiana  
(State or other jurisdiction of  
incorporation or organization)

35-1547518  
(I.R.S. Employer  
Identification No.)

711 Main Street, Jasper, Indiana 47546  
(Address of Principal Executive Offices and Zip Code)

Registrant's telephone number, including area code: (812) 482-1314

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company:

Large accelerated filer  Accelerated filer  Non-accelerated filer  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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class                       | Outstanding at May 1, 2014 |
|-----------------------------|----------------------------|
| Common Shares, no par value | 13,210,395                 |

CAUTION REGARDING FORWARD-LOOKING STATEMENTS AND ASSOCIATED RISKS

Information included in or incorporated by reference in this Quarterly Report on Form 10-Q, our other filings with the Securities and Exchange Commission (the “SEC”) and our press releases or other public statements, contains or may contain “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Please refer to the discussions of our forward-looking statements and associated risks in our annual report on Form 10-K for the year ended December 31, 2013, in Item 1, “Business – Forward-Looking Statements and Associated Risks” and our discussion of risk factors in Item 1A, “Risk Factors” of that annual report on Form 10-K, as updated from time to time in our subsequent SEC filings, including by Item 2 of Part I of this Report (“Management’s Discussion and Analysis of Financial Condition and Results of Operations”) at the conclusion of that Item 2 under the heading “Forward-Looking Statements and Associated Risks.”

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## GERMAN AMERICAN BANCORP, INC.

## CONSOLIDATED BALANCE SHEETS

(unaudited, dollars in thousands except share and per share data)

|  | March 31,<br>2014  | December 31,<br>2013 |
|--|--------------------|----------------------|
| <b>ASSETS</b>  |                    |                      |
| Cash and Due from Banks  | \$44,159           | \$37,370             |
| Federal Funds Sold and Other Short-term Investments  | 8,991              | 22,762               |
| Cash and Cash Equivalents  | 53,150             | 60,132               |
| Interest-bearing Time Deposits with Banks  | 100                | 100                  |
| Securities Available-for-Sale, at Fair Value   | 613,170            | 606,032              |
| Securities Held-to-Maturity, at Cost (Fair value of \$186 and \$271 on March 31, 2014 and December 31, 2013, respectively) | 184                | 268                  |
| Loans Held-for-Sale, at Fair Value   | 9,844              | 9,265                |
| Loans  | 1,367,184          | 1,385,212            |
| Less: Unearned Income  | (2,679)            | (2,830)              |
| Allowance for Loan Losses  | (15,484)           | (14,584)             |
| Loans, Net   | 1,349,021          | 1,367,798            |
| Stock in FHLB of Indianapolis and Other Restricted Stock, at Cost  | 9,004              | 9,004                |
| Premises, Furniture and Equipment, Net   | 39,983             | 40,430               |
| Other Real Estate  | 770                | 1,029                |
| Goodwill   | 20,536             | 20,536               |
| Intangible Assets  | 2,980              | 3,328                |
| Company Owned Life Insurance   | 31,389             | 31,178               |
| Accrued Interest Receivable and Other Assets   | 16,259             | 14,727               |
| <b>TOTAL ASSETS</b>  | <b>\$2,146,390</b> | <b>\$2,163,827</b>   |
| <b>LIABILITIES</b>   |                    |                      |
| Non-interest-bearing Demand Deposits   | \$409,630          | \$400,024            |
| Interest-bearing Demand, Savings, and Money Market Accounts  | 1,015,711          | 1,063,098            |
| Time Deposits  | 342,434            | 349,034              |
| Total Deposits   | 1,767,775          | 1,812,156            |
| FHLB Advances and Other Borrowings   | 159,991            | 140,770              |
| Accrued Interest Payable and Other Liabilities   | 11,883             | 10,804               |
| <b>TOTAL LIABILITIES</b>   | <b>1,939,649</b>   | <b>1,963,730</b>     |
| <b>SHAREHOLDERS' EQUITY</b>  |                    |                      |
| Preferred Stock, no par value; 500,000 shares authorized, no shares issued   | —                  | —                    |
| Common Stock, no par value, \$1 stated value; 30,000,000 shares authorized   | 13,208             | 13,174               |
| Additional Paid-in Capital   | 108,171            | 108,022              |
| Retained Earnings  | 88,361             | 84,164               |
| Accumulated Other Comprehensive Loss   | (2,999)            | (5,263)              |
| <b>TOTAL SHAREHOLDERS' EQUITY</b>  | <b>206,741</b>     | <b>200,097</b>       |

|   |             |             |
|---|-------------|-------------|
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY  | \$2,146,390 | \$2,163,827 |
| End of period shares issued and outstanding | 13,208,240  | 13,173,793  |

See accompanying notes to consolidated financial statements.

GERMAN AMERICAN BANCORP, INC.  
CONSOLIDATED STATEMENTS OF INCOME  
(unaudited, dollars in thousands except per share data)

|   | Three Months Ended<br>March 31, |                 |
|---|---------------------------------|-----------------|
|   | 2014                            | 2013            |
| <b>INTEREST INCOME</b>  |                                 |                 |
| Interest and Fees on Loans                                      | \$ 15,944                       | \$ 14,885       |
| Interest on Federal Funds Sold and Other Short-term Investments | 3                               | 10              |
| Interest and Dividends on Securities:                           |                                 |                 |
| Taxable   | 2,759                           | 2,841           |
| Non-taxable   | 975                             | 634             |
| <b>TOTAL INTEREST INCOME</b>                                    | <b>19,681</b>                   | <b>18,370</b>   |
| <b>INTEREST EXPENSE</b>   |                                 |                 |
| Interest on Deposits  | 1,036                           | 1,234           |
| Interest on FHLB Advances and Other Borrowings                  | 449                             | 911             |
| <b>TOTAL INTEREST EXPENSE</b>                                   | <b>1,485</b>                    | <b>2,145</b>    |
| <b>NET INTEREST INCOME</b>                                      | <b>18,196</b>                   | <b>16,225</b>   |
| Provision for Loan Losses                                       | 350                             | 350             |
| <b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>      | <b>17,846</b>                   | <b>15,875</b>   |
| <b>NON-INTEREST INCOME</b>                                      |                                 |                 |
| Trust and Investment Product Fees                               | 922                             | 817             |
| Service Charges on Deposit Accounts                             | 1,061                           | 955             |
| Insurance Revenues  | 2,556                           | 1,784           |
| Company Owned Life Insurance                                    | 201                             | 266             |
| Interchange Fee Income  | 447                             | 430             |
| Other Operating Income  | 390                             | 291             |
| Net Gains on Sales of Loans                                     | 476                             | 754             |
| Net Gains on Securities   | 228                             | 613             |
| <b>TOTAL NON-INTEREST INCOME</b>                                | <b>6,281</b>                    | <b>5,910</b>    |
| <b>NON-INTEREST EXPENSE</b>                                     |                                 |                 |
| Salaries and Employee Benefits                                  | 8,424                           | 7,784           |
| Occupancy Expense   | 1,316                           | 1,105           |
| Furniture and Equipment Expense                                 | 509                             | 475             |
| FDIC Premiums   | 275                             | 255             |
| Data Processing Fees  | 1,010                           | 665             |
| Professional Fees   | 692                             | 661             |
| Advertising and Promotion                                       | 478                             | 490             |
| Intangible Amortization   | 348                             | 367             |
| Other Operating Expenses  | 2,038                           | 1,660           |
| <b>TOTAL NON-INTEREST EXPENSE</b>                               | <b>15,090</b>                   | <b>13,462</b>   |
| Income before Income Taxes                                      | 9,037                           | 8,323           |
| Income Tax Expense  | 2,732                           | 2,514           |
| <b>NET INCOME</b>   | <b>\$ 6,305</b>                 | <b>\$ 5,809</b> |

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|                            |        |        |
|----------------------------|--------|--------|
| Basic Earnings Per Share   | \$0.48 | \$0.46 |
| Diluted Earnings Per Share | \$0.48 | \$0.46 |
| Dividends Per Share        | \$0.16 | \$0.15 |

See accompanying notes to consolidated financial statements.

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GERMAN AMERICAN BANCORP, INC.  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 (unaudited, dollars in thousands)

|   | Three Months Ended<br>March 31, |          |
|---|---------------------------------|----------|
|   | 2014                            | 2013     |
| NET INCOME  | \$6,305                         | \$5,809  |
| Other Comprehensive Income (Loss):                                    |                                 |          |
| Unrealized Gains (Losses) on Securities                               |                                 |          |
| Unrealized Holding Gain (Loss) Arising During the Period              | 3,733                           | (2,835 ) |
| Reclassification Adjustment for Losses (Gains) Included in Net Income | (228 )                          | (613 )   |
| Tax Effect  | (1,241 )                        | 1,212 )  |
| Net of Tax  | 2,264                           | (2,236 ) |
| Total Other Comprehensive Income (Loss)                               | 2,264                           | (2,236 ) |
| COMPREHENSIVE INCOME  | \$8,569                         | \$3,573  |



See accompanying notes to consolidated financial statements.

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GERMAN AMERICAN BANCORP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(unaudited, dollars in thousands)

|   | Three Months Ended |           |
|---|--------------------|-----------|
|   | March 31,          |           |
|   | 2014               | 2013      |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                   |                    |           |
| Net Income  | \$6,305            | \$5,809   |
| Adjustments to Reconcile Net Income to Net Cash from Operating Activities:    |                    |           |
| Net Amortization on Securities  | 479                | 939       |
| Depreciation and Amortization   | 1,216              | 1,099     |
| Loans Originated for Sale   | (22,414)           | (51,090)  |
| Proceeds from Sales of Loans Held-for-Sale                                    | 22,255             | 43,299    |
| Provision for Loan Losses   | 350                | 350       |
| Gain on Sale of Loans, net  | (476)              | (754)     |
| Gain on Securities, net   | (228)              | (613)     |
| Loss (Gain) on Sales of Other Real Estate and Repossessed Assets              | 2                  | 142       |
| Loss (Gain) on Disposition and Impairment of Premises and Equipment           | 1                  | (70)      |
| Increase in Cash Surrender Value of Company Owned Life Insurance              | (211)              | (264)     |
| Equity Based Compensation   | 158                | 85        |
| Change in Assets and Liabilities:   |                    |           |
| Interest Receivable and Other Assets  | 606                | 1,722     |
| Interest Payable and Other Liabilities  | 1,079              | (23)      |
| Net Cash from Operating Activities  | 9,122              | 631       |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                   |                    |           |
| Proceeds from Maturities, Calls, Redemptions of Securities Available-for-Sale | 18,315             | 43,537    |
| Proceeds from Sales of Securities Available-for-Sale                          | 254                | 74,749    |
| Purchase of Securities Available-for-Sale                                     | (25,776)           | (119,536) |
| Proceeds from Maturities of Securities Held-to-Maturity                       | 84                 | 78        |
| Purchase of Loans   | —                  | (712)     |
| Loans Made to Customers, net of Payments Received                             | 18,240             | 13,158    |
| Proceeds from Sales of Other Real Estate                                      | 444                | 308       |
| Property and Equipment Expenditures   | (396)              | (693)     |
| Proceeds from Sales of Property and Equipment                                 | —                  | 88        |
| Net Cash from Investing Activities  | 11,165             | 10,977    |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                   |                    |           |
| Change in Deposits  | (44,369)           | 18,982    |
| Change in Short-term Borrowings   | 19,240             | (47,274)  |
| Advances in Long-term Debt  | 1,500              | 30,000    |
| Repayments of Long-term Debt  | (1,557)            | (31,545)  |
| Issuance of Common Stock  | 25                 | —         |
| Dividends Paid  | (2,108)            | (1,896)   |
| Net Cash from Financing Activities  | (27,269)           | (31,733)  |
| Net Change in Cash and Cash Equivalents                                       | (6,982)            | (20,125)  |
| Cash and Cash Equivalents at Beginning of Year                                | 60,132             | 49,087    |
| Cash and Cash Equivalents at End of Period                                    | \$53,150           | \$28,962  |

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|  |         |           |
|--|---------|-----------|
| Cash Paid During the Period for                              |         |           |
| Interest   | \$1,588 | \$2,608   |
| Income Taxes   | —       | 4         |
| Supplemental Non Cash Disclosures                            |         |           |
| Loans Transferred to Other Real Estate                       | \$187   | \$543     |
| Reclassification of Loan to Secured Borrowing                | —       | 2,006     |
| Securities Transferred to Accounts Receivable                | 3,323   | —         |
| Accounts Receivable Transferred to Securities                | —       | (45,803 ) |
| See accompanying notes to consolidated financial statements. |         |           |

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GERMAN AMERICAN BANCORP, INC.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 March 31, 2014  
 (unaudited, dollars in thousands except share and per share data)

NOTE 1 – Basis of Presentation

German American Bancorp, Inc. operates primarily in the banking industry. The accounting and reporting policies of German American Bancorp, Inc. and its subsidiaries conform to U.S. generally accepted accounting principles. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. All adjustments which are, in the opinion of management, necessary for a fair presentation of the results for the periods reported have been included in the accompanying unaudited consolidated financial statements, and all such adjustments are of a normal recurring nature. It is suggested that these consolidated financial statements and notes be read in conjunction with the financial statements and notes thereto in the German American Bancorp, Inc. December 31, 2013 Annual Report on Form 10-K.

NOTE 2 – Per Share Data

The computations of Basic Earnings per Share and Diluted Earnings per Share are as follows:

|   | Three Months Ended<br>March 31, |            |
|---|---------------------------------|------------|
|   | 2014                            | 2013       |
| Basic Earnings per Share:                   |                                 |            |
| Net Income                                  | \$6,305                         | \$5,809    |
| Weighted Average Shares Outstanding         | 13,179,188                      | 12,641,842 |
| Basic Earnings per Share                    | \$0.48                          | \$0.46     |
| Diluted Earnings per Share:                 |                                 |            |
| Net Income                                  | \$6,305                         | \$5,809    |
| Weighted Average Shares Outstanding         | 13,179,188                      | 12,641,842 |
| Potentially Dilutive Shares, Net            | 24,513                          | 19,850     |
| Diluted Weighted Average Shares Outstanding | 13,203,701                      | 12,661,692 |
| Diluted Earnings per Share                  | \$0.48                          | \$0.46     |

For the three months ended March 31, 2014 and 2013, there were no anti-dilutive shares.

GERMAN AMERICAN BANCORP, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
March 31, 2014  
(unaudited, dollars in thousands except share and per share data)

## NOTE 3 – Securities

The amortized cost, unrealized gross gains and losses recognized in accumulated other comprehensive income (loss), and fair value of Securities Available-for-Sale at March 31, 2014 and December 31, 2013, were as follows:

| Securities Available-for-Sale:                  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|---|-------------------|------------------------------|-------------------------------|---------------|
| March 31, 2014                                  |                   |                              |                               |               |
| U.S. Treasury and Agency Securities             | \$20,000          | \$—                          | \$(871)                       | ) \$19,129    |
| Obligations of State and Political Subdivisions | 113,429           | 3,451                        | (324)                         | ) 116,556     |
| Mortgage-backed Securities - Residential        | 483,937           | 3,289                        | (10,094)                      | ) 477,132     |
| Equity Securities                               | 353               | —                            | —                             | 353           |
| Total   | \$617,719         | \$6,740                      | \$(11,289)                    | ) \$613,170   |
| December 31, 2013                               |                   |                              |                               |               |
| U.S. Treasury and Agency Securities             | \$20,000          | \$—                          | \$(1,048)                     | ) \$18,952    |
| Obligations of State and Political Subdivisions | 112,008           | 2,388                        | (899)                         | ) 113,497     |
| Mortgage-backed Securities - Residential        | 481,724           | 3,497                        | (11,991)                      | ) 473,230     |
| Equity Securities                               | 353               | —                            | —                             | 353           |
| Total   | \$614,085         | \$5,885                      | \$(13,938)                    | ) \$606,032   |

Equity securities that do not have readily determinable fair values are included in the above totals, are carried at historical cost and are evaluated for impairment on a periodic basis. All mortgage-backed securities in the above table are residential mortgage-backed securities and guaranteed by government sponsored entities.

The carrying amount, unrecognized gains and losses and fair value of Securities Held-to-Maturity at March 31, 2014 and December 31, 2013, were as follows:

| Securities Held-to-Maturity:                    | Carrying<br>Amount | Gross<br>Unrecognized<br>Gains | Gross<br>Unrecognized<br>Losses | Fair<br>Value |
|---|--------------------|--------------------------------|---------------------------------|---------------|
| March 31, 2014                                  |                    |                                |                                 |               |
| Obligations of State and Political Subdivisions | \$184              | \$2                            | \$—                             | \$186         |
| December 31, 2013                               |                    |                                |                                 |               |
| Obligations of State and Political Subdivisions | \$268              | \$3                            | \$—                             | \$271         |



GERMAN AMERICAN BANCORP, INC.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2014

(unaudited, dollars in thousands except share and per share data)

NOTE 3 - Securities (continued)

The amortized cost and fair value of Securities at March 31, 2014 by contractual maturity are shown below. Expected maturities may differ from contractual maturities because some issuers have the right to call or prepay certain obligations with or without call or prepayment penalties. Mortgage-backed and Equity Securities are not due at a single maturity date and are shown separately.

| Securities Available-for-Sale:           | Amortized<br>Cost | Fair<br>Value |
|--|-------------------|---------------|
| Due in one year or less                  | \$3,447           | \$3,499       |
| Due after one year through five years    | 10,882            | 11,145        |
| Due after five years through ten years   | 70,604            | 71,210        |
| Due after ten years                      | 48,496            | 49,831        |
| Mortgage-backed Securities - Residential | 483,937           | 477,132       |
| Equity Securities                        | 353               | 353           |
| Total                                    | \$617,719         | \$613,170     |

| Securities Held-to-Maturity:           | Carrying<br>Amount | Fair<br>Value |
|--|--------------------|---------------|
| Due in one year or less                | \$—                | \$—           |
| Due after one year through five years  | 184                | 186           |
| Due after five years through ten years | —                  | —             |
| Due after ten years                    | —                  | —             |
| Total                                  | \$184              | \$186         |

Proceeds from the Sales of Securities are summarized below:

|                             | Three Months<br>Ended<br>March 31, 2014 | Three Months<br>Ended<br>March 31, 2013 |
|-----------------------------|---|---|
| Proceeds from Sales         | \$254                                   | \$74,749                                |
| Gross Gains on Sales        | 228                                     | 613                                     |
| Income Taxes on Gross Gains | 80                                      | 215                                     |

GERMAN AMERICAN BANCORP, INC.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 March 31, 2014  
 (unaudited, dollars in thousands except share and per share data)

## NOTE 3 - Securities (continued)

Below is a summary of securities with unrealized losses as of March 31, 2014 and December 31, 2013, presented by length of time the securities have been in a continuous unrealized loss position:

|   | Less than 12 Months |                 | 12 Months or More |                 | Total      |                 |
|---|---------------------|-----------------|-------------------|-----------------|------------|-----------------|
|   | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| March 31, 2014                                  |                     |                 |                   |                 |            |                 |
| U.S. Treasury and Agency Securities             | \$19,129            | \$(871 )        | \$—               | \$—             | \$19,129   | \$(871 )        |
| Obligations of State and Political Subdivisions | 15,580              | (268 )          | 700               | (56 )           | 16,280     | (324 )          |
| Mortgage-backed Securities - Residential        | 264,004             | (6,501 )        | 78,365            | (3,593 )        | 342,369    | (10,094 )       |
| Equity Securities                               | —                   | —               | —                 | —               | —          | —               |
| Total   | \$298,713           | \$(7,640 )      | \$79,065          | \$(3,649 )      | \$377,778  | \$(11,289 )     |
| December 31, 2013                               |                     |                 |                   |                 |            |                 |
| U.S. Treasury and Agency Securities             | \$18,952            | \$(1,048 )      | \$—               | \$—             | \$18,952   | \$(1,048 )      |
| Obligations of State and Political Subdivisions | 38,878              | (899 )          | —                 | —               | 38,878     | (899 )          |
| Mortgage-backed Securities - Residential        | 346,028             | (11,903 )       | 1,735             | (88 )           | 347,763    | (11,991 )       |
| Equity Securities                               | —                   | —               | —                 | —               | —          | —               |
| Total   | \$403,858           | \$(13,850 )     | \$1,735           | \$(88 )         | \$405,593  | \$(13,938 )     |

Securities are written down to fair value when a decline in fair value is not considered temporary. In estimating other-than-temporary losses, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Company has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The Company doesn't intend to sell or expect to be required to sell these securities, and the decline in fair value is largely due to changes in market interest rates, therefore, the Company does not consider these securities to be other-than-temporarily impaired. All mortgage-backed securities in the Company's portfolio are guaranteed by government sponsored entities, are investment grade, and are performing as expected.

## NOTE 4 – Derivatives

The Company executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. The notional amounts of these interest rate swaps and the offsetting counterparty derivative instruments were \$17.8 million at March 31, 2014 and \$17.9 million at December 31, 2013. These interest rate swaps are simultaneously hedged by offsetting interest rate swaps that the Company executes with a third party, such that the Company minimizes its net risk exposure resulting from such transactions with approved, reputable, independent



counterparties with substantially matching terms. The agreements are considered stand alone derivatives and changes in the fair value of derivatives are reported in earnings as non-interest income.

Credit risk arises from the possible inability of counterparties to meet the terms of their contracts. The Company's exposure is limited to the replacement value of the contracts rather than the notional, principal or contract amounts. There are provisions in the agreements with the counterparties that allow for certain unsecured credit exposure up to an agreed threshold. Exposures in excess of the agreed thresholds are collateralized. In addition, the Company minimizes credit risk through credit approvals, limits, and monitoring procedures.

GERMAN AMERICAN BANCORP, INC.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 March 31, 2014  
 (unaudited, dollars in thousands except share and per share data)

NOTE 4 - Derivatives (continued)

The following table reflects the fair value hedges included in the Consolidated Balance Sheets as of:

|                                | March 31, 2014  |            | December 31, 2013 |            |
|--------------------------------|-----------------|------------|-------------------|------------|
|                                | Notional Amount | Fair Value | Notional Amount   | Fair Value |
| Included in Other Assets:      |                 |            |                   |            |
| Interest Rate Swaps            | \$ 17,753       | \$ 536     | \$ 17,853         | \$ 866     |
| Included in Other Liabilities: |                 |            |                   |            |
| Interest Rate Swaps            | \$ 17,753       | \$ 444     | \$ 17,853         | \$ 737     |

The following tables present the effect of derivative instruments on the Consolidated Statements of Income for the periods presented:

|   | Three Months Ended |      |
|---|--------------------|------|
|   | March 31, 2014     | 2013 |
| Interest Rate Swaps:                    |                    |      |
| Included in Interest Income / (Expense) | \$—                | \$—  |
| Included in Other Income / (Expense)    | (38)               | ) 2  |

NOTE 5 – Loans

Loans were comprised of the following classifications at March 31, 2014 and December 31, 2013:

|  | March 31, 2014 | December 31, 2013 |
|--|----------------|-------------------|
| Commercial:                                |                |                   |
| Commercial and Industrial Loans and Leases | \$ 344,045     | \$ 350,955        |
| Commercial Real Estate Loans               | 589,193        | 582,066           |
| Agricultural Loans                         | 174,651        | 192,880           |
| Retail:                                    |                |                   |
| Home Equity Loans                          | 81,228         | 81,504            |
| Consumer Loans                             | 46,796         | 49,124            |
| Residential Mortgage Loans                 | 131,271        | 128,683           |
| Subtotal                                   | 1,367,184      | 1,385,212         |
| Less: Unearned Income                      | (2,679)        | ) (2,830)         |
| Allowance for Loan Losses                  | (15,484)       | ) (14,584)        |
| Loans, Net                                 | \$ 1,349,021   | \$ 1,367,798      |



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## NOTE 5 - Loans (continued)

The following table presents the activity in the allowance for loan losses by portfolio class for the three months ending March 31, 2014 and 2013:

|                           | Commercial<br>and<br>Industrial<br>Loans and<br>Leases | Commercial<br>Real Estate<br>Loans | Agricultural<br>Loans | Home<br>Equity<br>Loans | Consumer<br>Loans | Residential<br>Mortgage<br>Loans | Unallocated | Total    |
|---------------------------|--|------------------------------------|-----------------------|-------------------------|-------------------|----------------------------------|-------------|----------|
| March 31, 2014            |  |                                    |                       |                         |                   |                                  |             |          |
| Beginning Balance         | \$3,983  | \$8,335                            | \$946                 | \$239                   | \$188             | \$281                            | \$612       | \$14,584 |
| Provision for Loan Losses | 1,322  | (1,057)                            | (16)                  | —                       | 48                | 7                                | 46          | 350      |
| Recoveries                | 69   | 703                                | —                     | —                       | 47                | 4                                | —           | 823      |
| Loans Charged-off         | —  | (111)                              | —                     | (30)                    | (97)              | (35)                             | —           | (273)    |
| Ending Balance            | \$5,374  | \$7,870                            | \$930                 | \$209                   | \$186             | \$257                            | \$658       | \$15,484 |
| March 31, 2013            |  |                                    |                       |                         |                   |                                  |             |          |
| Beginning Balance         | \$4,555  | \$8,931                            | \$989                 | \$141                   | \$214             | \$186                            | \$504       | \$15,520 |
| Provision for Loan Losses | 195  | 6                                  | (223)                 | 41                      | (7)               | 113                              | 225         | 350      |
| Recoveries                | 3  | 51                                 | —                     | —                       | 55                | 2                                | —           | 111      |
| Loans Charged-off         | —  | (109)                              | —                     | (64)                    | (73)              | (1)                              | —           | (247)    |
| Ending Balance            | \$4,753  | \$8,879                            | \$766                 | \$118                   | \$189             | \$300                            | \$729       | \$15,734 |

In determining the adequacy of the allowance for loan loss, general allocations are made for other pools of loans, including non-classified loans, homogeneous portfolios of consumer and residential real estate loans, and loans within certain industry categories believed to present unique risk of loss. General allocations of the allowance are primarily made based on a three-year historical average for loan losses for these portfolios, judgmentally adjusted for current economic factors and portfolio trends.

Loan impairment is reported when full repayment under the terms of the loan is not expected. This methodology is used for all loans, including loans acquired with deteriorated credit quality. For purchased loans, the assessment is made at the time of acquisition as well as over the life of loan. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate, or at the fair value of collateral if repayment is expected solely from the collateral. Commercial and industrial loans, commercial real estate loans, and agricultural loans are evaluated individually for impairment. Smaller balance homogeneous loans are evaluated for impairment in total. Such loans include real estate loans secured by one-to-four family residences and loans to individuals for household, family and other personal expenditures. Individually evaluated loans on non-accrual are generally considered impaired. Impaired loans, or portions thereof, are charged off when deemed uncollectible.



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## NOTE 5 - Loans (continued)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio class and based on impairment method as of March 31, 2014 and December 31, 2013:

| March 31, 2014   | Total       | Commercial<br>and<br>Industrial<br>Loans and<br>Leases | Commercial<br>Real Estate<br>Loans | Agricultural<br>Loans | Home<br>Equity<br>Loans | Consumer<br>Loans | Residential<br>Mortgage<br>Loans | Unallocated |
|--|-------------|--|------------------------------------|-----------------------|-------------------------|-------------------|----------------------------------|-------------|
| Allowance for Loan<br>Losses:<br>Ending Allowance<br>Balance<br>Attributable to<br>Loans:<br>Individually<br>Evaluated for<br>Impairment | \$3,995     | \$1,536  | \$2,459                            | \$—                   | \$—                     | \$—               | \$—                              | \$—         |
| Collectively<br>Evaluated for<br>Impairment  | 11,482      | 3,838  | 5,404                              | 930                   | 209                     | 186               | 257                              | 658         |
| Acquired with<br>Deteriorated Credit<br>Quality  | 7           | —  | 7                                  | —                     | —                       | —                 | —                                | —           |
| Total Ending<br>Allowance Balance  | \$15,484    | \$5,374  | \$7,870                            | \$930                 | \$209                   | \$186             | \$257                            | \$658       |
| Loans:<br>Loans Individually<br>Evaluated for<br>Impairment  | \$11,406    | \$6,380  | \$5,026                            | \$—                   | \$—                     | \$—               | \$—                              | \$—         |
| Loans Collectively<br>Evaluated for<br>Impairment  | 1,347,214   | 336,856  | 575,305                            | 176,860               | 81,527                  | 46,798            | 129,868                          | —           |
| Loans Acquired<br>with Deteriorated<br>Credit Quality  | 13,869      | 1,636  | 10,337                             | —                     | —                       | 130               | 1,766                            | —           |
| Total Ending Loans<br>Balance <sup>(1)</sup>   | \$1,372,489 | \$344,872  | \$590,668                          | \$176,860             | \$81,527                | \$46,928          | \$131,634                        | \$—         |

<sup>(1)</sup>Total recorded investment in loans includes \$5,305 in accrued interest.

| December 31, 2013 | Total | Commercial<br>and<br>Industrial<br>Loans | Commercial<br>Real Estate<br>Loans | Agricultural<br>Loans | Home<br>Equity<br>Loans | Consumer<br>Loans | Residential<br>Mortgage<br>Loans | Unallocated |
|-------------------|-------|--|------------------------------------|-----------------------|-------------------------|-------------------|----------------------------------|-------------|
|-------------------|-------|--|------------------------------------|-----------------------|-------------------------|-------------------|----------------------------------|-------------|

|   | Loans and Leases |           |           |           |          |          |           |       |
|---|------------------|-----------|-----------|-----------|----------|----------|-----------|-------|
| Allowance for Loan Losses:                      |                  |           |           |           |          |          |           |       |
| Ending Allowance Balance                        |                  |           |           |           |          |          |           |       |
| Attributable to Loans:                          |                  |           |           |           |          |          |           |       |
| Individually Evaluated for Impairment           | \$3,095          | \$45      | \$3,050   | \$—       | \$—      | \$—      | \$—       | \$—   |
| Collectively Evaluated for Impairment           | 11,481           | 3,938     | 5,277     | 946       | 239      | 188      | 281       | 612   |
| Acquired with Deteriorated Credit Quality       | 8                | —         | 8         | —         | —        | —        | —         | —     |
| Total Ending Allowance Balance                  | \$14,584         | \$3,983   | \$8,335   | \$946     | \$239    | \$188    | \$281     | \$612 |
| Loans:  |                  |           |           |           |          |          |           |       |
| Loans Individually Evaluated for Impairment     | \$8,458          | \$2,114   | \$6,344   | \$—       | \$—      | \$—      | \$—       | \$—   |
| Loans Collectively Evaluated for Impairment     | 1,367,591        | 347,808   | 566,389   | 195,171   | 81,812   | 49,131   | 127,280   | —     |
| Loans Acquired with Deteriorated Credit Quality | 14,753           | 1,981     | 10,871    | —         | —        | 134      | 1,767     | —     |
| Total Ending Loans Balance <sup>(1)</sup>       | \$1,390,802      | \$351,903 | \$583,604 | \$195,171 | \$81,812 | \$49,265 | \$129,047 | \$—   |

<sup>(1)</sup>Total recorded investment in loans includes \$5,590 in accrued interest.

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## NOTE 5 - Loans (continued)

The following table presents loans individually evaluated for impairment by class of loans as of March 31, 2014 and December 31, 2013:

| March 31, 2014   | Unpaid<br>Principal<br>Balance(1) | Recorded<br>Investment | Allowance for<br>Loan Losses<br>Allocated |
|--|-----------------------------------|------------------------|---|
| With No Related Allowance Recorded:  |                                   |                        |   |
| Commercial and Industrial Loans and Leases   | \$2,095                           | \$2,025                | \$—                                       |
| Commercial Real Estate Loans   | 2,342                             | 1,800                  | —   |
| Agricultural Loans   | —                                 | —                      | —   |
| Subtotal   | 4,437                             | 3,825                  | —   |
| With An Allowance Recorded:  |                                   |                        |   |
| Commercial and Industrial Loans and Leases   | 4,348                             | 4,357                  | 1,536                                     |
| Commercial Real Estate Loans   | 3,946                             | 3,790                  | 2,466                                     |
| Agricultural Loans   | —                                 | —                      | —   |
| Subtotal   | 8,294                             | 8,147                  | 4,002                                     |
| Total  | \$12,731                          | \$11,972               | \$4,002                                   |
| Loans Acquired With Deteriorated Credit Quality With No<br>Related Allowance Recorded (Included in the Total Above)    | \$982                             | \$559                  | \$—                                       |
| Loans Acquired With Deteriorated Credit Quality With An<br>Additional Allowance Recorded (Included in the Total Above) | \$32                              | \$7                    | \$7                                       |

(1) Unpaid Principal Balance is the remaining contractual payments inclusive of partial charge-offs.

| December 31, 2013  | Unpaid<br>Principal<br>Balance(1) | Recorded<br>Investment | Allowance for<br>Loan Losses<br>Allocated |
|--|-----------------------------------|------------------------|---|
| With No Related Allowance Recorded:  |                                   |                        |   |
| Commercial and Industrial Loans and Leases   | \$2,163                           | \$2,072                | \$—                                       |
| Commercial Real Estate Loans   | 4,710                             | 2,383                  | —   |
| Agricultural Loans   | —                                 | —                      | —   |
| Subtotal   | 6,873                             | 4,455                  | —   |
| With An Allowance Recorded:  |                                   |                        |   |
| Commercial and Industrial Loans and Leases   | 45                                | 45                     | 45  |
| Commercial Real Estate Loans   | 4,428                             | 4,417                  | 3,058                                     |
| Agricultural Loans   | —                                 | —                      | —   |
| Subtotal   | 4,473                             | 4,462                  | 3,103                                     |
| Total  | \$11,346                          | \$8,917                | \$3,103                                   |
| Loans Acquired With Deteriorated Credit Quality With No<br>Related Allowance Recorded (Included in the Total Above)    | \$987                             | \$451                  | \$—                                       |
| Loans Acquired With Deteriorated Credit Quality With An<br>Additional Allowance Recorded (Included in the Total Above) | \$33                              | \$8                    | \$8                                       |



(1) Unpaid Principal Balance is the remaining contractual payments inclusive of partial charge-offs.

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## NOTE 5 - Loans (continued)

The following table presents loans individually evaluated for impairment by class of loans for the three month period ended March 31, 2014 and 2013:

| March 31, 2014   | Average<br>Recorded<br>Investment | Interest Income<br>Recognized | Cash Basis<br>Recognized |
|--|-----------------------------------|-------------------------------|--------------------------|
| With No Related Allowance Recorded:  |                                   |                               |                          |
| Commercial and Industrial Loans and Leases   | \$2,135                           | \$30                          | \$33                     |
| Commercial Real Estate Loans   | 2,433                             | 3                             | 2                        |
| Agricultural Loans   | —                                 | —                             | —                        |
| Subtotal   | 4,568                             | 33                            | 35                       |
| With An Allowance Recorded:  |                                   |                               |                          |
| Commercial and Industrial Loans and Leases   | 4,371                             | 1                             | 1                        |
| Commercial Real Estate Loans   | 4,243                             | 4                             | 4                        |
| Agricultural Loans   | —                                 | —                             | —                        |
| Subtotal   | 8,614                             | 5                             | 5                        |
| Total  | \$13,182                          | \$38                          | \$40                     |
| Loans Acquired With Deteriorated Credit Quality With No<br>Related Allowance Recorded (Included in the Total Above)    | \$1,244                           | \$2                           | \$2                      |
| Loans Acquired With Deteriorated Credit Quality With An<br>Additional Allowance Recorded (Included in the Total Above) | \$33                              | \$—                           | \$1                      |
| <br>   |                                   |                               |                          |
| March 31, 2013   | Average<br>Recorded<br>Investment | Interest Income<br>Recognized | Cash Basis<br>Recognized |
| With No Related Allowance Recorded:  |                                   |                               |                          |
| Commercial and Industrial Loans and Leases   | \$110                             | \$—                           | \$1                      |
| Commercial Real Estate Loans   | 2,170                             | —                             | —                        |
| Agricultural Loans   | 2,422                             | 48                            | 16                       |
| Subtotal   | 4,702                             | 48                            | 17                       |
| With An Allowance Recorded:  |                                   |                               |                          |
| Commercial and Industrial Loans and Leases   | 2,533                             | 1                             | 1                        |
| Commercial Real Estate Loans   | 5,809                             | 6                             | 5                        |
| Agricultural Loans   | —                                 | —                             | —                        |
| Subtotal   | 8,342                             | 7                             | 6                        |
| Total  | \$13,044                          | \$55                          | \$23                     |
| Loans Acquired With Deteriorated Credit Quality With No<br>Related Allowance Recorded (Included in the Total Above)    | \$57                              | \$—                           | \$1                      |
| Loans Acquired With Deteriorated Credit Quality With An<br>Additional Allowance Recorded (Included in the Total Above) | \$112                             | \$1                           | \$1                      |



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NOTE 5 - Loans (continued)

All classes of loans, including loans acquired with deteriorated credit quality, are generally placed on non-accrual status when scheduled principal or interest payments are past due for 90 days or more or when the borrower's ability to repay becomes doubtful. For purchased loans, the determination is made at the time of acquisition as well as over the life of the loan. Uncollected accrued interest for each class of loans is reversed against income at the time a loan is placed on non-accrual. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. All classes of loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Loans are typically charged-off at 180 days past due, or earlier if deemed uncollectible. Exceptions to the non-accrual and charge-off policies are made when the loan is well secured and in the process of collection.

The following table presents the recorded investment in non-accrual loans and loans past due 90 days or more still on accrual by class of loans as of March 31, 2014 and December 31, 2013:

|  | Non-Accrual |         | Loans Past Due 90 Days<br>or More & Still Accruing |      |
|--|-------------|---------|--|------|
|  | 2014        | 2013    | 2014   | 2013 |
| Commercial and Industrial Loans and Leases                                       | \$4,331     | \$31    | \$16   | \$—  |
| Commercial Real Estate Loans   | 5,348       | 6,658   | —  | 8    |
| Agricultural Loans   | —           | —       | —  | —    |
| Home Equity Loans  | 139         | 114     | —  | —    |
| Consumer Loans   | 318         | 236     | —  | —    |
| Residential Mortgage Loans   | 1,640       | 1,339   | —  | —    |
| Total  | \$11,776    | \$8,378 | \$16   | \$8  |
| Loans Acquired With Deteriorated Credit Quality<br>(Included in the Total Above) | \$1,562     | \$1,705 | \$—  | \$—  |

The following table presents the aging of the recorded investment in past due loans by class of loans as of March 31, 2014 and December 31, 2013:

| March 31, 2014  | Total       | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | 90 Days<br>or More<br>Past Due | Total Past<br>Due | Loans Not<br>Past Due |
|---|-------------|------------------------|------------------------|--------------------------------|-------------------|-----------------------|
| Commercial and Industrial Loans and Leases  | \$344,872   | \$93                   | \$111                  | \$64                           | \$268             | \$344,604             |
| Commercial Real Estate Loans  | 590,668     | 619                    | 347                    | 1,331                          | 2,297             | 588,371               |
| Agricultural Loans  | 176,860     | 73                     | 5                      | —                              | 78                | 176,782               |
| Home Equity Loans   | 81,527      | 269                    | 132                    | 138                            | 539               | 80,988                |
| Consumer Loans  | 46,928      | 103                    | 36                     | 190                            | 329               | 46,599                |
| Residential Mortgage Loans  | 131,634     | 1,631                  | 37                     | 1,423                          | 3,091             | 128,543               |
| Total <sup>(1)</sup>  | \$1,372,489 | \$2,788                | \$668                  | \$3,146                        | \$6,602           | \$1,365,887           |
| Loans Acquired With Deteriorated<br>Credit Quality (Included in the Total<br>Above) | \$13,869    | \$—                    | \$—                    | \$996                          | \$996             | \$12,873              |

<sup>(1)</sup>Total recorded investment in loans includes \$5,305 in accrued interest.



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## NOTE 5 - Loans (continued)

| December 31, 2013   | Total       | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | 90 Days<br>or More<br>Past Due | Total<br>Past Due | Loans Not<br>Past Due |
|---|-------------|------------------------|------------------------|--------------------------------|-------------------|-----------------------|
| Commercial and Industrial Loans and Leases  | \$351,903   | \$256                  | \$78                   | \$—                            | \$334             | \$351,569             |
| Commercial Real Estate Loans  | 583,604     | 613                    | 62                     | 2,234                          | 2,909             | 580,695               |
| Agricultural Loans  | 195,171     | 62                     | —                      | —                              | 62                | 195,109               |
| Home Equity Loans   | 81,812      | 303                    | 33                     | 114                            | 450               | 81,362                |
| Consumer Loans  | 49,265      | 149                    | 66                     | 102                            | 317               | 48,948                |
| Residential Mortgage Loans  | 129,047     | 2,206                  | 192                    | 1,115                          | 3,513             | 125,534               |
| Total <sup>(1)</sup>  | \$1,390,802 | \$3,589                | \$431                  | \$3,565                        | \$7,585           | \$1,383,217           |
| Loans Acquired With Deteriorated<br>Credit Quality (Included in the Total<br>Above) | \$14,753    | \$148                  | \$—                    | \$1,103                        | \$1,251           | \$13,502              |

<sup>(1)</sup>Total recorded investment in loans includes \$5,590 in accrued interest.

## Troubled Debt Restructurings:

In certain instances, the Company may choose to restructure the contractual terms of loans. A troubled debt restructuring occurs when the Bank grants a concession to the borrower that it would not otherwise consider due to a borrower's financial difficulty. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without modification. This evaluation is performed under the Company's internal underwriting policy. The Company uses the same methodology for loans acquired with deteriorated credit quality as for all other loans when determining whether the loan is a troubled debt restructuring.

During the three months ended March 31, 2014, there was one loan modified as troubled debt restructuring. The modification of the terms of this loan included a permanent reduction of the recorded investment in the loan. During the three months ended March 31, 2013, there were no loans modified as troubled debt restructurings. There were no troubled debt restructurings for the three months ended March 31, 2014 and the year ended December 31, 2013 for loans acquired with deteriorated credit quality at the time of acquisition.

The following table presents the recorded investment of troubled debt restructurings by class of loans as of March 31, 2014 and December 31, 2013:

| March 31, 2014                             | Total   | Performing | Non-Accrual <sup>(1)</sup> |
|--|---------|------------|----------------------------|
| Commercial and Industrial Loans and Leases | \$2,045 | \$2,040    | \$5                        |
| Commercial Real Estate Loans               | 3,783   | 236        | 3,547                      |
| Total                                      | \$5,828 | \$2,276    | \$3,552                    |

| December 31, 2013                          | Total   | Performing | Non-Accrual <sup>(1)</sup> |
|--|---------|------------|----------------------------|
| Commercial and Industrial Loans and Leases | \$2,092 | \$2,086    | \$6                        |
| Commercial Real Estate Loans               | 4,325   | 364        | 3,961                      |
| Total                                      | \$6,417 | \$2,450    | \$3,967                    |

<sup>(1)</sup>The non-accrual troubled debt restructurings are included in the Non-Accrual Loan table presented on previous page.

The Company had not committed to lending any additional amounts as of March 31, 2014 to customers with outstanding loans that are classified as troubled debt restructurings. The Company has committed to lending an additional amount of \$40 as of December 31, 2013 to customers with outstanding loans that are classified as troubled debt restructurings.

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## NOTE 5 - Loans (continued)

The following table presents loans by class modified as troubled debt restructurings that occurred during the three months ending March 31, 2014 and 2013:

| March 31, 2014                             | Number of Loans | Pre-Modification<br>Outstanding Recorded<br>Investment | Post-Modification<br>Outstanding Recorded<br>Investment |
|--|-----------------|--|---|
| Commercial and Industrial Loans and Leases | —               | \$—  | \$—   |
| Commercial Real Estate Loans               | 1               | 197  | 197   |
| Total                                      | 1               | \$197  | \$197   |

The troubled debt restructurings described above increased the allowance for loan losses by \$0 and resulted in charge-offs of \$0 during the three months ending March 31, 2014.

| March 31, 2013                             | Number of Loans | Pre-Modification<br>Outstanding Recorded<br>Investment | Post-Modification<br>Outstanding Recorded<br>Investment |
|--|-----------------|--|---|
| Commercial and Industrial Loans and Leases | —               | \$—  | \$—   |
| Commercial Real Estate Loans               | —               | —  | —   |
| Total                                      | —               | \$—  | \$—   |

The troubled debt restructurings described above increased the allowance for loan losses by \$0 and resulted in charge-offs of \$0 during the three months ending March 31, 2013.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the three months ending March 31, 2014 and 2013:

| Troubled Debt Restructurings That Subsequently Defaulted:<br>March 31, 2014 | Number of Loans | Recorded Investment |
|---|-----------------|---------------------|
| Commercial and Industrial Loans and Leases                                  | —               | \$—                 |
| Commercial Real Estate Loans  | —               | —                   |
| Total   | —               | \$—                 |

The troubled debt restructurings that subsequently defaulted described above resulted in no change to the allowance for loan losses and no charge-offs during the three months ending March 31, 2014.

| Troubled Debt Restructurings That Subsequently Defaulted:<br>March 31, 2013 | Number of Loans | Recorded Investment |
|---|-----------------|---------------------|
| Commercial and Industrial Loans and Leases                                  | —               | \$—                 |
| Commercial Real Estate Loans  | —               | —                   |
| Total   | —               | \$—                 |

The troubled debt restructurings that subsequently defaulted described above resulted in no change to the allowance for loan losses and no charge-offs during the three months ending March 31, 2013.



A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms.

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NOTE 5 - Loans (continued)

Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company classifies loans as to credit risk by individually analyzing loans. This analysis includes commercial and industrial loans, commercial real estate loans, and agricultural loans with an outstanding balance greater than \$100. This analysis is typically performed on at least an annual basis. The Company uses the following definitions for risk ratings:

**Special Mention.** Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

**Substandard.** Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

**Doubtful.** Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. Based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

| March 31, 2014  | Pass        | Special<br>Mention | Substandard | Doubtful | Total       |
|---|-------------|--------------------|-------------|----------|-------------|
| Commercial and Industrial Loans and Leases                                    | \$310,939   | \$18,311           | \$15,622    | \$—      | \$344,872   |
| Commercial Real Estate Loans  | 548,452     | 20,895             | 21,321      | —        | 590,668     |
| Agricultural Loans  | 172,856     | 3,799              | 205         | —        | 176,860     |
| Total   | \$1,032,247 | \$43,005           | \$37,148    | \$—      | \$1,112,400 |
| Loans Acquired With Deteriorated Credit Quality (Included in the Total Above) | \$3,085     | \$659              | \$8,229     | \$—      | \$11,973    |
| December 31, 2013   | Pass        | Special<br>Mention | Substandard | Doubtful | Total       |
| Commercial and Industrial Loans and Leases                                    | \$324,685   | \$15,485           | \$11,733    | \$—      | \$351,903   |
| Commercial Real Estate Loans  | 539,533     | 20,168             | 23,903      | —        | 583,604     |
| Agricultural Loans  | 192,609     | 2,357              | 205         | —        | 195,171     |
| Total   | \$1,056,827 | \$38,010           | \$35,841    | \$—      | \$1,130,678 |
|   | \$3,121     | \$661              | \$9,070     | \$—      | \$12,852    |

Loans Acquired With Deteriorated Credit  
Quality (Included in the Total Above)

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GERMAN AMERICAN BANCORP, INC.  
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NOTE 5 - Loans (continued)

The Company considers the performance of the loan portfolio and its impact on the allowance for loan losses. For home equity, consumer and residential mortgage loan classes, the Company also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in home equity, consumer and residential mortgage loans based on payment activity as of March 31, 2014 and December 31, 2013:

|  | Home Equity<br>Loans | Consumer Loans | Residential<br>Mortgage Loans |
|--|----------------------|----------------|-------------------------------|
| March 31, 2014   |                      |                |                               |
| Performing   | \$81,388             | \$46,610       | \$129,994                     |
| Nonperforming  | 139                  | 318            | 1,640                         |
| Total  | \$81,527             | \$46,928       | \$131,634                     |
| Loans Acquired With Deteriorated Credit Quality<br>(Included in the Total Above) | \$—                  | \$130          | \$1,766                       |
| December 31, 2013  |                      |                |                               |
| Performing   | \$81,698             | \$49,029       | \$127,708                     |
| Nonperforming  | 114                  | 236            | 1,339                         |
| Total  | \$81,812             | \$49,265       | \$129,047                     |
| Loans Acquired With Deteriorated Credit Quality<br>(Included in the Total Above) | \$—                  | \$134          | \$1,767                       |

The Company has purchased loans, for which there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected. The recorded investment of those loans is as follows:

|                                   | March 31, 2014    |
|-----------------------------------|-------------------|
| Commercial and Industrial Loans   | \$1,636           |
| Commercial Real Estate Loans      | 10,337            |
| Home Equity Loans                 | —                 |
| Consumer Loans                    | 130               |
| Residential Mortgage Loans        | 1,766             |
| Total                             | \$13,869          |
| Carrying Amount, Net of Allowance | \$13,862          |
|                                   | December 31, 2013 |
| Commercial and Industrial Loans   | \$1,981           |
| Commercial Real Estate Loans      | 10,871            |
| Home Equity Loans                 | —                 |
| Consumer Loans                    | 134               |
| Residential Mortgage Loans        | 1,767             |
| Total                             | \$14,753          |

Carrying Amount, Net of Allowance

\$14,745

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GERMAN AMERICAN BANCORP, INC.  
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## NOTE 5 - Loans (continued)

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

|  | 2014    | 2013   |
|--|---------|--------|
| Balance at January 1                             | \$2,790 | \$170  |
| New Loans Purchased                              | —       | —      |
| Accretion of Income                              | (92     | ) (212 |
| Reclassifications from Non-accretable Difference | —       | 250    |
| Charge-off of Accretable Yield                   | —       | —      |
| Balance at March 31                              | \$2,698 | \$208  |

For those purchased loans disclosed above, the Company did not increase the allowance for loan losses during the three months ended March 31, 2014. For those purchased loans disclosed above, the Company decreased the allowance for loan losses by \$8 during the three months ended March 31, 2013. No allowances for loan losses were reversed during the same period.

## NOTE 6 – Segment Information

The Company's operations include three primary segments: core banking, trust and investment advisory services, and insurance operations. The core banking segment involves attracting deposits from the general public and using such funds to originate consumer, commercial and agricultural, commercial and agricultural real estate, and residential mortgage loans, primarily in the Company's local markets. The core banking segment also involves the sale of residential mortgage loans in the secondary market. The trust and investment advisory services segment involves providing trust, investment advisory, and brokerage services to customers. The insurance segment offers a full range of personal and corporate property and casualty insurance products, primarily in the Company's banking subsidiary's local markets.

The core banking segment is comprised by the Company's banking subsidiary, German American Bancorp, which operated through 37 banking offices at March 31, 2014. Net interest income from loans and investments funded by deposits and borrowings is the primary revenue for the core-banking segment. The trust and investment advisory services segment's revenues are comprised primarily of fees generated by German American Financial Advisors & Trust Company. These fees are derived by providing trust, investment advisory, and brokerage services to its customers. The insurance segment primarily consists of German American Insurance, Inc., which provides a full line of personal and corporate insurance products. Commissions derived from the sale of insurance products are the primary source of revenue for the insurance segment.

The following segment financial information has been derived from the internal financial statements of German American Bancorp, Inc., which are used by management to monitor and manage the financial performance of the Company. The accounting policies of the three segments are the same as those of the Company. The evaluation process for segments does not include holding company income and expense. Holding company amounts are the primary differences between segment amounts and consolidated totals, and are reflected in the column labeled "Other" below, along with amounts to eliminate transactions between segments.



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NOTE 6 - Segment Information (continued)

|                                   | Core<br>Banking | Trust and<br>Investment<br>Advisory<br>Services | Insurance | Other   | Consolidated<br>Totals |
|-----------------------------------|-----------------|---|-----------|---------|------------------------|
| Three Months Ended                |                 |   |           |         |                        |
| March 31, 2014                    |                 |   |           |         |                        |
| Net Interest Income               | \$18,313        | \$4   | \$1       | \$(122) | ) \$18,196             |
| Net Gains on Sales of Loans       | 476             | —   | —         | —       | 476                    |
| Net Gains on Securities           | 228             | —   | —         | —       | 228                    |
| Trust and Investment Product Fees | 2               | 920   | —         | —       | 922                    |
| Insurance Revenues                | (3              | ) 5   | 2,554     | —       | 2,556                  |
| Noncash Items:                    |                 |   |           |         |                        |
| Provision for Loan Losses         | 350             | —   | —         | —       | 350                    |
| Depreciation and Amortization     | 1,143           | 6   | 29        | 38      | 1,216                  |
| Income Tax Expense (Benefit)      | 2,490           | (42   | ) 501     | (217    | ) 2,732                |
| Segment Profit (Loss)             | 5,698           | (69   | ) 718     | (42     | ) 6,305                |
| Segment Assets at March 31, 2014  | 2,156,332       | 11,573  | 6,067     | (27,582 | ) 2,146,390            |

|                                     | Core<br>Banking | Trust and<br>Investment<br>Advisory<br>Services | Insurance | Other   | Consolidated<br>Totals |
|-------------------------------------|-----------------|---|-----------|---------|------------------------|
| Three Months Ended                  |                 |   |           |         |                        |
| March 31, 2013                      |                 |   |           |         |                        |
| Net Interest Income                 | \$16,764        | \$5   | \$7       | \$(551) | ) \$16,225             |
| Net Gains on Sales of Loans         | 754             | —   | —         | —       | 754                    |
| Net Gains on Securities             | 613             | —   | —         | —       | 613                    |
| Trust and Investment Product Fees   | 3               | 815   | —         | (1      | ) 817                  |
| Insurance Revenues                  | 9               | 13  | 1,762     | —       | 1,784                  |
| Noncash Items:                      |                 |   |           |         |                        |
| Provision for Loan Losses           | 350             | —   | —         | —       | 350                    |
| Depreciation and Amortization       | 950             | 7   | 105       | 37      | 1,099                  |
| Income Tax Expense (Benefit)        | 2,744           | (2  | ) 147     | (375    | ) 2,514                |
| Segment Profit (Loss)               | 5,848           | (8  | ) 211     | (242    | ) 5,809                |
| Segment Assets at December 31, 2013 | 2,171,837       | 11,663  | 5,636     | (25,309 | ) 2,163,827            |

NOTE 7 – Stock Repurchase Plan

On April 26, 2001 the Company announced that its Board of Directors approved a stock repurchase program for up to 607,754 of the outstanding Common Shares of the Company. Shares may be purchased from time to time in the open market and in large block privately negotiated transactions. The Company is not obligated to purchase any shares under the program, and the program may be discontinued at any time before the maximum number of shares specified



by the program are purchased. The Board of Directors established no expiration date for this program. As of March 31, 2014, the Company had purchased 334,965 shares under the program. No shares were purchased under the program during the three months ended March 31, 2014 and 2013.

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NOTE 8 – Equity Plans and Equity Based Compensation

The Company maintains three equity incentive plans under which stock options, restricted stock, and other equity incentive awards can be granted. At March 31, 2014, the Company has reserved 438,813 shares of Common Stock (as adjusted for subsequent stock dividends and subject to further customary anti-dilution adjustments) for the purpose of issuance pursuant to outstanding and future grants of options, restricted stock, and other equity awards to officers, directors and other employees of the Company.

For the three months ended March 31, 2014 and 2013, the Company granted no options, and accordingly, recorded no stock option expense related to option grants during the three months ended March 31, 2014 and 2013. The Company recorded no other stock compensation expense applicable to options during the three months ended March 31, 2014 and 2013 because all outstanding options were fully vested prior to 2007. In addition, there was no unrecognized option expense as all outstanding options were fully vested prior to March 31, 2014 and 2013.

During the periods presented, awards of long-term incentives were granted in the form of restricted stock. Awards that were granted to management under a management incentive plan were granted in tandem with cash credit entitlements (in the form of 60% restricted stock grants and 40% cash credit entitlements for 2014 and 50% restricted stock grants and 50% cash credit entitlements prior to 2014). The management restricted stock grants and tandem cash credit entitlements awarded in 2013 will vest in three equal installments of 33.3% with the first annual vesting on December 5th of the year of the grant and on December 5th of the next two succeeding years. Awards that were granted to directors as additional retainer for their services do not include any cash credit entitlement. These director restricted stock grants are subject to forfeiture in the event that the recipient of the grant does not continue in service as a director of the Company through December 5th of the year after grant or do not satisfy certain meeting attendance requirements, at which time they generally vest 100 percent. For measuring compensation costs, restricted stock awards are valued based upon the market value of the common shares on the date of grant. During the three months ended March 31, 2014 and 2013, the Company granted awards of 31,080 and 29,170 shares of restricted stock, respectively.

The following table presents expense recorded for restricted stock and cash entitlements as well as the related tax effect for the periods presented:

|                          | Three Months Ended<br>March 31, |       |
|--------------------------|---------------------------------|-------|
|                          | 2014                            | 2013  |
| Restricted Stock Expense | \$ 158                          | \$ 85 |
| Cash Entitlement Expense | 99                              | 54    |
| Tax Effect               | (104                            | ) (56 |
| Net of Tax               | \$ 153                          | \$ 83 |

Unrecognized expense associated with the restricted stock grants and cash entitlements totaled \$2,127 and \$1,251 as of March 31, 2014 and 2013, respectively.

The Company maintains an Employee Stock Purchase Plan whereby eligible employees have the option to purchase the Company's common stock at a discount. The purchase price of the shares under this Plan has been set at 95% of the fair market value of the Company's common stock as of the last day of the plan year. The plan provided for the

purchase of up to 500,000 shares of common stock, which the Company may obtain by purchases on the open market or from private sources, or by issuing authorized but unissued common shares. Funding for the purchase of common stock is from employee and Company contributions.

The Employee Stock Purchase Plan is not considered compensatory. There was no expense recorded for the employee stock purchase plan during the three months ended March 31, 2014 and 2013, nor was there any unrecognized compensation expense as of March 31, 2014 and 2013 for the Employee Stock Purchase Plan.

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NOTE 9 – Fair Value

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

Investment Securities: The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). Level 3 pricing is obtained from a third-party based upon similar trades that are not traded frequently without adjustment by the Company. At March 31, 2014, the Company held \$10.8 million in Level 3 securities which consist of \$10.5 million of non-rated Obligations of State and Political Subdivisions and \$353 thousand of equity securities that are not actively traded. Absent the credit rating, significant assumptions must be made such that the credit risk input becomes an unobservable input and thus these securities are reported by the Company in a Level 3 classification.

Derivatives: The fair values of derivatives are based on valuation models using observable market data as of the measurement date (Level 2).

Impaired Loans: Fair values for impaired collateral dependent loans are generally based on appraisals obtained from licensed real estate appraisers and in certain circumstances consideration of offers obtained to purchase properties prior to foreclosure. Appraisals for commercial real estate generally use three methods to derive value: cost, sales or market comparison and income approach. The cost method bases value in the cost to replace the current property. Value of market comparison approach evaluates the sales price of similar properties in the same market area. The income approach considers net operating income generated by the property and an investors required return. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Comparable sales adjustments are based on known sales prices of similar type and similar use properties and duration of time that the property has been on the market to sell. Such adjustments made in the appraisal process are typically significant and result in a Level 3 classification of the inputs for determining fair value.

Appraisals for both collateral-dependent impaired loans and other real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, a member of the Company's Risk Management Area reviews the assumptions and approaches utilized in the appraisal. In determining the value of impaired collateral dependent loans and other real estate owned, significant unobservable inputs may be used which include: physical condition of comparable properties sold, net operating income generated by the property and investor rates of return.

Other Real Estate: Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate (ORE) are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property utilizing similar techniques as discussed above for Impaired Loans, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, impairment loss is recognized.

Loans Held-for-Sale: The fair values of loans held for sale are determined by using quoted prices for similar assets, adjusted for specific attributes of that loan resulting in a Level 2 classification.

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## NOTE 9 - Fair Value (continued)

## Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis, including financial assets and liabilities for which the Company has elected the fair value option, are summarized below:

|   | Fair Value Measurements at March 31, 2014 Using                |   |   | Total     |
|---|--|---|---|-----------|
|   | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |           |
| Assets:   |  |   |   |           |
| U.S. Treasury and Agency Securities             | \$—  | \$19,129                                      | \$—                                       | \$19,129  |
| Corporate Securities                            | —  | —   | —   | —         |
| Obligations of State and Political Subdivisions | —  | 106,080                                       | 10,476                                    | 116,556   |
| Mortgage-backed Securities-Residential          | —  | 477,132                                       | —   | 477,132   |
| Equity Securities                               | —  | —   | 353                                       | 353       |
| Total Securities                                | \$—  | \$602,341                                     | \$10,829                                  | \$613,170 |
| Loans Held-for-Sale                             | \$—  | \$9,844                                       | \$—                                       | \$9,844   |
| Derivative Assets                               | \$—  | \$536   | \$—                                       | \$536     |
| Derivative Liabilities                          | \$—  | \$444   | \$—                                       | \$444     |
|   |  |   |   |           |
|   | Fair Value Measurements at December 31, 2013 Using             |   |   | Total     |
|   | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |           |
| Assets:   |  |   |   |           |
| U.S. Treasury and Agency Securities             | \$—  | \$18,952                                      | \$—                                       | \$18,952  |
| Corporate Securities                            | —  | —   | —   | —         |
| Obligations of State and Political Subdivisions | —  | 102,665                                       | 10,832                                    | 113,497   |
| Mortgage-backed Securities-Residential          | —  | 473,230                                       | —   | 473,230   |
| Equity Securities                               | —  | —   | 353                                       | 353       |
| Total Securities                                | \$—  | \$594,847                                     | \$11,185                                  | \$606,032 |
| Loans Held-for-Sale                             | \$—  | \$9,265                                       | \$—                                       | \$9,265   |

|                        |     |       |     |       |
|------------------------|-----|-------|-----|-------|
| Derivative Assets      | \$— | \$866 | \$— | \$866 |
| Derivative Liabilities | \$— | \$737 | \$— | \$737 |

There were no transfers between Level 1 and Level 2 for the periods ended March 31, 2014 and December 31, 2013.

At March 31, 2014, the aggregate fair value of the Loans Held-for-Sale was \$9,844, aggregate contractual principal balance was \$9,676 with a difference of \$168. At December 31, 2013, the aggregate fair value of the Loans Held-for-Sale was \$9,265, aggregate contractual principle balance was \$9,129 with a difference of \$136.

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NOTE 9 - Fair Value (continued)

The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months ended March 31, 2014 and 2013:

|   | Obligations of State<br>and Political<br>Subdivisions |          | Equity Securities |       | Corporate Securities |      |
|---|---|----------|-------------------|-------|----------------------|------|
|   | 2014  | 2013     | 2014              | 2013  | 2014                 | 2013 |
|   | Balance of Recurring Level 3 Assets at<br>January 1   | \$10,832 | \$12,169          | \$353 | \$353                | \$—  |
| Total Gains or Losses (realized/unrealized)<br>Included in Earnings | 69  | (21)     | —                 | —     | —                    | —    |
| Maturities / Calls  | (425)   | (420)    | —                 | —     | —                    | —    |
| Purchases   | —   | —        | —                 | —     | —                    | —    |
| Balance of Recurring Level 3 Assets at<br>March 31                  | \$10,476  | \$11,728 | \$353             | \$353 | \$—                  | \$—  |

Of the total gain/loss included in earnings for the three months ended March 31, 2014, \$69 was attributable to other changes in fair value. Of the total gain/loss included in earnings for the three months ended March 31, 2013, \$(21) was attributable to other changes in fair value. The three months ended March 31, 2014 and 2013 included no gain/loss attributable to interest income on securities.

Assets and Liabilities Measured on a Non-Recurring Basis

Assets and liabilities measured at fair value on a non-recurring basis are summarized below:

|   | Fair Value Measurements at March 31, 2014 Using                         |   |   | Total   |
|---|---|---|---|---------|
|   | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs (Level 3) |         |
| Assets:                                     |   |   |   |         |
| Impaired Loans with Specific<br>Allocations |   |   |   |         |
| Commercial and Industrial Loans             | \$—   | \$—   | \$2,811   | \$2,811 |
| Commercial Real Estate Loans                | —   | —   | 1,311   | 1,311   |
| Agricultural Loans                          | —   | —   | —   | —       |
| Other Real Estate<br>Commercial Real Estate | —   | —   | —   | —       |
|   | Fair Value Measurements at December 31, 2013 Using                      |   |   |         |
|   | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs (Level 3) | Total   |



Assets:

Impaired Loans with Specific Allocations

|                                 |     |     |       |       |
|---------------------------------|-----|-----|-------|-------|
| Commercial and Industrial Loans | \$— | \$— | \$—   | \$—   |
| Commercial Real Estate Loans    | —   | —   | 1,346 | 1,346 |
| Agricultural Loans              | —   | —   | —     | —     |
| Other Real Estate               |     |     |       |       |
| Commercial Real Estate          | —   | —   | 20    | 20    |

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NOTE 9 - Fair Value (continued)

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of \$8,124 with a valuation allowance of \$4,002, resulting in an additional provision for loan losses of \$863 for the period ended March 31, 2014. For the three months ended March 31, 2013, impaired loans resulted in an additional provision for loan losses of \$50. Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of \$4,449 with a valuation allowance of \$3,103, resulting in an additional provision for loan losses of \$1,024 for the year ended December 31, 2013.

Other Real Estate which is measured at the lower of carrying or fair value less costs to sell. No charge to earnings was included in the three months ended March 31, 2014. A charge to earnings through Other Operating Income of \$207 was included in the three months ended March 31, 2013. Other Real Estate which is measured at the lower of carrying or fair value less costs to sell had a carrying value of \$20 at December 31, 2013.

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at March 31, 2014 and December 31, 2013:

| March 31, 2014                                   | Fair Value | Valuation Technique(s)    | Unobservable Input(s)   | Range (Weighted Average) |
|--|------------|---------------------------|---|--------------------------|
| Impaired Loans - Commercial and Industrial Loans | \$2,811    | Sales comparison approach | Adjustment for differences between comparable sales             | 41%-90% (42%)            |
| Impaired Loans - Commercial Real Estate Loans    | \$1,311    | Sales comparison approach | Adjustment for physical condition of comparable properties sold | 12%-80% (53%)            |
|  |            | Income approach           | Adjustment for net operating income generated by the property   |                          |
|  |            | Cost approach             | Adjustment for investor rates of return                         |                          |
| December 31, 2013                                | Fair Value | Valuation Technique(s)    | Unobservable Input(s)   | Range (Weighted Average) |
| Impaired Loans - Commercial Real Estate Loans    | \$1,346    | Sales comparison approach | Adjustment for physical condition of comparable properties sold | 12%-80% (53%)            |
|  |            | Income approach           | Adjustment for net operating income generated by the property   |                          |
|  |            | Cost approach             | Adjustment for investor rates of return                         |                          |
|  | \$20       |                           |   | 50% (50%)                |

Other Real Estate - Commercial Real  
Estate Loans

|                           |   |
|---------------------------|---|
| Sales comparison approach | Adjustment for physical condition of comparable properties sold |
| Income approach           | Adjustment for net operating income generated by the property   |
| Cost approach             | Adjustment for investor rates of return                         |

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NOTE 9 - Fair Value (continued)

The carrying amounts and estimated fair values of the Company's financial instruments not previously presented are provided in the table below for the periods ending March 31, 2014 and December 31, 2013. Not all of the Company's assets and liabilities are considered financial instruments, and therefore are not included in the table. Because no active market exists for a significant portion of the Company's financial instruments, fair value estimates were based on subjective judgments, and therefore cannot be determined with precision.

|  | Carrying Value | Fair Value Measurements at<br>March 31, 2014 Using |            |           | Total        |
|--|----------------|--|------------|-----------|--------------|
|  |                | Level 1  | Level 2    | Level 3   |              |
| <b>Financial Assets:</b>                   |                |  |            |           |              |
| Cash and Short-term Investments            | \$53,250       | \$44,159   | \$9,091    | \$—       | \$53,250     |
| Securities Held-to-Maturity                | 184            | —  | 186        | —         | 186          |
| FHLB Stock and Other Restricted Stock      | 9,004          | N/A  | N/A        | N/A       | N/A          |
| Loans, Net                                 | 1,344,899      | —  | —          | 1,346,930 | 1,346,930    |
| Accrued Interest Receivable                | 7,573          | —  | 2,195      | 5,378     | 7,573        |
| <b>Financial Liabilities:</b>              |                |  |            |           |              |
| Demand, Savings, and Money Market Deposits | (1,425,341 )   | (1,425,341 )                                       | —          | —         | (1,425,341 ) |
| Time Deposits                              | (342,434 )     | —  | (345,169 ) | —         | (345,169 )   |
| Short-term Borrowings                      | (72,774 )      | —  | (72,774 )  | —         | (72,774 )    |
| Long-term Debt                             | (87,217 )      | —  | (83,258 )  | (5,330 )  | (88,588 )    |
| Accrued Interest Payable                   | (675 )         | —  | (627 )     | (48 )     | (675 )       |
| <b>Unrecognized Financial Instruments:</b> |                |  |            |           |              |
| Commitments to Extend Credit               | —              | —  | —          | —         | —            |
| Standby Letters of Credit                  | —              | —  | —          | —         | —            |
| Commitments to Sell Loans                  | —              | —  | —          | —         | —            |

|  | Carrying Value | Fair Value Measurements at<br>December 31, 2013 Using |            |           | Total        |
|--|----------------|---|------------|-----------|--------------|
|  |                | Level 1   | Level 2    | Level 3   |              |
| <b>Financial Assets:</b>                   |                |   |            |           |              |
| Cash and Short-term Investments            | \$60,232       | \$37,370  | \$22,862   | \$—       | \$60,232     |
| Securities Held-to-Maturity                | 268            | —   | 271        | —         | 271          |
| FHLB Stock and Other Restricted Stock      | 9,004          | N/A   | N/A        | N/A       | N/A          |
| Loans, Net                                 | 1,366,452      | —   | —          | 1,370,339 | 1,370,339    |
| Accrued Interest Receivable                | 7,470          | —   | 1,918      | 5,552     | 7,470        |
| <b>Financial Liabilities:</b>              |                |   |            |           |              |
| Demand, Savings, and Money Market Deposits | (1,463,122 )   | (1,463,122 )  | —          | —         | (1,463,122 ) |
| Time Deposits                              | (349,034 )     | —   | (351,707 ) | —         | (351,707 )   |
| Short-term Borrowings                      | (53,533 )      | —   | (53,533 )  | —         | (53,533 )    |
| Long-term Debt                             | (87,237 )      | —   | (83,329 )  | (5,311 )  | (88,640 )    |
| Accrued Interest Payable                   | (777 )         | —   | (732 )     | (45 )     | (777 )       |
| <b>Unrecognized Financial Instruments:</b> |                |   |            |           |              |

|                              |   |   |   |   |   |
|------------------------------|---|---|---|---|---|
| Commitments to Extend Credit | — | — | — | — | — |
| Standby Letters of Credit    | — | — | — | — | — |
| Commitments to Sell Loans    | — | — | — | — | — |

Cash and Short-term Investments:

The carrying amount of cash and short-term investments approximate fair values and are classified as Level 1 or Level 2.

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NOTE 9 - Fair Value (continued)

Securities Held-to-Maturity:

The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2).

FHLB Stock and Other Restricted Stock:

It is not practical to determine the fair values of FHLB stock and other restricted stock due to restrictions placed on their transferability.

Loans:

Fair values of loans, excluding loans held for sale and collateral dependent impaired loans having a specific allowance allocation, are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans are valued as described previously. The methods utilized to estimate fair value of loans do not necessarily represent an exit price.

Accrued Interest Receivable:

The carrying amount of accrued interest approximates fair value resulting in a Level 2 or Level 3 classification consistent with the asset they are associated with.

Deposits:

The fair values disclosed for demand deposits (e.g., interest and non-interest checking, savings and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) resulting in a Level 1 classification. Fair values for fixed rate time deposits are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

Short-term Borrowings:

The carrying amounts of federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings, generally maturing within ninety days, approximate their fair values resulting in a Level 2 classification.

Long-term Debt:

The fair values of the Company's long-term borrowings are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification.

The fair values of the Company's subordinated debentures are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 3 classification.

Accrued Interest Payable:

The carrying amount of accrued interest approximates fair value resulting in a Level 2 or Level 3 classification consistent with the liability they are associated with.

Off-balance Sheet Instruments:

Commitments to extend credit and standby letters of credit are generally short-term or variable rate with minimal fees charged. These instruments have no carrying value, and the fair value is not material. The fair value of commitments to sell loans is the cost or benefit of settling the commitments with the counter-party at the reporting date. At March 31, 2014 and December 31, 2013, none of the Company's commitments to sell loans were mandatory, and there is no cost or benefit to settle these commitments.

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## NOTE 10 – Other Comprehensive Income (Loss)

The tables below summarize the changes in accumulated other comprehensive income (loss) by component for the periods ending March 31, 2014 and 2013, net of tax:

| March 31, 2014   | Unrealized Gains and<br>Losses on<br>Available-for-Sale Securities | Defined<br>Benefit<br>Pension Items | Postretirement<br>Benefit Items | Total      |
|--|--|-------------------------------------|---------------------------------|------------|
| Beginning Balance  | \$ (5,231 )  | \$—                                 | \$(32 )                         | \$(5,263 ) |
| Other Comprehensive Income (Loss)<br>Before Reclassification               | 2,412  | —                                   | —                               | 2,412      |
| Amounts Reclassified from Accumulated<br>Other Comprehensive Income (Loss) | (148 )   | —                                   | —                               | (148 )     |
| Net Current Period Other<br>Comprehensive Income (Loss)                    | 2,264  | —                                   | —                               | 2,264      |
| Ending Balance   | \$ (2,967 )  | \$—                                 | \$(32 )                         | \$(2,999 ) |

| March 31, 2013  | Unrealized Gains and<br>Losses on<br>Available-for-Sale Securities | Defined<br>Benefit<br>Pension Items | Postretirement<br>Benefit Items | Total    |
|---|--|-------------------------------------|---------------------------------|----------|
| Beginning Balance   | \$ 10,643  | \$(231 )                            | \$(61 )                         | \$10,351 |
| Other Comprehensive Income (Loss)<br>Before Reclassification                  | (1,890 )   | —                                   | —                               | (1,890 ) |
| Amounts Reclassified from<br>Accumulated Other Comprehensive<br>Income (Loss) | (346 )   | —                                   | —                               | (346 )   |
| Net Current Period Other<br>Comprehensive Income (Loss)                       | (2,236 )   | —                                   | —                               | (2,236 ) |
| Ending Balance  | \$ 8,407   | \$(231 )                            | \$(61 )                         | \$8,115  |

The tables below summarize the classifications out of accumulated other comprehensive income (loss) by component for the periods ending March 31, 2014 and 2013:

| Details about Accumulated Other<br>Comprehensive Income (Loss) Components | Amount Reclassified From<br>Accumulated Other<br>Comprehensive Income (Loss) | Affected Line Item in the Statement<br>Where Net Income is Presented |
|---|--|--|
| Unrealized Gains and Losses on<br>Available-for-Sale Securities           | \$ (228 )  | ) Net (Gain) Loss on Securities                                      |
|   | 80   | ) Income Tax Expense   |
|   | (148 )   | ) Net of Tax   |
| Total Reclassifications for the quarter ended<br>March 31, 2014           | \$(148 )   | )  |





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| Details about Accumulated Other<br>Comprehensive Income (Loss) Components | Amount Reclassified From<br>Accumulated Other<br>Comprehensive Income (Loss) | Affected Line Item in the Statement<br>Where Net Income is Presented |
|---|--|--|
| Unrealized Gains and Losses on<br>Available-for-Sale Securities           | \$(613   | ) Net (Gain) Loss on Securities                                      |
|   | 267  | Income Tax Expense   |
|   | (346   | ) Net of Tax   |
| Total Reclassifications for the quarter ended<br>March 31, 2013           | \$(346   | )  |

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

### GERMAN AMERICAN BANCORP, INC. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

German American Bancorp, Inc., is a NASDAQ-traded (symbol: GABC) financial services holding company based in Jasper, Indiana. German American, through its banking subsidiary German American Bancorp, operates 37 commercial and retail banking offices in 13 southern Indiana counties. The Company also owns a trust, brokerage, and financial planning subsidiary (German American Financial Advisors & Trust Company) and a full line property and casualty insurance agency (German American Insurance, Inc.).

Throughout this Management's Discussion and Analysis, as elsewhere in this report, when we use the term "Company," we will usually be referring to the business and affairs (financial and otherwise) of the Company and its subsidiaries and affiliates as a whole. Occasionally, we will refer to the term "parent company" or "holding company" when we mean to refer to only German American Bancorp, Inc.

This section presents an analysis of the consolidated financial condition of the Company as of March 31, 2014 and December 31, 2013 and the consolidated results of operations for the three months ended March 31, 2014 and 2013. This discussion should be read in conjunction with the consolidated financial statements and other financial data presented elsewhere herein and with the financial statements and other financial data, as well as the Management's Discussion and Analysis of Financial Condition and Results of Operations, included in the Company's December 31, 2013 Annual Report on Form 10-K.

#### MANAGEMENT OVERVIEW

This updated discussion should be read in conjunction with the Management Overview that was included in our Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's December 31, 2013 Annual Report on Form 10-K.

Net income for the quarter ended March 31, 2014 totaled \$6,305,000, or \$0.48 per share, an increase of \$496,000 or 9% and an increase of \$0.02 per share or 4%, from the quarter ended March 31, 2013 net income of \$5,809,000, or \$0.46 per share.

As compared to the same quarter prior year results, first quarter 2014 earnings were positively affected by a \$1,971,000, or 12%, increase in net interest income due primarily to an increased level of earning assets and an improved net interest margin. Also contributing to the improved earnings during the first quarter of 2014 was an increased level of non-interest income driven primarily by increased insurance revenues.

Partially mitigating the improvement in net interest income and non-interest income was an increase in non-interest expenses of \$1,628,000, or 12%, during the first quarter of 2014 compared to the first quarter of 2013. The increase in non-interest expenses was largely impacted by the inclusion of the United Commerce Bancorp operations which was acquired by the Company effective October 1, 2013, a new financial center in Columbus, Indiana, and the implementation of new digital banking systems.

#### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The financial condition and results of operations for German American Bancorp, Inc. presented in the Consolidated Financial Statements, accompanying Notes to the Consolidated Financial Statements, and selected financial data appearing elsewhere within this Report, are, to a large degree, dependent upon the Company's accounting policies. The selection of and application of these policies involve estimates, judgements, and uncertainties that are subject to change. The critical accounting policies and estimates that the Company has determined to be the most susceptible to change in the near term relate to the determination of the allowance for loan losses, the valuation of securities available for sale, and the valuation allowance on deferred tax assets.

## Allowance for Loan Losses

The Company maintains an allowance for loan losses to cover probable incurred credit losses at the balance sheet date. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off. A provision for loan losses is charged to operations based on management's periodic evaluation of the necessary allowance balance. Evaluations are conducted at least quarterly and more often if deemed necessary. The ultimate recovery of all loans is susceptible to future market factors beyond the Company's control.

The Company has an established process to determine the adequacy of the allowance for loan losses. The determination of the allowance is inherently subjective, as it requires significant estimates, including the amounts and timing of expected future cash flows on impaired loans, estimated losses on other classified loans and pools of homogeneous loans, and consideration of past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors, all of which may be susceptible to significant change. The allowance consists of two components of allocations, specific and general. These two components represent the total allowance for loan losses deemed adequate to cover losses inherent in the loan portfolio.

Commercial and agricultural loans are subject to a standardized grading process administered by an internal loan review function. The need for specific reserves is considered for credits when graded substandard or when: (a) the customer's cash flow or net worth appears insufficient to repay the loan; (b) the loan has been criticized in a regulatory examination; (c) the loan is on non-accrual; or, (d) other reasons where the ultimate collectibility of the loan is in question, or the loan characteristics require special monitoring. Specific allowances are established in cases where management has identified significant conditions or circumstances related to an individual credit that we believe indicates the loan is impaired. Specific allocations on impaired loans are determined by comparing the loan balance to the present value of expected cash flows or expected collateral proceeds. Allocations are also applied to categories of loans not considered individually impaired but for which the rate of loss is expected to be greater than historical averages, including those graded substandard and non-performing consumer or residential real estate loans. Such allocations are based on past loss experience and information about specific borrower situations and estimated collateral values.

General allocations are made for other pools of loans, including non-classified loans, homogeneous portfolios of consumer and residential real estate loans, and loans within certain industry categories believed to present unique risk of loss. General allocations of the allowance are primarily made based on a three-year historical average for loan losses for these portfolios, judgmentally adjusted for economic factors and portfolio trends.

Due to the imprecise nature of estimating the allowance for loan losses, the Company's allowance for loan losses includes a minor unallocated component. The unallocated component of the allowance for loan losses incorporates the Company's judgmental determination of inherent losses that may not be fully reflected in other allocations, including factors such as economic uncertainties, lending staff quality, industry trends impacting specific portfolio segments, and broad portfolio quality trends. Therefore, the ratio of allocated to unallocated components within the total allowance may fluctuate from period to period.

## Securities Valuation

Securities available-for-sale are carried at fair value, with unrealized holding gains and losses reported separately in accumulated other comprehensive income (loss), net of tax. The Company obtains market values from a third party on

a monthly basis in order to adjust the securities to fair value. Equity securities that do not have readily determinable fair values are carried at cost. Additionally, when securities are deemed to be other than temporarily impaired, a charge will be recorded through earnings; therefore, future changes in the fair value of securities could have a significant impact on the Company's operating results. In determining whether a market value decline is other than temporary, management considers the reason for the decline, the extent of the decline, the duration of the decline and whether the Company intends to sell or believes it will be required to sell the securities prior to recovery. As of March 31, 2014, gross unrealized losses on the securities available-for-sale portfolio totaled approximately \$11,289,000 and gross unrealized gains totaled approximately \$6,740,000. As of March 31, 2014, held-to-maturity securities had a gross unrecognized gain of approximately \$2,000.

#### Income Tax Expense

Income tax expense involves estimates related to the valuation allowance on deferred tax assets and loss contingencies related to exposure from tax examinations.

A valuation allowance reduces deferred tax assets to the amount management believes is more likely than not to be realized. In evaluating the realization of deferred tax assets, management considers the likelihood that sufficient taxable income of appropriate character will be generated within carryback and carryforward periods, including consideration of available tax planning strategies. Tax related loss contingencies, including assessments arising from tax examinations and tax strategies, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. In considering the likelihood of loss, management considers the nature of the contingency, the progress of any examination or related protest or appeal, the views of legal counsel and other advisors, experience of the Company or other enterprises in similar matters, if any, and management's intended response to any assessment.

## RESULTS OF OPERATIONS

### Net Income:

Net income for the quarter ended March 31, 2014 totaled \$6,305,000, or \$0.48 per share, an increase of \$496,000 or 9% and an increase of \$0.02 per share or 4%, from the quarter ended March 31, 2013 net income of \$5,809,000, or \$0.46 per share.

### Net Interest Income:

Net interest income is the Company's single largest source of earnings, and represents the difference between interest and fees realized on earning assets, less interest paid on deposits and borrowed funds. Several factors contribute to the determination of net interest income and net interest margin, including the volume and mix of earning assets, interest rates, and income taxes. Many factors affecting net interest income are subject to control by management policies and actions. Factors beyond the control of management include the general level of credit and deposit demand, Federal Reserve Board monetary policy, and changes in tax laws.

The following table summarizes net interest income (on a tax-equivalent basis). For tax-equivalent adjustments an effective tax rate of 35% was used for all periods presented<sup>(1)</sup>.

|   | Average Balance Sheet<br>(Tax-equivalent basis / dollars in thousands) |                     |                 |   |                                      |                     |                 |   |
|---|--|---------------------|-----------------|---|--------------------------------------|---------------------|-----------------|---|
|   | Three Months Ended<br>March 31, 2014                                   |                     |                 |   | Three Months Ended<br>March 31, 2013 |                     |                 |   |
|   | Principal<br>Balance   | Income /<br>Expense | Yield /<br>Rate |   | Principal<br>Balance                 | Income /<br>Expense | Yield /<br>Rate |   |
| <b>Assets</b>   |  |                     |                 |   |                                      |                     |                 |   |
| Federal Funds Sold and Other<br>Short-term Investments        | \$12,149   | \$3                 | 0.10            | % | \$16,831                             | \$10                | 0.24            | % |
| <b>Securities:</b>  |  |                     |                 |   |                                      |                     |                 |   |
| Taxable   | 506,337  | 2,759               | 2.18            | % | 557,412                              | 2,841               | 2.04            | % |
| Non-taxable   | 115,790  | 1,501               | 5.18            | % | 77,011                               | 975                 | 5.07            | % |
| Total Loans and Leases <sup>(2)</sup>                         | 1,371,361  | 16,018              | 4.73            | % | 1,211,852                            | 14,936              | 4.99            | % |
| Total Interest Earning Assets                                 | 2,005,637  | 20,281              | 4.08            | % | 1,863,106                            | 18,762              | 4.07            | % |
| Other Assets  | 142,374  |                     |                 |   | 136,559                              |                     |                 |   |
| Less: Allowance for Loan Losses                               | (15,202 )  |                     |                 |   | (15,750 )                            |                     |                 |   |
| Total Assets  | \$2,132,809  |                     |                 |   | \$1,983,915                          |                     |                 |   |
| <b>Liabilities and Shareholders' Equity</b>                   |  |                     |                 |   |                                      |                     |                 |   |
| Interest-bearing Demand, Savings<br>and Money Market Deposits | \$1,041,009  | \$321               | 0.13            | % | \$965,953                            | \$382               | 0.16            | % |
| Time Deposits   | 340,160  | 715                 | 0.85            | % | 334,679                              | 852                 | 1.03            | % |
| FHLB Advances and Other<br>Borrowings                         | 130,727  | 449                 | 1.39            | % | 140,363                              | 911                 | 2.63            | % |
| Total Interest-bearing Liabilities                            | 1,511,896  | 1,485               | 0.40            | % | 1,440,995                            | 2,145               | 0.60            | % |
| Demand Deposit Accounts                                       | 405,386  |                     |                 |   | 336,472                              |                     |                 |   |
| Other Liabilities   | 10,909   |                     |                 |   | 20,428                               |                     |                 |   |
| Total Liabilities   | 1,928,191  |                     |                 |   | 1,797,895                            |                     |                 |   |
| Shareholders' Equity  | 204,618  |                     |                 |   | 186,020                              |                     |                 |   |
| Total Liabilities and Shareholders'<br>Equity                 | \$2,132,809  |                     |                 |   | \$1,983,915                          |                     |                 |   |
| <b>Cost of Funds</b>  |  |                     |                 |   |                                      |                     |                 |   |
| Net Interest Income   |  | \$18,796            |                 |   |                                      | \$16,617            |                 |   |
| Net Interest Margin   |  |                     | 3.78            | % |                                      |                     | 3.60            | % |

(1) Effective tax rates were determined as though interest earned on the Company's investments in municipal bonds and loans was fully taxable.

(2) Loans held-for-sale and non-accruing loans have been included in average loans.

Net interest income increased \$1,971,000 or 12% (an increase of \$2,179,000 or 13% on a tax-equivalent basis) for the quarter ended March 31, 2014 compared with the same quarter of 2013. The increased level of net interest income during the first quarter of 2014 compared with the first quarter of 2013 was driven by a higher level of earning assets and a higher net interest margin (expressed as a percentage of average earning assets).

The net interest margin represents tax-equivalent net interest income expressed as a percentage of average earning assets. The tax equivalent net interest margin was 3.78% for the first quarter of 2014 compared to 3.60% during the



first quarter of 2013. The yield on earning assets totaled 4.08% during the quarter ended March 31, 2014 compared to 4.07% in the same period of 2013 while the cost of funds (expressed as a percentage of average earning assets) totaled 0.30% during the quarter ended March 31, 2014 compared to 0.47% in the same period of 2013.

The improvement of the net interest margin and net interest income in the first quarter of 2014 compared with the first quarter of 2013 was attributable to an increased level of average loans outstanding, to the improvement in the yield on the Company's securities portfolio and to the continued decline in the Company's cost of funds. Accretion of loan discounts on acquired loans contributed approximately 5 basis points on an annualized basis to the net interest margin in the first quarter of 2014 and 8 basis points in the first quarter of 2013.

## Provision for Loan Losses:

The Company provides for loan losses through regular provisions to the allowance for loan losses. The provision is affected by net charge-offs on loans and changes in specific and general allocations of the allowance. During the quarter ended March 31, 2014, the provision for loan loss totaled \$350,000 which was flat to the \$350,000 provision during the first quarter of 2013. The provision for loan loss represented 0.10% on an annualized basis of average loans outstanding during the first quarter of 2014 and 0.12% during the first quarter of 2013. The Company realized net recoveries of \$550,000 or 0.16% on an annualized basis of average loans outstanding during the three months ended March 31, 2014, compared with net charge-offs of \$136,000 or 0.04% on an annualized basis of average loans outstanding during the same period of 2013.

The provision for loan losses made during the three months ended March 31, 2014 was made at a level deemed necessary by management to absorb estimated, probable incurred losses in the loan portfolio. A detailed evaluation of the adequacy of the allowance for loan losses is completed quarterly by management, the results of which are used to determine provision for loan losses. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors.

## Non-interest Income:

During the quarter ended March 31, 2014, non-interest income totaled \$6,281,000, an increase of \$371,000, or 6%, compared with the first quarter of 2013.

| Non-interest Income<br>(dollars in thousands) | Three Months<br>Ended March 31, |         | Change From<br>Prior Period |                   |   |
|---|---------------------------------|---------|-----------------------------|-------------------|---|
|   | 2014                            | 2013    | Amount<br>Change            | Percent<br>Change |   |
| Trust and Investment Product Fees             | \$922                           | \$817   | \$105                       | 13                | % |
| Service Charges on Deposit Accounts           | 1,061                           | 955     | 106                         | 11                |   |
| Insurance Revenues                            | 2,556                           | 1,784   | 772                         | 43                |   |
| Company Owned Life Insurance                  | 201                             | 266     | (65)                        | (24)              | ) |
| Interchange Fee Income                        | 447                             | 430     | 17                          | 4                 |   |
| Other Operating Income                        | 390                             | 291     | 99                          | 34                |   |
| Subtotal                                      | 5,577                           | 4,543   | 1,034                       | 23                |   |
| Net Gains on Sales of Loans                   | 476                             | 754     | (278)                       | (37)              | ) |
| Net Gains on Securities                       | 228                             | 613     | (385)                       | (63)              | ) |
| Total Non-interest Income                     | \$6,281                         | \$5,910 | \$371                       | 6                 |   |

During the first quarter of 2014, trust and investment product fees increased \$105,000, or 13%, compared with first quarter of 2013. The increase was due to an increase in in brokerage revenues. Service charges on deposit accounts increased \$106,000, or 11%, during the first quarter of 2014 compared with the same period of 2013. This increase was largely attributable to an expanded customer base in part enhanced by the acquisition of United Commerce Bancorp.

Insurance revenues increased \$772,000, or 43%, during the quarter ended March 31, 2014, compared with the first quarter of 2013. The increase during the first quarter of 2014 compared with first quarter of 2013 was due to increased contingency revenue. Contingency revenue during the first quarter of 2014 totaled \$1,049,000 compared with \$246,000 during the first quarter of 2013. The fluctuation in contingency revenue during 2014 and 2013 is a normal course of business type of variance and is reflective of claims and loss experience with insurance carriers that the

Company represents through its property and casualty insurance agency.

Net gains on sales of loans totaled \$476,000 during the quarter ended March 31, 2014, a decline of \$278,000, or 37%, compared with the first quarter of 2013. Loan sales totaled \$21.9 million during the first quarter of 2014, compared with \$42.5 million during the first quarter of 2013.

During the first quarter of 2014, the Company realized a net gain on the sale of securities of \$228,000 related to the sale of \$3.3 million of securities, compared with a net gain on the sale of securities of \$613,000 related to the sale of approximately \$29.8 million of securities in the first quarter of 2013.

## Non-interest Expense:

During the quarter ended March 31, 2014, non-interest expense totaled \$15,090,000, an increase of \$1,628,000, or 12%, compared with the first quarter of 2013.

| Non-interest Income<br>(dollars in thousands) | Three Months<br>Ended March 31, |          | Change From<br>Prior Period |                   |   |
|---|---------------------------------|----------|-----------------------------|-------------------|---|
|   | 2014                            | 2013     | Amount<br>Change            | Percent<br>Change |   |
| Salaries and Employee Benefits                | \$8,424                         | \$7,784  | \$640                       | 8                 | % |
| Occupancy, Furniture and Equipment Expense    | 1,825                           | 1,580    | 245                         | 16                |   |
| FDIC Premiums                                 | 275                             | 255      | 20                          | 8                 |   |
| Data Processing Fees                          | 1,010                           | 665      | 345                         | 52                |   |
| Professional Fees                             | 692                             | 661      | 31                          | 5                 |   |
| Advertising and Promotion                     | 478                             | 490      | (12)                        | (2)               | ) |
| Intangible Amortization                       | 348                             | 367      | (19)                        | (5)               | ) |
| Other Operating Expenses                      | 2,038                           | 1,660    | 378                         | 23                |   |
| Total Non-interest Expense                    | \$15,090                        | \$13,462 | \$1,628                     | 12                |   |

Salaries and benefits increased \$640,000, or 8%, during the quarter ended March 31, 2014 compared with the first quarter of 2013. The increase in salaries and benefits during the first quarter of 2014 compared the same period of 2013 was primarily the result of an increased number of full-time equivalent employees which were largely the result of the acquisition of United Commerce Bancorp and the opening of a full service banking location in Columbus, Indiana.

Occupancy, furniture and equipment expense increased \$245,000, or 16%, during the quarter ended March 31, 2014 compared with the first quarter of 2013. The increase was largely related to a larger number of banking offices driven by the acquisition of United Commerce Bancorp and the new banking location in Columbus.

Data processing fees increased \$345,000, or 52%, during the first quarter of 2014 compared with the same quarter of 2013. The increase was primarily attributable to costs associated with the implementation of new commercial and retail digital banking platforms late in the fourth quarter of 2013 and in the first quarter of 2014.

Other operating expenses increased \$378,000, or 23%, during the first quarter of 2014 compared with the first quarter of 2013. The increase was largely related to collection cost associated with residential loans sold on the secondary market, losses sustained from fraudulent debit card activity which resulted from a phone scam that targeted the Company's customers during the first quarter of 2014 and was also attributable to the United Commerce Bancorp acquisition and opening of the Columbus, Indiana full service banking location.

## Income Taxes:

The Company's effective income tax rate was 30.2% during the three months ended March 31, 2014 and 2013. The effective tax rate in all periods presented was lower than the blended statutory rate of 40.5% resulting primarily from the Company's tax-exempt investment income on securities, loans and company owned life insurance, income tax credits generated from investments in a new markets tax credit project and affordable housing projects, and income generated by subsidiaries domiciled in a state with no state or local income tax.

## FINANCIAL CONDITION

Total assets at March 31, 2014 decreased \$17.4 million to \$2.146 billion compared with \$2.164 billion in total assets at December 31, 2013. The decline in total assets was primarily attributable to a decline in period-end loan balances.

March 31, 2014 loans outstanding decreased by \$18.0 million, or approximately 5% on an annualized basis, compared with year-end 2013. The reduction in loans during the first quarter of 2014 compared with year-end 2013 was largely related to a seasonal decline in agricultural loans.

| End of Period Loan Balances:<br>(dollars in thousands) | March 31,<br>2014 | December 31,<br>2013 | Current Period<br>Change |
|--|-------------------|----------------------|--------------------------|
| Commercial & Industrial Loans                          | \$344,045         | \$350,955            | \$(6,910 )               |
| Commercial Real Estate Loans                           | 589,193           | 582,066              | 7,127                    |
| Agricultural Loans                                     | 174,651           | 192,880              | (18,229 )                |
| Home Equity & Consumer Loans                           | 128,024           | 130,628              | (2,604 )                 |
| Residential Mortgage Loans                             | 131,271           | 128,683              | 2,588                    |
| Total Loans  | \$1,367,184       | \$1,385,212          | \$(18,028 )              |

The Company's allowance for loan losses totaled \$15.5 million at March 31, 2014 representing an increase of \$900,000, or 25% on an annualized basis, from December 31, 2013. The allowance for loan losses represented 1.13% of period-end loans at March 31, 2014 compared with 1.05% of period-end loans at December 31, 2013. Under acquisition accounting treatment, loans acquired are recorded at fair value which includes a credit risk component, and therefore the allowance on loans acquired is not carried over from the seller. The Company held a discount on acquired loans of \$5.4 million as of March 31, 2014 and \$5.9 million at year-end 2013.

Total deposits decreased \$44.4 million, or 10% on an annualized basis, as of March 31, 2014 compared with December 31, 2013 total deposits. The decline was primarily attributable to withdrawals from large balance deposit relationships. These relationships continue to maintain significant deposit balances with the Company.

| End of Period Deposit Balances:<br>(dollars in thousands) | March 31,<br>2014 | December 31,<br>2013 | Current Period<br>Change |
|---|-------------------|----------------------|--------------------------|
| Non-interest-bearing Demand Deposits                      | \$409,630         | \$400,024            | \$9,606                  |
| Interest-bearing Demand, Savings, & Money Market Accounts | 1,015,711         | 1,063,098            | (47,387 )                |
| Time Deposits < \$100,000                                 | 216,227           | 224,361              | (8,134 )                 |
| Time Deposits of \$100,000 or more                        | 126,207           | 124,673              | 1,534                    |
| Total Deposits  | \$1,767,775       | \$1,812,156          | \$(44,381 )              |

The following is an analysis of the Company's non-performing assets at March 31, 2014 and December 31, 2013:

|   |                   |                      |  |   |
|---|-------------------|----------------------|--|---|
| Non-performing Assets:<br>(dollars in thousands)    | March 31,<br>2014 | December 31,<br>2013 |  |   |
| Non-accrual Loans                                   | \$11,776          | \$8,378              |  |   |
| Past Due Loans (90 days or more and still accruing) | 16                | 8                    |  |   |
| Total Non-performing Loans                          | 11,792            | 8,386                |  |   |
| Other Real Estate                                   | 770               | 1,029                |  |   |
| Total Non-performing Assets                         | \$12,562          | \$9,415              |  |   |
| <br>  |                   |                      |  |   |
| Restructured Loans                                  | \$2,246           | \$2,418              |  |   |
| <br>  |                   |                      |  |   |
| Non-performing Loans to Total Loans                 | 0.86              | % 0.61               |  | % |
| Allowance for Loan Loss to Non-performing Loans     | 131.31            | % 173.91             |  | % |

Non-performing assets totaled \$12.6 million or 0.59% of total assets at March 31, 2014 compared to \$9.4 million or 0.44% of total assets at December 31, 2013. Non-performing loans totaled \$11.8 million or 0.86% of total loans at March 31, 2014 representing a \$3.4 million, or 41%, increase in non-performing loans compared to the \$8.4 million of non-performing loans at December 31, 2013. The increase in non-performing loans was largely the result of the placement of a single commercial and industrial loan relationship to a manufacturing company on non-accrual status during the first quarter of 2014.

Non-accrual commercial real estate loans totaled \$5.3 million at March 31, 2014 representing a decline of \$1.4 million, or 20%, from the \$6.7 million of non-accrual commercial real estate loans at year-end 2013. Non-accrual commercial real estate loans represented 45% of the total non-performing loans at March 31, 2014 compared to 79% of total non-performing loans at year-end 2013. Non-accrual commercial and industrial loans totaled \$4.3 million at March 31, 2014 representing an increase of \$4.3 million from the \$0.03 million of non-accrual commercial and industrial loans at December 31, 2013. Non-accrual commercial and industrial loans represented 37% of the total non-performing loans at March 31, 2014 compared with less than 1% of total non-performing loans at year-end 2013.

At March 31, 2014, three commercial loan relationships represented approximately 65% of the total non-performing loans of the Company. The first relationship was a \$4.3 million commercial and industrial loan relationship to a manufacturing company secured by the business assets of the company. The loan was placed on non-accrual status during the first quarter of 2014. The second relationship was a \$1.5 million commercial real estate loan secured by various commercial real estate properties. This loan was in non-performing status as of December 31, 2013. The borrower has made all contractual payments due during 2014 and the principal balance of the loan was reduced by approximately \$0.6 million during the first three months of 2014. The third relationship was a \$1.9 million commercial real estate loan secured by a commercial warehouse facility. This loan was in non-performing status as of year-end 2013. The borrower has made all contractual payments due during 2014 and the principal balance of this relationship was reduced by \$0.02 million during the first three months of 2014. These three relationships represent the only loan relationships greater than \$1.0 million included in non-performing loans.

The Company purchases individual loans and groups of loans. Purchased loans that show evidence of credit deterioration since origination are recorded at the amount paid (or allocated fair value in a purchase business combination), such that there is no carryover of the seller's allowance for loan losses. After acquisition, incurred losses are recognized by an increase in the allowance for loan losses.

Purchased loans that indicated evidence of credit deterioration since origination at the time of acquisition by the Company did not have a material adverse impact on the Company's key credit metrics during 2013 or during the first

quarter of 2014. The key credit metrics the Company measures generally include non-performing loans, past due loans, and adversely classified loans.

Non-performing purchased loans with evidence of credit deterioration since origination totaled \$1,562,000 at March 31, 2014 compared with \$1,705,000 at December 31, 2013. The non-performing purchased loans with evidence of credit deterioration since origination represented approximately 13% of total non-performing loans at March 31, 2014 compared with approximately 20% of total non-performing loans at December 31, 2013.



Past due purchased loans with evidence of credit deterioration since origination totaled \$996,000 at March 31, 2014 and \$1,250,000 at year-end 2013. Past due purchased loans with evidence of credit deterioration since origination represented approximately 15% of total past due loans at March 31, 2014 and approximately 16% of total past due loans at year-end 2013.

Adversely classified purchased loans with evidence of credit deterioration since origination totaled \$8.2 million at March 31, 2014 compared with \$9.0 million at December 31, 2013. Adversely classified purchased loans with evidence of credit deterioration since origination represented approximately 22% of total adversely classified loans at March 31, 2014 compared with approximately 25% of total adversely classified loans at year-end 2013.

Loan impairment is reported when full repayment under the terms of the loan is not expected. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate, or at the fair value of collateral if repayment is expected solely from the collateral. Commercial and industrial loans, commercial real estate loans, and agricultural loans are evaluated individually for impairment. Smaller balance homogeneous loans are evaluated for impairment in total. Such loans include real estate loans secured by one-to-four family residences and loans to individuals for household, family and other personal expenditures. Individually evaluated loans on non-accrual are generally considered impaired. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

#### Capital Resources:

Federal banking regulations provide guidelines for determining the capital adequacy of bank holding companies and banks. These guidelines provide for a more narrow definition of core capital and assign a measure of risk to the various categories of assets. The Company is required to maintain minimum levels of capital in proportion to total risk-weighted assets and off-balance sheet exposures such as loan commitments and standby letters of credit.

Tier 1, or core capital, consists of shareholders' equity plus certain amounts of instruments commonly referred to as trust preferred securities, less goodwill, core deposit intangibles, other identifiable intangibles and certain deferred tax assets defined by bank regulations. Tier 2 capital currently consists of the amount of the allowance for loan losses which does not exceed a defined maximum allowance limit of 1.25 percent of gross risk adjusted assets and certain amounts of subordinated debenture obligations. Total capital is the sum of Tier 1 and Tier 2 capital.

The minimum requirements under these standards are generally at least a 4.0 percent leverage ratio, which is Tier 1 capital divided by defined "total assets"; 4.0 percent Tier 1 capital to risk-adjusted assets; and, an 8.0 percent total capital to risk-adjusted assets ratios. Under these guidelines, the Company, on a consolidated basis, and its subsidiary bank, have capital ratios that exceed the regulatory minimums.

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) requires federal regulatory agencies to define capital tiers. These are: well-capitalized, adequately-capitalized, under-capitalized, significantly under-capitalized, and critically under-capitalized. Under these regulations, a "well-capitalized" entity must achieve a Tier 1 risk-based capital ratio of at least 6.0 percent; a total capital ratio of at least 10.0 percent; and, a leverage ratio of at least 5.0 percent, and not be under a capital directive. The Company's subsidiary bank was categorized as well-capitalized as of March 31, 2014.

At March 31, 2014, management was not under such a capital directive, nor was it aware of any current recommendations by banking regulatory authorities which, if they were to be implemented, would have or are reasonably likely to have, a material effect on the Company's liquidity, capital resources or operations.

The table below presents the Company's consolidated capital ratios under regulatory guidelines:

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|  | Minimum for<br>Capital<br>Adequacy<br>Purposes | At March 31,<br>2014 | At December<br>31, 2013 |   |
|--|--|----------------------|-------------------------|---|
| Leverage Ratio                         | 4.00   | % 9.05               | % 8.78                  | % |
| Tier 1 Capital to Risk-adjusted Assets | 4.00   | % 12.50              | % 12.12                 | % |
| Total Capital to Risk-adjusted Assets  | 8.00   | % 13.51              | % 13.07                 | % |

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In July 2013, the two federal banking regulatory agencies that have authority to regulate the Company's capital resources and capital structure (the Board of Governors of the Federal Reserve System (FRB) and Federal Deposit Insurance Corporation (FDIC)) took action to finalize the application to the United States banking industry of new regulatory capital requirements that are established by the international banking framework commonly referred to as "Basel III" and to implement certain other changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. These rules make significant changes to the U.S. bank regulatory capital framework, and generally increase capital requirements for banking organizations. Although the Company believes that these new rules, as they are phased in over a multi-year period commencing January 1, 2015, will in general increase the amount of capital that the Company and the Bank may be required to maintain, the Company does not presently expect that any materially burdensome compliance efforts with these final capital rules will be required of the Company prior to January 1, 2015. For additional information, also see the discussion in Item 1 of the Company's annual report on Form 10-K for the year ended December 31, 2013.

As of March 31, 2014, shareholders' equity increased by \$6.6 million, or 13% on an annualized basis, to \$206.7 million compared with \$200.1 million at year-end 2013. The increase in shareholders' equity was primarily attributable to an increase of \$4.2 million in retained earnings and an increase of \$2.3 million in accumulated other comprehensive income related to a decrease in net unrealized losses in the Company's securities available-for-sale portfolio. Shareholders' equity represented 9.6% of total assets at March 31, 2014 and 9.3% of total assets at December 31, 2013. Shareholders' equity included \$23.5 million of goodwill and other intangible assets at March 31, 2014 compared to \$23.9 million of goodwill and other intangible assets at year-end 2013.

#### Liquidity:

The Consolidated Statement of Cash Flows details the elements of changes in the Company's consolidated cash and cash equivalents. Total cash and cash equivalents decreased \$7.0 million during the three months ended March 31, 2014 ending at \$53.2 million. During the three months ended March 31, 2014, operating activities resulted in net cash inflows of \$9.1 million. Investing activities resulted in net cash inflows of \$11.2 million during the three months ended March 31, 2014. Financing activities resulted in net cash outflows for the three months ended March 31, 2014 of \$27.3 million.

The parent company is a corporation separate and distinct from its bank and other subsidiaries. The Company uses funds at the parent company level to pay dividends to its shareholders, to acquire or make other investments in other businesses or their securities or assets, to repurchase its stock from time to time, and for other general corporate purposes including debt service. The parent company does not have access at the parent-company level to the deposits and certain other sources of funds that are available to its bank subsidiary to support its operations. Instead, the parent company has historically derived most of its revenues from dividends paid to the parent company by its bank subsidiary. The Company's banking subsidiary is subject to statutory restrictions on its ability to pay dividends to the parent company. The parent company has in recent years supplemented the dividends received from its subsidiaries with borrowings. As of March 31, 2014, the parent company had approximately \$14.3 million of cash and cash equivalents available to meet its cash flow needs.

#### FORWARD-LOOKING STATEMENTS AND ASSOCIATED RISKS

The Company from time to time in its oral and written communications makes statements relating to its expectations regarding the future. These types of statements are considered "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. The Company may include forward-looking statements in filings with the Securities and Exchange Commission ("SEC"), 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. Such forward looking statements can include statements about the Company's net interest income or net interest margin; its adequacy

of allowance for loan losses, levels of provisions for loan losses, and the quality of the Company's loans and other assets; simulations of changes in interest rates; expected results from mergers with or acquisitions of other businesses; litigation results; tax estimates and recognition; dividend policy; parent company cash resources and cash requirements, and parent company capital resources; estimated cost savings, plans and objectives for future operations; and expectations about the Company's financial and business performance and other business matters as well as economic and market conditions and trends. They often can be identified by the use of words like "expect," "may," "will," "would," "could," "should," "intend," "project," "estimate," "believe" or "anticipate," or similar expressions.

Forward-looking statements speak only as of the date they are made, and the Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the forward-looking statement is made.

Readers are cautioned that, by their nature, all forward-looking statements are based on assumptions and are subject to risks, uncertainties, and other factors. Actual results may differ materially and adversely from the expectations of the Company that are expressed or implied by any forward-looking statement. The discussions in this Item 2 list some of the factors that could cause the Company's actual results to vary materially from those expressed or implied by any forward-looking statements. Other risks, uncertainties, and factors that could cause the Company's actual results to vary materially from those expressed or implied by any forward-looking statement include the unknown future direction of interest rates and the timing and magnitude of any changes in interest rates; changes in competitive conditions; the introduction, withdrawal, success and timing of asset/liability management strategies or of mergers and acquisitions and other business initiatives and strategies; changes in customer borrowing, repayment, investment and deposit practices; changes in fiscal, monetary and tax policies; changes in financial and capital markets; deterioration in general economic conditions, either nationally or locally, resulting in, among other things, credit quality deterioration; capital management activities, including possible future sales of new securities, or possible repurchases or redemptions by the Company of outstanding debt or equity securities; risks of expansion through acquisitions and mergers, such as unexpected credit quality problems of the acquired loans or other assets, unexpected attrition of the customer base of the acquired institution or branches, and difficulties in integration of the acquired operations; factors driving impairment charges on investments; the impact, extent and timing of technological changes; litigation liabilities, including related costs, expenses, settlements and judgments, or the outcome of matters before regulatory agencies, whether pending or commencing in the future; actions of the Federal Reserve Board; changes in accounting principles and interpretations; potential increases of federal deposit insurance premium expense, and possible future special assessments of FDIC premiums, either industry wide or specific to the Company's banking subsidiary; actions of the regulatory authorities under the Dodd-Frank Wall Street Reform and Consumer Protection Act and the Federal Deposit Insurance Act and other possible legislative and regulatory actions and reforms; and the continued availability of earnings and excess capital sufficient for the lawful and prudent declaration and payment of cash dividends. Such statements reflect our views with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to the operations, results of operations, growth strategy and liquidity of the Company. Readers are cautioned not to place undue reliance on these forward-looking statements.

Investors should consider these risks, uncertainties, and other factors, in addition to those mentioned by the Company in its Annual Report on Form 10-K for its fiscal year ended December 31, 2013, and other SEC filings from time to time, when considering any forward-looking statement.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's exposure to market risk is reviewed on a regular basis by the Asset/Liability Committee and Boards of Directors of the parent company and its subsidiary bank. Primary market risks which impact the Company's operations are liquidity risk and interest rate risk.

The liquidity of the parent company is dependent upon the receipt of dividends from its subsidiary bank, which is subject to certain regulatory limitations. The Bank's source of funding is predominately core deposits, maturities of securities, repayments of loan principal and interest, federal funds purchased, securities sold under agreements to repurchase and borrowings from the Federal Home Loan Bank.

The Company monitors interest rate risk by the use of computer simulation modeling to estimate the potential impact on its net interest income under various interest rate scenarios, and by estimating its static interest rate sensitivity position. Another method by which the Company's interest rate risk position can be estimated is by computing estimated changes in its net portfolio value ("NPV"). This method estimates interest rate risk exposure from movements in interest rates by using interest rate sensitivity analysis to determine the change in the NPV of discounted cash flows from assets and liabilities.

NPV represents the market value of portfolio equity and is equal to the estimated market value of assets minus the estimated market value of liabilities. Computations are based on a number of assumptions, including the relative levels of market interest rates and prepayments in mortgage loans and certain types of investments. These computations do not contemplate any actions management may undertake in response to changes in interest rates, and should not be relied upon as indicative of actual results. In addition, certain shortcomings are inherent in the method of computing NPV. Should interest rates remain or decrease below current levels, the proportion of adjustable rate loans could decrease in future periods due to refinancing activity. In the event of an interest rate change, prepayment levels would likely be different from those assumed in the table. Lastly, the ability of many borrowers to repay their adjustable rate debt may decline during a rising interest rate environment.

The Company from time to time utilizes derivatives to manage interest rate risk. Management continuously evaluates the merits of such interest rate risk products but does not anticipate the use of such products to become a major part of the Company's risk management strategy.

The table below provides an assessment of the risk to NPV in the event of a sudden and sustained 2% increase and decrease in prevailing interest rates (dollars in thousands).

Interest Rate Sensitivity as of March 31, 2014

| Changes in Rates | Net Portfolio Value |          | Net Portfolio Value as a % of Present Value of Assets |              |
|------------------|---------------------|----------|---|--------------|
|                  | Amount              | % Change | NPV Ratio   | Change       |
| +2%              | \$199,445           | (16.60   | )% 9.74   | % (139) b.p. |
| Base             | 239,145             | —        | 11.13   | % —          |
| -2%              | 214,362             | (10.36   | )% 9.76   | % (137) b.p. |

This Item 3 includes forward-looking statements. See “Forward-looking Statements” included in Part I, Item 2 of this Report for a discussion of certain factors that could cause the Company’s actual exposure to market risk to vary materially from that expressed or implied above. These factors include possible changes in economic conditions; interest rate fluctuations, competitive product and pricing pressures within the Company’s markets; and equity and fixed income market fluctuations. Actual experience may also vary materially to the extent that the Company’s assumptions described above prove to be inaccurate.

Item 4. Controls and Procedures

As of March 31, 2014, the Company carried out an evaluation, under the supervision and with the participation of its principal executive officer and principal financial officer, of the effectiveness of the design and operation of its disclosure controls and procedures. Based on this evaluation, the Company’s principal executive officer and principal financial officer concluded that the Company’s disclosure controls and procedures were as of that date effective in timely alerting them to material information required to be included in the Company’s periodic reports filed with the Securities and Exchange Commission. There are inherent limitations to the effectiveness of systems of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective systems of disclosure controls and procedures can provide only reasonable assurances of achieving their control objectives.

There was no change in the Company’s internal control over financial reporting that occurred during the Company’s first fiscal quarter of 2014 that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

## PART II. OTHER INFORMATION

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(e) The following table sets forth information regarding the Company's purchases of its common shares during each of the three months ended March 31, 2014.

| Period           | Total Number of Shares (or Units) Purchased | Average Price Paid Per Share (or Unit) | Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs | Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased under the Plans or Programs <sup>(1)</sup> |
|------------------|---|--|---|--|
| 1/1/14 – 1/31/14 | —   | —                                      | —   | 272,789  |
| 2/1/14 – 2/28/14 | —   | —                                      | —   | 272,789  |
| 3/1/14 – 3/31/14 | —   | —                                      | —   | 272,789  |
|                  | —   | —                                      | —   |  |

<sup>(1)</sup> On April 26, 2001, the Company announced that its Board of Directors had approved a stock repurchase program for up to 607,754 of its outstanding common shares, of which the Company had purchased 334,965 common shares through March 31, 2014 (both such numbers adjusted for subsequent stock dividends). The Board of Directors established no expiration date for this program. The Company purchased no shares under this program during the three months ended March 31, 2014.



Item 6. Exhibits

The exhibits described by the Exhibit Index immediately following the Signature Page of this Report are incorporated herein by reference.

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.

GERMAN AMERICAN BANCORP, INC.

Date: May 9, 2014

By/s/Mark A. Schroeder  
Mark A. Schroeder  
Chairman and Chief Executive Officer

Date: May 9, 2014

By/s/Bradley M. Rust  
Bradley M. Rust  
Executive Vice President and Chief Financial Officer

INDEX OF EXHIBITS

| Exhibit No. | Description   |
|-------------|---|
| 10.1*       | Description of Executive Management Incentive Plan for 2014 adopted by the Board of Directors on February 24, 2014, is incorporated by reference from the description included in Exhibit 5.02 of the Registrant's Current Report on Form 8-K filed February 28, 2014.  |
| 10.2* **    | Form of LTI Restricted Stock Award Agreement that evidences the terms of awards of restricted stock grants and related cash entitlements that were granted to executive officers during February 2014 pursuant to the Management Long-Term Incentive Plan component of the 2013 Executive Management Incentive Plan with respect to the performance period ended December 31, 2013.                 |
| 31.1        | Sarbanes-Oxley Act of 2002, Section 302 Certification for Chairman and Chief Executive Officer.   |
| 31.2        | Sarbanes-Oxley Act of 2002, Section 302 Certification for Executive Vice President and Chief Financial Officer.   |
| 32.1        | Sarbanes-Oxley Act of 2002, Section 906 Certification for Chairman and Chief Executive Officer.   |
| 32.2        | Sarbanes-Oxley Act of 2002, Section 906 Certification for Executive Vice President and Chief Financial Officer.   |
| 101**+      | The following materials from German American Bancorp, Inc.'s Form 10-Q Report for the quarterly period ended March 31, 2014, formatted in XBRL: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Cash Flows, and (v) the Notes to Consolidated Financial Statements. |

\*Exhibits that describe or evidence all management contracts or compensatory plans or arrangements required to be filed as exhibits to this Report are indicated by an asterisk.

\*\*Exhibits that are furnished or filed with this Report (other than through incorporation by reference to other disclosures or exhibits) are indicated by a double asterisk.

+Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are furnished and not deemed filed or part of a registration statement or prospectus for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, and are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.