

FIRST MERCHANTS CORP
Form 10-Q
May 10, 2013

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

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

For the quarterly period ended March 31, 2013
OR
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the Transition Period from _____ to _____

Commission File Number 0-17071

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

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

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

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

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

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

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

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

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

As of April 30, 2013, there were 28,781,559 outstanding common shares of the registrant.

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

CONSOLIDATED CONDENSED BALANCE SHEETS

	March 31, 2013 (Unaudited)	December 31, 2012
ASSETS		
Cash and cash equivalents	\$51,592	\$101,460
Interest-bearing time deposits	60,407	38,443
Investment securities available for sale	532,867	513,343
Investment securities held to maturity (fair value of \$351,439 and \$378,174)	336,696	361,020
Mortgage loans held for sale	26,555	22,300
Loans, net of allowance for loan losses of \$68,537 and \$69,366	2,811,005	2,832,843
Premises and equipment	53,762	52,749
Federal Reserve and Federal Home Loan Bank stock	32,777	32,785
Interest receivable	15,346	16,367
Core deposit intangibles	7,767	8,154
Goodwill	141,375	141,375
Cash surrender value of life insurance	126,098	125,397
Other real estate owned	13,130	13,263
Tax asset, deferred and receivable	27,597	30,867
Other assets	15,856	14,455
TOTAL ASSETS	\$4,252,830	\$4,304,821
LIABILITIES		
Deposits:		
Noninterest-bearing	\$763,965	\$801,597
Interest-bearing	2,546,843	2,544,786
Total Deposits	3,310,808	3,346,383
Borrowings:		
Federal funds purchased		18,862
Securities sold under repurchase agreements	161,813	141,828
Federal Home Loan Bank advances	93,169	94,238
Subordinated debentures and term loans	111,778	112,161
Total Borrowings	366,760	367,089
Interest payable	1,348	1,841
Other liabilities	35,356	37,272
Total Liabilities	3,714,272	3,752,585
COMMITMENTS AND CONTINGENT LIABILITIES		
STOCKHOLDERS' EQUITY		
Preferred Stock, no-par value, \$1,000 liquidation value:		
Authorized - 500,000 shares		
Senior Non-Cumulative Perpetual Preferred Stock, Series B		
Issued and outstanding - 68,087 and 90,782.94 shares	68,087	90,783
Cumulative Preferred Stock, \$1,000 par value, \$1,000 liquidation value:		
Authorized - 600 shares		
Issued and outstanding - 125 shares	125	125

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Common Stock, \$.125 stated value:

Authorized - 50,000,000 shares

Issued and outstanding - 28,780,609 and 28,692,616 shares

Additional paid-in capital

Retained earnings

Accumulated other comprehensive loss

Total Stockholders' Equity

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY

3,598

256,966

216,530

(6,748

538,558

\$4,252,830

3,587

256,843

206,397

) (5,499)

552,236

\$4,304,821

See notes to consolidated condensed financial statements.

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PART I. FINANCIAL INFORMATION

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(table dollar amounts in thousands, except share data)

CONSOLIDATED CONDENSED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended March 31,	
	2013	2012
INTEREST INCOME		
Loans receivable:		
Taxable	\$37,159	\$35,848
Tax exempt	117	117
Investment securities:		
Taxable	3,618	4,574
Tax exempt	2,454	2,562
Deposits with financial institutions	19	25
Federal Reserve and Federal Home Loan Bank stock	371	343
Total Interest Income	43,738	43,469
INTEREST EXPENSE		
Deposits	2,891	4,110
Federal funds purchased	11	12
Securities sold under repurchase agreements	194	295
Federal Home Loan Bank advances	459	994
Subordinated debentures and term loans	725	1,942
Total Interest Expense	4,280	7,353
NET INTEREST INCOME	39,458	36,116
Provision for loan losses	2,102	4,875
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	37,356	31,241
OTHER INCOME		
Service charges on deposit accounts	2,729	2,819
Fiduciary activities	2,107	1,983
Other customer fees	2,780	2,586
Commission income	2,172	1,667
Earnings on cash surrender value of life insurance	700	1,378
Net gains and fees on sales of loans	2,378	1,952
Net realized gains on sales of available for sale securities	248	789
Gain on FDIC modified whole bank transaction		9,124
Other income	763	360
Total Other Income	13,877	22,658
OTHER EXPENSES		
Salaries and employee benefits	20,791	19,354
Net occupancy	2,602	2,651
Equipment	1,774	1,805
Marketing	467	442
Outside data processing fees	1,480	1,376
Printing and office supplies	331	267
Core deposit amortization	387	469
FDIC assessments	744	1,117

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Other real estate owned and credit-related expenses	1,866	2,186
Other expenses	4,258	4,361
Total Other Expenses	34,700	34,028
INCOME BEFORE INCOME TAX	16,533	19,871
Income tax expense	4,668	5,500
NET INCOME	11,865	14,371
Preferred stock dividends and discount accretion	(857	) (1,135
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS	\$11,008	\$13,236
Per Share Data:		
Basic Net Income Available to Common Stockholders	\$0.38	\$0.46
Diluted Net Income Available to Common Stockholders	\$0.38	\$0.46
Cash Dividends Paid	\$0.03	\$0.01
Average Diluted Shares Outstanding (in thousands)	28,971	28,755

See notes to consolidated condensed financial statements.

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(table dollar amounts in thousands, except share data)

CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended March 31,	
	2013	2012
Net income	\$11,865	\$14,371
Other comprehensive income net of tax:		
Unrealized holding loss on securities available for sale arising during the period, net of income tax of \$1,139 and \$11	(2,115)	(20)
Unrealized gain (loss) on securities available for sale for which a portion of an other than temporary impairment has been recognized in income, net of tax of \$39 and \$7	72	(14)
Unrealized gain on cash flow hedges arising during the period, net of income tax of \$104 and \$163	193	303
Amortization of items previously recorded in accumulated other comprehensive income, net of income tax of \$345 and \$282	640	521
Reclassification adjustment for gains included in net income net of income tax expense of \$21 and \$276	(39)	(513)
	(1,249)	277
Comprehensive income	\$10,616	\$14,648

See notes to consolidated condensed financial statements.

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(table dollar amounts in thousands, except share data)

CONSOLIDATED CONDENSED STATEMENT OF STOCKHOLDERS' EQUITY

(Unaudited)

	Preferred		Common Stock		Additional		Accumulated	Total
	Shares	Amount	Shares	Amount	Paid in Capital	Retained Earnings	Other Comprehensive Loss	
Balances, December 31, 2012	90,908	\$90,908	28,692,616	\$3,587	\$256,843	\$206,397	\$ (5,499)	\$552,236
Comprehensive Income								
Net Income						11,865		11,865
Other Comprehensive Income, net of tax							(1,249)	(1,249)
Cash Dividends on Common Stock (\$.03 per Share)						(875)		(875)
Cash Dividends on Preferred Stock under Small Business Lending Fund						(857)		(857)
Preferred Stock redeemed under Small Business Lending Fund		(22,696)						(22,696)
Share-based Compensation			101,681	13	361			374
Stock Issued Under Employee Benefit Plans			11,997	1	154			155
Stock Issued Under Dividend Reinvestment and Stock Purchase Plan			4,052	1	62			63
Stock options exercised			2,250		16			16
Stock Redeemed			(31,987)	(4)	(470)			(474)
Balances, March 31, 2013	68,212	\$68,212	28,780,609	\$3,598	\$256,966	\$216,530	\$ (6,748)	\$538,558

See notes to consolidated condensed financial statements.

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PART I. FINANCIAL INFORMATION

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(table dollar amounts in thousands, except share data)

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

	March 31, 2013	2012	
Cash Flow From Operating Activities:			
Net income	\$11,865	\$14,371	
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	2,102	4,875	
Depreciation and amortization	1,069	1,149	
Change in deferred taxes	5,574	4,682	
Share-based compensation	374	326	
Mortgage loans originated for sale	(92,411	) (91,199)
Proceeds from sales of mortgage loans	88,156	86,925	
Gain on acquisition		(9,124)
Gains on sales of securities available for sale	(248	) (789)
Change in interest receivable	1,021	1,521	
Change in interest payable	(493	) (1,198)
Other adjustments	(5,168	) (1,023)
Net cash provided by operating activities	\$11,841	\$10,516	
Cash Flows from Investing Activities:			
Net change in interest-bearing deposits	\$(21,964	) \$18,561	
Purchases of:			
Securities available for sale	(73,470	) (52,706)
Securities held to maturity		(566)
Proceeds from sales of securities available for sale	21,721	21,928	
Proceeds from maturities of:			
Securities available for sale	31,542	22,653	
Securities held to maturity	23,628	14,949	
Change in Federal Reserve and Federal Home Loan Bank stock	8	5	
Net change in loans	16,561	6,390	
Net cash received from acquisition		29,113	
Proceeds from the sale of other real estate owned	2,536	1,983	
Other adjustments	(2,082	) (719)
Net cash provided (used) by investing activities	\$(1,520	) \$61,591	
Cash Flows from Financing Activities:			
Net change in :			
Demand and savings deposits	\$3,062	\$22,890	
Certificates of deposit and other time deposits	(38,637	) (3,876)
Borrowings	19,985	10,936	
Repayment of borrowings	(19,931	) (112,878)
Cash dividends on common stock	(875	) (289)
Cash dividends on preferred stock	(857	) (1,135)
Stock issued under employee benefit plans	155	119	
Stock issued under dividend reinvestment and stock purchase plans	63	29	

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Stock options exercised	16		
Stock redeemed	(474)	(224)
Cumulative preferred stock redeemed (SBLF)	(22,696)	
Net cash used in financing activities	\$(60,189	)	\$(84,428)
Net Change in Cash and Cash Equivalents	(49,868	)	(12,321)
Cash and Cash Equivalents, January 1	101,460		73,312
Cash and Cash Equivalents, March 31	\$51,592		\$60,991
Additional cash flow information:			
Interest paid	\$4,773		\$8,184
Income tax paid (refunded)	\$104		\$1,000
Loans transferred to other real estate owned	\$3,175		\$2,425
Non-cash investing activities using trade date accounting	\$4,489		\$2,390
Liabilities assumed, net of cash			\$166,112

See notes to consolidated condensed financial statements.

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PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

NOTE 1

GENERAL

Financial Statement Preparation

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

The consolidated condensed balance sheet of the Corporation as of December 31, 2012, has been derived from the audited consolidated balance sheet of the Corporation as of that date. Certain information and note disclosures normally included in the Corporation’s annual financial statements, prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted. These consolidated condensed financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Corporation’s Form 10-K annual report filed with the Securities and Exchange Commission. The results of operations for the three months ended March 31, 2013, are not necessarily indicative of the results to be expected for the year.

NOTE 2

PURCHASE AND ASSUMPTION

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

Under the terms of the Agreement, the Bank acquired \$147.7 million in assets, including approximately \$11.9 million of cash and cash equivalents, \$18.9 million of marketable securities, \$1.8 million in Federal Home Loan Bank stock, \$113.0 million in loans and \$2.1 million of premises and other assets. The Bank assumed approximately \$135.7 million of liabilities, including approximately \$125.9 million in customer deposits, \$9.6 million of other borrowed money and \$402,000 in other liabilities. These balances are book balances and do not reflect the fair value adjustments which are shown on the following table. The acquisition did not include any loss sharing agreement with the FDIC.

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

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

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

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

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

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PART I. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(table dollar amounts in thousands, except share data)

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

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

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

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

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

NOTE 3

INVESTMENT SECURITIES

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at March 31, 2013				
U.S. Government-sponsored agency securities	\$4,228	\$159		\$4,387
State and municipal	151,379	8,615	\$122	159,872
U.S. Government-sponsored mortgage-backed securities	357,307	9,444	216	366,535

Corporate obligations

6,173

5,806