

GERMAN AMERICAN BANCORP, INC.  
Form 10-K  
March 03, 2009

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended: December 31, 2008

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 0-11244

GERMAN AMERICAN BANCORP, INC.

(Exact name of registrant as specified in its charter)

INDIANA 35-1547518  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

711 Main Street, Box 810, Jasper, Indiana 47546  
(Address of Principal Executive Offices) (Zip Code)

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

Securities registered pursuant to Section 12 (b) of the Act	
Title of Each Class	Name of each exchange on which registered
Common Shares, No Par Value	The NASDAQ Stock Market LLC
Preferred Stock Purchase Rights	

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.  Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K:

Edgar Filing: GERMAN AMERICAN BANCORP, INC. - Form 10-K

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or 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 Act).  Yes  No

The aggregate market value of the registrant's common shares held by non-affiliates of the registrant, computed by reference to the price at which the common shares were last sold, as of June 30, 2008 (the last business day of the registrant's most recently completed second fiscal quarter) was approximately \$119,841,000. This calculation does not reflect a determination that persons are affiliates for any other purposes.

As of February 24, 2009, there were outstanding 11,030,288 common shares, no par value, of the registrant.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement of German American Bancorp, Inc., for the Annual Meeting of its Shareholders to be held May 14, 2009, to the extent stated herein, are incorporated by reference into Part III.

---

GERMAN AMERICAN BANCORP, INC.  
 ANNUAL REPORT ON FORM 10-K  
 For Fiscal Year Ended December 31, 2008

Table of Contents

<b>PART I</b>		
Item 1.	Business	3-7
Item 1A.	Risk Factors	8-11
Item 1B.	Unresolved Staff Comments	11
Item 2.	Properties	11
Item 3.	Legal Proceedings	11
Item 4.	Submission of Matters to a Vote of Security Holders	11
<b>PART II</b>		
Item 5.	Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	12-13
Item 6.	Selected Financial Data	14
Item 7.	Management’s Discussion and Analysis of Financial Condition and Results of Operations	15-30
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	30
Item 8.	Financial Statements and Supplementary Data	31-65
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	66
Item 9A.	Controls and Procedures	66
Item 9B.	Other Information	66
<b>PART III</b>		
Item 10.	Directors and Executive Officers of the Registrant	67
Item 11.	Executive Compensation	67
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	67-68
Item 13.	Certain Relationships and Related Transactions	68

Item 14.	Principal Accountant Fees and Services	68
----------	--	----

PART IV

Item 15.	Exhibits and Financial Statement Schedules	69
----------	--	----

SIGNATURES		70
------------	--	----

INDEX OF EXHIBITS		71-73
-------------------	--	-------

Information included in or incorporated by reference in this Annual Report on Form 10-K, our other filings with the Securities and Exchange Commission and our press releases or other public statements, contain or may contain “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Please refer to a discussion of our forward- looking statements and associated risks in Item 1, “Business – Forward-Looking Statements and Associated Risks” and our discussion of risk factors in Item 1A, “Risk Factors” in this Annual Report on Form 10-K.

## PART I

### Item 1. Business.

#### General.

German American Bancorp, Inc. is a financial services holding company based in Jasper, Indiana. The Company’s Common Stock is traded on NASDAQ’s Global Select Market under the symbol GABC. The principal subsidiary of German American Bancorp, Inc., is its banking subsidiary, German American Bancorp, which operates through 28 retail banking offices in the ten contiguous Southern Indiana counties of Daviess, Dubois, Gibson, Knox, Lawrence, Martin, Monroe, Perry, Pike, and Spencer. German American Bancorp, Inc., also owns a trust, brokerage, and financial planning subsidiary, which operates from the banking offices of the bank subsidiary and a full line property and casualty insurance agency with seven insurance agency offices throughout its market area.

Throughout 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 consolidated subsidiaries 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.

The Company’s lines of business include retail and commercial banking, mortgage banking, comprehensive financial planning, full service brokerage and trust administration, and a full range of personal and corporate insurance products. Financial and other information by segment is included in Note 16 – Segment Information of the Notes to the Consolidated Financial Statements included in Item 8 of this Report and is incorporated into this Item 1 by reference. Substantially all of the Company’s revenues are derived from customers located in, and substantially all of its assets are located in, the United States.

#### Subsidiaries.

The Company’s principal operating subsidiaries are described in the following table:

1) Name	2) Type of Business	3) Principal Office Location
German American Bancorp	Commercial Bank	Jasper, IN
German American Insurance, Inc.	Multi-Line Insurance Agency	Jasper, IN
German American Financial Advisors & Trust Company	Trust, Brokerage, Financial Planning	Jasper, IN

Two of these subsidiaries (German American Bancorp and German American Insurance, Inc.) do business in the various communities served by the Company under distinctive trade names that relate to the names under which the Company (or a predecessor) has done banking or insurance business with the public in those communities in prior years.

#### Competition.

The industries in which the Company operates are highly competitive. The Company's subsidiary bank competes for commercial and retail banking business within its core banking segment not only with financial institutions that have offices in the same counties but also with financial institutions that compete from other locations in Southern Indiana and elsewhere. The Company's subsidiaries compete with commercial banks, savings and loan associations, savings banks, credit unions, production credit associations, federal land banks, finance companies, credit card companies, personal loan companies, investment brokerage firms, insurance agencies, insurance companies, lease finance companies, money market funds, mortgage companies, and other non-depository financial intermediaries. Many of these banks and other organizations have substantially greater resources than the Company.

Employees.

At February 28, 2009 the Company and its subsidiaries employed approximately 342 full-time equivalent employees. There are no collective bargaining agreements, and employee relations are considered to be good.

3

---

## Regulation and Supervision.

The Company is subject to regulation and supervision by the Board of Governors of the Federal Reserve System (“FRB”) under the Bank Holding Company Act of 1956, as amended (“BHC Act”), and is required to file with the FRB annual reports and such additional information as the FRB may require. The FRB may also make examinations or inspections of the Company. Under FRB policy, the Company is expected to act as a source of financial strength to its bank subsidiary, and to commit resources to support that subsidiary, even in circumstances where the Company might not do so absent such an FRB policy.

The Company’s subsidiary bank is under the supervision of and subject to examination by the Indiana Department of Financial Institutions (“DFI”), and the Federal Deposit Insurance Corporation (“FDIC”). Regulation and examination by banking regulatory agencies are primarily for the benefit of depositors rather than shareholders.

With certain exceptions, the BHC Act prohibits a bank holding company from engaging in (or acquiring direct or indirect control of more than 5 percent of the voting shares of any company engaged in) nonbanking activities. One of the principal exceptions to this prohibition is for activities deemed by the FRB to be “closely related to banking.” Under current regulations, bank holding companies and their subsidiaries are permitted to engage in such banking-related business ventures as consumer finance; equipment leasing; credit life insurance; computer service bureau and software operations; mortgage banking; and securities brokerage.

Under the BHC Act, certain well-managed and well-capitalized bank holding companies may elect to be treated as a “financial holding company” and, as a result, be permitted to engage in a broader range of activities that are “financial in nature” and in activities that are determined to be incidental or complementary to activities that are financial in nature. These activities include underwriting; dealing in and making a market in securities; insurance underwriting and agency activities; and merchant banking. Banks may also engage through financial subsidiaries in certain of the activities permitted for financial holding companies, subject to certain conditions. The Company has not elected to become a financial holding company and its subsidiary bank has not elected to form financial subsidiaries.

The Company's bank subsidiary and that bank’s subsidiaries may generally engage in activities that are permissible activities for state chartered banks under Indiana banking law, without regard to the limitations that might apply to such activities under the BHC Act if the Company were to engage directly in such activities at the parent company level or through parent company subsidiaries that were not also bank subsidiaries.

Indiana law and the BHC Act restrict certain types of expansion by the Company and its bank subsidiary. The Company and its subsidiaries may be required to apply for prior approval from (or give prior notice and an opportunity for review to) the FRB, the DFI, and/or other bank regulatory or other regulatory agencies, as a condition to the acquisition or establishment of new offices, or the acquisition (by merger or consolidation, purchase or otherwise) of the stock, business or properties of other banks or other companies.

The earnings of commercial banks and their holding companies are affected not only by general economic conditions but also by the policies of various governmental regulatory authorities. In particular, the FRB regulates money and credit conditions and interest rates in order to influence general economic conditions, primarily through open-market operations in U.S. Government securities, varying the discount rate on bank borrowings, and setting reserve requirements against bank deposits. These policies have a significant influence on overall growth and distribution of bank loans, investments and deposits, and affect interest rates charged on loans and earned on investments or paid for time and savings deposits. FRB monetary policies have had a significant effect on the operating results of commercial banks in the past and this is expected to continue in the future. The general effect, if any, of such policies upon the future business and earnings of the Company cannot accurately be predicted.

The Company and its bank subsidiary are required by law to maintain minimum levels of capital. These required capital levels are expressed in terms of capital ratios, known as the leverage ratio and the capital to risk-based assets ratios. The Company and its bank subsidiary each exceeded the minimum required capital levels for each measure of capital adequacy as of December 31, 2008. See Note 9 to the Company's consolidated financial statements that are presented in Item 8 of this Report, which Note 9 is incorporated herein by reference.

Also, federal regulations define five categories of financial institutions for purposes of implementing prompt corrective action and supervisory enforcement requirements of the Federal Deposit Insurance Corporation Improvements Act of 1991. The category to which the most highly capitalized institutions are assigned is termed "well-capitalized." Institutions falling into this category must have a total risk-based capital ratio (the ratio of total capital to risk-weighted assets) of at least 10%, a Tier 1 risk-based capital ratio (the ratio of Tier 1, or "core", capital to risk-weighted assets) of at least 6%, a leverage ratio (the ratio of Tier 1 capital to total assets) of at least 5%, and must not be subject to any written agreement, order, or directive from its regulator relative to meeting and maintaining a specific capital level. On December 31, 2008, the Company had a total risk-based capital ratio of 11.42%, a Tier 1 risk-based capital ratio of 9.37% (based on Tier 1 capital of \$89,507,000 and total risk-weighted assets of \$954,833,000), and a leverage ratio of 7.54%. The Company's affiliate bank met all of the requirements of the "well-capitalized" category. In addition the Company meets the requirements of the FRB to be considered a "well-capitalized" bank holding company. Accordingly, the Company does not expect these regulations to significantly impact operations.



The parent company is a corporation separate and distinct from its bank and other subsidiaries. Most of the parent company's revenues historically have been comprised of dividends, fees, and interest paid to it by its bank subsidiary, and this is expected to continue in the future. This subsidiary is subject to statutory restrictions on its ability to pay dividends. The FRB possesses enforcement powers over bank holding companies and their non-bank subsidiaries that enable it to prevent or remedy actions that in its view may represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability in appropriate cases to proscribe the payment of dividends by banks and bank holding companies. The FDIC and DFI possess similar enforcement powers over the bank subsidiary. The "prompt corrective action" provisions of federal banking law impose further restrictions on the payment of dividends by insured banks which fail to meet specified capital levels and, in some cases, their parent bank holding companies.

#### Federal Deposit Insurance Assessments.

The deposits of the Company's bank subsidiary are insured up to applicable limits by the Deposit Insurance Fund, or the DIF, of the FDIC and are subject to deposit insurance assessments to maintain the DIF. The FDIC utilizes a risk-based assessment system that imposes insurance premiums based upon a risk matrix that takes into account a bank's capital level and supervisory rating.

Effective January 1, 2007, the FDIC imposed deposit assessment rates based on the risk category of the bank subsidiary. Risk Category I is the lowest risk category while Risk Category IV is the highest risk category. Because of favorable loss experience and a healthy reserve ratio in the Bank Insurance Fund, or the BIF, of the FDIC, well-capitalized and well-managed banks, have in recent years paid minimal premiums for FDIC insurance. With the additional deposit insurance, a deposit premium refund, in the form of credit offsets, was granted to banks that were in existence on December 31, 1996 and paid deposit insurance premiums prior to that date. For 2008, the Company's subsidiary bank utilized the credits to offset a majority of its 2007 FDIC insurance assessment.

For 2007 and 2008, the Company's subsidiary bank qualified for the best rating, Risk Category I. For banks under \$10 billion in total assets in Risk Category I, the 2007 and 2008 deposit assessment ranged from 5 to 7 basis points of total qualified deposits. The actual assessment is dependent upon certain risk measures as defined in the final rule.

On October 16, 2008, the FDIC published a restoration plan designed to replenish the Deposit Insurance Fund over a period of five years and to increase the deposit insurance reserve ratio, which decreased to 1.01% of insured deposits on June 30, 2008, to the statutory minimum of 1.15% of insured deposits by December 31, 2013. In order to implement the restoration plan, the FDIC proposes to change both its risk-based assessment system and its base assessment rates. For the first quarter of 2009 only, the FDIC increased all FDIC deposit assessment rates by 7 basis points. These new rates range from 12 to 14 basis points for Risk Category I institutions to 50 basis points for Risk Category IV institutions.

Under the FDIC's restoration plan, the FDIC proposes to establish new initial base assessment rates that will be subject to adjustment as described below. Beginning April 1, 2009, the base assessment rates would range from 10 to 14 basis points for Risk Category I institutions to 45 basis points for Risk Category IV institutions.

Changes to the risk-based assessment system would include increasing premiums for institutions that rely on excessive amounts of brokered deposits, increasing premiums for excessive use of secured liabilities (including Federal Home Loan Bank advances), lowering premiums for smaller institutions with very high capital levels, and adding financial ratios and debt issuer ratings to the premium calculations for banks with over \$10 billion in assets, while providing a reduction for their unsecured debt.

Either an increase in the Risk Category of the Company's bank subsidiary or adjustments to the base assessment rates could result in a material increase in our expense for federal deposit insurance.

In addition, all institutions with deposits insured by the FDIC are required to pay assessments to fund interest payments on bonds issued by the Financing Corporation (FICO), a mixed-ownership government corporation established to recapitalize a predecessor to the Deposit Insurance Fund. The current annualized assessment rate is 1.14 basis points, or approximately .285 basis points per quarter. These assessments will continue until the Financing Corporation bonds mature in 2019.

#### Recent Legislative and Regulatory Developments.

In response to unprecedented market turmoil, the Emergency Economic Stabilization Act of 2008 (“EESA”) was enacted on October 3, 2008. EESA authorizes the U.S. Treasury Department to provide up to \$700 billion in funding for the financial services industry. Pursuant to the EESA, the Treasury was initially authorized to use \$350 billion for the Troubled Asset Relief Program (“TARP”). Of this amount, Treasury allocated \$250 billion to the TARP Capital Purchase Program (“CPP”). On January 15, 2009, the second \$350 billion of TARP monies was released to the Treasury. The Secretary's authority under TARP expires on December 31, 2009 unless the Secretary certifies to Congress that an extension is necessary, provided that his authority may not be extended beyond October 3, 2010.

EESA temporarily raised the basic limit on federal deposit insurance coverage from \$100,000 to \$250,000 per depositor. The temporary increase in deposit insurance coverage became effective on October 3, 2008. EESA provides that the basic deposit insurance limit will return to \$100,000 after December 31, 2009.

On October 14, 2008, the FDIC announced the Temporary Liquidity Guarantee Program (“TLGP”). The final rule was adopted on November 21, 2008. The FDIC stated that its purpose is to strengthen confidence and encourage liquidity in the banking system by guaranteeing newly issued senior unsecured debt of banks of 31 days or greater, thrifts, and certain holding companies, and by providing full deposit insurance coverage of all transaction accounts, regardless of dollar amount. Inclusion in the program was voluntary. Participating institutions are assessed fees based on a sliding scale, depending on length of maturity. Shorter-term debt has a lower fee structure and longer-term debt has a higher fee. The range is from 50 basis points on debt of 180 days or less, and a maximum of 100 basis points for debt with maturities of one year or longer, on an annualized basis. A 10-basis point surcharge is added to a participating institution's current insurance assessment in order to fully cover all transaction accounts. The Company's bank subsidiary elected to participate in both parts of the TLGP.

#### Status of the Company's Opportunity to Obtain Additional Equity Capital Under EESA.

In November 2008, the Company applied to participate in the CPP. By letter dated January 26, 2009, the Treasury Department advised the Company that the application had been accepted, and the Treasury Department offered to invest up to \$25 million in newly issued shares of preferred stock of the Company under the terms and conditions of the CPP. As part of its investment, the Treasury Department also would receive warrants to purchase common stock of the Company having an aggregate market price of 15% of the investment amount. Under the terms of the Company's approval to participate in the CPP, the Company was required to close upon the investment transaction within 30 days of the date of the January 26 letter.

During the thirty-day closing period established by the Treasury Department letter, the Company's Board of Directors authorized a special committee of the Board to further evaluate not only the possible CPP investment plan but also an alternative plan to augment the Company's regulatory capital. After further evaluation, the special committee determined that proceeding with an alternative capital plan was in the best interests of the Company and that the Company should defer taking any action to close upon the financing available to it under the CPP. Accordingly, the Company on February 20, 2009 requested that the Treasury Department indefinitely postpone the Company's closing under the CPP. The Company's Board of Directors on March 2, 2009, ratified the committee's determination to postpone the closing of the CPP financing, and determined that the Company should decline participation in the CPP and should advise the Treasury Department that it was withdrawing its CPP application. On March 3, 2009, the Company advised the Treasury Department to this effect.

#### Internet Address; Internet Availability of SEC Reports.

The Company's Internet address is [www.germanamericanbancorp.com](http://www.germanamericanbancorp.com).

The Company makes available, free of charge through the Shareholder Information section of its Internet website, a link to the Internet website of the Securities and Exchange Commission (SEC) by which the public may view the Company's annual report on Form 10-K, its quarterly reports on Form 10-Q, its current reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after those reports are filed with or furnished to the SEC.

## 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. Such forward-looking statements can include statements about the Company’s net interest income or net interest margin; adequacy of allowance for loan losses, and the quality of the Company’s loans, investment securities and other assets; simulations of changes in interest rates; litigation results; dividend policy; 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. All statements other than statements of historical fact included in this report, including statements regarding our financial position, business strategy and the plans and objectives of our management for future operations, are forward-looking statements. When used in this report, words such as “anticipate”, “believe”, “estimate”, “expect”, “intend”, and similar expressions, as they relate to us or our management, identify forward-looking statements.

Such forward-looking statements are based on the beliefs of our management, as well as assumptions made by and information currently available to our management, 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 Item 1A, “Risk Factors,” and in Item 7 of this Form 10-K, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” 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 but not limited to:

- 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;
- continued 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;
  - 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;
- actions of the Department of the Treasury and the Federal Deposit Insurance Corporation under the EESA and the Federal Deposit Insurance Act and other 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. It is intended that these forward-looking statements speak only as of the date they are made. We do not undertake any obligation to release publicly any revisions to these forward-looking statements to reflect future events or circumstances or to reflect the occurrence of unanticipated events.

Item 1A. Risk Factors.

While we have a history of profitability and operate with capital that exceeds the requirements of bank regulatory agencies, the financial services industry in which we operate has been adversely affected by the current economic emergency conditions. Further, an investment in our common stock (like an investment in the equity securities of any business enterprise) is subject to other investment risks and uncertainties. The following describes some of the principal risks and uncertainties to which our industry in general, and we and our assets and businesses specifically, are subject; other risks are briefly identified in our cautionary statement that is included under the heading "Forward-Looking Statements and Associated Risks" in Part I, Item 1, "Business." Although we seek ways to manage these risks and uncertainties and to develop programs to control those that we can, we ultimately cannot predict the future. Future results may differ materially from past results, and from our expectations and plans.

Risks Related to the Financial Services Industry Including Recent Market, Legislative and Regulatory Events

Difficult national market conditions have adversely affected our industry.

Declines in the housing market over the past few years, falling home prices and increasing foreclosures, unemployment and under-employment have negatively impacted the credit performance of loans that were related to real estate and resulted in significant write-downs of asset values by many financial institutions. These write-downs have caused many financial institutions to seek additional capital, to reduce or eliminate dividends, to merge with larger and stronger institutions and, in some cases, to fail. Reflecting concern about the stability of the financial markets, many lenders and institutional investors have reduced or ceased providing funding to borrowers, including to other financial institutions. This market turmoil and tightening of credit have on a national basis generally led to an increased level of commercial and consumer delinquencies, lack of consumer confidence, increased market volatility and widespread reduction of business activity. These conditions can place downward pressure on the credit worthiness of bank customers and their inclinations to borrow. A continued or worsening disruption and volatility could negatively impact customers' ability to seek new loans or to repay existing loans. The personal wealth of many borrowers and guarantors could be negatively impacted by the recent severe market declines. To date, the impact of these adverse conditions in the primary market areas of Southern Indiana that we serve has generally not been as severe as in other areas of Indiana and the United States. If current levels of market disruption and volatility worsen in our primary service areas, however, we could experience an adverse effect, which may be material, on our ability to access capital and on our business, financial condition and results of operations.

There can be no assurance that recently enacted legislation will stabilize the U.S. financial system.

The U.S. Treasury and banking regulators are implementing a number of programs under the Emergency Economic Stabilization Act of 2008 and otherwise to address capital and liquidity issues in the banking system. There can be no assurance as to the actual impact that these programs will have on the financial markets, including the extreme levels of volatility and limited credit availability currently being experienced. The failure of these programs to stabilize the financial markets and a continuation or worsening of current financial market conditions could materially and adversely affect our business, financial condition, results of operations, or access to credit. We may be required to pay higher FDIC premiums than those published for 2009 because market developments have impacted the deposit insurance fund of the FDIC and reduced the ratio of reserves to insured deposits. See Part I, Item 1, "Business — Federal Deposit Insurance Assessments," for more information.

We operate in a highly regulated environment and changes in laws and regulations to which we are subject may adversely affect our results of operations.

The banking industry in which we operate is subject to extensive regulation and supervision under federal and state laws and regulations. The restrictions imposed by such laws and regulations limit the manner in which we conduct

our business, undertake new investments and activities and obtain financing. These regulations are designed primarily for the protection of the deposit insurance funds and consumers and not to benefit our shareholders. Financial institution regulation has been the subject of significant legislation in recent years and may be the subject of further significant legislation, none of which is in our control. Significant new laws or changes in, or repeals of, existing laws (including changes in federal or state laws affecting corporate taxpayers generally or financial institutions specifically) could have a material adverse effect on our business, financial condition, results of operations or liquidity. Further, federal monetary policy, particularly as implemented through the Federal Reserve System, significantly affects credit conditions, and any unfavorable change in these conditions could have a material adverse effect on our business, financial condition, results of operations or liquidity.



### Additional Risks Related to Our Operations and Business and Financial Strategies

If our actual loan losses exceed our estimates, our earnings and financial condition will be impacted.

A significant source of risk for any bank or other enterprise that lends money arises from the possibility that losses will be sustained because borrowers, guarantors and related parties may fail (because of financial difficulties or other reasons) to perform in accordance with the terms of their loan agreements. In our case, we originate many loans that are secured, but some loans are unsecured depending on the nature of the loan. With respect to secured loans, the collateral securing the repayment of these loans includes a wide variety of real and personal property that may be insufficient to cover the obligations owed under such loans, due to adverse changes in collateral values caused by changes in prevailing economic, environmental and other conditions, including declines in the value of real estate and other external events.

We could be adversely affected by changes in interest rates.

Our earnings and cash flows are largely dependent upon our net interest income. Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions, demand for loans, securities and deposits, and policies of various governmental and regulatory agencies and, in particular, the monetary policies of the Board of Governors of the Federal Reserve System. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, our net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings. Any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on our financial condition, results of operations, and cash flows.

Our success is tied to the economic vitality of our Southern Indiana markets.

We conduct business from offices that are exclusively located in ten contiguous counties of Southern Indiana, from which substantially all of our customer base is drawn. Because of the geographic concentration of our operations and customer base, our results depend largely upon economic conditions in this area. To date, the impact of the nation's adverse economic conditions in the primary market areas of Southern Indiana that we serve has generally not been as severe as in other areas of Indiana and the United States. If current levels of market disruption and volatility worsen in our primary service areas, however, the quality of our loan portfolio, and the demand for our products and services, could be adversely affected, and this could have a material adverse effect on our business, financial condition, results of operations or liquidity.

We face substantial competition.

The banking and financial services business in our markets is highly competitive. We compete with much larger regional, national, and international competitors, including competitors that have no (or only a limited number of) offices physically located within our markets. In addition, new banks could be organized in our market area which might bid aggressively for new business to capture market share in these markets. Developments increasing the nature or level of our competition, or decreasing the effectiveness by which we compete, could have a material adverse effect on our business, financial condition, results of operations or liquidity. See also Part I, Item 1, of this report, "Business— Competition," and "Business —Regulation and Supervision."

The manner in which we report our financial condition and results of operations may be affected by accounting changes.

Our financial condition and results of operations that are presented in our consolidated financial statements, accompanying notes to the consolidated financial statements, and selected financial data appearing in this report, are, to a large degree, dependent upon our accounting policies. The selection of and application of these policies involve estimates, judgments and uncertainties that are subject to change, and the effect of any change in estimates or judgments that might be caused by future developments or resolution of uncertainties could be materially adverse to our reported financial condition and results of operations. In addition, authorities that prescribe accounting principles and standards for public companies from time to time change those principles or standards or adopt formal or informal interpretations of existing principles or standards. Such changes or interpretations (to the extent applicable to us) could result in changes that would be materially adverse to our reported financial condition and results of operations.

Liquidity risk could impair our ability to fund operations and jeopardize our financial condition.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale of securities or loans and other sources could have a substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities or the terms of which are acceptable to us could be impaired by factors that affect us specifically or the financial services industry or economy in general. Although we have historically been able to replace maturing deposits and borrowings as necessary, we might not be able to replace such funds in the future if, among other things, our results of operations or financial condition or the results of operations or financial condition of our lenders or market conditions were to change.

The value of securities in our investment securities portfolio may be negatively affected by continued disruptions in securities markets.

The market for investment securities has become extremely volatile over the past twelve months. Volatile market conditions may detrimentally affect the value of securities that we hold in our investment portfolio, such as through reduced valuations due to the perception of heightened credit and liquidity risks. There can be no assurance that declines in market value associated with these disruptions will not result in other than temporary impairments of these assets, which would lead to accounting charges that could have a material adverse effect on our net income and capital levels.

The soundness of other financial institutions could adversely affect us.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services companies are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds, and other institutional clients. As a result, defaults by, or even rumors or questions about, one or more financial services companies, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. Many of these transactions expose us to credit risk in the event of default of our counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by us cannot be realized or is liquidated at prices not sufficient to recover the full amount due us.

We are dependent on key personnel and the loss of one or more of those key personnel could harm our business.

Competition for qualified employees and personnel in the financial services industry (including banking personnel, trust and investments personnel, and insurance personnel) is intense and there are a limited number of qualified persons with knowledge of and experience in our local Southern Indiana markets. Our success depends to a significant degree upon our ability to attract and retain qualified loan origination executives, sales executives for our trust and investment products and services, and sales executives for our insurance products and services. We also depend upon the continued contributions of our management personnel, and in particular upon the abilities of our senior executive management, and the loss of the services of one or more of them could harm our business.

Our controls and procedures may fail or be circumvented.

Management regularly reviews and updates our internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of our controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, results of operations, cash flows and financial condition.

We are subject to security and operational risks relating to our use of technology that could damage our reputation and our business.

We rely heavily on communications and information systems to conduct our business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan and other systems. The occurrence of any failures, interruptions or security breaches of information systems used to process customer transactions could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability.

We face risks associated with acquisitions or mergers.

We may pursue acquisition or merger opportunities in the future. Risks commonly encountered in merger and acquisitions include, among other things, difficulty of integrating the operations, systems and personnel of acquired companies and branches; potential disruption of our ongoing business; potential diversion of our management's time and attention; potential exposure to unknown or contingent liabilities of the acquired or merged company; exposure to potential asset quality issues of the acquired or merged company; possible loss of key employees and customers of the acquired or merged company; difficulty in estimating the value of the acquired or merged company; and environmental liability with acquired loans, and their collateral, or with any real estate. We may not be successful in overcoming these risks or any other problems encountered in connection with mergers or acquisitions.

We are exposed to risk of environmental liabilities with respect to properties to which we take title.

In the course of our business, we may own or foreclose and take title to real estate, and could be subject to environmental liabilities with respect to these properties (including liabilities for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination), or may be required to investigate or clean up hazardous or toxic substances, or chemical releases at a property.

Item 1B. Unresolved Staff Comments. None.

Item 2. Properties.

The Company's executive offices are located in the main office building of its bank subsidiary, German American Bancorp, at 711 Main Street, Jasper, Indiana. The main office building contains approximately 23,600 square feet of office space. The Company's subsidiaries conduct their operations from 34 other locations in Southern Indiana.

Item 3. Legal Proceedings.

There are no material pending legal proceedings, other than routine litigation incidental to the business of the Company's subsidiaries, to which the Company or any of its subsidiaries is a party or of which any of their property is the subject.

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

There were no matters submitted during the fourth quarter of 2008 to a vote of security holders, by solicitation of proxies or otherwise.

## PART II

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

## Market and Dividend Information

German American Bancorp, Inc.'s stock is traded on NASDAQ's Global Select Market under the symbol GABC. The quarterly high and low closing prices for the Company's common stock as reported by NASDAQ and quarterly cash dividends declared and paid are set forth in the table below.

	2008			2007		
	High	Low	Cash Dividend	High	Low	Cash Dividend
Fourth Quarter	\$ 12.90	\$ 10.65	\$ 0.140	\$ 14.00	\$ 12.12	\$ 0.140
Third Quarter	\$ 13.60	\$ 11.00	\$ 0.140	\$ 14.09	\$ 11.91	\$ 0.140
Second Quarter	\$ 13.23	\$ 11.39	\$ 0.140	\$ 14.45	\$ 13.10	\$ 0.140
First Quarter	\$ 13.29	\$ 11.31	\$ 0.140	\$ 14.50	\$ 13.22	\$ 0.140
			\$ 0.560			\$ 0.560

The Common Stock was held of record by approximately 3,686 shareholders at February 10, 2009.

Cash dividends paid to the Company's shareholders are primarily funded from dividends received by the parent company from its bank subsidiary. The declaration and payment of future dividends will depend upon the earnings and financial condition of the Company and its subsidiaries, general economic conditions, compliance with regulatory requirements affecting the ability of the bank subsidiary to declare dividends, and other factors.

Transfer Agent:	Computershare Priority Processing 250 Royall St Canton, MA 02021 Contact: Shareholder Relations (800) 884-4225	Shareholder Information and Corporate Office:	Terri A. Eckerle German American Bancorp, Inc P. O. Box 810 Jasper, Indiana 47547-0810 (812) 482-1314 (800) 482-1314
-----------------	---	---	---

## Stock Performance Graph

The following graph compares the Company's five-year cumulative total returns with those of the Russell 2000 Stock Index, Russell Microcap Stock Index, and the Indiana Bank Peer Group. The Indiana Bank Peer Group (which is a custom peer group identified by Company management) includes all Indiana-based commercial bank holding companies (excluding companies owning thrift institutions that are not regulated as bank holding companies) that have been in existence as commercial bank holding companies throughout the five-year period ended December 2008, the stocks of which have been traded on an established securities market (NYSE, AMEX, NASDAQ) throughout that five-year period. The companies comprising the Indiana Bank Peer Group for purposes of the December 2008 comparison were: 1st Source Corp., Community Bank Shares of IN, First Financial Corp., First Merchants Corp., Integra Bank Corp., Irwin Financial Corp., Lakeland Financial Corp., MainSource Financial Group, Old National Bancorp, Indiana Community Bancorp, Horizon Bancorp, Monroe Bancorp, and Tower Financial Corp. The returns of each company in the Indiana Bank Peer Group have been weighted to reflect the company's market capitalization. The Russell 2000 Stock Index, which is designed to measure the performance of the small-cap segment of the U.S. equity universe, is a subset of the Russell 3000 Index (which measures the performance of the largest 3000 U.S. companies)

that includes approximately 2,000 of the smallest securities in that index based on a combination of their market cap and current index membership, and is annually reconstituted at the end of each June. The Company's stock was included in the Russell 2000 through June 2005. The Russell Microcap Stock Index is an index representing the smallest 1,000 securities in the small-cap Russell 2000 Index plus the next 1,000 securities, which is also annually reconstituted at the end of each June. The Company's stock is currently included in the Russell Microcap Index.

## Stock Repurchase Program Information

The following table sets forth information regarding the Company's purchases of its common shares during each of the three months ended December 31, 2008.

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 (1)
October 2008	—	—	—	272,789
November 2008	—	—	—	272,789
December 2008	—	—	—	272,789

(1) 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 December 31, 2008 (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 quarter ended December 31, 2008.



## Item 6. Selected Financial Data.

The following selected data should be read in conjunction with the consolidated financial statements and related notes that are included in Item 8 of this Report, and "Management's Discussion and Analysis of Financial Condition and Results of Operations," which is included in Item 7 of this Report (dollars in thousands, except per share data).

	2008	2007	2006	2005	2004
<b>Summary of Operations:</b>					
Interest Income	\$ 67,845	\$ 72,261	\$ 63,594	\$ 50,197	\$ 47,710
Interest Expense	26,908	33,646	27,398	17,984	16,471
Net Interest Income	40,937	38,615	36,196	32,213	31,239
Provision for Loan Losses	3,990	3,591	925	1,903	2,015
Net Interest Income after Provision					
For Loan Losses	36,947	35,024	35,271	30,310	29,224
Non-interest Income	18,210	15,704	15,993	14,502	9,620
Non-interest Expense	36,716	37,221	37,059	31,756	30,609
Income before Income Taxes	18,441	13,507	14,205	13,056	8,235
Income Tax Expense	5,638	4,102	3,984	3,335	996
Net Income	\$ 12,803	\$ 9,405	\$ 10,221	\$ 9,721	\$ 7,239
<b>Year-end Balances:</b>					
Total Assets	\$ 1,190,828	\$ 1,131,710	\$ 1,093,424	\$ 946,467	\$ 942,094
Total Loans, Net of Unearned Income	890,436	867,721	796,259	651,956	629,793
Total Deposits	941,750	877,421	867,618	746,821	750,383
Total Long-term Debt	105,608	86,786	68,333	66,606	69,941
Total Shareholders' Equity	105,174	97,116	92,391	82,255	83,669
<b>Average Balances:</b>					
Total Assets	\$ 1,174,583	\$ 1,114,140	\$ 1,029,838	\$ 925,851	\$ 927,528
Total Loans, Net of Unearned Income	880,630	840,849	715,260	634,526	622,240
Total Deposits	922,137	889,736	814,440	730,220	731,467
Total Shareholders' Equity	99,711	93,677	88,451	84,479	82,558
<b>Per Share Data (1):</b>					
Net Income	\$ 1.16	\$ 0.85	\$ 0.93	\$ 0.89	\$ 0.66
Cash Dividends	0.56	0.56	0.56	0.56	0.56
Book Value at Year-end	9.54	8.81	8.39	7.73	7.68
<b>Other Data at Year-end:</b>					
	3,684	3,647	3,438	3,494	3,219

Number of Shareholders					
Number of Employees	348	371	397	367	372
Weighted Average					
Number of Shares (1)	11,029,519	11,009,536	10,994,739	10,890,987	10,914,622
Selected Performance Ratios:					
Return on Assets	1.09%	0.84%	0.99%	1.05%	0.78%
Return on Equity	12.84%	10.04%	11.56%	11.51%	8.77%
Equity to Assets	8.83%	8.58%	8.45%	8.69%	8.88%
Dividend Payout	48.25%	65.65%	60.29%	62.83%	84.46%
Net Charge-offs to					
Average Loans	0.29%	0.32%	0.50%	0.26%	0.24%
Allowance for Loan					
Losses to Loans	1.07%	0.93%	0.90%	1.42%	1.40%
Net Interest Margin	3.82%	3.83%	3.96%	3.92%	3.86%

(1) Share and Per Data excludes the dilutive effect of stock options.

Year to year financial information comparability is affected by the purchase accounting treatment for mergers and acquisitions.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

INTRODUCTION

---

German American Bancorp, Inc. is a financial services holding company based in Jasper, Indiana. The Company's Common Stock is traded on NASDAQ's Global Select Market, under the symbol GABC. The principal subsidiary of German American Bancorp, Inc., is its banking subsidiary, German American Bancorp, which operates through 28 retail banking offices in the ten contiguous Southern Indiana counties of Daviess, Dubois, Gibson, Knox, Lawrence, Martin, Monroe, Perry, Pike, and Spencer. German American Bancorp, Inc., also owns a trust, brokerage, and financial planning subsidiary, which operates from the banking offices of the bank subsidiary, and full line property and casualty insurance agency with seven insurance agency offices throughout its market area.

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.

The information in this Management's Discussion and Analysis is presented as an analysis of the major components of the Company's operations for the years 2006 through 2008 and its financial condition as of December 31, 2008 and 2007. This information should be read in conjunction with the accompanying consolidated financial statements and footnotes contained elsewhere in this report and with the description of business included in Item 1 of this Report (including the cautionary disclosure regarding "Forward Looking Statements and Associated Risks"). Financial and other information by segment is included in Note 16 to the Company's consolidated financial statements included in Item 8 of this Report and is incorporated into this Item 7 by reference.

The statements of management's expectations and goals concerning the Company's future operations and performance that are set forth in the following Management Overview and in other sections of this Item 7 are forward-looking statements, and readers are cautioned that these forward-looking statements are based on assumptions and are subject to risks, uncertainties, and other factors. Actual results may differ materially from the expectations of the Company that is expressed or implied by any forward-looking statement. This Item 7, as well as the discussions in Item 1 ("Business") entitled "Forward-Looking Statements and Associated Risks" and in Item 1A ("Risk Factors") (which discussions are incorporated in this Item 7 by reference) list some of the factors that could cause the Company's actual results to vary materially from those expressed or implied by any such forward-looking statements.

MANAGEMENT OVERVIEW

The Company's net income increased \$3,398,000 or 36% to \$12,803,000 or \$1.16 per share in 2008 compared to \$9,405,000 or \$0.85 per share in 2007. The Company's strong annual operating performance during 2008 was driven by successive record quarterly earnings in each quarter of 2008. Current year earnings were positively affected by increases within the Company's net interest income and non-interest income and a modestly lower level of non-interest expenses. The improvement in the level of net interest income was largely attributable to balance sheet growth which included loan growth of approximately 3% and deposit growth of 7%. The Company experienced 16% growth in non-interest income while lowering non-interest expense by 1% during 2008 compared with 2007. The reduction in non-interest expense was attributable to a 4% reduction in salaries and employee benefit expense attributable to a decrease of approximately 7% of full-time equivalent employees during 2008. This reduction in staffing levels was principally due to actions taken as a result of the Company's previously-announced formal review of operating effectiveness and efficiency. Management believes that this decrease in staffing levels in relation to current operations is sustainable and therefore will be of continuing benefit to earnings in future years.

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, judgments 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 special mention, 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 or special mention 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 five-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, all securities are required to be written down to fair value

when a decline in fair value is other than temporary; 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 and the duration of the decline. As of December 31, 2008, gross unrealized losses on the securities available-for-sale portfolio totaled approximately \$323,000.

#### 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 increased \$3,398,000 or 36% to \$12,803,000 or \$1.16 per share in 2008 compared to \$9,405,000 or \$0.85 per share in 2007. The increase in earnings in 2008 compared with 2007 was attributable to improvement in net interest income, non-interest income, and non-interest expense, partially offset by a higher provision for loan losses.

Net income declined \$816,000 or 8% to \$9,405,000 or \$0.85 per share in 2007 compared to \$10,221,000 or \$0.93 per share in 2006. The decline in earnings during 2007 compared with 2006 was largely the result of an increase in the provision for loan losses. Partially mitigating the increased provision was an increase in net interest income.

### 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.

Net interest income increased \$2,322,000 or 6% (an increase of \$2,320,000 or 6% on a tax-equivalent basis) for the year ended 2008 compared with 2007. The increase in net interest income was primarily attributable to an increased level of average earning assets for the year ended 2008 compared with 2007. Average earning assets totaled \$1.086 billion during 2008 compared with \$1.023 billion during 2007. During 2008, average loans outstanding totaled \$880.6 million, an increase of \$39.8 million or 5%, compared to the \$840.8 million in average loans outstanding during 2007. Average commercial and agricultural loans totaled \$639.4 million, an increase of \$50.4 million or 9% during 2008 compared with 2007. Average residential mortgage loans and consumer loans totaled \$241.2 million during 2008 representing a decline of \$10.6 million or 4% from 2007.

For 2008, the net interest margin remained relatively stable at 3.82% compared to 3.83% during 2007. Net interest margin is tax equivalent net interest income expressed as a percentage of average earning assets. The Company's yield on earning assets totaled 6.30% compared with a cost of funds (expressed as a percentage of average earning assets) of 2.48% netting to a net interest margin of 3.82% for the year ended December 31, 2008. The Company's yield on earning assets was 7.12% compared with a cost of funds of 3.29% netting to a net interest margin of 3.83% for the year ended December 31, 2007.

Net interest income increased \$2,419,000 or 7% (an increase of \$1,953,000 or 5% on a tax-equivalent basis) for the year ended 2007 compared with 2006. The increase in net interest income was primarily attributable to an increased level of average earning assets for the year ended 2007 compared with 2006. The higher level of earning assets was primarily attributable to an increase in the average level of loans outstanding, and in particular a higher level of average commercial and agricultural loans. Average earning assets totaled \$1.023 billion during 2007 compared with \$941.6 million during 2006.

For 2007, the net interest margin decreased to 3.83% compared to 3.96% during 2006. The Company's yield on earning assets totaled 7.12% compared with a cost of funds of 3.29% netting to a net interest margin of 3.83% for the year ended December 31, 2007. The Company's yield on earning assets was 6.87% compared with a cost of funds of 2.91% netting to a net interest margin of 3.96% for the year ended December 31, 2006.

17

---



The following table summarizes net interest income (on a tax-equivalent basis) for each of the past three years. For tax-equivalent adjustments, an effective tax rate of 34% was used for all years presented (1).

Average Balance Sheet  
(Tax-equivalent basis / dollars in thousands)

	Twelve Months Ended December 31, 2008			Twelve Months Ended December 31, 2007			Twelve Months Ended December 31, 2006		
	Principal Balance	Income / Yield / Expense Rate		Principal Balance	Income / Yield / Expense Rate		Principal Balance	Income / Yield / Expense Rate	
<b>ASSETS</b>									
Federal Funds Sold and Other									
Short-term Investments	\$ 35,065	\$ 593	1.69%	\$ 9,626	\$ 478	4.96%	\$ 10,971	\$ 545	4.97%
Securities:									
Taxable	152,709	8,007	5.24%	149,108	6,992	4.69%	174,007	7,763	4.46%
Non-taxable	18,061	1,164	6.44%	23,913	1,423	5.95%	41,312	2,721	6.59%
Total Loans and Leases (2)	880,630	58,669	6.66%	840,849	63,958	7.61%	715,260	53,621	7.50%
<b>TOTAL INTEREST EARNING ASSETS</b>	<b>1,086,465</b>	<b>68,433</b>	<b>6.30%</b>	<b>1,023,496</b>	<b>72,851</b>	<b>7.12%</b>	<b>941,550</b>	<b>64,650</b>	<b>6.87%</b>
Other Assets	97,275			98,389			97,570		
Less: Allowance for Loan Losses	(9,157)			(7,745)			(9,282)		
<b>TOTAL ASSETS</b>	<b>\$ 1,174,583</b>			<b>\$ 1,114,140</b>			<b>\$ 1,029,838</b>		
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>									
Interest-bearing									
Demand Deposits	\$ 212,467	\$ 3,440	1.62%	\$ 153,033	\$ 3,280	2.14%	\$ 140,786	\$ 2,625	1.86%
Savings Deposits	209,593	3,407	1.63%	177,001	4,858	2.74%	174,095	4,263	2.45%
Time Deposits	359,115	14,365	4.00%	425,878	19,151	4.50%	369,800	14,441	3.91%
FHLB Advances and Other Borrowings	138,887	5,696	4.10%	117,084	6,357	5.43%	113,559	6,069	5.34%
<b>TOTAL INTEREST-BEARING LIABILITIES</b>	<b>920,062</b>	<b>26,908</b>	<b>2.92%</b>	<b>872,996</b>	<b>33,646</b>	<b>3.85%</b>	<b>798,240</b>	<b>27,398</b>	<b>3.43%</b>
Demand Deposit Accounts	140,962			133,824			129,759		
Other Liabilities	13,848			13,643			13,388		
<b>TOTAL LIABILITIES</b>	<b>1,074,872</b>			<b>1,020,463</b>			<b>941,387</b>		

Shareholders' Equity	99,711	93,677	88,451
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 1,174,583	\$ 1,114,140	\$ 1,029,838
NET INTEREST INCOME	\$ 41,525	\$ 39,205	\$ 37,252
NET INTEREST MARGIN	3.82%	3.83%	3.96%

(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. Interest income on loans includes loan fees of \$127, \$806, and \$1,727 for 2008, 2007, and 2006, respectively.

The following table sets forth for the periods indicated a summary of the changes in interest income and interest expense resulting from changes in volume and changes in rates:

Net Interest Income – Rate / Volume Analysis  
(Tax-Equivalent basis, dollars in thousands)

	2008 compared to 2007			2007 compared to 2006		
	Increase / (Decrease) Due to (1)			Increase / (Decrease) Due to (1)		
	Volume	Rate	Net	Volume	Rate	Net
<b>Interest Income:</b>						
Federal Funds Sold and Other						
Short-term Investments	\$ 597	\$ (482)	\$ 115	\$ (67)	\$ —	(67)
Taxable Securities	172	843	1,015	(1,153)	382	(771)
Non-taxable Securities	(370)	111	(259)	(1,056)	(242)	(1,298)
Loans and Leases	2,922	(8,211)	(5,289)	9,542	795	10,337
Total Interest Income	3,321	(7,739)	(4,418)	7,266	935	8,201
<b>Interest Expense:</b>						
Savings and Interest-bearing						
Demand	1,921	(3,212)	(1,291)	344	906	1,250
Time Deposits	(2,808)	(1,978)	(4,786)	2,356	2,354	4,710
FHLB Advances and Other						
Borrowings	1,059	(1,720)	(661)	190	98	288
Total Interest Expense	172	(6,910)	(6,738)	2,890	3,358	6,248
Net Interest Income	\$ 3,149	\$ (829)	\$ 2,320	\$ 4,376	\$ (2,423)	\$ 1,953

(1) The change in interest due to both rate and volume has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

See the Company's Average Balance Sheet and the discussions headed USES OF FUNDS, SOURCES OF FUNDS, and "RISK MANAGEMENT – Liquidity and Interest Rate Risk Management" for further information on the Company's net interest income, net interest margin, and interest rate sensitivity position.

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 required on the allowance for loan losses. Provisions for loan losses totaled \$3,990,000, \$3,591,000, and \$925,000 in 2008, 2007, and 2006, respectively.

The level of provision increased by \$399,000 or 11% in 2008 compared with 2007. The increase in provision was largely attributable to an increased level of non-performing loans in 2008 and overall growth in the Company's loan portfolio. The level of provision for loan losses totaled 0.45% of average outstanding loans during 2008 while net charge-offs represented 0.29% of average loans outstanding during 2008. Accordingly, the Company's allowance for loan losses increased to 1.07% of total loans at year-end 2008 compared with 0.93% at year-end 2007.

The increased level of provision for loan losses during 2007 compared with 2006 was largely attributable to a write-down of a single non-performing credit facility secured by two hotel properties and growth within the Company's loan portfolio. An additional contributing factor to the elevated levels of provision during the year ended

December 31, 2007 compared with 2006 was the settlement of a large non-performing credit in 2006. The specific allocation to this credit as of year end 2005 exceeded the level of charge-off actually incurred during 2006 by approximately \$450,000.

Provisions for loan losses in all periods were 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 provisions 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. Refer also to the sections entitled CRITICAL ACCOUNTING POLICIES AND ESTIMATES and "RISK MANAGEMENT – Lending and Loan Administration" for further discussion of the provision and allowance for loan losses.

## NON-INTEREST INCOME

During 2008, Non-interest Income increased \$2,506,000 or 16% compared with 2007. The increase was realized in all categories with the exception of Trust and Investment Product Fees. During 2007, Non-interest Income declined \$289,000 or 2% compared with 2006. The decline was primarily attributable to Net Gain (Loss) on Securities largely offset by increases in Trust and Investment Product Fees, Service Charges on Deposit Accounts, and Insurance Revenues.

Non-interest Income (dollars in thousands)	Years Ended December 31,			% Change From Prior Year	
	2008	2007	2006	2008	2007
Trust and Investment Product Fees	\$ 2,288	\$ 2,590	\$ 2,210	(12)%	17%
Service Charges on Deposit Accounts	4,920	4,361	3,901	13	12
Insurance Revenues	6,306	5,794	5,094	9	14
Other Operating Income	3,203	2,817	2,920	14	(4)
Subtotal	16,717	15,562	14,125	7	10
Net Gains on Sales of Loans and Related Assets	1,399	822	917	70	(10)
Net Gain (Loss) on Securities	94	(680)	951	n/m(1)	n/m(1)
TOTAL NON-INTEREST INCOME	\$ 18,210	\$ 15,704	\$ 15,993	16	(2)

(1) n/m = not meaningful

Trust and Investment Product Fees totaled \$2,288,000 during the year ended December 31, 2008 representing a decline of \$302,000 or 12% from 2007, while Trust and Investment Product Fees increased \$380,000 or 17% during 2007 as compared to 2006. These changes were driven by varying levels of brokerage commission revenue.

Service Charges on Deposit Accounts totaled \$4,920,000 during the year ended December 31, 2008 representing an increase of \$559,000 or 13% over 2007. The increase was attributable to a combination of increased gross fees and a reduced level of refunded and waived fees. Service Charges on Deposit Accounts increased \$460,000 or 12% during 2007 as compared to 2006. These increases were largely attributable to increased usage and fees associated with the Company's overdraft protection service program.

During the year ended December 31, 2008, Insurance Revenues totaled \$6,306,000 which was an increase of \$512,000 or 9% compared to 2007. The increase was largely attributable to an increase in contingency revenue at the Company's property and casualty insurance subsidiary, German American Insurance. Insurance Revenues increased \$700,000 or 14% during 2007 as compared 2006. The increase in Insurance Revenues during 2007 was attributable primarily to commission income from Keach and Grove Insurance, Inc. which was acquired October 1, 2006 and thereby not included in the Company results during the first nine months of 2006.

During the year ended December 31, 2008, the net gain on sale of residential loans totaled \$1,399,000, an increase of \$577,000 or 70% over the gain of \$822,000 recognized in the year ended December 31, 2007. The increase was largely attributable to higher levels of residential loan sales during 2008 compared with 2007. Net Gains on Sales of Loans and Related Assets declined \$95,000 or 10% during 2007 compared with 2006 primarily due to the sale of the Company's mortgage servicing rights portfolio during 2006 at a gain of \$198,000. Loan sales for 2008, 2007, and 2006 totaled \$108.0 million, \$67.0 million, and \$55.6 million, respectively.

The Company recognized a net gain on securities of \$94,000 during the year ended December 31, 2008. The Company recognized gains on securities sold of \$1,031,000 during 2008 and other-than-temporary impairment expense of \$937,000 on its portfolio of non-controlling investments in other banking organizations. During 2007, the Company recognized a \$680,000 net loss on securities related to its portfolio of non-controlling investments in other

banking organizations. The net loss resulted from the sale of one of the investment holdings at a modest gain and the recognition of an other-than-temporary impairment charge in connection with the valuation of other holdings within the portfolio. During 2006, the Company recognized a gain of \$951,000 on the sale of its portfolio of FHLMC and FNMA preferred stock.

## NON-INTEREST EXPENSE

During the year ended December 31, 2008, Non-interest Expense totaled \$36,716,000, a decline of \$505,000 or 1% from the year ended 2007. During 2007, Non-interest Expense remained stable with a less than 1% increase as compared with 2006.

Non-interest Expense (dollars in thousands)	Years Ended December 31,			% Change From Prior Year	
	2008	2007	2006	2008	2007
Salaries and Employee Benefits	\$ 20,786	\$ 21,671	\$ 21,491	(4)%	1%
Occupancy, Furniture and Equipment Expense	5,677	5,379	4,988	6	8
FDIC Premiums	208	103	108	102	(5)
Data Processing Fees	1,493	1,370	1,646	9	(17)
Professional Fees	1,670	1,418	1,786	18	(21)
Advertising and Promotion	1,078	957	940	13	2
Supplies	570	625	619	(9)	1
Intangible Amortization	889	894	698	(1)	28
Other Operating Expenses	4,345	4,804	4,783	(10)	1
<b>TOTAL NON-INTEREST EXPENSE</b>	<b>\$ 36,716</b>	<b>\$ 37,221</b>	<b>\$ 37,059</b>	<b>(1)</b>	<b>1</b>

Salaries and Employee Benefits totaled \$20,786,000 during the year ended December 31, 2008 representing a decline of \$885,000 or 4% from the year ended December 31, 2007. The decline was largely attributable to a decrease of approximately 28 full-time equivalent employees, or 7% of total FTEs, during the year ended December 31, 2008 compared with year ended 2007. Salaries and Employee Benefits expense increased \$180,000 or 1% during 2007 compared with 2006.

Occupancy, Furniture and Equipment Expense totaled \$5,677,000 during the year ended December 31, 2008 representing an increase of \$298,000 or 6% from the year ended 2007. The increases were largely attributable to higher levels of furniture, fixtures and equipment depreciation. Occupancy, Furniture and Equipment Expense increased \$391,000 or 8% during 2007 compared with 2006. This increase was primarily attributable to the opening of a branch bank facility in Bloomington, Indiana during the first quarter of 2007 and an insurance agency acquisition during the fourth quarter of 2006.

Professional Fees increased \$252,000 or 18% during 2008 compared with 2007. The increases were due primarily to professional fees associated with the Company's formal review of effectiveness and efficiency. Professional Fees decreased \$368,000 or 21% during 2007 compared with 2006. The decline in 2007 was largely due to an elevated level of professional fees in 2006 associated with a core processing computer conversion at the Company's banking subsidiary.

Other Operating Expenses decreased \$459,000 or 10% during 2008 compared with 2007. The decline in costs was primarily attributable to a lower level of collection costs and a lower level of losses associated with fraudulent ATM and debit card transactions. Intangible Amortization increased \$196,000 or 28% during 2007 compared to 2006 due to an insurance agency acquisition during the fourth quarter of 2006.

The FDIC charges insured financial institutions premiums to maintain the Deposit Insurance Fund at a certain level. See Part I, Item 1, "Business – Federal Deposit Insurance Assessments." On October 16, 2008, the FDIC published a restoration plan designed to replenish the Deposit Insurance Fund over a period of five years and to increase the deposit insurance reserve ratio. In order to implement the restoration plan, the FDIC proposes to change both its risk-based assessment system and its base assessment rates. Either an increase in the Risk Category of our

bank subsidiary, or adjustments to the base assessment rates, could materially increase our deposit insurance premiums and assessments.

#### PROVISION FOR INCOME TAXES

The Company records a provision for current income taxes payable, along with a provision for deferred taxes payable in the future. Deferred taxes arise from temporary differences, which are items recorded for financial statement purposes in a different period than for income tax returns. The Company's effective tax rate was 30.6%, 30.4%, and 28.0%, respectively, in 2008, 2007, and 2006. The effective tax rate in all periods is lower than the blended statutory rate of 39.6%. The lower effective rate in all periods primarily resulted from the Company's tax-exempt investment income on securities and loans, income tax credits generated by investments in affordable housing projects, and income generated by subsidiaries domiciled in a state with no state or local income tax. See Note 11 to the Company's consolidated financial statements included in Item 8 of this Report for additional details relative to the Company's income tax provision.



## CAPITAL RESOURCES

---

The Company and its affiliate bank are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. The prompt corrective action regulations provide five classifications, including well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized, although these terms are not used to represent overall financial condition. The Company and its affiliate bank at year-end 2008 were categorized as well-capitalized as that term is defined by applicable regulations. See Note 9 to the Company's consolidated financial statements included in Item 8 of this Report for actual and required capital ratios and for additional information regarding capital adequacy.

The Company continues to maintain a strong capital position. Shareholders' equity totaled \$105.2 million and \$97.1 million at December 31, 2008 and 2007, respectively. Total equity represented 8.8% and 8.6%, respectively, of year-end total assets. The Company paid cash dividends of \$6.2 million or \$0.56 per share in 2008 and 2007. The increase in shareholders' equity during 2008 compared with 2007 was primarily the result of increased retained earnings of \$6.3 million and a change in the unrealized gain on available-for-sale securities of \$1.6 million.

In November 2008, the Company applied to participate in the Capital Purchase Program established by the United States Treasury Department under the Emergency Economic Stabilization Act of 2008. By letter dated January 26, 2009, the Treasury Department advised the Company that the application had been accepted, and the Treasury Department offered to invest up to \$25 million in newly issued shares of preferred stock of the Company under the terms and conditions of the CPP. As part of its investment, the Treasury Department also would receive warrants to purchase common stock of the Company having an aggregate market price of 15% of the investment amount. Under the terms of the Company's approval to participate in the CPP, the Company was required to close upon the investment transaction within 30 days of the date of the January 26 letter.

During the thirty-day closing period established by the Treasury Department letter, the Company's Board of Directors authorized a special committee of the Board to further evaluate not only the possible CPP investment plan but also an alternative plan to augment the Company's regulatory capital. After further evaluation, the special committee determined that proceeding with an alternative capital plan was in the best interests of the Company and that the Company should defer taking any action to close upon the financing available to it under the CPP. Accordingly, the Company, on February 20, 2009, requested that the Treasury Department indefinitely postpone the Company's closing under the CPP. The Company's Board of Directors on March 2, 2009, ratified the committee's determination to postpone the closing of the CPP financing, and determined that the Company should decline participation in the CPP and should advise the Treasury Department that it was withdrawing its CPP application. On March 3, 2009, the Company advised the Treasury Department to this effect.

## USES OF FUNDS

---

### LOANS

Total loans at year-end 2008 increased \$21.9 million or 3% compared with year-end 2007. Commercial and industrial loans increased \$48.2 million or 11% during 2008, while agricultural loans decreased \$5.7 million or 3%, residential mortgage loans decreased \$16.8 million or 14%, and consumer loans declined \$3.8 million or 3% during 2008. The decrease in residential mortgage loans was the result of a declining interest rate environment during 2008 and the sale of the majority of the Company's fixed rate residential mortgage production into the secondary market rather than hold in its portfolio.

Total loans at year-end 2007 increased \$72.0 million or 9% compared with year-end 2006. Commercial and industrial loans increased \$54.8 million or 14%, agricultural loans increased \$16.7 million or 11%, and residential mortgage loans increased \$2.2 million or 2% during 2007 while consumer loans declined \$1.7 million or 1% during 2007.

The composition of the loan portfolio shifted modestly at year-end 2008 compared with year-end 2007 with the heaviest concentration in commercial and industrial loans which comprised 57% of the total loan portfolio at year-end 2008, compared with 53% in 2007. The Company's commercial lending is extended to various industries, including hotel, agribusiness and manufacturing, as well as health care, wholesale, and retail services.

Loan Portfolio (dollars in thousands)	December 31,				
	2008	2007	2006	2005	2004
Commercial and Industrial Loans	\$ 505,191	\$ 457,033	\$ 402,285	\$ 319,681	\$ 314,354
Agricultural Loans	159,923	165,592	148,872	101,355	99,557
Consumer Loans	127,343	131,110	132,791	129,587	122,888
Residential Mortgage Loans	100,054	116,908	114,687	102,891	94,800
Total Loans	892,511	870,643	798,635	653,514	631,599
Less: Unearned Income	(2,075)	(2,922)	(2,376)	(1,558)	(1,806)
Subtotal	890,436	867,721	796,259	651,956	629,793
Less: Allowance for Loan Losses	(9,522)	(8,044)	(7,129)	(9,265)	(8,801)
Loans, Net	\$ 880,914	\$ 859,677	\$ 789,130	\$ 642,691	\$ 620,992
<b>Ratio of Loans to Total Loans</b>					
Commercial and Industrial Loans	57%	53%	50%	49%	50%
Agricultural Loans	18%	19%	19%	15%	16%
Consumer Loans	14%	15%	17%	20%	19%
Residential Mortgage Loans	11%	13%	14%	16%	15%
Totals	100%	100%	100%	100%	100%

The Company's policy is generally to extend credit to consumer and commercial borrowers in its primary geographic market area in Southern Indiana. Commercial extensions of credit outside this market area are generally concentrated in real estate loans within a 120 mile radius of the Company's primary market and are granted on a selective basis. These out-of-market credits include participations that the Company may purchase from time to time in loans that are originated by banks in which the Company owns (or previously owned) non-controlling common stock investments. These banks operate (or operated) from headquarters in Indianapolis, Indiana, Evansville, Indiana and Louisville, Kentucky.

The following table indicates the amounts of loans (excluding residential mortgages on 1-4 family residences and consumer loans) outstanding as of December 31, 2008, which, based on remaining scheduled repayments of principal, are due in the periods indicated (dollars in thousands).

	Within One Year	One to Five Years	After Five Years	Total
Commercial and Agricultural	\$ 323,611	\$ 280,411	\$ 61,092	\$ 665,114

	Interest Sensitivity	
	Fixed Rate	Variable Rate
Loans maturing after one year	\$ 109,188	\$ 232,315

## INVESTMENTS

The investment portfolio is a principal source for funding the Company's loan growth and other liquidity needs of its subsidiaries. The Company's securities portfolio consists of money market securities, uncollateralized federal agency securities, municipal obligations of state and political subdivisions, and mortgage-backed securities issued by U.S. government agencies. Money market securities include federal funds sold, interest-bearing balances with banks, and other short-term investments. The composition of the year-end balances in the investment portfolio is presented in Note 2 to the Company's consolidated financial statements included in Item 8 of this Report and in the table below:

Investment Portfolio, at Amortized Cost (dollars in thousands)	2008		December 31, 2007		2006	
		%		%		%
<b>Federal Funds Sold and Short-term</b>						
Investments	\$ 27,791	14%	\$ 2,631	2%	\$ 5,935	3%
U.S. Treasury and Agency Securities	—	—	25,306	16	28,083	15
<b>Obligations of State and Political</b>						
Subdivisions	19,887	10	15,851	10	25,788	13
Mortgage-backed Securities	151,499	74	105,302	69	125,340	66
Equity Securities	3,620	2	4,557	3	6,236	3
<b>Total Securities Portfolio</b>	<b>\$ 202,797</b>	<b>100%</b>	<b>\$ 153,647</b>	<b>100%</b>	<b>\$ 191,382</b>	<b>100%</b>

The amortized cost of investment securities, including federal funds sold and short-term investments, increased \$45.8 million at year-end 2008 compared with year-end 2007. The increase in the portfolio during 2008 was largely due to the growth of the Company's core deposit base at a greater pace than the Company's loan portfolio. The amortized cost of investment securities, including federal funds sold and short-term investments, decreased \$37.7 million at year-end 2007 compared with year-end 2006. The decline in the portfolio during 2007 was largely the result of a strategic decision by the Company to utilize cash flows generated by the securities portfolio to fund loan growth.

The largest concentration in the investment portfolio continues to be in mortgage related securities representing 76% of the total securities portfolio at December 31, 2008. The Company's level of obligations of state and political subdivisions increased to \$16.6 million or 8% of the portfolio at December 31, 2008.

The Company's equity securities portfolio at year-end 2008 consisted of non-controlling common stock investments in four unaffiliated banking companies. During January 2009, one of these unaffiliated banking companies was acquired by an unrelated organization and the Company's common stock holdings was liquidated as a part of the acquisition. The decline in the amortized cost of equity securities at December 31, 2008 compared with December 31, 2007 was related to \$937,000 of other-than-temporary impairment charges recognized on the Company's equity securities portfolio.

Investment Securities, at Carrying Value  
(dollars in thousands)

	2008	December 31, 2007	2006
<b>Securities Held-to-Maturity</b>			
Obligations of State and Political Subdivisions	\$ 3,326	\$ 4,464	\$ 6,135
<b>Securities Available-for-Sale</b>			
U.S. Treasury and Agency Securities	\$ —	\$ 25,739	\$ 28,133
Obligations of State and Political Subdivisions	16,868	11,602	19,928
Mortgage-backed Securities	155,627	105,489	123,859
Equity Securities	3,345	5,470	7,302
Subtotal of Securities Available-for-Sale	175,840	148,300	179,222
<b>Total Securities</b>	<b>\$ 179,166</b>	<b>\$ 152,764</b>	<b>\$ 185,357</b>

The Company's \$175.8 million available-for-sale portion of the investment portfolio provides an additional funding source for the liquidity needs of the Company's subsidiaries and for asset/liability management requirements. Although management has the ability to sell these securities if the need arises, their designation as available-for-sale should not necessarily be interpreted as an indication that management anticipates such sales.

The amortized cost of debt securities at December 31, 2008 are shown in the following table by expected maturity. Mortgage-backed securities are based on estimated average lives. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations. Equity securities do not have contractual maturities, and are excluded from the table below.

Maturities and Average Yields of Securities at December 31, 2008  
(dollars in thousands)

Within One Year	After One But Within Five Years	After Five But Within Ten Years	After Ten Years
--------------------	------------------------------------	------------------------------------	--------------------

Edgar Filing: GERMAN AMERICAN BANCORP, INC. - Form 10-K

	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
U.S. Treasuries and Agencies	\$ —	N/A	\$ —	N/A	\$ —	N/A	\$ —	N/A
State and Political Subdivisions	2,002	7.93%	5,871	7.32%	3,457	8.17%	8,557	7.32%
Mortgage-backed Securities	41,790	5.94%	99,707	5.19%	138	2.96%	9,864	5.00%
<b>Totals</b>	<b>\$ 43,792</b>	<b>6.03%</b>	<b>\$ 105,578</b>	<b>5.31%</b>	<b>\$ 3,595</b>	<b>7.97%</b>	<b>\$ 18,421</b>	<b>6.08%</b>

A tax-equivalent adjustment using a tax rate of 34 percent was used in the above table.

In addition to the other uses of funds discussed previously, the Company had certain long-term contractual obligations as of December 31, 2008. These contractual obligations primarily consisted of long-term borrowings with the FHLB and JPMorgan Chase Bank, N.A., time deposits, and lease commitments for certain office facilities. Scheduled principal payments on long-term borrowings, time deposits, and future minimum lease payments are outlined in the table below.

Contractual Obligations (dollars in thousands)	Payments Due By Period				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Long-term Borrowings	\$ 104,892	\$ 20,026	\$ 33,814	\$ 28,069	\$ 22,983
Time Deposits	354,468	266,221	62,729	25,517	1
Capital Lease Obligation	1,508	81	162	162	1,103
Operating Lease					
Commitments	1,943	255	362	210	1,116
Total	\$ 462,811	\$ 286,583	\$ 97,067	\$ 53,958	\$ 25,203

#### SOURCES OF FUNDS

The Company's primary source of funding is its base of core customer deposits. Core deposits consist of demand deposits, savings, interest-bearing checking, money market accounts, and certificates of deposit of less than \$100,000. Other sources of funds are certificates of deposit of \$100,000 or more, brokered deposits, overnight borrowings from other financial institutions and securities sold under agreement to repurchase. The membership of the Company's affiliate bank in the Federal Home Loan Bank System (FHLB) provides a significant additional source for both long and short-term collateralized borrowings. In addition, the Company, as a separate and distinct corporation from its bank and other subsidiaries, also has the ability to borrow funds from other financial institutions and to raise debt or equity capital from the capital markets and other sources. The following pages contain a discussion of changes in these areas.

The table below illustrates changes between years in the average balances of all funding sources:

Funding Sources - Average Balances (dollars in thousands)	December 31,			% Change From Prior Year	
	2008	2007	2006	2008	2007
Demand Deposits					
Non-interest-bearing	\$ 140,962	\$ 133,824	\$ 129,759	5%	3%
Interest-bearing	212,467	153,033	140,786	39	9
Savings Deposits	57,948	57,266	61,453	1	(7)
Money Market Accounts	151,645	119,735	112,642	27	6
Other Time Deposits	258,314	283,994	276,815	(9)	3
Total Core Deposits	821,336	747,852	721,455	10	4
Certificates of Deposits of \$100,000 or more and Brokered Deposits	100,801	141,884	92,985	(29)	53
FHLB Advances and Other Borrowings	138,887	117,084	113,559	19	3
Total Funding Sources	\$ 1,061,024	\$ 1,006,820	\$ 927,999	5	8

Maturities of certificates of deposit of \$100,000 or more are summarized as follows:  
(dollars in thousands)

	3 Months Or Less	3 thru 6 Months	6 thru 12 Months	Over 12 Months	Total
December 31, 2008	\$ 18,582	\$ 26,406	\$ 9,676	\$ 14,465	\$ 69,129

## CORE DEPOSITS

The Company's overall level of average core deposits increased approximately 10% during 2008 following a 4% increase during 2007. The Company's ability to attract core deposits continues to be influenced by competition and the interest rate environment, as well as the increased availability of alternative investment products. Core deposits continue to represent a stable and viable funding source for the Company's operations. Core deposits represented 77% of average total funding sources during 2008 compared with 74% during 2007 and 78% during 2006.

Demand, savings, and money market deposits have provided a growing source of funding for the Company in each of the periods reported. Average demand, savings, and money market deposits increased 21% during 2008 following a 4% increase in 2007. Average demand, savings, and money market deposits totaled \$563.0 million or 69% of core deposits (53% of total funding sources) in 2008 compared with \$463.9 million or 62% of core deposits (46% of total funding sources) in 2007 and \$444.6 million or 62% of core deposits (48% of total funding sources) in 2006.



Other time deposits consist of certificates of deposits in denominations of less than \$100,000. These deposits declined by 9% during 2008 following an increase of 3% in 2007. Other time deposits comprised 31% of core deposits in 2008 and 38% in 2007 and 2006.

#### OTHER FUNDING SOURCES

Federal Home Loan Bank advances and other borrowings represent the Company's most significant source of other funding. Average borrowed funds increased \$21.8 million or 19% during 2008 following an increase of \$3.5 million or 3% in 2007. Borrowings comprised approximately 13% of average total funding sources in 2008 and 12% in 2007 and 2006. The increase in average borrowed funds during 2008 compared with 2007 was largely attributable to borrowings from the Federal Home Loan Bank for asset/ liability management purposes and liquidity needs.

Certificates of deposits in denominations of \$100,000 or more and brokered deposits are an additional source of other funding for the Company's bank subsidiary. Large denomination certificates and brokered deposits decreased \$41.1 million or 29% during 2008 following an increase of \$48.9 million or 53% during 2007. Large certificates and brokered deposits comprised approximately 10% of average total funding sources in 2008, 14% in 2007 and 10% in 2006. This type of funding is used as both long-term and short-term funding sources.

The bank subsidiary of the Company also utilizes short-term funding sources from time to time. These sources consist of overnight federal funds purchased from other financial institutions, secured repurchase agreements that generally mature within one day of the transaction date, and secured overnight variable rate borrowings from the FHLB. These borrowings represent an important source of short-term liquidity for the Company's bank subsidiary. Long-term debt at the Company's bank subsidiary is in the form of FHLB advances, which are secured by the pledge of certain investment securities and residential and housing-related mortgage loans. See Note 8 to the Company's consolidated financial statements included in Item 8 of this Report for further information regarding borrowed funds.

#### PARENT COMPANY FUNDING SOURCES

The parent company is a corporation separate and distinct from its bank and other subsidiaries. For information regarding the financial condition, result of operations, and cash flows of the Company, presented on a parent-company-only basis, see Note 17 to the Company's consolidated financial statements included in Item 8 of this Report.

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. 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, which are discussed in detail below.

On December 29, 2006, the Company and JPMorgan Chase Bank, N.A. (the "Lender") executed and delivered to each other a Second Amended and Restated Loan and Subordinated Debenture Purchase Agreement ("Restated Agreement"), and the Company executed and delivered to the Lender a \$10 million Subordinated Debenture, a \$10 million Term Note and a \$15 million Revolving Note (which Revolving Note has since been replaced with a \$10 million note, as discussed below) pursuant to the Restated Agreement to evidence its obligations for amounts that may from time to time be borrowed thereunder. The Company's obligations under the Term Note and Revolving Note are secured by a pledge of all of the Company's stock in its sole depository institution subsidiary, German American Bancorp, pursuant to a pledge agreement. The Restated Agreement established new credit facilities that replaced the

Company's prior credit facilities with the Lender.

The term loan established under the Restated Agreement is evidenced by a term note in the principal amount of \$10 million, which matures on the following schedule: \$1.0 million principal amount was payable on January 1, 2008 and \$1.5 million payable on January 1 of each of the years 2009 through 2014, inclusive. Interest is payable quarterly on the outstanding principal balance, and the balance was \$7.5 million at year-end 2008 (the \$1.5 million principal payment due January 1, 2009 was made in late December 2008).

The subordinated loan established under the Restated Agreement is evidenced by a subordinated debenture in the principal amount of \$10 million, and matures in a single installment of principal on January 1, 2014. Interest is payable quarterly on the outstanding principal balance.

On September 30, 2008, the Company and Lender executed and delivered to each other an amendment to the Restated Agreement, as previously amended in September 2007 (as twice amended, the "Amended Restated Agreement") between the Lender and the Company. Pursuant to this 2008 amendment, the Company's revolving line of credit established by the Restated Agreement (which was to have expired and become due September 30, 2008) was extended through September 30, 2009. The amount of the credit available to the Company under the revolving line of credit is \$10 million under the terms of the Amended Restated Agreement. In addition, the interest rate payable by the Company to the Lender in respect of LIBOR-based advances under the Amended Restated Agreement is LIBOR plus 165 basis points, and the Amended Restated Agreement includes a provision for a non-refundable fee on the unused portion of the maximum amount available under the line of credit of 35 basis points per annum, due quarterly in arrears.

Pursuant to the Amended Restated Agreement, the Company made certain representations and warranties to the Lender, and agreed to comply with certain affirmative and negative covenants with the Lender, which are substantially the same and updated the representations, warranties, and covenants that were included in the Restated Agreement. Among the affirmative covenants are provisions requiring that (a) the Company maintain the capital ratios of the Company and of its subsidiary bank(s) at levels that would be considered "well-capitalized" under the prompt corrective action regulations of the federal banking agencies (these capital maintenance covenants were modified by the prior amendment to the Restated Agreement dated September 28, 2007 for the interim periods through December 31, 2008), and (b) the Company maintain a consolidated ratio of (i) the sum of its non-performing loans plus other real estate owned (real estate that is neither used in the ordinary course of the business of the Company or its subsidiaries nor held for future use) (OREO) to (ii) the sum of the Company's loans plus OREO, of not greater than 3.25%. At December 31, 2008, this ratio was 1.14%.

See Note 8 to the Company's consolidated financial statements included in Item 8 of this Report for further information regarding the parent company borrowed funds.

## RISK MANAGEMENT

---

The Company is exposed to various types of business risk on an on-going basis. These risks include credit risk, liquidity risk and interest rate risk. Various procedures are employed at the Company's affiliate banks to monitor and mitigate risk in the loan and investment portfolios, as well as risks associated with changes in interest rates. Following is a discussion of the Company's philosophies and procedures to address these risks.

### LENDING AND LOAN ADMINISTRATION

Primary responsibility and accountability for day-to-day lending activities rests with the Company's subsidiary bank. Loan personnel at the subsidiary bank have the authority to extend credit under guidelines approved by the bank's board of directors. The executive loan committee serves as a vehicle for communication and for the pooling of knowledge, judgment and experience of its members. The committee provides valuable input to lending personnel, acts as an approval body, and monitors the overall quality of the bank's loan portfolio. The Corporate Credit Risk Management Committee, comprised of members of the Company's and its subsidiary bank's executive officers and board of directors, strives to ensure a consistent application of the Company's lending policies. The Company also maintains a comprehensive risk-grading and loan review program, which includes quarterly reviews of problem loans, delinquencies and charge-offs. The purpose of this program is to evaluate loan administration, credit quality, loan documentation and the adequacy of the allowance for loan losses.

The Company maintains an allowance for loan losses to cover probable, incurred credit losses identified during its loan review process. Management estimates the required level of allowance for loan losses 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. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgement, should be charged-off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed.

The allowance for loan losses is comprised of: (a) specific reserves on individual credits; (b) general reserves for certain loan categories and industries, and overall historical loss experience; and (c) unallocated reserves based on performance trends in the loan portfolios, current economic conditions, and other factors that influence the level of estimated probable losses. The need for specific reserves are considered for credits 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.

Allowance for Loan Losses (dollars in thousands)	Years Ended December 31,				
	2008	2007	2006	2005	2004
<b>Balance of Allowance for Possible Losses at Beginning of Period</b>	\$ 8,044	\$ 7,129	\$ 9,265	\$ 8,801	\$ 8,265
<b>Loans Charged-off:</b>					
Commercial and Industrial Loans	2,153	2,107	3,059	1,278	904
Agricultural Loans	28	361	—	3	—
Consumer Loans	687	507	705	624	654
Residential Mortgage Loans	256	269	184	238	292
<b>Total Loans Charged-off</b>	<b>3,124</b>	<b>3,244</b>	<b>3,948</b>	<b>2,143</b>	<b>1,850</b>
<b>Recoveries of Previously Charged-off Loans:</b>					
Commercial and Industrial Loans	334	323	98	205	118
Agricultural Loans	—	55	30	53	11
Consumer Loans	267	172	240	149	218
Residential Mortgage Loans	11	18	35	58	24
<b>Total Recoveries</b>	<b>612</b>	<b>568</b>	<b>403</b>	<b>465</b>	<b>371</b>
<b>Net Loans Recovered (Charged-off)</b>	<b>(2,512)</b>	<b>(2,676)</b>	<b>(3,545)</b>	<b>(1,678)</b>	<b>(1,479)</b>
<b>Additions to Allowance Charged to Expense</b>	<b>3,990</b>	<b>3,591</b>	<b>925</b>	<b>1,903</b>	<b>2,015</b>
Allowance from Acquired Subsidiary	—	—	484	239	—
<b>Balance at End of Period</b>	<b>\$ 9,522</b>	<b>\$ 8,044</b>	<b>\$ 7,129</b>	<b>\$ 9,265</b>	<b>\$ 8,801</b>
<b>Net Charge-offs to Average Loans Outstanding</b>	<b>0.29%</b>	<b>0.32%</b>	<b>0.50%</b>	<b>0.26%</b>	<b>0.24%</b>
<b>Provision for Loan Losses to Average Loans Outstanding</b>	<b>0.45%</b>	<b>0.43%</b>	<b>0.13%</b>	<b>0.30%</b>	<b>0.32%</b>
<b>Allowance for Loan Losses to Total Loans at Year-end</b>	<b>1.07%</b>	<b>0.93%</b>	<b>0.90%</b>	<b>1.42%</b>	<b>1.40%</b>

The following table indicates the breakdown of the allowance for loan losses for the periods indicated (dollars in thousands):

Commercial and Industrial Loans	\$ 7,379	\$ 5,892	\$ 5,134	\$ 6,486	\$ 5,906
Agricultural Loans	1,264	1,349	1,001	822	982
Consumer Loans	481	483	602	1,127	1,043
Residential Mortgage Loans	398	320	341	710	790
Unallocated	—	—	51	120	80
<b>Total Allowance for Loan Losses</b>	<b>\$ 9,522</b>	<b>\$ 8,044</b>	<b>\$ 7,129</b>	<b>\$ 9,265</b>	<b>\$ 8,801</b>

The allowance for loan losses at year-end 2008 increased to \$9.5 million or 1.07% of total loans compared to \$8.0 million or 0.93% of total loans at year-end 2007. The increase in the allowance for loan losses was partially attributable to an increase in the level of non-performing and adversely classified loans during 2008. Also contributing to the increased allowance was the Company's commercial and industrial loan portfolio growth during 2008 and the required provision for loan losses that resulted from that growth in accordance with the Company's standard methodology for determining the adequacy of its allowance for loan losses. Finally, an additional contributing factor to the increased level of allowance for loan losses was an elevated level of net charge-offs during the past three years and the effect of those charge-offs on the Company's historic loss ratios and the resulting required level of loan loss reserves. Net charge-offs totaled \$2.5 million or 0.29% of average loans outstanding during 2008. This compares to net charge-offs of \$2.7 million or 0.32% of average loans outstanding during 2007 and \$3.5 million or 0.50% of average loans outstanding in 2006.

Please see "RESULTS OF OPERATIONS – Provision for Loan Losses" and "CRITICAL ACCOUNTING POLICIES AND ESTIMATES – Allowance for Loan Losses" for additional information regarding the allowance.

## NON-PERFORMING ASSETS

Non-performing assets consist of: (a) non-accrual loans; (b) loans which have been renegotiated to provide for a reduction or deferral of interest or principal because of deterioration in the financial condition of the borrower; (c) loans past due 90 days or more as to principal or interest; and, (d) other real estate owned. Loans are 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. Uncollected accrued interest is reversed against income at the time a loan is placed on non-accrual. Loans are typically charged-off at 120 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 an analysis of the Company's non-performing assets.

Non-performing Assets (dollars in thousands)	December 31,				
	2008	2007	2006	2005	2004
Non-accrual Loans	\$ 8,316	\$ 4,356	\$ 9,652	\$ 14,763	\$ 5,750
Past Due Loans (90 days or more)	34	8	—	944	831
Restructured Loans	—	—	—	—	—
Total Non-performing Loans	8,350	4,364	9,652	15,707	6,581
Other Real Estate	1,818	1,517	845	506	213
Total Non-performing Assets	\$ 10,168	\$ 5,881	\$ 10,497	\$ 16,213	\$ 6,794
Non-performing Loans to Total Loans	0.94%	0.50%	1.21%	2.41%	1.04%
Allowance for Loan Losses to Non-performing Loans	114.04%	184.33%	73.86%	58.99%	133.73%

The Company's level of overall non-performing assets increased by approximately \$4.3 million and non-performing loans increased by approximately \$4.0 million during 2008 compared with year-end 2007. This level of non-performing loans represents 0.94% of total loans outstanding at December 31, 2008, an increase from 0.50% as of year-end 2007. The increase in non-performing loans was primarily related to commercial credits that were generally less than \$1.0 million. The largest credit facility, and only credit in excess of \$1.0 million, that was in non-accrual status at December 31, 2008, totaled \$1.2 million.

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 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. The total dollar amount of impaired loans at December 31, 2008 was \$5,945,000. For additional detail on impaired loans, see Note 3 to the Company's consolidated financial statements included in Item 8 of this Report.

Interest income recognized on non-performing loans for 2008 was \$343,000. The gross interest income that would have been recognized in 2008 on non-performing loans if the loans had been current in accordance with their original terms was \$1,136,000. Loans are typically placed on non-accrual status when scheduled principal or interest payments are past due for 90 days or more, unless the loan is well secured and in the process of collection.

## LIQUIDITY AND INTEREST RATE RISK MANAGEMENT

Liquidity is a measure of the ability of the Company's subsidiary bank to fund new loan demand, existing loan commitments and deposit withdrawals. The purpose of liquidity management is to match sources of funds with anticipated customer borrowings and withdrawals and other obligations to ensure a dependable funding base, without unduly penalizing earnings. Failure to properly manage liquidity requirements can result in the need to satisfy customer withdrawals and other obligations on less than desirable terms. The liquidity of the parent company is dependent upon the receipt of dividends from its bank subsidiary, which are subject to certain regulatory limitations explained in Note 9 to the Company's consolidated financial statements included in Item 8 of this Report, as enhanced by its ability to draw upon term financing arrangements and a line of credit established by the parent company with a correspondent bank lender as described under "SOURCES OF FUNDS – Parent Company Funding Sources", above. The subsidiary bank's source of funding is predominately core deposits, time deposits in excess of \$100,000 and brokered certificates of deposit, 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.

Interest rate risk is the exposure of the Company's financial condition to adverse changes in market interest rates. In an effort to estimate the impact of sustained interest rate movements to the Company's earnings, the Company monitors interest rate risk through computer-assisted simulation modeling of its net interest income. The Company's simulation modeling monitors the potential impact to net interest income under various interest rate scenarios. The Company's objective is to actively manage its asset/liability position within a one-year interval and to limit the risk in any of the interest rate scenarios to a reasonable level of tax-equivalent net interest income within that interval. The Company's Asset/Liability Committee monitors compliance within established guidelines of the Funds Management Policy. See Item 7A. Quantitative and Qualitative Disclosures About Market Risk section for further discussion regarding interest rate risk.



## OFF-BALANCE SHEET ARRANGEMENTS

The Company has no off-balance sheet arrangements other than stand-by letters of credit as disclosed in Note 14 to the Company's consolidated financial statements included in Item 8 of this Report.

## Item 7A. 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 Board of Directors. Primary market risks, which impact the Company's operations, are liquidity risk and interest rate risk, as discussed above.

As discussed previously, 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. 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 following table provides an assessment of the risk to NPV in the event of sudden and sustained 1% and 2% increases and decreases in prevailing interest rates. The table indicates that as of December 31, 2008 the Company's estimated NPV might be expected to decrease under both an increase or decrease of 2% in prevailing interest rates (dollars in thousands).

## Interest Rate Sensitivity as of December 31, 2008

Changes in Rates	Net Portfolio Value		Net Portfolio Value as a % of Present Value of Assets			
	Amount	% Change	NPV Ratio	Change		
+2%	\$ 135,270	-1.53%	11.54%	9	b.p.	
+1%	140,009	1.92%	11.77%	32	b.p.	
Base	137,375	—	11.45%	—		
-1%	126,696	-7.77%	10.51%	(94	) b.p.	
-2%	110,215	-19.77%	9.12%	(233	) b.p.	

The above discussion, and the portions of MANAGEMENT'S DISCUSSION AND ANALYSIS in Item 7 of this Report that are referenced in the above discussion contain statements relating to future results of the Company that are considered "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to, among other things, simulation of the impact on net interest income from changes in interest rates. Actual results may differ materially from those expressed or implied therein as a result of certain risks and uncertainties, including those risks and uncertainties expressed above, those that are described in

MANAGEMENT'S DISCUSSION AND ANALYSIS in Item 7 of this Report, and those that are described in Item 1 of this Report, "Business," under the caption "Forward-Looking Statements and Associated Risks," which discussions are incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data.

---

Report of Independent Registered Public Accounting Firm

---

Board of Directors and Shareholders  
German American Bancorp, Inc.  
Jasper, Indiana

We have audited the accompanying consolidated balance sheets of German American Bancorp, Inc. as of December 31, 2008 and 2007 and the related consolidated statements of income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2008. We also have audited German American Bancorp, Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). German American Bancorp, Inc.'s management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on the company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of German American Bancorp, Inc. as of December 31, 2008 and 2007, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion German American Bancorp, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control – Integrated Framework issued by the COSO.

Louisville, Kentucky  
February 28, 2009

/s/ Crowe Horwath LLP  
Crowe Horwath LLP

## Consolidated Balance Sheets

Dollars in thousands, except per share data

	December 31,	
	2008	2007
<b>ASSETS</b>		
Cash and Due from Banks	\$ 17,201	\$ 25,283
Federal Funds Sold and Other Short-term Investments	27,791	2,631
Cash and Cash Equivalents	44,992	27,914
Securities Available-for-Sale, at Fair Value	175,840	148,300
Securities Held-to-Maturity, at Cost (Fair value of \$3,358 and \$4,496 on December 31, 2008 and 2007, respectively)	3,326	4,464
Loans Held-for-Sale	3,166	5,697
Loans	892,511	870,643
Less: Unearned Income	(2,075)	(2,922)
Allowance for Loan Losses	(9,522)	(8,044)
Loans, Net	880,914	859,677
Stock in FHLB of Indianapolis and Other Restricted Stock, at Cost	10,621	10,621
Premises, Furniture and Equipment, Net	22,330	22,783
Other Real Estate	1,818	1,517
Goodwill	9,655	9,655
Intangible Assets	3,141	4,030
Company Owned Life Insurance	23,338	22,533
Accrued Interest Receivable and Other Assets	11,687	14,519
<b>TOTAL ASSETS</b>	<b>\$ 1,190,828</b>	<b>\$ 1,131,710</b>
<b>LIABILITIES</b>		
Non-interest-bearing Demand Deposits	\$ 147,977	\$ 136,212
Interest-bearing Demand, Savings, and Money Market Accounts	439,305	353,643
Time Deposits	354,468	387,566
Total Deposits	941,750	877,421
FHLB Advances and Other Borrowings	131,664	144,170
Accrued Interest Payable and Other Liabilities	12,240	13,003
<b>TOTAL LIABILITIES</b>	<b>1,085,654</b>	<b>1,034,594</b>
Commitments and Contingencies (Note 14)		
<b>SHAREHOLDERS' EQUITY</b>		
Preferred Stock, \$10 par value; 500,000 shares authorized, no shares issued	—	—

Edgar Filing: GERMAN AMERICAN BANCORP, INC. - Form 10-K

Common Stock, no par value, \$1 stated value; 20,000,000 shares authorized	11,030	11,029
Additional Paid-in Capital	68,371	68,408
Retained Earnings	23,019	16,681
Accumulated Other Comprehensive Income	2,754	998
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>105,174</b>	<b>97,116</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 1,190,828</b>	<b>\$ 1,131,710</b>
End of period shares issued and outstanding	11,030,288	11,029,484

See accompanying notes to consolidated financial statements.

Consolidated Statements of Income  
Dollars in thousands, except per share data

	Years Ended December 31,		
	2008	2007	2006
<b>INTEREST INCOME</b>			
Interest and Fees on Loans	\$ 58,477	\$ 63,852	\$ 53,490
Interest on Federal Funds Sold and Other Short-term Investments	593	478	545
Interest and Dividends on Securities:			
Taxable	8,007	6,992	7,763
Non-taxable	768	939	1,796
<b>TOTAL INTEREST INCOME</b>	<b>67,845</b>	<b>72,261</b>	<b>63,594</b>
<b>INTEREST EXPENSE</b>			
Interest on Deposits	21,212	27,289	21,329
Interest on FHLB Advances and Other Borrowings	5,696	6,357	6,069
<b>TOTAL INTEREST EXPENSE</b>	<b>26,908</b>	<b>33,646</b>	<b>27,398</b>
<b>NET INTEREST INCOME</b>	<b>40,937</b>	<b>38,615</b>	<b>36,196</b>
Provision for Loan Losses	3,990	3,591	925
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>36,947</b>	<b>35,024</b>	<b>35,271</b>
<b>NON-INTEREST INCOME</b>			
Trust and Investment Product Fees	2,288	2,590	2,210
Service Charges on Deposit Accounts	4,920	4,361	3,901
Insurance Revenues	6,306	5,794	5,094
Other Operating Income	3,203	2,817	2,920
Net Gains on Sales of Loans and Related Assets	1,399	822	917
Net Gain (Loss) on Securities	94	(680)	951
<b>TOTAL NON-INTEREST INCOME</b>	<b>18,210</b>	<b>15,704</b>	<b>15,993</b>
<b>NON-INTEREST EXPENSE</b>			
Salaries and Employee Benefits	20,786	21,671	21,491
Occupancy Expense	3,249	3,144	2,797
Furniture and Equipment Expense	2,428	2,235	2,191
Data Processing Fees	1,493	1,370	1,646
Professional Fees	1,670	1,418	1,786
Advertising and Promotion	1,078	957	940
Supplies	570	625	619
Intangible Amortization	889	894	698
Other Operating Expenses	4,553	4,907	4,891
<b>TOTAL NON-INTEREST EXPENSE</b>	<b>36,716</b>	<b>37,221</b>	<b>37,059</b>

Income before Income Taxes	18,441	13,507	14,205
Income Tax Expense	5,638	4,102	3,984
NET INCOME	\$ 12,803	\$ 9,405	\$ 10,221
Earnings per Share	\$ 1.16	\$ 0.85	\$ 0.93
Diluted Earnings per Share	\$ 1.16	\$ 0.85	\$ 0.93

See accompanying notes to consolidated financial statements.



Consolidated Statements of Changes in Shareholders' Equity  
Dollars in thousands, except per share data

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income / (Loss)	Total Shareholders' Equity
Balances, January 1, 2006	10,643,514	\$ 10,643	\$ 63,784	\$ 9,391	\$ (1,563)	\$ 82,255
<b>Comprehensive Income:</b>						
Net Income				10,221		10,221
Changes in Unrealized Gain (Loss) on Securities Available for Sale, net					1,242	1,242
Change in Minimum Pension Liability					38	38
<b>Total Comprehensive Income</b>						<b>11,501</b>
Cash Dividends (\$.56 per share)				(6,162)		(6,162)
<b>Issuance of Common Stock for:</b>						
Exercise of Stock Options	1,704	2	15			17
Mergers and Acquisitions	349,468	349	4,252			4,601
Employee Stock Purchase Plan			(30)			(30)
Restricted Share Grants	13,876	14	166			180
Stock Option Grants			29			29
Balances, December 31, 2006	11,008,562	11,008	68,216	13,450	(283)	92,391
<b>Comprehensive Income:</b>						
Net Income				9,405		9,405
Changes in Unrealized Gain (Loss) on Securities Available for Sale, net					1,210	1,210
Change in Unrecognized Loss on Postretirement Benefit Obligation					30	30
Change in Unrecognized Amounts in Pension					41	41
<b>Total Comprehensive Income</b>						<b>10,686</b>
Cash Dividends (\$.56 per share)				(6,174)		(6,174)
			(70)			(70)

Employee Stock Purchase Plan							
Restricted Share Grants	20,922	21	262				283
Balances, December 31, 2007	11,029,484	11,029	68,408	16,681	998		97,116
Comprehensive Income:							
Net Income				12,803			12,803
Changes in Unrealized Gain (Loss) on Securities Available for Sale, net					1,612		1,612
Change in Unrecognized Loss on Postretirement Benefit Obligation					144		144
Total Comprehensive Income							14,559
Cash Dividends (\$.56 per share)				(6,177)			(6,177)
Adjustment to Initially Apply EITF 06-04				(288)			(288)
Employee Stock Purchase Plan							
Restricted Share Grants	804	1	9	(46)			10
Balances, December 31, 2008	11,030,288	\$ 11,030	\$ 68,371	\$ 23,019	\$ 2,754	\$	105,174

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows  
Dollars in thousands

	Years Ended December 31,		
	2008	2007	2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net Income	\$ 12,803	\$ 9,405	\$ 10,221
Adjustments to Reconcile Net Income to Net Cash from Operating Activities:			
Net (Accretion) Amortization on Securities	(812)	(383)	(180)
Depreciation and Amortization	3,362	3,140	2,818
Amortization and Impairment of Mortgage Servicing Rights	—	—	271
Loans Originated for Sale	(105,448)	(71,091)	(55,281)
Proceeds from Sales of Loans Held-for-Sale	109,378	67,817	55,985
Loss in Investment in Limited Partnership	141	178	397
Provision for Loan Losses	3,990	3,591	925
Gain on Sale of Loans and Mortgage Servicing Rights, net	(1,399)	(822)	(917)
Gain on Securities, net	(1,031)	(62)	(951)
Loss (Gain) on Sales of Other Real Estate and Repossessed Assets	62	(52)	23
Loss (Gain) on Disposition and Impairment of Premises and Equipment	(25)	120	23
Other-than-temporary Impairment on Securities	937	742	—
Increase in Cash Surrender Value of Company Owned Life Insurance	(805)	(823)	(865)
Equity Based Compensation	10	331	284
Change in Assets and Liabilities:			
Interest Receivable and Other Assets	1,798	1,070	(1,298)
Interest Payable and Other Liabilities	(827)	(406)	633
Net Cash from Operating Activities	22,134	12,755	12,088
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Proceeds from Maturity of Other Short-term Investments	—	200	—
Proceeds from Maturities of Securities Available-for-Sale	52,304	41,899	60,033
Proceeds from Sales of Securities Available-for-Sale	53,641	998	13,001
Purchase of Securities Available-for-Sale	(130,170)	(10,434)	(62,006)
Proceeds from Maturities of Securities Held-to-Maturity	1,140	1,671	2,558
Proceeds from Redemption of Federal Home Loan Bank Stock	—	—	3,862
Purchase of Loans	(29,574)	(23,065)	(22,043)
Proceeds from Sales of Loans	5,369	3,953	30,520
Loans Made to Customers, net of Payments Received	(4,447)	(58,503)	(109,862)
Proceeds from Sale of Mortgage Servicing Rights	—	—	3,554
Proceeds from Sales of Other Real Estate	3,068	2,987	890
Property and Equipment Expenditures	(2,122)	(1,372)	(3,461)
Proceeds from Sales of Property and Equipment	65	62	292
Acquire Capitalized Lease	—	(13)	—
Acquire Banking Entities	—	—	(4,111)
Acquire Insurance Agencies	—	—	(2,260)
Net Cash from Investing Activities	(50,726)	(41,617)	(89,033)

## CASH FLOWS FROM FINANCING ACTIVITIES

Change in Deposits	64,388	9,862	73,366
Change in Short-term Borrowings	(31,328)	5,828	12,623
Advances in Long-term Debt	25,000	30,000	26,500
Repayments of Long-term Debt	(6,167)	(12,317)	(32,530)
Issuance of Common Stock	—	—	17
Employee Stock Purchase Plan	(46)	(118)	(105)
Dividends Paid	(6,177)	(6,174)	(6,162)
Net Cash from Financing Activities	45,670	27,081	73,709
Net Change in Cash and Cash Equivalents	17,078	(1,781)	(3,236)
Cash and Cash Equivalents at Beginning of Year	27,914	29,695	32,931
Cash and Cash Equivalents at End of Year	\$ 44,992	\$ 27,914	\$ 29,695
Cash Paid During the Year for			
Interest	\$ 27,246	\$ 33,781	\$ 25,805
Income Taxes	6,122	2,395	3,605
Supplemental Non Cash Disclosures			
Loans Transferred to Other Real Estate	\$ 3,353	\$ 4,919	\$ 1,016

See accompanying notes to consolidated financial statements.

---

Notes to the Consolidated Financial Statements

Dollars in thousands, except per share data

---

NOTE 1 – Summary of Significant Accounting Policies

Description of Business and Basis of Presentation

German American Bancorp, Inc. operations are primarily comprised of three business segments: core banking, trust and investment advisory services, and insurance operations. The accounting and reporting policies of German American Bancorp, Inc. and its subsidiaries conform to U.S. generally accepted accounting principles. The more significant policies are described below. The consolidated financial statements include the accounts of the Company and its subsidiaries after elimination of all material intercompany accounts and transactions. Certain prior year amounts have been reclassified to conform with current classifications. The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts and disclosures. Actual results could differ from those estimates. Estimates susceptible to change in the near term include the allowance for loan losses, other-than-temporary impairment of securities, the valuation allowance on deferred tax assets, and loss contingencies.

Securities

Securities classified as available-for-sale are securities that the Company intends to hold for an indefinite period of time, but not necessarily until maturity. These include securities that management may use as part of its asset/liability strategy, or that may be sold in response to changes in interest rates, changes in prepayment risk, or similar reasons. Equity securities with readily determinable fair values are classified as available-for-sale. Equity securities that do not have readily determinable fair values are carried at historical cost and evaluated for impairment on a periodic basis. Securities classified as available-for-sale are reported at market value with unrealized gains or losses included as a separate component of equity, net of tax. Securities classified as held-to-maturity are securities that the Company has both the ability and positive intent to hold to maturity. Securities held-to-maturity are carried at amortized cost.

Premium amortization is deducted from, and discount accretion is added to, interest income using the level yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Gains and losses on sales are recorded on trade date and are computed on the identified securities method. 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: the length of time and extent that fair value has been less than cost, the financial condition and near term prospects of the issuer, and the Company's ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in fair value.

Loans Held for Sale

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or market value, in aggregate. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings.

Mortgage loans held for sale are generally sold on a servicing released basis. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at the principal balance outstanding, net of unearned interest, deferred loan fees and costs, and an allowance for loan losses. Interest income is accrued on unpaid principal balance and includes amortization of net deferred loan fees and costs over the loan term without anticipating prepayments.

Interest income is discontinued on impaired loans and loans past due 90 days or more, unless the loan is well secured and in process of collection. All interest accrued but not received for loans placed on non-accrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

#### Certain Purchased 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.

---

Notes to the Consolidated Financial Statements

Dollars in thousands, except per share data

---

NOTE 1 – Summary of Significant Accounting Policies (continued)

Such purchased loans are accounted for individually or aggregated into pools of loans based on common risk characteristics (e.g., credit score, loan type, and date of origination). The Company estimates the amount and timing of expected cash flows for each purchased loan or pool, and the expected cash flows in excess of amount paid is recorded as interest income over the remaining life of the loan or pool (accretable yield). The excess of the loan's or pool's contractual principal and interest over expected cash flows is not recorded (nonaccretable difference).

Over the life of the loan or pool, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses. 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. 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. 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. The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or special mention. The general component covers non-classified loans and is based on historical loss experience adjusted for current factors.

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 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.

Federal Home Loan Bank (FHLB) Stock

The Bank is a member of the FHLB of Indianapolis. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Premises, Furniture and Equipment

Land is carried at cost. Premises, furniture, and equipment are stated at cost less accumulated depreciation. Buildings and related components are depreciated using the straight-line method with useful lives ranging from 10 to 40 years. Furniture, fixtures, and equipment are depreciated using the straight-line method with useful lives ranging from 3 to 10 years.

#### Other Real Estate

Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

#### Goodwill and Other Intangible Assets

Goodwill results from prior business acquisitions and represents the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Goodwill is not amortized, but is assessed at least annually for impairment with any such impairment recognized in the period identified.

Other intangible assets consist of core deposit and acquired customer relationship intangible assets. They are initially measured at fair value and then are amortized over their estimated useful lives, which range from 7 to 10 years.



---

Notes to the Consolidated Financial Statements

Dollars in thousands, except per share data

---

NOTE 1 – Summary of Significant Accounting Policies (continued)

Company Owned Life Insurance

The Company has purchased life insurance policies on certain directors and executives. This life insurance is recorded at its cash surrender value or the amount that can be realized, which considers any adjustments or changes that are probable at settlement.

Servicing Rights

During the second quarter of 2006, the Company sold its mortgage loan servicing rights portfolio and commenced selling all secondary market residential mortgage loans on a servicing-released basis. Prior to the second quarter of 2006 servicing rights were recognized and included with other assets for purchased rights and for the allocated value of retained servicing rights on loans sold. Servicing rights were expensed in proportion to, and over the period of, estimated net servicing revenues. Impairment was evaluated based on the fair value of the rights, using groupings of the underlying loans as to type and age, with any impairment of a grouping reported as a valuation allowance. Fair value was determined based upon discounted cash flows using market based assumptions.

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe currently that there are any such matters that will have a material impact on the financial statements.

Loan Commitments and Related Financial Instruments

Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Restrictions on Cash

At December 31, 2008 and 2007, respectively, the company was required to have \$945 and \$1,701 on deposit with the Federal Reserve, or as cash on hand.

Long-term Assets

Premises and equipment, core deposit and other intangible assets, and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Stock Based Compensation

Compensation cost is recognized for stock options and restricted stock awards issued to employees, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Corporation's common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period.

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale and changes in unrecognized amounts in pension and other postretirement benefits, which are also recognized as a separate component of equity.

#### Income Taxes

Deferred tax liabilities and assets are determined at each balance sheet date and are the result of differences in the financial statement and tax bases of assets and liabilities. Income tax expense is the amount due on the current year tax returns plus or minus the change in deferred taxes. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

#### Retirement Plans

Pension expense under the suspended defined benefit plan is the net of interest cost, return on plan assets and amortization of gains and losses not immediately recognized. Employee 401(k) and profit sharing plan expense is the amount of matching contributions. Deferred compensation and supplemental retirement plan expense allocates the benefits over years of service.

---

Notes to the Consolidated Financial Statements

Dollars in thousands, except per share data

---

NOTE 1 – Summary of Significant Accounting Policies (continued)

Earnings Per Share

Earnings per share are based on net income divided by the weighted average number of shares outstanding during the period. Diluted earnings per share show the potential dilutive effect of additional common shares issuable under the Company's stock based compensation plans. Earnings per share are retroactively restated for stock dividends.

Cash Flow Reporting

The Company reports net cash flows for customer loan transactions, deposit transactions and deposits made with other financial institutions. Cash and cash equivalents are defined to include cash on hand, demand deposits in other institutions and Federal Funds Sold.

Fair Values of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 15. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Reclassifications

Some items in the prior year financial statements were reclassified to conform to the current presentation.

New Accounting Pronouncements

In September 2006, the FASB issued Statement No. 157, Fair Value Measurements (FAS 157). This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This Statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The standard was effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued Staff Position (FSP) 157-2, Effective Date of FASB Statement No. 157. This FSP delays the effective date of FAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The impact of adoption was not material. In October 2008, the FASB issued Staff Position (FSP) 157-3, Determining the Fair Value of a Financial Asset when the Market for That Asset Is Not Active. This FSP clarifies the application of FAS 157 in a market that is not active. The impact of adoption was not material.

In February 2007, the FASB issued Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. The standard provides companies with an option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The new standard was effective for the Company on January 1, 2008. The Company did not elect the fair value option for any financial assets or financial liabilities as of January 1, 2008 or subsequently.

In September 2006, the FASB Emerging Issues Task Force finalized Issue No. 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements. This issue requires that a liability be recorded during the service period when a split-dollar life insurance agreement

continues after participants' employment or retirement. The required accrued liability will be based on either the post-employment benefit cost for the continuing life insurance or based on the future death benefit depending on the contractual terms of the underlying agreement. This issue became effective for the Company on January 1, 2008. The impact of adoption of this issue was an adjustment to lower retained earnings of the Company by \$288 effective January 1, 2008.

On November 5, 2007, the SEC issued Staff Accounting Bulletin No. 109, Written Loan Commitments Recorded at Fair Value through Earnings ("SAB 109"). Previously, SAB 105, Application of Accounting Principles to Loan Commitments, stated that in measuring the fair value of a derivative loan commitment, a company should not incorporate the expected net future cash flows related to the associated servicing of the loan. SAB 109 supersedes SAB 105 and indicates that the expected net future cash flows related to the associated servicing of the loan should be included in measuring fair value for all written loan commitments that are accounted for at fair value through earnings. SAB 105 also indicated that internally-developed intangible assets should not be recorded as part of the fair value of a derivative loan commitment, and SAB 109 retains that view. SAB 109 was effective for derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. The impact of adoption was not material.

---

Notes to the Consolidated Financial Statements  
Dollars in thousands, except per share data

---

## NOTE 1 – Summary of Significant Accounting Policies (continued)

## Effect of Newly Issued but Not Yet Effective Accounting Standards

In December 2007, the FASB issued FAS No. 141 (revised 2007), Business Combinations (“FAS 141(R)”), which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in an acquiree, including the recognition and measurement of goodwill acquired in a business combination. FAS No. 141(R) is effective for fiscal years beginning on or after December 15, 2008. Earlier adoption is prohibited. The impact of the adoption of this standard will depend upon the nature of any future acquisitions.

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB No. 51” (“SFAS No. 160”), which will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity within the consolidated balance sheets. FAS No. 160 is effective as of the beginning of the first fiscal year beginning on or after December 15, 2008. Earlier adoption is prohibited and the Corporation does not expect the adoption of FAS No. 160 to have a significant impact on its results of operations or financial position.

## NOTE 2 – Securities

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Securities Available-for-Sale:</b>				
<b>2008</b>				
U.S. Treasury and Agency Securities	\$ —	\$ —	\$ —	\$ —
Obligations of State and Political Subdivisions	16,561	307	—	16,868
Mortgage-backed Securities	151,499	4,132	(4)	155,627
Equity Securities	3,620	44	(319)	3,345
<b>Total</b>	<b>\$ 171,680</b>	<b>\$ 4,483</b>	<b>\$ (323)</b>	<b>\$ 175,840</b>
<b>2007</b>				
U.S. Treasury and Agency Securities	\$ 25,306	\$ 433	\$ —	\$ 25,739
Obligations of State and Political Subdivisions	11,387	216	(1)	11,602
Mortgage-backed Securities	105,302	608	(421)	105,489
Equity Securities	4,557	913	—	5,470
<b>Total</b>	<b>\$ 146,552</b>	<b>\$ 2,170</b>	<b>\$ (422)</b>	<b>\$ 148,300</b>

The carrying amount, unrecognized gains and losses and fair value of Securities Held-to-Maturity were as follows:

Gross                      Gross

Edgar Filing: GERMAN AMERICAN BANCORP, INC. - Form 10-K

	Carrying Amount	Unrecognized Gains	Unrecognized Losses	Fair Value
<b>Securities Held-to-Maturity:</b>				
<b>2008</b>				
Obligations of State and Political Subdivisions	\$ 3,326	\$ 32	\$ —	\$ 3,358
<b>2007</b>				
Obligations of State and Political Subdivisions	\$ 4,464	\$ 32	\$ —	\$ 4,496

40

---

---

Notes to the Consolidated Financial Statements  
Dollars in thousands, except per share data

---

## NOTE 2 – Securities (continued)

The amortized cost and fair value of Securities at December 31, 2008 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. Asset-backed, Mortgage-backed and Equity Securities are not due at a single maturity date and are shown separately.

	Amortized Cost	Fair Value
<b>Securities Available-for-Sale:</b>		
Due in one year or less	\$ 1,590	\$ 1,597
Due after one year through five years	4,640	4,681
Due after five years through ten years	2,262	2,365
Due after ten years	8,069	8,225
Mortgage-backed Securities	151,499	155,627
Equity Securities	3,620	3,345
Totals	\$ 171,680	\$ 175,840

	Carrying Amount	Fair Value
<b>Securities Held-to-Maturity:</b>		
Due in one year or less	\$ 412	\$ 413
Due after one year through five years	1,231	1,246
Due after five years through ten years	1,195	1,208
Due after ten years	488	491
Totals	\$ 3,326	\$ 3,358

Proceeds from the Sales of Securities are summarized below:

	2008 Available- for-Sale	2007 Available- for-Sale	2006 Available- for-Sale
Proceeds from Sales and Calls	\$ 53,641	\$ 998	\$ 13,001
Gross Gains on Sales and Calls	1,031	62	951
Income Taxes on Gross Gains	351	25	323

The carrying value of securities pledged to secure repurchase agreements, public and trust deposits, and for other purposes as required by law was \$101,333 and \$102,829 as of December 31, 2008 and 2007, respectively.

Below is a summary of securities with unrealized losses as of year-end 2008 and 2007, presented by length of time the securities have been in a continuous unrealized loss position:

Edgar Filing: GERMAN AMERICAN BANCORP, INC. - Form 10-K

At December 31, 2008:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury Securities and Obligations of Government Corporations and Agencies	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Obligations of State and Political Subdivisions	—	—	—	—	—	—
Mortgage-backed Securities	1,253	(2)	617	(2)	1,870	(4)
Equity Securities	1,705	(319)	—	—	1,705	(319)
<b>Total</b>	<b>\$ 2,958</b>	<b>\$ (321)</b>	<b>\$ 617</b>	<b>\$ (2)</b>	<b>\$ 3,575</b>	<b>\$ (323)</b>

At December 31, 2007:

	Less than 12 Months	12 Months or More	Total
--	---------------------	-------------------	-------