GERMAN AMERICAN BANCORP, INC.
Form 10-Q
May 10, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarterly Period Ended March 31, 2018

Commission File Number 001-15877

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES x NO ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES x NO ¨

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

Large accelerated filer x	Accelerated filer ¨	Non-accelerated filer ¨	Smaller reporting company ¨	Emerging growth company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.
¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):
YES ¨ NO x

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

Class	Outstanding at May 1, 2018
Common Shares, no par value	22,967,448

CAUTION REGARDING FORWARD-LOOKING STATEMENTS AND ASSOCIATED RISKS

Information included in or incorporated by reference in this Quarterly Report on Form 10-Q, our other filings with the Securities and Exchange Commission (the "SEC") and our press releases or other public statements, contains or may contain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Please refer to the discussions of our forward-looking statements and associated risks in our Annual Report on Form 10-K for the year ended December 31, 2017, in Item 1, "Business – Forward-Looking Statements and Associated Risks" and our discussion of risk factors in Item 1A, "Risk Factors" of that Annual Report on Form 10-K, as updated from time to time in our subsequent SEC filings, including by Item 2 of Part I of this Report ("Management's Discussion and Analysis of Financial Condition and Results of Operations") at the conclusion of that Item 2 under the heading "Forward-Looking Statements and Associated Risks."

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
GERMAN AMERICAN BANCORP, INC.
CONSOLIDATED BALANCE SHEETS
(unaudited, dollars in thousands except share and per share data)

	March 31, 2018	December 31, 2017
ASSETS		
Cash and Due from Banks	$32,023	$58,233
Federal Funds Sold and Other Short-term Investments	8,187	12,126
Cash and Cash Equivalents	40,210	70,359
Securities Available-for-Sale, at Fair Value	737,604	740,641
Other Investments	353	353
Loans Held-for-Sale, at Fair Value	6,628	6,719
Loans	2,153,848	2,145,019
Less: Unearned Income	(3,302)	(3,381)
Allowance for Loan Losses	(14,460)	(15,694)
Loans, Net	2,136,086	2,125,944
Stock in FHLB of Indianapolis and Other Restricted Stock, at Cost	13,048	13,048
Premises, Furniture and Equipment, Net	58,024	54,246
Other Real Estate	68	54
Goodwill	54,058	54,058
Intangible Assets	1,896	2,102
Company Owned Life Insurance	46,386	46,385
Accrued Interest Receivable and Other Assets	30,657	30,451
TOTAL ASSETS	$3,125,018	$3,144,360
LIABILITIES		
Non-interest-bearing Demand Deposits	$599,374	$606,134
Interest-bearing Demand, Savings, and Money Market Accounts	1,465,150	1,490,033
Time Deposits	402,597	387,885
Total Deposits	2,467,121	2,484,052
FHLB Advances and Other Borrowings	274,473	275,216
Accrued Interest Payable and Other Liabilities	19,419	20,521
TOTAL LIABILITIES	2,761,013	2,779,789
SHAREHOLDERS’ EQUITY		
Preferred Stock, no par value; 500,000 shares authorized, no shares issued	—	—
Common Stock, no par value, $1 stated value; 45,000,000 shares authorized	22,969	22,934
Additional Paid-in Capital	165,532	165,288
Retained Earnings	187,342	178,969
Accumulated Other Comprehensive Loss	(11,838)	(2,620)
TOTAL SHAREHOLDERS’ EQUITY	364,005	364,571
TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY	$3,125,018	$3,144,360
End of period shares issued and outstanding	22,968,813	22,934,403

See accompanying notes to consolidated financial statements.

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

	Three Months Ended March 31,	
	2018	2017
INTEREST INCOME		
Interest and Fees on Loans	$23,950	$22,262
Interest on Federal Funds Sold and Other Short-term Investments	56	27
Interest and Dividends on Securities:		
Taxable	2,998	2,719
Non-taxable	2,141	2,025
TOTAL INTEREST INCOME	29,145	27,033
INTEREST EXPENSE		
Interest on Deposits	2,283	1,443
Interest on FHLB Advances and Other Borrowings	1,252	865
TOTAL INTEREST EXPENSE	3,535	2,308
NET INTEREST INCOME	25,610	24,725
Provision for Loan Losses	350	500
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	25,260	24,225
NON-INTEREST INCOME		
Trust and Investment Product Fees	1,773	1,243
Service Charges on Deposit Accounts	1,471	1,484
Insurance Revenues	2,930	2,640
Company Owned Life Insurance	312	254
Interchange Fee Income	1,482	1,023
Other Operating Income	604	857
Net Gains on Sales of Loans	650	687
Net Gains on Securities	270	—
TOTAL NON-INTEREST INCOME	9,492	8,188
NON-INTEREST EXPENSE		
Salaries and Employee Benefits	12,126	11,444
Occupancy Expense	1,744	1,549
Furniture and Equipment Expense	665	633
FDIC Premiums	237	239
Data Processing Fees	1,127	1,011
Professional Fees	871	803
Advertising and Promotion	701	778
Intangible Amortization	206	253
Other Operating Expenses	2,778	2,326
TOTAL NON-INTEREST EXPENSE	20,455	19,036
Income before Income Taxes	14,297	13,377
Income Tax Expense	2,484	3,821
NET INCOME	$11,813	$9,556

Basic Earnings per Share	$0.51	$0.42
Diluted Earnings per Share	$0.51	$0.42
Dividends per Share	$0.15	$0.13

See accompanying notes to consolidated financial statements.

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

	Three Months Ended March 31, 2018	2017
NET INCOME	$11,813	$9,556
Other Comprehensive Income (Loss):		
Unrealized Gains (Losses) on Securities:		
Unrealized Holding Gain (Loss) Arising During the Period	(11,452)	6,179
Reclassification Adjustment for Gains Included in Net Income	(270)	—
Tax Effect	2,504	(2,181)
Net of Tax	(9,218)	3,998
Total Other Comprehensive Income (Loss)	(9,218)	3,998
COMPREHENSIVE INCOME	$2,595	$13,554

See accompanying notes to consolidated financial statements.

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

	Three Months Ended March 31,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	$11,813	$9,556
Adjustments to Reconcile Net Income to Net Cash from Operating Activities:		
Net Amortization (Accretion) on Securities	(904)	808
Depreciation and Amortization	1,199	1,127
Loans Originated for Sale	(29,822)	(24,566)
Proceeds from Sales of Loans Held-for-Sale	30,592	33,615
Provision for Loan Losses	350	500
Gain on Sale of Loans, net	(650)	(687)
Gain on Securities, net	(270)	—
Loss (Gain) on Sales of Other Real Estate and Repossessed Assets	(13)	—
Loss on Disposition and Donation of Premises and Equipment	(1)	—
Increase in Cash Surrender Value of Company Owned Life Insurance	(252)	(261)
Equity Based Compensation	279	295
Change in Assets and Liabilities:		
Interest Receivable and Other Assets	16	(1,602)
Interest Payable and Other Liabilities	1,402	3,857
Net Cash from Operating Activities	13,739	22,642
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from Maturity of Securities Available-for-Sale	22,930	21,154
Proceeds from Sales of Securities Available-for-Sale	7,295	—
Purchase of Securities Available-for-Sale	(37,736)	(32,351)
Purchase of Loans	—	(59)
Proceeds from Sales of Loans	6,000	—
Loans Made to Customers, net of Payments Received	(16,519)	6,182
Proceeds from Sales of Other Real Estate	26	152
Property and Equipment Expenditures	(4,790)	(2,433)
Proceeds from Sales of Property and Equipment	1	—
Net Cash from Investing Activities	(22,793)	(7,355)
CASH FLOWS FROM FINANCING ACTIVITIES		
Change in Deposits	(16,894)	(23,003)
Change in Short-term Borrowings	9,297	(40,985)
Advances in Long-term Debt	35,000	25,000
Repayments of Long-term Debt	(45,058)	(776)
Dividends Paid	(3,440)	(2,900)
Net Cash from Financing Activities	(21,095)	(42,664)
Net Change in Cash and Cash Equivalents	(30,149)	(27,377)
Cash and Cash Equivalents at Beginning of Year	70,359	64,816
Cash and Cash Equivalents at End of Period	$40,210	$37,439

Cash Paid During the Period for		
Interest	$3,641	$2,361
Income Taxes	—	—
Supplemental Non Cash Disclosures		
Loans Transferred to Other Real Estate	$27	$118

See accompanying notes to consolidated financial statements.

GERMAN AMERICAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2018
(unaudited, dollars in thousands except share and per share data)

NOTE 1 – Basis of Presentation

German American Bancorp, Inc. operates primarily in the banking industry. The accounting and reporting policies of German American Bancorp, Inc. and its subsidiaries (hereinafter collectively referred to as the "Company") conform to U.S. generally accepted accounting principles. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. All adjustments which are, in the opinion of management, necessary for a fair presentation of the results for the periods reported have been included in the accompanying unaudited consolidated financial statements, and all such adjustments are of a normal recurring nature. It is suggested that these consolidated financial statements and notes be read in conjunction with the financial statements and notes thereto in the Company's Annual Report on Form 10-K for the year ended December 31, 2017. Certain items included in the prior period financial statements were reclassified to conform to the current presentation. There was no effect on net income or total shareholders' equity based on these reclassifications.

NOTE 2 - Revenue Recognition

In May 2014, the Financial Accounting Standards Board (the "FASB") issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). On January 1, 2018, the Company adopted ASU 2014-09 and all subsequent amendments to the ASU that modified Topic 606. Topic 606 creates a single framework for recognizing revenue from contracts with customers that fall within its scope and revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets. Since the guidance does not apply to revenue associated with financial instruments, the new guidance did not have a material impact on revenue most closely associated with financial instruments, including interest income and expense. The majority of the Company's revenues are from financial instruments and are not within the scope of Topic 606. The Company completed its overall assessment of revenue streams and related contracts, including service charges on deposit accounts, interchange income, and trust and investment brokerage fees. Based on the assessment, the Company concluded that ASU 2014-09 did not materially change the method in which the Company currently recognizes revenue for these revenue streams. The Company also completed its evaluation of certain costs related to these revenue streams to determine whether certain revenue streams should be reported gross versus net of certain expenses. Based on its evaluation, the Company determined that the classification of certain debit card related costs should change and now be reported as expenses versus contra-revenue. This reclassification change resulted in an immaterial impact to both revenue and expense. The Company adopted ASU 2014-09 and its related amendments utilizing the modified retrospective approach. Since there was no net income impact upon adoption of this guidance, a cumulative adjustment to retained earnings was not deemed necessary. Consistent with the modified retrospective approach, the Company did not adjust prior period amounts for the debit card costs noted above.

A description of the Company's revenue streams accounted for under Topic 606 follows:

Service Charges on Deposit Accounts: The Company earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which include services such as stop payment charges and statement rendering, are recognized at the time the transaction is executed (the point in time the Company fills the customer's request). Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs.

Interchange Fee Income: The Company earns interchange fees from debit/credit cardholder transactions conducted through various payment networks. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder.

Trust and Investment Product Fees: The Company earns trust and investment brokerage fees from its contracts with trust and brokerage customers to manage assets for investment and/or to transact their accounts. These fees are primarily earned over time as the Company provides the contracted monthly or quarterly services and are generally assessed based on the market value of assets under management at month-end. Fees that are transaction based, including trade execution services, are recognized at the point in time that the transaction is executed (trade date).

Insurance Revenues: The Company earns insurance revenue from commissions derived from the sale of personal and corporate property and casualty insurance products. These commissions are primarily earned over time as the Company provides the contracted insurance product to customers.

GERMAN AMERICAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2018
(unaudited, dollars in thousands except share and per share data

NOTE 2 - Revenue Recognition (continued)

The following table presents non-interest income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the three months ended March 31, 2018 and 2017.

	Three Months Ended March 31,	
Non-interest Income	2018	2017
In-Scope of Topic 606:		
Trust and Investment Product Fees	$1,773	$1,243
Service Charges on Deposit Accounts	1,471	1,484
Insurance Revenues	2,930	2,640
Interchange Fee Income	1,482	1,023
Other Operating Income	378	344
Non-interest Income (in-scope of Topic 606)	8,034	6,734
Non-interest Income (out-of-scope of Topic 606)	1,458	1,454
Total Non-interest Income	$9,492	$8,188

NOTE 3 – Per Share Data

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

	Three Months Ended March 31,	
	2018	2017
Basic Earnings per Share:		
Net Income	$11,813	$ 9,556
Weighted Average Shares Outstanding	22,940,402	22,908,648
Basic Earnings per Share	$0.51	$ 0.42
Diluted Earnings per Share:		
Net Income	$11,813	$ 9,556
Weighted Average Shares Outstanding	22,940,402	22,908,648
Potentially Dilutive Shares, Net	—	—
Diluted Weighted Average Shares Outstanding	22,940,402	22,908,648
Diluted Earnings per Share	$0.51	$ 0.42

For the three months ended March 31, 2018 and 2017, there were no anti-dilutive shares.

GERMAN AMERICAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2018
(unaudited, dollars in thousands except share and per share data

NOTE 4 – Securities

The amortized cost, unrealized gross gains and losses recognized in accumulated other comprehensive income (loss), and fair value of Securities Available-for-Sale at March 31, 2018 and December 31, 2017, were as follows:

Securities Available-for-Sale:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2018				
Obligations of State and Political Subdivisions	$ 271,135	$ 3,893	$ (2,275)	$ 272,753
MBS/CMO - Residential	481,192	76	(16,417)	464,851
Total	$ 752,327	$ 3,969	$ (18,692)	$ 737,604
December 31, 2017				
Obligations of State and Political Subdivisions	$ 267,437	$ 6,733	$ (861)	$ 273,309
MBS/CMO - Residential	476,205	416	(9,289)	467,332
Total	$ 743,642	$ 7,149	$ (10,150)	$ 740,641

All mortgage-backed securities in the above table (identified above and throughout this Note 4 as "MBS/CMO - Residential") are residential mortgage-backed securities and guaranteed by government sponsored entities.

Equity securities that do not have readily determinable fair values are included as "Other Investments" on the Consolidated Balance Sheet, are carried at historical cost and are evaluated for impairment on a periodic basis. The Company's equity securities consist of one non-controlling investment in a single banking organization at March 31, 2018 and December 31, 2017. The original investment totaled $1,350 and other-than-temporary impairment was previously recorded totaling $997. When a decline in fair value below cost is deemed to be other-than-temporary, the unrealized loss must be recognized as a charge to earnings.

The amortized cost and fair value of securities at March 31, 2018 by contractual maturity are shown below. Expected maturities may differ from contractual maturities because some issuers have the right to call or prepay certain obligations with or without call or prepayment penalties. Mortgage-backed Securities are not due at a single maturity date and are shown separately in the table below.

Securities Available-for-Sale:	Amortized Cost	Fair Value
Due in one year or less	$ 2,814	$ 2,835
Due after one year through five years	20,970	21,520
Due after five years through ten years	80,105	81,462
Due after ten years	167,246	166,936
MBS/CMO - Residential	481,192	464,851
Total	$ 752,327	$ 737,604

Proceeds from the Sales of Securities are summarized below:

	Three Months Ended March 31, 2018	Three Months Ended March 31, 2017
Proceeds from Sales	$ 7,295	$ —
Gross Gains on Sales	270	—
Income Taxes on Gross Gains	57	—

The carrying value of securities pledged to secure repurchase agreements, public and trust deposits, and for other purposes as required by law was $226,893 and $165,404 as of March 31, 2018 and December 31, 2017, respectively.

GERMAN AMERICAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2018
(unaudited, dollars in thousands except share and per share data

NOTE 4 - Securities (continued)

Below is a summary of securities with unrealized losses as of March 31, 2018 and December 31, 2017, presented by length of time the securities have been in a continuous unrealized loss position:

March 31, 2018	Less than 12 Months Fair Value	Less than 12 Months Unrealized Loss	12 Months or More Fair Value	12 Months or More Unrealized Loss	Total Fair Value	Total Unrealized Loss
Obligations of State and Political Subdivisions	$74,634	$(1,264)	$23,716	$(1,011)	$98,350	$(2,275)
MBS/CMO - Residential	222,993	(5,380)	236,726	(11,037)	459,719	(16,417)
Total	$297,627	$(6,644)	$260,442	$(12,048)	$558,069	$(18,692)

December 31, 2017	Less than 12 Months Fair Value	Less than 12 Months Unrealized Loss	12 Months or More Fair Value	12 Months or More Unrealized Loss	Total Fair Value	Total Unrealized Loss
Obligations of State and Political Subdivisions	$33,230	$(237)	$24,161	$(624)	$57,391	$(861)
MBS/CMO - Residential	172,354	(2,048)	250,520	(7,241)	422,874	(9,289)
Total	$205,584	$(2,285)	$274,681	$(7,865)	$480,265	$(10,150)

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

NOTE 5 – Derivatives

The Company executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. The notional amounts of these interest rate swaps and the offsetting counterparty derivative instruments were $87.3 million at March 31, 2018 and $87.8 million at December 31, 2017. These interest rate swaps are simultaneously hedged by offsetting interest rate swaps that the Company executes with a third party, such that the Company minimizes its net risk exposure resulting from such transactions with approved, reputable, independent counterparties with substantially matching terms. The agreements are considered stand alone derivatives and changes in the fair value of derivatives are reported in earnings as non-interest income.

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

GERMAN AMERICAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2018
(unaudited, dollars in thousands except share and per share data)

NOTE 5 - Derivatives (continued)

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

	March 31, 2018		December 31, 2017	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Included in Other Assets:				
Interest Rate Swaps	$87,257	$ 2,232	$87,788	$ 1,564
Included in Other Liabilities:				
Interest Rate Swaps	$87,257	$ 2,210	$87,788	$ 1,633

The following table presents the effect of derivative instruments on the Consolidated Statements of Income for the periods presented:

	Three Months Ended March 31,	
	2018	2017
Interest Rate Swaps:		
Included in Other Operating Income	$90	$348

NOTE 6 – Loans

Loans were comprised of the following classifications at March 31, 2018 and December 31, 2017:

	March 31, 2018	December 31, 2017
Commercial:		
Commercial and Industrial Loans and Leases	$482,219	$486,668
Commercial Real Estate Loans	947,948	926,729
Agricultural Loans	329,138	333,227
Retail:		
Home Equity Loans	151,943	152,187
Consumer Loans	64,492	67,475
Residential Mortgage Loans	178,108	178,733
Subtotal	2,153,848	2,145,019
Less: Unearned Income	(3,302)	(3,381)
Allowance for Loan Losses	(14,460)	(15,694)
Loans, Net	$2,136,086	$2,125,944

The following tables present the activity in the allowance for loan losses by portfolio class for the three months ended March 31, 2018 and 2017:

March 31, 2018	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated	Total
Beginning Balance	$ 4,735	$ 4,591	$ 4,894	$ 330	$ 298	$ 343	$ 503	$ 15,694
Provision for Loan Losses	367	25	(69)	(44)	97	(18)	(8)	350
Recoveries	1	6	—	2	89	2	—	100
Loans Charged-off	(1,500)	—	—	(16)	(168)	—	—	(1,684)
Ending Balance	$ 3,603	$ 4,622	$ 4,825	$ 272	$ 316	$ 327	$ 495	$ 14,460

GERMAN AMERICAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2018
(unaudited, dollars in thousands except share and per share data)

NOTE 6 - Loans (continued)

March 31, 2017	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated	Total
Beginning Balance	$ 3,725	$ 5,452	$ 4,094	$ 283	$ 235	$ 329	$ 690	$ 14,808
Provision for Loan Losses	(115)	278	267	17	118	19	(84)	500
Recoveries	2	5	—	—	60	27	—	94
Loans Charged-off	—	(39)	—	(1)	(169)	(27)	—	(236)
Ending Balance	$ 3,612	$ 5,696	$ 4,361	$ 299	$ 244	$ 348	$ 606	$ 15,166

In determining the adequacy of the allowance for loan loss, general allocations are made for 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 historical averages for loan losses for these portfolios, judgmentally adjusted for current economic factors and portfolio trends.

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

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 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.

GERMAN AMERICAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2018
(unaudited, dollars in thousands except share and per share data)

NOTE 6 - Loans (continued)

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio class and based on impairment method as of March 31, 2018 and December 31, 2017:

March 31, 2018	Total	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated
Allowance for Loan Losses:								
Ending Allowance Balance Attributable to Loans:								
Individually Evaluated for Impairment	$1,181	$252	$929	$—	$—	$—	$—	$ —
Collectively Evaluated for Impairment	13,238	3,348	3,660	4,825	272	316	322	495
Acquired with Deteriorated Credit Quality	41	3	33	—	—	—	5	—
Total Ending Allowance Balance	$14,460	$3,603	$4,622	$4,825	$272	$316	$327	$ 495
Loans:								
Loans Individually Evaluated for Impairment	$9,793	$4,249	$5,401	$143	$—	$—	$—	n/m[2]
Loans Collectively Evaluated for Impairment	2,144,933	478,473	938,731	332,888	152,527	64,655	177,659	n/m[2]
Loans Acquired with Deteriorated Credit Quality	8,819	790	6,194	957	—	—	878	n/m[2]
Total Ending Loans Balance[1]	$2,163,545	$483,512	$950,326	$333,988	$152,527	$64,655	$178,537	n/m[2]

[1]Total recorded investment in loans includes $9,697 in accrued interest.
[2]n/m = not meaningful

December 31, 2017	Total	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated
Allowance for Loan Losses:								

Ending Allowance Balance Attributable to Loans:								
Individually Evaluated for Impairment	$2,228	$1,399	$829	$—	$—	$—	$—	$ —
Collectively Evaluated for Impairment	13,455	3,333	3,759	4,894	330	298	338	503
Acquired with Deteriorated Credit Quality	11	3	3	—	—	—	5	—
Total Ending Allowance Balance	$15,694	$4,735	$4,591	$4,894	$330	$298	$343	$ 503
Loans:								
Loans Individually Evaluated for Impairment	$11,633	$5,918	$5,552	$163	$—	$—	$—	n/m[2]
Loans Collectively Evaluated for Impairment	2,133,752	481,152	917,036	336,849	152,757	67,647	178,311	n/m[2]
Loans Acquired with Deteriorated Credit Quality	9,117	988	6,452	789	—	—	888	n/m[2]
Total Ending Loans Balance[1]	$2,154,502	$488,058	$929,040	$337,801	$152,757	$67,647	$179,199	n/m[2]

[1]Total recorded investment in loans includes $9,483 in accrued interest.
[2]n/m = not meaningful

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NOTE 6 - Loans (continued)

The following tables present loans individually evaluated for impairment by class of loans as of March 31, 2018 and December 31, 2017:

March 31, 2018	Unpaid Principal Balance(1)	Recorded Investment	Allowance for Loan Losses Allocated
With No Related Allowance Recorded:			
Commercial and Industrial Loans and Leases	$ 1,186	$ 1,145	$ —
Commercial Real Estate Loans	1,384	1,233	—
Agricultural Loans	858	686	—
Subtotal	3,428	3,064	—
With An Allowance Recorded:			
Commercial and Industrial Loans and Leases	3,333	3,113	255
Commercial Real Estate Loans	4,760	4,567	962
Agricultural Loans	—	—	—
Subtotal	8,093	7,680	1,217
Total	$ 11,521	$ 10,744	$ 1,217
Loans Acquired With Deteriorated Credit Quality With No Related Allowance Recorded (Included in the Total Above)	$ 832	$ 544	$ —
Loans Acquired With Deteriorated Credit Quality With An Additional Allowance Recorded (Included in the Total Above)	$ 620	$ 407	$ 36

(1) Unpaid Principal Balance is the remaining contractual principal payments gross of partial charge-offs and discounts.

December 31, 2017	Unpaid Principal Balance(1)	Recorded Investment	Allowance for Loan Losses Allocated
With No Related Allowance Recorded:			
Commercial and Industrial Loans and Leases	$ 1,205	$ 1,166	$ —
Commercial Real Estate Loans	1,812	1,495	—
Agricultural Loans	919	749	—
Subtotal	3,936	3,410	—
With An Allowance Recorded:			
Commercial and Industrial Loans and Leases	4,804	4,763	1,402
Commercial Real Estate Loans	4,489	4,465	832
Agricultural Loans	—	—	—
Subtotal	9,293	9,228	2,234
Total	$ 13,229	$ 12,638	$ 2,234
	$ 1,255	$ 797	$ —

Loans Acquired With Deteriorated Credit Quality With No Related Allowance Recorded (Included in the Total Above)			
Loans Acquired With Deteriorated Credit Quality With An Additional Allowance Recorded (Included in the Total Above)	$ 252	$ 208	$ 6

[(1)] Unpaid Principal Balance is the remaining contractual principal payments gross of partial charge-offs and discounts.

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NOTE 6 - Loans (continued)

The following tables present loans individually evaluated for impairment by class of loans for the three month period ended March 31, 2018 and 2017:

March 31, 2018	Average Recorded Investment	Interest Income Recognized	Cash Basis Recognized
With No Related Allowance Recorded:			
Commercial and Industrial Loans and Leases	$ 1,183	$ 13	$ 1
Commercial Real Estate Loans	1,407	13	6
Agricultural Loans	700	—	—
Subtotal	3,290	26	7
With An Allowance Recorded:			
Commercial and Industrial Loans and Leases	4,284	1	—
Commercial Real Estate Loans	4,623	3	—
Agricultural Loans	—	—	—
Subtotal	8,907	4	—
Total	$ 12,197	$ 30	$ 7
Loans Acquired With Deteriorated Credit Quality With No Related Allowance Recorded (Included in the Total Above)	$ 563	$ —	$ —
Loans Acquired With Deteriorated Credit Quality With An Additional Allowance Recorded (Included in the Total Above)	$ 412	$ 4	$ —

March 31, 2017	Average Recorded Investment	Interest Income Recognized	Cash Basis Recognized
With No Related Allowance Recorded:			
Commercial and Industrial Loans and Leases	$ 16	$ —	$ —
Commercial Real Estate Loans	522	4	4
Agricultural Loans	719	5	—
Subtotal	1,257	9	4
With An Allowance Recorded:			
Commercial and Industrial Loans and Leases	103	1	1
Commercial Real Estate Loans	2,423	6	6
Agricultural Loans	497	—	—
Subtotal	3,023	7	7
Total	$ 4,280	$ 16	$ 11
Loans Acquired With Deteriorated Credit Quality With No Related Allowance Recorded (Included in the Total Above)	$ 209	$ —	$ —
Loans Acquired With Deteriorated Credit Quality With An Additional Allowance Recorded (Included in the Total Above)	$ 1,007	$ 7	$ 7

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NOTE 6 - Loans (continued)

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

The following tables present the recorded investment in non-accrual loans and loans past due 90 days or more still on accrual by class of loans as of March 31, 2018 and December 31, 2017:

	Non-Accrual Loans		Loans Past Due 90 Days or More & Still Accruing	
	March 31, 2018	December 31, 2017	March 31, 2018	December 31, 2017
Commercial and Industrial Loans and Leases	$3,105	$4,753	$—	$ —
Commercial Real Estate Loans	4,502	4,618	893	474
Agricultural Loans	697	748	228	268
Home Equity Loans	188	199	—	—
Consumer Loans	71	286	—	—
Residential Mortgage Loans	916	487	—	—
Total	$9,479	$ 11,091	$ 1,121	$ 742
Loans Acquired With Deteriorated Credit Quality (Included in the Total Above)	$822	$ 866	$—	$ —

The following tables present the aging of the recorded investment in past due loans by class of loans as of March 31, 2018 and December 31, 2017:

March 31, 2018	Total	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Loans Not Past Due
Commercial and Industrial Loans and Leases	$483,512	$ 659	$ 180	$ 633	$1,472	$482,040
Commercial Real Estate Loans	950,326	1,195	—	2,237	3,432	946,894
Agricultural Loans	333,988	106	—	228	334	333,654
Home Equity Loans	152,527	529	94	188	811	151,716
Consumer Loans	64,655	303	62	71	436	64,219
Residential Mortgage Loans	178,537	3,860	123	701	4,684	173,853
Total(1)	$2,163,545	$ 6,652	$ 459	$ 4,058	$11,169	$2,152,376
Loans Acquired With Deteriorated Credit Quality (Included in the Total Above)	$8,819	$ 518	$ —	$ 27	$545	$8,274

[1]Total recorded investment in loans includes $9,697 in accrued interest.

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NOTE 6 - Loans (continued)

December 31, 2017	Total	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Loans Not Past Due
Commercial and Industrial Loans and Leases	$488,058	$ 209	$ 1,365	$ 905	$2,479	$485,579
Commercial Real Estate Loans	929,040	1,229	1,650	677	3,556	925,484
Agricultural Loans	337,801	27	—	268	295	337,506
Home Equity Loans	152,757	366	93	199	658	152,099
Consumer Loans	67,647	246	97	286	629	67,018
Residential Mortgage Loans	179,199	2,850	1,247	261	4,358	174,841
Total[1]	$2,154,502	$ 4,927	$ 4,452	$ 2,596	$11,975	$2,142,527
Loans Acquired With Deteriorated Credit Quality (Included in the Total Above)	$9,117	$ 342	$ 74	$ 27	$443	$8,674

[1]Total recorded investment in loans includes $9,483 in accrued interest.

Troubled Debt Restructurings:

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

During the three months ended March 31, 2018, there were no loans modified as a troubled debt restructuring. During the three months ended March 31, 2017, there was one loan modified as a troubled debt restructuring.

The following tables present the recorded investment of troubled debt restructurings by class of loans as of March 31, 2018 and December 31, 2017:

March 31, 2018	Total	Performing	Non-Accrual[1]
Commercial and Industrial Loans and Leases	$224	$ 124	$ 100
Commercial Real Estate Loans	—	—	—
Total	$224	$ 124	$ 100

December 31, 2017	Total	Performing	Non-Accrual[1]
Commercial and Industrial Loans and Leases	$258	$ 125	$ 133
Commercial Real Estate Loans	24	24	—
Total	$282	$ 149	$ 133

[1]The non-accrual troubled debt restructurings are included in the Non-Accrual Loan table presented on a previous page.

The Company had not committed to lending any additional amounts as of March 31, 2018 and December 31, 2017 to customers with outstanding loans that are classified as troubled debt restructurings.

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NOTE 6 - Loans (continued)

The following tables present loans by class modified as troubled debt restructurings that occurred during the three months ending March 31, 2018 and 2017:

March 31, 2018	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial and Industrial Loans and Leases	—	$ —	$ —
Commercial Real Estate Loans	—	—	—
Total	—	$ —	$ —

The troubled debt restructurings described above increased the allowance for loan losses by $0 and resulted in charge-offs of $0 during the three months ending March 31, 2018.

March 31, 2017	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial and Industrial Loans and Leases	—	$ —	$ —
Commercial Real Estate Loans	1	28	28
Total	1	$ 28	$ 28

The troubled debt restructurings described above increased the allowance for loan losses by $2 and resulted in charge-offs of $0 during the three months ending March 31, 2017.

Additionally, there were no loans modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the three months ending March 31, 2018 and 2017.

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

Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company classifies loans as to credit risk by individually analyzing loans. This analysis includes commercial and industrial loans, commercial real estate loans, and agricultural loans with an outstanding balance greater than $250. This analysis is typically performed on at least an annual basis. The Company uses the following definitions for risk ratings:

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

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

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

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NOTE 6 - Loans (continued)

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

March 31, 2018	Pass	Special Mention	Substandard	Doubtful	Total
Commercial and Industrial Loans and Leases	$459,442	$7,953	$ 16,117	$ —	$483,512
Commercial Real Estate Loans	917,878	16,163	16,285	—	950,326
Agricultural Loans	300,012	27,917	6,059	—	333,988
Total	$1,677,332	$52,033	$ 38,461	$ —	$1,767,826
Loans Acquired With Deteriorated Credit Quality (Included in the Total Above)	$2,395	$1,652	$ 3,894	$ —	$7,941

December 31, 2017	Pass	Special Mention	Substandard	Doubtful	Total
Commercial and Industrial Loans and Leases	$462,212	$7,901	$ 17,945	$ —	$488,058
Commercial Real Estate Loans	894,027	18,037	16,976	—	929,040
Agricultural Loans	304,032	27,288	6,481	—	337,801
Total	$1,660,271	$53,226	$ 41,402	$ —	$1,754,899
Loans Acquired With Deteriorated Credit Quality (Included in the Total Above)	$2,604	$1,647	$ 3,978	$ —	$8,229

The Company considers the performance of the loan portfolio and its impact on the allowance for loan losses. For home equity, consumer and residential mortgage loan classes, the Company also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in home equity, consumer and residential mortgage loans based on payment activity as of March 31, 2018 and December 31, 2017:

March 31, 2018	Home Equity Loans	Consumer Loans	Residential Mortgage Loans
Performing	$152,339	$ 64,584	$ 177,621
Nonperforming	188	71	916
Total	$152,527	$ 64,655	$ 178,537
Loans Acquired With Deteriorated Credit Quality (Included in the Total Above)	$—	$ —	$ 878

December 31, 2017	Home Equity Loans	Consumer Loans	Residential Mortgage Loans
Performing	$152,558	$ 67,361	$ 178,712
Nonperforming	199	286	487
Total	$152,757	$ 67,647	$ 179,199
Loans Acquired With Deteriorated Credit Quality (Included in the Total Above)	$—	$ —	$ 888

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NOTE 6 - Loans (continued)

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

	March 31, 2018	December 31, 2017
Commercial and Industrial Loans	$ 790	$ 988
Commercial Real Estate Loans	6,194	6,452
Agricultural Loans	957	789
Residential Mortgage Loans	878	888
Total	$ 8,819	$ 9,117
Carrying Amount, Net of Allowance	$ 8,778	$ 9,106

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

	2018	2017
Balance at January 1	$2,734	$2,521
New Loans Purchased	—	—
Accretion of Income	(81)	(42)
Reclassifications from Non-accretable Difference	86	311
Charge-off of Accretable Yield	—	—
Balance at March 31	$2,739	$2,790

For those purchased loans disclosed above, the Company increased the allowance for loan losses by $30 and $11 during the three months ended March 31, 2018 and 2017. No allowance for loan losses were reversed during the same period.

The carrying amount of consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process according to local requirements of the applicable jurisdiction totaled $28 as of March 31, 2018 and $14 as of December 31, 2017.

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NOTE 7 – Repurchase Agreements Accounted for as Secured Borrowings

Repurchase agreements are short-term borrowings included in FHLB Advances and Other Borrowings and mature overnight and continuously. Repurchase agreements, which were secured by mortgage-backed securities, totaled $31,796 and $41,499 as of March 31, 2018 and December 31, 2017, respectively. Risk could arise when the collateral pledged to a repurchase agreement declines in fair value. The Company minimizes risk by consistently monitoring the value of the collateral pledged. At the point in time where the collateral has declined in fair value, the Company is required to provide additional collateral based on the value of the underlying securities.

NOTE 8 – Segment Information

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

The core banking segment is comprised by the Company’s banking subsidiary, German American Bancorp, which operated through 53 banking offices at March 31, 2018. Effective April 1, 2018, the legal name of German American Bancorp was changed to German American Bank. Net interest income from loans and investments funded by deposits and borrowings is the primary revenue for the core-banking segment. The trust and investment advisory services segment’s revenues are comprised primarily of fees generated by the trust operations of the Company's banking subsidiary and by German American Investment Services, Inc. These fees are derived by providing trust, investment advisory, and brokerage services to its customers. The insurance segment primarily consists of German American Insurance, Inc., which provides a full line of personal and corporate insurance products. Commissions derived from the sale of insurance products are the primary source of revenue for the insurance segment.

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

	Core Banking	Trust and Investment Advisory Services	Insurance	Other	Consolidated Totals
Three Months Ended March 31, 2018					
Net Interest Income	$ 25,790	$ 3	$ 2	$ (185)	$ 25,610
Net Gains on Sales of Loans	650	—	—	—	650
Net Gains on Securities	270	—	—	—	270

Trust and Investment Product Fees	2	1,771	—	—	1,773
Insurance Revenues	1	2	2,927	—	2,930
Noncash Items:					
Provision for Loan Losses	350	—	—	—	350
Depreciation and Amortization	1,115	1	19	64	1,199
Income Tax Expense (Benefit)	2,244	136	321	(217)	2,484
Segment Profit (Loss)	10,762	385	939	(273)	11,813
Segment Assets at March 31, 2018	3,126,137	2,461	11,165	(14,745)	3,125,018

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NOTE 8 - Segment Information (continued)

	Core Banking	Trust and Investment Advisory Services	Insurance	Other	Consolidated Totals
Three Months Ended March 31, 2017					
Net Interest Income	$ 24,909	$ 1	$ 2	$ (187)	$ 24,725
Net Gains on Sales of Loans	687	—	—	—	687
Net Gains on Securities	—	—	—	—	—
Trust and Investment Product Fees	1	1,244	—	(2)	1,243
Insurance Revenues	2	5	2,633	—	2,640
Noncash Items:					
Provision for Loan Losses	500	—	—	—	500
Depreciation and Amortization	1,041	3	19	64	1,127
Income Tax Expense (Benefit)	3,622	34	427	(262)	3,821
Segment Profit (Loss)	8,965	44	673	(126)	9,556
Segment Assets at December 31, 2017	3,142,096	1,987	10,078	(9,801)	3,144,360

NOTE 9 – Stock Repurchase Plan

On April 26, 2001, the Company announced that its Board of Directors approved a stock repurchase program for up to 911,631 of the outstanding shares of common stock of the Company. Shares may be purchased from time to time in the open market and in large block privately negotiated transactions. The Company is not obligated to purchase any shares under the program, and the program may be discontinued at any time before the maximum number of shares specified by the program are purchased. The Board of Directors established no expiration date for this program. As of March 31, 2018, the Company had purchased 502,447 shares under the program. No shares were purchased under the program during the three months ended March 31, 2018 and 2017.

NOTE 10 – Equity Plans and Equity Based Compensation

The Company maintains three equity incentive plans under which stock options, restricted stock, and other equity incentive awards can be granted. At March 31, 2018, the Company has reserved 386,754 shares of common stock for the purpose of issuance pursuant to outstanding and future grants of options, restricted stock, and other equity awards to officers, directors and other employees of the Company.

For the three months ended March 31, 2018 and 2017, the Company granted no options. The Company recorded no stock compensation expense applicable to options during the three months ended March 31, 2018 and 2017 because all outstanding options were fully vested prior to 2007. In addition, there was no unrecognized option expense.

During the periods presented, awards of long-term incentives were granted in the form of restricted stock. Awards that were granted to management under a management incentive plan were granted in tandem with cash credit entitlements (typically in the form of 60% restricted stock grants and 40% cash credit entitlements). The management and employee restricted stock grants and tandem cash credit entitlements awarded will vest in three equal installments of 33.3% with the first annual vesting on December 5th of the year of the grant and on December 5th of the next two succeeding years. Awards that were granted to directors as additional retainer for their services do not include any cash credit entitlement. These director restricted stock grants are subject to forfeiture in the event that the recipient of the grant does not continue in service as a director of the Company through December 5th of the year after grant or does not satisfy certain meeting attendance requirements, at which time they generally vest 100 percent. For measuring compensation costs, restricted stock awards are valued based upon the market value of the common shares on the date of grant. During the three months ended March 31, 2018 and 2017, the Company granted awards of 34,860 and 37,890 shares of restricted stock, respectively. Total unvested restricted stock awards at March 31, 2018 and December 31, 2017 were 80,716 and 46,306, respectively.

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NOTE 10 - Equity Plans and Equity Based Compensation (continued)

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

	Three Months Ended March 31,	
	2018	2017
Restricted Stock Expense	$278	$306
Cash Entitlement Expense	170	158
Tax Effect	(117)	(182)
Net of Tax	$331	$282

Unrecognized expense associated with the restricted stock grants and cash entitlements totaled $3,449 and $3,201 as of March 31, 2018 and 2017, respectively.

The Company maintains an Employee Stock Purchase Plan whereby eligible employees have the option to purchase the Company's common stock at a discount. The purchase price of the shares under this Plan has been set at 95% of the fair market value of the Company's common stock as of the last day of the plan year. The plan provided for the purchase of up to 750,000 shares of common stock, which the Company may obtain by purchases on the open market or from private sources, or by issuing authorized but unissued common shares. At March 31, 2018, there were 557,203 shares available for future issuance under this plan. Funding for the purchase of common stock is from employee and Company contributions.

There was no expense recorded for the employee stock purchase plan during the three months ended March 31, 2018 and 2017. There was no unrecognized compensation expense as of March 31, 2018 and 2017 for the Employee Stock Purchase Plan.

NOTE 11 – Fair Value

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

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

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

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

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

Investment Securities: The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). Level 3 pricing is obtained from a third-party based upon similar trades that are not traded frequently without adjustment by the Company. At March 31, 2018, the Company held $5.5 million in Level 3 securities which consist of $5.2 million of non-rated Obligations of State and Political Subdivisions and $353 thousand of equity securities that are not actively traded. Absent the credit rating, significant assumptions must be made such that the credit risk input becomes an unobservable input and thus these securities are reported by the Company in a Level 3 classification.

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

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NOTE 11 - Fair Value (continued)

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

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

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

Loan Servicing Rights: On a quarterly basis, loan servicing rights are evaluated for impairment based upon the fair value of the rights as compared to carrying amount resulting in a Level 2 classification. The valuation model utilizes interest rate, prepayment speed, and default rate assumptions that market participants would use in estimating future net servicing income and that can be validated against available market data.

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

Assets and Liabilities Measured on a Recurring Basis

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

	Fair Value Measurements at March 31, 2018 Using			
	Quoted Prices in Active Markets	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total

	for Identical Assets (Level 1)			
Assets:				
Obligations of State and Political Subdivisions	$ —	$ 267,582	$ 5,171	$ 272,753
MBS/CMO - Residential	—	464,851	—	464,851
Equity Securities	—	—	353	353
Total Securities	$ —	$ 732,433	$ 5,524	$ 737,957
Loans Held-for-Sale	$ —	$ 6,628	$ —	$ 6,628
Derivative Assets	$ —	$ 2,232	$ —	$ 2,232
Mortgage Servicing Rights	$ —	$ 531	$ —	$ 531
Derivative Liabilities	$ —	$ 2,210	$ —	$ 2,210

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NOTE 11 - Fair Value (continued)

	Fair Value Measurements at December 31, 2017 Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets:				
Obligations of State and Political Subdivisions	$ —	$ 267,660	$ 5,649	$ 273,309
MBS/CMO - Residential	—	467,332	—	467,332
Equity Securities	—	—	353	353
Total Securities	$ —	$ 734,992	$ 6,002	$ 740,994
Loans Held-for-Sale	$ —	$ 6,719	$ —	$ 6,719
Derivative Assets	$ —	$ 1,564	$ —	$ 1,564
Mortgage Servicing Rights	$ —	$ 547	$ —	$ 547
Derivative Liabilities	$ —	$ 1,633	$ —	$ 1,633

There were no transfers between Level 1 and Level 2 for the periods ended March 31, 2018 and December 31, 2017.

At March 31, 2018, the aggregate fair value of the Loans Held-for-Sale was $6,628. Aggregate contractual principal balance was $6,478 with a difference of $150. At December 31, 2017, the aggregate fair value of the Loans Held-for-Sale was $6,719. Aggregate contractual principal balance was $6,576 with a difference of $143.

The tables below present a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months ended March 31, 2018 and 2017:

	Obligations of State and Political Subdivisions		Equity Securities	
	2018	2017	2018	2017
Balance of Recurring Level 3 Assets at January 1	$ 5,649	$ 7,566	$ 353	$ 353
Total Gains or Losses Included in Other Comprehensive Income	(18)	17	—	—
Maturities / Calls	(460)	(865)	—	—
Purchases	—	—	—	—
Balance of Recurring Level 3 Assets at March 31	$ 5,171	$ 6,718	$ 353	$ 353

Of the total gain/loss included in earnings for the three months ended March 31, 2018 and 2017, ($18) and $17 was attributable to other changes in fair value, respectively.

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NOTE 11 - Fair Value (continued)

Assets and Liabilities Measured on a Non-Recurring Basis

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

	Fair Value Measurements at March 31, 2018 Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets:				
Impaired Loans				
Commercial and Industrial Loans	$ —	$ —	$ 2,853	$ 2,853
Commercial Real Estate Loans	—	—	3,240	3,240

	Fair Value Measurements at December 31, 2017 Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets:				
Impaired Loans				
Commercial and Industrial Loans	$ —	$ —	$ 3,354	$ 3,354
Commercial Real Estate Loans	—	—	3,438	3,438

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of $7,274 with a valuation allowance of $1,181, resulting in a decrease to the provision for loan losses of $1,047 for the period ended March 31, 2018. For the three months ended March 31, 2017, impaired loans resulted in an increase to the provision for loan losses of $278. Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of $9,020 with a valuation allowance of $2,228, resulting in an increase to the provision for loan losses of $1,973 for the year ended December 31, 2017.

There was no Other Real Estate carried at fair value less costs to sell at March 31, 2018. No charge to earnings was included in the three months ended March 31, 2018 and 2017. There was no Other Real Estate carried at fair value less costs to sell at December 31, 2017. No charge to earnings was included in the year ended December 31, 2017.

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at March 31, 2018 and December 31, 2017:

March 31, 2018	Fair Value	Unobservable Input(s)

		Valuation Technique(s)		Range (Weighted Average)
Impaired Loans - Commercial and Industrial Loans	$ 2,853	Sales comparison approach	Adjustment for physical condition of comparable properties sold	0%-95% (88%)
Impaired Loans - Commercial Real Estate Loans	$ 3,240	Sales comparison approach	Adjustment for physical condition of comparable properties sold	17%-76% (47%)

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NOTE 11 - Fair Value (continued)

December 31, 2017	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Impaired Loans - Commercial and Industrial Loans	$ 3,354	Sales comparison approach	Adjustment for physical condition of comparable properties sold	0%-95% (84%)
Impaired Loans - Commercial Real Estate Loans	$ 3,438	Sales comparison approach	Adjustment for physical condition of comparable properties sold	30%-76% (47%)

The carrying amounts and estimated fair values of the Company's financial instruments not previously presented are provided in the tables below for the periods ending March 31, 2018 and December 31, 2017. Not all of the Company's assets and liabilities are considered financial instruments, and therefore are not included in the tables. Because no active market exists for a significant portion of the Company's financial instruments, fair value estimates were based on subjective judgments, and therefore cannot be determined with precision. In accordance with the adoption of ASU 2016-01, the tables below present the fair values measured using an exit price notion. The fair value of loans as of December 31, 2017 was measured using an entrance price notion.

		Fair Value Measurements at March 31, 2018 Using			
	Carrying Value	Level 1	Level 2	Level 3	Total
Financial Assets:					
Cash and Short-term Investments	$ 40,210	$ 32,023	$ 8,187	$ —	$ 40,210
Loans, Net	2,129,993	—	—	2,099,154	2,099,154
FHLB Stock and Other Restricted Stock	13,048	N/A	N/A	N/A	N/A
Accrued Interest Receivable	13,633	—	3,885	9,748	13,633
Financial Liabilities:					
Demand, Savings, and Money Market Deposits	(2,064,524)	(2,064,524)	—	—	(2,064,524)
Time Deposits	(402,597)	—	(401,234)	—	(401,234)
Short-term Borrowings	(142,796)	—	(142,796)	—	(142,796)
Long-term Debt	(131,677)	—	(118,619)	(10,709)	(129,328)
Accrued Interest Payable	(952)	—	(886)	(66)	(952)

		Fair Value Measurements at December 31, 2017 Using			
	Carrying Value	Level 1	Level 2	Level 3	Total
Financial Assets:					
Cash and Short-term Investments	$ 70,359	$ 48,467	$ 16,349	$ —	$ 64,816
Loans, Net	2,119,152	—	—	2,120,154	2,120,154
FHLB Stock and Other Restricted Stock	13,048	N/A	N/A	N/A	N/A
Accrued Interest Receivable	13,258	—	3,574	9,684	13,258
Financial Liabilities:					
Demand, Savings, and Money Market Deposits	(2,096,167)	(1,096,167)	—	—	(1,096,167)
Time Deposits	(387,885)	—	(388,640)	—	(388,640)

Short-term Borrowings	(133,499)	—	(133,499)	—	(133,499)
Long-term Debt	(141,717)	—	(129,366)	(11,052)	(140,418)
Accrued Interest Payable	(1,058)	—	(1,042)	(16)	(1,058)

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NOTE 12 - Other Comprehensive Income (Loss) (continued)

NOTE 12 - Other Comprehensive Income (Loss)

The tables below summarize the changes in accumulated other comprehensive income (loss) by component for the three months ended March 31, 2018 and 2017, net of tax:

March 31, 2018	Unrealized Gains and Losses on Available-for-Sale Securities	Postretirement Benefit Items	Total
Beginning Balance at January 1, 2018	$ (2,335)	$ (285)	$(2,620)
Other Comprehensive Income (Loss) Before Reclassification	(9,005)	—	(9,005)
Amounts Reclassified from Accumulated Other Comprehensive Income (Loss)	(213)	—	(213)
Net Current Period Other Comprehensive Income (Loss)	(9,218)	—	(9,218)
Ending Balance at March 31, 2018	$ (11,553)	$ (285)	$(11,838)