

FIRST FINANCIAL CORP /IN/  
Form 10-Q  
November 09, 2012  
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**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 September 30, 2012**

**Commission File Number 0-16759**

**FIRST FINANCIAL CORPORATION**

(Exact name of registrant as specified in its charter)

**INDIANA**  
(State or other jurisdiction  
incorporation or organization)

**35-1546989**  
(I.R.S. Employer  
Identification No.)

**One First Financial Plaza, Terre Haute, IN**  
(Address of principal executive office)

**47807**  
(Zip Code)

**(812)238-6000**

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(Registrant's telephone number, including area code)

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 period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No .

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

|   |   |
|---|---|
| Large accelerated filer <input type="checkbox"/>  | Accelerated filer <input checked="" type="checkbox"/> |
| Non-accelerated filer <input type="checkbox"/><br>(Do not check if a smaller reporting company) | Smaller reporting company <input type="checkbox"/>    |

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

As of November 5, 2012, the registrant had outstanding 13,237,523 shares of common stock, without par value.

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## Item 1. Financial Statements

## FIRST FINANCIAL CORPORATION

## CONSOLIDATED BALANCE SHEETS

(Dollar amounts in thousands, except per share data)

|   | September 30,<br>2012 | December 31,<br>2011 |
|---|-----------------------|----------------------|
|   | (Unaudited)           |                      |
| <b>ASSETS</b>                                 |                       |                      |
| Cash and due from banks                       | \$ 63,638             | \$ 134,280           |
| Federal funds sold and short-term investments | 55,773                | 11,725               |
| Securities available-for-sale                 | 656,506               | 666,287              |
| Loans:  |                       |                      |
| Commercial                                    | 1,078,449             | 1,099,324            |
| Residential                                   | 507,446               | 505,600              |
| Consumer                                      | 273,196               | 289,717              |
|   | 1,859,091             | 1,894,641            |
| Less:   |                       |                      |
| Unearned Income                               | (930)                 | (962)                |
| Allowance for loan losses                     | (21,457)              | (19,241)             |
|   | 1,836,704             | 1,874,438            |
| Restricted Stock                              | 21,296                | 22,282               |
| Accrued interest receivable                   | 12,785                | 12,947               |
| Premises and equipment, net                   | 44,722                | 40,105               |
| Bank-owned life insurance                     | 76,280                | 82,646               |
| Goodwill                                      | 37,612                | 37,612               |
| Other intangible assets                       | 4,216                 | 5,142                |
| Other real estate owned                       | 8,670                 | 4,964                |
| FDIC Indemnification asset                    | 1,602                 | 2,384                |
| Other assets                                  | 59,437                | 59,964               |
| <b>TOTAL ASSETS</b>                           | <b>\$ 2,879,241</b>   | <b>\$ 2,954,776</b>  |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>    |                       |                      |
| Deposits:                                     |                       |                      |
| Noninterest-bearing                           | \$ 430,619            | \$ 435,236           |
| Interest-bearing:                             |                       |                      |
| Certificates of deposit of \$100 or more      | 233,814               | 242,001              |
| Other interest-bearing deposits               | 1,595,237             | 1,597,262            |
|   | 2,259,670             | 2,274,499            |
| Short-term borrowings                         | 43,997                | 100,022              |
| Other borrowings                              | 125,863               | 146,427              |
| Other liabilities                             | 80,950                | 86,867               |
| <b>TOTAL LIABILITIES</b>                      | <b>2,510,480</b>      | <b>2,607,815</b>     |
| Shareholders equity                           |                       |                      |

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|  |              |    |           |
|--|--------------|----|-----------|
| Common stock, \$.125 stated value per share;                 |              |    |           |
| Authorized shares-40,000,000                                 |              |    |           |
| Issued shares-14,490,609 in 2012 and 14,450,966 in 2011      |              |    |           |
| Outstanding shares-13,237,523 in 2012 and 13,197,880 in 2011 | 1,808        |    | 1,806     |
| Additional paid-in capital                                   | 69,692       |    | 69,328    |
| Retained earnings  | 336,147      |    | 318,130   |
| Accumulated other comprehensive income (loss)                | (7,077)      |    | (10,494)  |
| Treasury shares at cost-1,253,086 in 2012 and 2011           | (31,809)     |    | (31,809)  |
| TOTAL SHAREHOLDERS EQUITY                                    | 368,761      |    | 346,961   |
| TOTAL LIABILITIES AND SHAREHOLDERS EQUITY                    | \$ 2,879,241 | \$ | 2,954,776 |

See accompanying notes.

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## FIRST FINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(Dollar amounts in thousands, except per share data)

|  | Three Months Ended<br>September 30, |                     | Nine Months Ended<br>September 30, |                     |
|--|-------------------------------------|---------------------|------------------------------------|---------------------|
|  | 2012<br>(unaudited)                 | 2011<br>(unaudited) | 2012<br>(unaudited)                | 2011<br>(unaudited) |
| <b>INTEREST INCOME:</b>  |                                     |                     |                                    |                     |
| Loans, including related fees  | \$ 24,725                           | \$ 22,943           | \$ 75,149                          | \$ 68,903           |
| <b>Securities:</b>   |                                     |                     |                                    |                     |
| Taxable  | 3,308                               | 4,016               | 10,339                             | 12,532              |
| Tax-exempt   | 1,827                               | 1,712               | 5,442                              | 5,075               |
| Other  | 568                                 | 479                 | 1,781                              | 1,426               |
| <b>TOTAL INTEREST INCOME</b>   | <b>30,428</b>                       | <b>29,150</b>       | <b>92,711</b>                      | <b>87,936</b>       |
| <b>INTEREST EXPENSE:</b>   |                                     |                     |                                    |                     |
| Deposits   | 1,881                               | 2,974               | 6,714                              | 9,339               |
| Short-term borrowings  | 33                                  | 56                  | 116                                | 151                 |
| Other borrowings   | 1,108                               | 1,216               | 3,648                              | 3,628               |
| <b>TOTAL INTEREST EXPENSE</b>  | <b>3,022</b>                        | <b>4,246</b>        | <b>10,478</b>                      | <b>13,118</b>       |
| <b>NET INTEREST INCOME</b>   | <b>27,406</b>                       | <b>24,904</b>       | <b>82,233</b>                      | <b>74,818</b>       |
| Provision for loan losses  | 2,559                               | 1,360               | 7,304                              | 3,894               |
| <b>NET INTEREST INCOME AFTER PROVISION FOR<br/>LOAN LOSSES</b>               | <b>24,847</b>                       | <b>23,544</b>       | <b>74,929</b>                      | <b>70,924</b>       |
| <b>NON-INTEREST INCOME:</b>  |                                     |                     |                                    |                     |
| Trust and financial services   | 1,413                               | 1,002               | 4,332                              | 3,530               |
| Service charges and fees on deposit accounts                                 | 2,560                               | 2,305               | 7,166                              | 6,808               |
| Other service charges and fees   | 2,506                               | 2,142               | 7,237                              | 6,223               |
| Securities gains/(losses), net   | 17                                  |                     | 677                                | 7                   |
| Total impairment losses  |                                     | (13)                | (11)                               | (110)               |
| Loss recognized in other comprehensive loss                                  |                                     |                     |                                    |                     |
| Net impairment loss recognized in earnings                                   |                                     | (13)                | (11)                               | (110)               |
| Insurance commissions  | 1,736                               | 1,935               | 5,426                              | 5,328               |
| Gain on sales of mortgage loans  | 1,253                               | 406                 | 2,970                              | 1,144               |
| Other  | 203                                 | 1,133               | 1,159                              | 2,168               |
| <b>TOTAL NON-INTEREST INCOME</b>   | <b>9,688</b>                        | <b>8,910</b>        | <b>28,956</b>                      | <b>25,098</b>       |
| <b>NON-INTEREST EXPENSE:</b>   |                                     |                     |                                    |                     |
| Salaries and employee benefits   | 13,695                              | 11,475              | 42,005                             | 34,430              |
| Occupancy expense  | 1,465                               | 1,171               | 4,370                              | 3,624               |
| Equipment expense  | 1,335                               | 1,079               | 4,016                              | 3,308               |
| FDIC Expense   | 494                                 | 161                 | 1,449                              | 1,440               |
| Other  | 5,975                               | 4,667               | 17,646                             | 14,113              |
| <b>TOTAL NON-INTEREST EXPENSE</b>  | <b>22,964</b>                       | <b>18,553</b>       | <b>69,486</b>                      | <b>56,915</b>       |
| <b>INCOME BEFORE INCOME TAXES</b>  | <b>11,571</b>                       | <b>13,901</b>       | <b>34,399</b>                      | <b>39,107</b>       |
| Provision for income taxes   | 3,480                               | 4,087               | 10,160                             | 12,073              |
| <b>NET INCOME</b>  | <b>8,091</b>                        | <b>9,814</b>        | <b>24,239</b>                      | <b>27,034</b>       |
| <b>OTHER COMPREHENSIVE INCOME</b>  |                                     |                     |                                    |                     |
| Change in unrealized gains/losses on securities, net of<br>reclassifications | 3,123                               | 6,322               | 3,763                              | 21,828              |
| Tax effect   | (1,249)                             | (2,529)             | (1,505)                            | (8,731)             |
|  | 1,874                               | 3,793               | 2,258                              | 13,097              |
| Change in funded status of post retirement benefits                          | 645                                 | 505                 | 1,932                              | 1,513               |

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|  |                  |                  |                  |                  |
|--|------------------|------------------|------------------|------------------|
| Tax effect   | (258)            | (202)            | (773)            | (605)            |
|  | 387              | 303              | 1,159            | 908              |
| <b>TOTAL OTHER COMPREHENSIVE INCOME</b>                      | <b>2,261</b>     | <b>4,096</b>     | <b>3,417</b>     | <b>14,005</b>    |
| <b>COMPREHENSIVE INCOME</b>                                  | <b>\$ 10,352</b> | <b>\$ 13,910</b> | <b>\$ 27,656</b> | <b>\$ 41,039</b> |
| <b>PER SHARE DATA</b>  |                  |                  |                  |                  |
| Basic and Diluted  | \$ 0.61          | \$ 0.75          | \$ 1.83          | \$ 2.06          |
| Dividends per Share  | \$               | \$               | \$ 0.47          | \$ 0.47          |
| Weighted average number of shares outstanding (in thousands) | 13,238           | 13,152           | 13,233           | 13,152           |

See accompanying notes.

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## FIRST FINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

Three Months Ended

September 30, 2012, and 2011

(Dollar amounts in thousands, except per share data)

(Unaudited)

|  | Common<br>Stock | Additional<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income/(Loss) | Treasury<br>Stock | Total      |
|--|-----------------|-----------------------|----------------------|--|-------------------|------------|
| Balance, July 1, 2012  | \$ 1,807        | \$ 69,571             | \$ 328,056           | \$ (9,338)   | \$ (31,809)       | \$ 358,287 |
| Net income   |                 |                       | 8,091                |  |                   | 8,091      |
| Change in net unrealized<br>gains/(losses) on securities<br>available for-sale, net of tax |                 |                       |                      | 1,874  |                   | 1,874      |
| Change in funded status of<br>retirement plans, net of tax                                 |                 |                       |                      | 387  |                   | 387        |
| Omnibus Equity Incentive Plan  | 1               | 121                   |                      |  |                   | 122        |
| Balance, September 30, 2012  | \$ 1,808        | \$ 69,692             | \$ 336,147           | \$ (7,077)   | \$ (31,809)       | \$ 368,761 |
| Balance, July 1, 2011  | \$ 1,806        | \$ 68,944             | \$ 304,358           | \$ 540   | \$ (32,983)       | \$ 342,665 |
| Net income   |                 |                       | 9,814                |  |                   | 9,814      |
| Change in net unrealized<br>gains/(losses) on securities<br>available for-sale, net of tax |                 |                       |                      | 3,793  |                   | 3,793      |
| Change in funded status of<br>retirement plans, net of tax                                 |                 |                       |                      | 303  |                   | 303        |
| Balance, September 30, 2011  | \$ 1,806        | \$ 68,944             | \$ 314,172           | \$ 4,636   | \$ (32,983)       | \$ 356,575 |

See accompanying notes.



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## FIRST FINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

Nine Months Ended

September 30, 2012, and 2011

(Dollar amounts in thousands, except per share data)

(Unaudited)

|  | Common<br>Stock | Additional<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income/(Loss) | Treasury<br>Stock | Total      |
|--|-----------------|-----------------------|----------------------|--|-------------------|------------|
| Balance, January 1, 2012   | \$ 1,806        | \$ 69,328             | \$ 318,130           | \$ (10,494)  | \$ (31,809)       | \$ 346,961 |
| Net income   |                 |                       | 24,239               |  |                   | 24,239     |
| Change in net unrealized<br>gains/(losses) on securities<br>available for-sale, net of tax |                 |                       |                      | 2,258  |                   | 2,258      |
| Change in funded status of<br>retirement plans, net of tax                                 |                 |                       |                      | 1,159  |                   | 1,159      |
| Omnibus Equity Incentive Plan  | 2               | 364                   |                      |  |                   | 366        |
| Cash Dividends, \$.47 per share  |                 |                       | (6,222)              |  |                   | (6,222)    |
| Balance, September 30, 2012  | \$ 1,808        | \$ 69,692             | \$ 336,147           | \$ (7,077)   | \$ (31,809)       | \$ 368,761 |
| Balance, January 1, 2011   | \$ 1,806        | \$ 68,944             | \$ 293,319           | \$ (9,369)   | \$ (32,983)       | \$ 321,717 |
| Net income   |                 |                       | 27,034               |  |                   | 27,034     |
| Change in net unrealized<br>gains/(losses) on securities<br>available for-sale, net of tax |                 |                       |                      | 13,097   |                   | 13,097     |
| Change in funded status of<br>retirement plans, net of tax                                 |                 |                       |                      | 908  |                   | 908        |
| Cash Dividends, \$.47 per share  |                 |                       | (6,181)              |  |                   | (6,181)    |
| Balance, September 30, 2011  | \$ 1,806        | \$ 68,944             | \$ 314,172           | \$ 4,636   | \$ (32,983)       | \$ 356,575 |

See accompanying notes.

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## FIRST FINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollar amounts in thousands, except per share data)

|   | 2012      | Nine Months Ended<br>September 30,<br>(Unaudited) | 2011             |
|---|-----------|---|------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                      |           |   |                  |
| Net Income  | \$        | 24,239  | \$ 27,034        |
| Adjustments to reconcile net income to net cash provided by operating activities: |           |   |                  |
| Net amortization (accretion) of premiums and discounts on investments             |           | 2,209   | 11               |
| Provision for loan losses   |           | 7,304   | 3,894            |
| Securities (gains) losses   |           | (677)   | (7)              |
| Securities impairment loss  |           | 11  | 110              |
| Gain on exchange of bank owned life insurance                                     |           |   | (928)            |
| (Gain) loss on sale of other real estate  |           | 46  | 232              |
| Restricted stock compensation   |           | 366   |                  |
| Depreciation and amortization   |           | 3,741   | 2,329            |
| Other, net  |           | 2,345   | (5,300)          |
| <b>NET CASH FROM OPERATING ACTIVITIES</b>   |           | <b>39,584</b>                                     | <b>27,375</b>    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                      |           |   |                  |
| Proceeds from sales of securities available-for-sale                              |           | 9,015   | 3,368            |
| Redemption of restricted stock  |           | 1,172   |                  |
| Purchases of restricted stock   |           | (186)   |                  |
| Purchases of customer list  |           | (114)   |                  |
| Redemption of bank owned life insurance   |           | 7,319   |                  |
| Purchases of bank owned life insurance  |           | (1,551)   | (4,500)          |
| Calls, maturities and principal reductions on securities available-for-sale       |           | 99,465  | 98,661           |
| Purchases of securities available-for-sale  |           | (96,953)  | (127,003)        |
| Loans made to customers, net of repayment   |           | 24,248  | (23,755)         |
| Proceeds from sales of other real estate owned                                    |           | 3,210   | 3,285            |
| Net change in federal funds sold  |           | (44,048)  | 5,104            |
| Additions to premises and equipment   |           | (7,318)   | (374)            |
| <b>NET CASH FROM INVESTING ACTIVITIES</b>   |           | <b>(5,741)</b>                                    | <b>(45,214)</b>  |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                      |           |   |                  |
| Net change in deposits  |           | (15,945)  | 23,857           |
| Net change in short-term borrowings   |           | (56,025)  | 6,531            |
| Dividends paid  |           | (12,425)  | (12,231)         |
| Repayments on other borrowings  |           | (20,090)  | (1,583)          |
| <b>NET CASH FROM FINANCING ACTIVITIES</b>   |           | <b>(104,485)</b>                                  | <b>16,574</b>    |
| <b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>                                    |           | <b>(70,642)</b>                                   | <b>(1,265)</b>   |
| <b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>                             |           | <b>134,280</b>                                    | <b>58,511</b>    |
| <b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>                                   | <b>\$</b> | <b>63,638</b>                                     | <b>\$ 57,246</b> |

See accompanying notes.

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## FIRST FINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The accompanying September 30, 2012 and 2011 consolidated financial statements are unaudited. The December 31, 2011 consolidated financial statements are as reported in the First Financial Corporation (the Corporation) 2011 annual report. The information presented does not include all information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. The following notes should be read together with notes to the consolidated financial statements included in the 10-K filed with the Securities and Exchange Commission for the fiscal year ended December 31, 2011.

1. Significant Accounting Policies

The significant accounting policies followed by the Corporation and its subsidiaries for interim financial reporting are consistent with the accounting policies followed for annual financial reporting. All adjustments which are, in the opinion of management, necessary for a fair statement of the results for the periods reported have been included in the accompanying consolidated financial statements and are of a normal recurring nature. The Corporation reports financial information for only one segment, banking. Some items in the prior year financials were reclassified to conform to the current presentation.

The Omnibus Equity Incentive Plan is a long-term incentive plan that was designed to align the interests of participants with the interests of shareholders. Under the plan, awards may be made based on certain performance measures. The grants are made in restricted stock units that are subject to a vesting schedule. These shares vest over 3 years in increments of 33%, 33%, and 34% respectively. In 2012, 39,643 shares were awarded. These shares had a grant date value of \$1.4 million, vest over three years and their grant is not subject to future performance measures. Outstanding shares are increased at the award date for the total shares awarded.

2. Allowance for Loan Losses

The following table presents the activity of the allowance for loan losses by portfolio segment for the three months ended September 30.

| Allowance for Loan Losses:<br>(Dollar amounts in thousands) | September 30, 2012 |             |          |             | Total     |
|---|--------------------|-------------|----------|-------------|-----------|
|   | Commercial         | Residential | Consumer | Unallocated |           |
| Beginning balance   | \$ 13,190          | \$ 2,124    | \$ 3,744 | \$ 1,034    | \$ 20,092 |
| Provision for loan losses*                                  | 765                | 1,594       | 196      | 85          | 2,640     |
| Loans charged -off  | (715)              | (381)       | (779)    |             | (1,875)   |
| Recoveries  | 167                | 36          | 397      |             | 600       |
| Ending Balance  | \$ 13,407          | \$ 3,373    | \$ 3,558 | \$ 1,119    | \$ 21,457 |

\* Provision before decrease of \$81 thousand in 2012 for increase in FDIC indemnification asset

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| Allowance for Loan Losses:<br>(Dollar amounts in thousands) | September 30, 2011 |             |          |             |    | Total   |
|---|--------------------|-------------|----------|-------------|----|---------|
|   | Commercial         | Residential | Consumer | Unallocated |    |         |
| Beginning balance   | \$ 12,886          | \$ 3,564    | \$ 3,978 | \$ 1,197    | \$ | 21,625  |
| Provision for loan losses*                                  | (422)              | 727         | 545      | 785         |    | 1,635   |
| Loans charged -off  | (536)              | (325)       | (802)    |             |    | (1,663) |
| Recoveries  | 310                |             | 221      |             |    | 531     |
| Ending Balance  | \$ 12,238          | \$ 3,966    | \$ 3,942 | \$ 1,982    | \$ | 22,128  |

\* Provision before increase of \$275 thousand in 2011 for decrease in FDIC indemnification asset

The following table presents the activity of the allowance for loan losses by portfolio segment for the nine months ended September 30.

| Allowance for Loan Losses:<br>(Dollar amounts in thousands) | September 30, 2012 |             |          |             |    | Total   |
|---|--------------------|-------------|----------|-------------|----|---------|
|   | Commercial         | Residential | Consumer | Unallocated |    |         |
| Beginning balance   | \$ 12,119          | \$ 2,728    | \$ 3,889 | \$ 505      | \$ | 19,241  |
| Provision for loan losses*                                  | 3,642              | 2,859       | 1,185    | 614         |    | 8,300   |
| Loans charged -off  | (2,917)            | (2,289)     | (2,635)  |             |    | (7,841) |
| Recoveries  | 563                | 75          | 1,119    |             |    | 1,757   |
| Ending Balance  | \$ 13,407          | \$ 3,373    | \$ 3,558 | \$ 1,119    | \$ | 21,457  |

\* Provision before decrease of \$1.0 million in 2012 for increase in FDIC indemnification asset

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| Allowance for Loan Losses:<br>(Dollar amounts in thousands) | September 30, 2011 |             |          |             | Total     |
|---|--------------------|-------------|----------|-------------|-----------|
|   | Commercial         | Residential | Consumer | Unallocated |           |
| Beginning balance   | \$ 12,809          | \$ 2,873    | \$ 4,551 | \$ 2,103    | \$ 22,336 |
| Provision for loan losses*                                  | 1,587              | 2,021       | 578      | (121)       | 4,065     |
| Loans charged -off  | (2,903)            | (1,015)     | (1,993)  |             | (5,911)   |
| Recoveries  | 745                | 87          | 806      |             | 1,638     |
| Ending Balance  | \$ 12,238          | \$ 3,966    | \$ 3,942 | \$ 1,982    | \$ 22,128 |

\* Provision before increase of \$171 thousand in 2011 for decrease in FDIC indemnification asset

The following table presents the allocation of the allowance for loan losses and the recorded investment in loans by portfolio segment and based on the impairment method at September 30, 2012 and December 31, 2011.

| Ending Balance Attributable to Loans:<br>(Dollar amounts in thousands) | September 30, 2012 |             |          |             | Total     |
|--|--------------------|-------------|----------|-------------|-----------|
|  | Commercial         | Residential | Consumer | Unallocated |           |
| Individually evaluated for impairment                                  | \$ 4,084           | \$ 1,468    | \$ 3,558 | \$ 1,119    | \$ 5,552  |
| Collectively evaluated for impairment                                  | 8,732              | 1,814       | 3,558    | 1,119       | 15,223    |
| Acquired with deteriorated credit quality                              | 591                | 91          |          |             | 682       |
| Ending Balance   | \$ 13,407          | \$ 3,373    | \$ 3,558 | \$ 1,119    | \$ 21,457 |

| Loans:<br>(Dollar amounts in thousands)   | September 30, 2012 |             |            | Total        |
|---|--------------------|-------------|------------|--------------|
|   | Commercial         | Residential | Consumer   |              |
| Individually evaluated for impairment     | \$ 24,709          | \$ 6,992    | \$ 274,543 | \$ 31,701    |
| Collectively evaluated for impairment     | 1,043,521          | 496,774     | 274,543    | 1,814,838    |
| Acquired with deteriorated credit quality | 16,655             | 5,397       | 7          | 22,059       |
| Ending Balance                            | \$ 1,084,885       | \$ 509,163  | \$ 274,550 | \$ 1,868,598 |

| Ending Balance Attributable to Loans:<br>(Dollar amounts in thousands) | December 31, 2011 |             |          |             | Total     |
|--|-------------------|-------------|----------|-------------|-----------|
|  | Commercial        | Residential | Consumer | Unallocated |           |
| Individually evaluated for impairment                                  | \$ 3,071          | \$ 190      | \$ 3,889 | \$ 505      | \$ 3,261  |
| Collectively evaluated for impairment                                  | 8,264             | 2,183       | 3,889    | 505         | 14,841    |
| Acquired with deteriorated credit quality                              | 784               | 355         |          |             | 1,139     |
| Ending Balance   | \$ 12,119         | \$ 2,728    | \$ 3,889 | \$ 505      | \$ 19,241 |

| Loans<br>(Dollar amounts in thousands)    | December 31, 2011 |             |            | Total        |
|---|-------------------|-------------|------------|--------------|
|   | Commercial        | Residential | Consumer   |              |
| Individually evaluated for impairment     | \$ 25,393         | \$ 2,213    | \$ 291,190 | \$ 27,606    |
| Collectively evaluated for impairment     | 1,036,963         | 492,139     | 291,190    | 1,820,292    |
| Acquired with deteriorated credit quality | 43,389            | 12,986      | 11         | 56,386       |
| Ending Balance                            | \$ 1,105,745      | \$ 507,338  | \$ 291,201 | \$ 1,904,284 |

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The following tables present loans individually evaluated for impairment by class of loans.

| (Dollar amounts in thousands)       | September 30, 2012             |                        |  |
|-------------------------------------|--------------------------------|------------------------|--|
|                                     | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Allowance<br>for Loan<br>Losses<br>Allocated |
| With no related allowance recorded: |                                |                        |  |
| Commercial                          |                                |                        |  |
| Commercial & Industrial             | \$ 2,496                       | \$ 2,496               | \$   |
| Farmland                            |                                |                        |  |
| Non Farm, Non Residential           |                                |                        |  |
| Agriculture                         |                                |                        |  |
| All Other Commercial                |                                |                        |  |
| Residential                         |                                |                        |  |
| First Liens                         |                                |                        |  |
| Home Equity                         |                                |                        |  |
| Junior Liens                        |                                |                        |  |
| Multifamily                         |                                |                        |  |
| All Other Residential               |                                |                        |  |
| Consumer                            |                                |                        |  |
| Motor Vehicle                       |                                |                        |  |
| All Other Consumer                  |                                |                        |  |
| With an allowance recorded:         |                                |                        |  |
| Commercial                          |                                |                        |  |
| Commercial & Industrial             | 15,389                         | 15,389                 | 3,925  |
| Farmland                            | 891                            | 891                    | 49   |
| Non Farm, Non Residential           | 7,581                          | 7,581                  | 182  |
| Agriculture                         |                                |                        |  |
| All Other Commercial                | 1,315                          | 1,315                  | 56   |
| Residential                         |                                |                        |  |
| First Liens                         | 1,255                          | 1,255                  | 190  |
| Home Equity                         | 197                            | 197                    |  |
| Junior Liens                        |                                |                        |  |
| Multifamily                         | 5,540                          | 5,540                  | 1,278  |
| All Other Residential               |                                |                        |  |
| Consumer                            |                                |                        |  |
| Motor Vehicle                       |                                |                        |  |
| All Other Consumer                  |                                |                        |  |
| <b>TOTAL</b>                        | <b>\$ 34,664</b>               | <b>\$ 34,664</b>       | <b>\$ 5,680</b>                              |

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| (Dollar amounts in thousands)       | December 31, 2011              |                        |  |                                   |                                  |   |
|-------------------------------------|--------------------------------|------------------------|--|-----------------------------------|----------------------------------|---|
|                                     | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Allowance<br>for Loan<br>Losses<br>Allocated | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Cash Basis<br>Interest Income<br>Recognized |
| With no related allowance recorded: |                                |                        |  |                                   |                                  |   |
| Commercial                          |                                |                        |  |                                   |                                  |   |
| Commercial & Industrial             | \$                             | \$                     | \$   | \$ 1,929                          | \$ 165                           | \$  |
| Farmland                            |                                |                        |  |                                   |                                  |   |
| Non Farm, Non Residential           | 4,444                          | 4,444                  |  | 3,262                             |                                  |   |
| Agriculture                         |                                |                        |  |                                   |                                  |   |
| All Other Commercial                |                                |                        |  |                                   |                                  |   |
| Residential                         |                                |                        |  |                                   |                                  |   |
| First Liens                         | 750                            | 750                    |  | 150                               |                                  |   |
| Home Equity                         |                                |                        |  |                                   |                                  |   |
| Junior Liens                        |                                |                        |  |                                   |                                  |   |
| Multifamily                         | 250                            | 250                    |  | 50                                |                                  |   |
| All Other Residential               |                                |                        |  |                                   |                                  |   |
| Consumer                            |                                |                        |  |                                   |                                  |   |
| Motor Vehicle                       |                                |                        |  |                                   |                                  |   |
| All Other Consumer                  |                                |                        |  |                                   |                                  |   |
| With an allowance recorded:         |                                |                        |  |                                   |                                  |   |
| Commercial                          |                                |                        |  |                                   |                                  |   |
| Commercial & Industrial             | 17,890                         | 17,866                 | 2,664  | 16,746                            |                                  |   |
| Farmland                            | 891                            | 891                    | 49   | 360                               |                                  |   |
| Non Farm, Non Residential           | 4,816                          | 4,816                  | 957  | 8,717                             |                                  |   |
| Agriculture                         |                                |                        |  |                                   |                                  |   |
| All Other Commercial                | 1,517                          | 1,517                  | 66   | 1,671                             |                                  |   |
| Residential                         |                                |                        |  |                                   |                                  |   |
| First Liens                         | 1,213                          | 1,213                  | 190  | 2,014                             |                                  |   |
| Home Equity                         |                                |                        |  |                                   |                                  |   |
| Junior Liens                        | 879                            | 879                    | 347  | 937                               |                                  |   |
| Multifamily                         |                                |                        |  | 510                               |                                  |   |
| All Other Residential               |                                |                        |  |                                   |                                  |   |
| Consumer                            |                                |                        |  |                                   |                                  |   |
| Motor Vehicle                       |                                |                        |  |                                   |                                  |   |
| All Other Consumer                  |                                |                        |  |                                   |                                  |   |
| <b>TOTAL</b>                        | <b>\$ 32,650</b>               | <b>\$ 32,626</b>       | <b>\$ 4,273</b>                              | <b>\$ 36,346</b>                  | <b>\$ 165</b>                    | <b>\$</b>                                   |



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| (Dollar amounts in thousands)          | Three Months Ended<br>September 30, 2012 |                                  |   | Nine Months Ended<br>September 30, 2012 |                                  |   |
|--|--|----------------------------------|---|---|----------------------------------|---|
|  | Average<br>Recorded<br>Investment        | Interest<br>Income<br>Recognized | Cash Basis<br>Interest Income<br>Recognized | Average<br>Recorded<br>Investment       | Interest<br>Income<br>Recognized | Cash Basis<br>Interest Income<br>Recognized |
| With no related allowance<br>recorded: |  |                                  |   |   |                                  |   |
| Commercial                             |  |                                  |   |   |                                  |   |
| Commercial & Industrial                | \$ 2,531                                 | \$                               | \$  | \$ 1,266                                | \$                               | \$  |
| Farmland                               |  |                                  |   |   |                                  |   |
| Non Farm, Non Residential              | 987                                      |                                  |   | 2,098                                   |                                  |   |
| Agriculture                            |  |                                  |   |   |                                  |   |
| All Other Commercial                   |  |                                  |   |   |                                  |   |
| Residential                            |  |                                  |   |   |                                  |   |
| First Liens                            |  |                                  |   | 188                                     |                                  |   |
| Home Equity                            |  |                                  |   |   |                                  |   |
| Junior Liens                           |  |                                  |   |   |                                  |   |
| Multifamily                            |  |                                  |   | 62                                      |                                  |   |
| All Other Residential                  |  |                                  |   |   |                                  |   |
| Consumer                               |  |                                  |   |   |                                  |   |
| Motor Vehicle                          |  |                                  |   |   |                                  |   |
| All Other Consumer                     |  |                                  |   |   |                                  |   |
| With an allowance recorded:            |  |                                  |   |   |                                  |   |
| Commercial                             |  |                                  |   |   |                                  |   |
| Commercial & Industrial                | 15,427                                   |                                  |   | 16,648                                  |                                  |   |
| Farmland                               | 891                                      |                                  |   | 891                                     |                                  |   |
| Non Farm, Non Residential              | 5,045                                    |                                  |   | 4,404                                   |                                  |   |
| Agriculture                            |  |                                  |   |   |                                  |   |
| All Other Commercial                   | 1,313                                    |                                  |   | 1,400                                   |                                  |   |
| Residential                            |  |                                  |   |   |                                  |   |
| First Liens                            | 1,234                                    |                                  |   | 1,224                                   |                                  |   |
| Home Equity                            | 99                                       |                                  |   | 49                                      |                                  |   |
| Junior Liens                           |  |                                  |   | 220                                     |                                  |   |
| Multifamily                            | 2,770                                    |                                  |   | 1,385                                   |                                  |   |
| All Other Residential                  |  |                                  |   |   |                                  |   |
| Consumer                               |  |                                  |   |   |                                  |   |
| Motor Vehicle                          |  |                                  |   |   |                                  |   |
| All Other Consumer                     |  |                                  |   |   |                                  |   |
| <b>TOTAL</b>                           | <b>\$ 30,297</b>                         | <b>\$</b>                        | <b>\$</b>                                   | <b>\$ 29,835</b>                        | <b>\$</b>                        | <b>\$</b>                                   |

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| (Dollar amounts in thousands)       | Three Months Ended<br>September 30, 2011 |                                  |   | Nine Months Ended<br>September 30, 2011 |                                  |   |
|-------------------------------------|--|----------------------------------|---|---|----------------------------------|---|
|                                     | Average<br>Recorded<br>Investment        | Interest<br>Income<br>Recognized | Cash Basis<br>Interest Income<br>Recognized | Average<br>Recorded<br>Investment       | Interest<br>Income<br>Recognized | Cash Basis<br>Interest Income<br>Recognized |
| With no related allowance recorded: |  |                                  |   |   |                                  |   |
| Commercial                          |  |                                  |   |   |                                  |   |
| Commercial & Industrial             | \$                                       | \$                               | \$  | \$ 2,411                                | \$                               | \$  |
| Farmland                            |  |                                  |   |   |                                  |   |
| Non Farm, Non Residential           | 2,877                                    |                                  |   | 2,967                                   |                                  |   |
| Agriculture                         |  |                                  |   |   |                                  |   |
| All Other Commercial                |  |                                  |   |   |                                  |   |
| Residential                         |  |                                  |   |   |                                  |   |
| First Liens                         |  |                                  |   |   |                                  |   |
| Home Equity                         |  |                                  |   |   |                                  |   |
| Junior Liens                        |  |                                  |   |   |                                  |   |
| Multifamily                         |  |                                  |   |   |                                  |   |
| All Other Residential               |  |                                  |   |   |                                  |   |
| Consumer                            |  |                                  |   |   |                                  |   |
| Motor Vehicle                       |  |                                  |   |   |                                  |   |
| All Other Consumer                  |  |                                  |   |   |                                  |   |
| With an allowance recorded:         |  |                                  |   |   |                                  |   |
| Commercial                          |  |                                  |   |   |                                  |   |
| Commercial & Industrial             | 18,108                                   | 76                               |   | 16,466                                  | 310                              | 1   |
| Farmland                            | 454                                      |                                  |   | 227                                     |                                  |   |
| Non Farm, Non Residential           | 9,395                                    |                                  |   | 9,692                                   |                                  |   |
| Agriculture                         |  |                                  |   |   |                                  |   |
| All Other Commercial                | 1,703                                    |                                  |   | 1,710                                   |                                  |   |
| Residential                         |  |                                  |   |   |                                  |   |
| First Liens                         | 2,518                                    |                                  |   | 2,214                                   |                                  |   |
| Home Equity                         |  |                                  |   |   |                                  |   |
| Junior Liens                        | 887                                      |                                  |   | 952                                     |                                  |   |
| Multifamily                         | 638                                      |                                  |   | 638                                     |                                  |   |
| All Other Residential               |  |                                  |   |   |                                  |   |
| Consumer                            |  |                                  |   |   |                                  |   |
| Motor Vehicle                       |  |                                  |   |   |                                  |   |
| All Other Consumer                  |  |                                  |   |   |                                  |   |
| <b>TOTAL</b>                        | <b>\$ 36,580</b>                         | <b>\$ 76</b>                     | <b>\$</b>                                   | <b>\$ 37,277</b>                        | <b>\$ 310</b>                    | <b>\$ 1</b>                                 |

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The table below presents non-performing loans.

| (Dollar amounts in thousands) | September 30, 2012                        |  |                  |
|-------------------------------|---|--|------------------|
|                               | Loans Past Due Over 90 Day Still Accruing | Non-accrual Troubled Debt Restructurings | Nonaccrual       |
| <b>Commercial</b>             |   |  |                  |
| Commercial & Industrial       | \$ 1,303                                  | \$ 11,842                                | \$ 11,231        |
| Farmland                      | 433                                       |  | 908              |
| Non Farm, Non Residential     | 960                                       | 4,937                                    | 6,725            |
| Agriculture                   | 4   |  | 115              |
| All Other Commercial          |   |  | 5,581            |
| <b>Residential</b>            |   |  |                  |
| First Liens                   | 836                                       | 3,866                                    | 7,352            |
| Home Equity                   | 19  |  | 214              |
| Junior Liens                  | 303                                       |  | 420              |
| Multifamily                   |   |  | 7,501            |
| All Other Residential         |   |  | 155              |
| <b>Consumer</b>               |   |  |                  |
| Motor Vehicle                 | 106                                       | 676                                      | 177              |
| All Other Consumer            | 6   | 17                                       | 1,534            |
| <b>TOTAL</b>                  | <b>\$ 3,970</b>                           | <b>\$ 21,338</b>                         | <b>\$ 41,913</b> |

| (Dollar amounts in thousands) | December 31, 2011                         |  |                  |
|-------------------------------|---|--|------------------|
|                               | Loans Past Due Over 90 Day Still Accruing | Non-accrual Troubled Debt Restructurings | Nonaccrual       |
| <b>Commercial</b>             |   |  |                  |
| Commercial & Industrial       | \$ 317                                    | \$ 12,590                                | \$ 9,673         |
| Farmland                      | 74  |  | 979              |
| Non Farm, Non Residential     | 237                                       |  | 12,542           |
| Agriculture                   |   |  | 225              |
| All Other Commercial          |   |  | 3,171            |
| <b>Residential</b>            |   |  |                  |
| First Liens                   | 1,150                                     | 3,856                                    | 7,398            |
| Home Equity                   | 8   |  |                  |
| Junior Liens                  | 154                                       | 898                                      | 1,240            |
| Multifamily                   |   |  | 668              |
| All Other Residential         | 136                                       |  | 171              |
| <b>Consumer</b>               |   |  |                  |
| Motor Vehicle                 | 77  |  | 294              |
| All Other Consumer            | 4   |  | 1,741            |
| <b>TOTAL</b>                  | <b>\$ 2,157</b>                           | <b>\$ 17,344</b>                         | <b>\$ 38,102</b> |

Covered loans included in loans past due over 90 days still on accrual are \$712 thousand at September 30, 2012 and \$413 thousand at December 31, 2011. Covered loans included in non-accrual loans are \$4.3 million at September 30, 2012 and \$5.6 million at December 31, 2011. Covered loans of \$3.0 million at September 30, 2012 and \$5.0 million at December 31, 2011 are deemed impaired and have allowance for loan loss allocated to them of \$129 thousand and \$1.0 million, respectively for September 30, 2012 and December 31, 2011. Non-performing loans include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.



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The following table presents the aging of the recorded investment in loans by past due category and class of loans.

| (Dollar amounts in thousands) | September 30, 2012     |                        |                                     |                   |                     |                     |
|-------------------------------|------------------------|------------------------|-------------------------------------|-------------------|---------------------|---------------------|
|                               | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | Greater<br>than 90 days<br>Past Due | Total<br>Past Due | Current             | Total               |
| <b>Commercial</b>             |                        |                        |                                     |                   |                     |                     |
| Commercial & Industrial       | \$ 3,039               | \$ 802                 | \$ 4,311                            | \$ 8,152          | \$ 460,964          | \$ 469,116          |
| Farmland                      | 22                     | 164                    | 1,325                               | 1,511             | 88,762              | 90,273              |
| Non Farm, Non Residential     | 812                    | 227                    | 2,753                               | 3,792             | 315,500             | 319,292             |
| Agriculture                   | 239                    | 191                    | 15                                  | 445               | 115,501             | 115,946             |
| All Other Commercial          | 453                    | 57                     | 608                                 | 1,118             | 89,140              | 90,258              |
| <b>Residential</b>            |                        |                        |                                     |                   |                     |                     |
| First Liens                   | 1,846                  | 965                    | 4,532                               | 7,343             | 351,053             | 358,396             |
| Home Equity                   | 119                    | 22                     | 19                                  | 160               | 43,750              | 43,910              |
| Junior Liens                  | 314                    | 199                    | 352                                 | 865               | 38,454              | 39,319              |
| Multifamily                   |                        | 1,830                  | 5,602                               | 7,432             | 49,219              | 56,651              |
| All Other Residential         |                        | 170                    |                                     | 170               | 10,717              | 10,887              |
| <b>Consumer</b>               |                        |                        |                                     |                   |                     |                     |
| Motor Vehicle                 | 4,189                  | 391                    | 112                                 | 4,692             | 245,730             | 250,422             |
| All Other Consumer            | 217                    | 57                     | 6                                   | 280               | 23,848              | 24,128              |
| <b>TOTAL</b>                  | <b>\$ 11,250</b>       | <b>\$ 5,075</b>        | <b>\$ 19,635</b>                    | <b>\$ 35,960</b>  | <b>\$ 1,832,638</b> | <b>\$ 1,868,598</b> |

| (Dollar amounts in thousands) | December 31, 2011      |                        |                                     |                   |                     |                     |
|-------------------------------|------------------------|------------------------|-------------------------------------|-------------------|---------------------|---------------------|
|                               | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | Greater<br>than 90 days<br>Past Due | Total<br>Past Due | Current             | Total               |
| <b>Commercial</b>             |                        |                        |                                     |                   |                     |                     |
| Commercial & Industrial       | \$ 2,717               | \$ 740                 | \$ 4,452                            | \$ 7,909          | \$ 472,370          | \$ 480,279          |
| Farmland                      | 5                      | 57                     | 1,034                               | 1,096             | 98,158              | 99,254              |
| Non Farm, Non Residential     | 2,945                  | 420                    | 7,754                               | 11,119            | 310,724             | 321,843             |
| Agriculture                   | 88                     |                        | 97                                  | 185               | 114,162             | 114,347             |
| All Other Commercial          | 120                    |                        | 1,588                               | 1,708             | 88,313              | 90,021              |
| <b>Residential</b>            |                        |                        |                                     |                   |                     |                     |
| First Liens                   | 11,436                 | 2,016                  | 5,316                               | 18,768            | 340,269             | 359,037             |
| Home Equity                   | 175                    | 62                     | 8                                   | 245               | 44,939              | 45,184              |
| Junior Liens                  | 1,333                  | 183                    | 190                                 | 1,706             | 39,903              | 41,609              |
| Multifamily                   |                        | 100                    | 668                                 | 768               | 46,216              | 46,984              |
| All Other Residential         | 128                    |                        | 136                                 | 264               | 14,261              | 14,525              |
| <b>Consumer</b>               |                        |                        |                                     |                   |                     |                     |
| Motor Vehicle                 | 3,450                  | 563                    | 77                                  | 4,090             | 260,102             | 264,192             |
| All Other Consumer            | 174                    | 48                     | 5                                   | 227               | 26,782              | 27,009              |
| <b>TOTAL</b>                  | <b>\$ 22,571</b>       | <b>\$ 4,189</b>        | <b>\$ 21,325</b>                    | <b>\$ 48,085</b>  | <b>\$ 1,856,199</b> | <b>\$ 1,904,284</b> |

The Corporation has allocated \$1.7 million and \$1.6 million of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of September 30, 2012 and December 31, 2011. The Corporation has not committed to lend additional amounts as of September 30, 2012 and December 31, 2011 to customers with outstanding loans that are classified as troubled debt restructurings. There were \$162 thousand in modifications that were troubled debt restructurings in the quarter ended March 31, 2012, \$655 thousand for the three months ended June 30, 2012 and \$5.06 million for the three months ended September 30, 2012, resulting in no impact to the allowance for loan losses. \$4.9 million of the \$5.06 added in the third quarter was one non-farm, non residential loan that is collateralized well enough to expect no loss. The remaining \$126 thousand added in the third quarter were all other consumer loans. There were \$15 thousand in loans that defaulted during the three and nine months ended September 30, 2012 that had been restructured within the past 12 months.

Credit Quality Indicators:

The Corporation 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 Corporation analyzes loans individually by classifying the loans as to credit risk. This analysis includes non-homogeneous loans, such as commercial loans, with an outstanding balance greater than \$50 thousand. Any consumer loans outstanding to a borrower who had commercial loans analyzed will be similarly risk rated. This analysis is performed on a quarterly basis. The Corporation uses the following definitions for risk ratings:

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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 debt service capacity of the borrower or of any pledged collateral. These loans have a well-defined weakness or weaknesses which have clearly jeopardized repayment of principal and interest as originally intended. They are characterized by the distinct possibility that the institution will sustain some future loss if the deficiencies are not corrected.

Doubtful: Loans classified as doubtful have all the weaknesses inherent in those graded substandard, with the added characteristic that the severity of the weaknesses makes collection or liquidation in full highly questionable or improbable based upon currently existing facts, conditions, and values.

Furthermore, non-homogeneous loans which were not individually analyzed, but are 90+ days past due or on non-accrual are classified as substandard. Loans included in homogeneous pools, such as residential or consumer may be classified as substandard due to 90+ days delinquency, non-accrual status, bankruptcy, or loan restructuring. Loans listed as not rated are either less than \$50 thousand or are included in groups of homogeneous loans.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. As of September 30, 2012 and December 31, 2011, and based on the most recent analysis performed, the risk category of loans by class of loans are as follows:

| (Dollar amounts in thousands) | September 30, 2012  |                    |                   |                  |                   |                     |
|-------------------------------|---------------------|--------------------|-------------------|------------------|-------------------|---------------------|
|                               | Pass                | Special<br>Mention | Substandard       | Doubtful         | Not Rated         | Total               |
| <b>Commercial</b>             |                     |                    |                   |                  |                   |                     |
| Commercial & Industrial       | \$ 392,252          | \$ 27,090          | \$ 39,143         | \$ 7,416         | \$ 1,859          | \$ 467,760          |
| Farmland                      | 80,907              | 4,809              | 2,575             |                  | 110               | 88,401              |
| Non Farm, Non Residential     | 267,667             | 22,505             | 25,139            | 952              | 2,042             | 318,305             |
| Agriculture                   | 107,179             | 6,598              | 365               |                  | 71                | 114,213             |
| All Other Commercial          | 80,871              | 1,026              | 6,567             | 56               | 1,252             | 89,772              |
| <b>Residential</b>            |                     |                    |                   |                  |                   |                     |
| First Liens                   | 112,902             | 3,824              | 16,956            | 945              | 222,442           | 357,069             |
| Home Equity                   | 13,298              | 527                | 1,628             | 25               | 28,352            | 43,830              |
| Junior Liens                  | 10,855              | 288                | 481               | 71               | 27,474            | 39,169              |
| Multifamily                   | 42,504              | 3,563              | 8,563             | 1,899            |                   | 56,529              |
| All Other Residential         | 2,832               |                    | 36                |                  | 7,979             | 10,847              |
| <b>Consumer</b>               |                     |                    |                   |                  |                   |                     |
| Motor Vehicle                 | 11,481              | 394                | 349               | 40               | 236,951           | 249,215             |
| All Other Consumer            | 4,794               | 99                 | 106               | 14               | 18,968            | 23,981              |
| <b>TOTAL</b>                  | <b>\$ 1,127,542</b> | <b>\$ 70,723</b>   | <b>\$ 101,908</b> | <b>\$ 11,418</b> | <b>\$ 547,500</b> | <b>\$ 1,859,091</b> |





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December 31, 2011

| (Dollar amounts in thousands) | Pass                | Special<br>Mention | Substandard       | Doubtful         | Not Rated         | Total               |
|-------------------------------|---------------------|--------------------|-------------------|------------------|-------------------|---------------------|
| <b>Commercial</b>             |                     |                    |                   |                  |                   |                     |
| Commercial & Industrial       | \$ 386,734          | \$ 25,343          | \$ 53,026         | \$ 7,128         | \$ 6,717          | \$ 478,948          |
| Farmland                      | 89,213              | 4,250              | 3,015             | 69               | 619               | 97,166              |
| Non Farm, Non Residential     | 254,761             | 28,684             | 32,704            | 4,271            | 393               | 320,813             |
| Agriculture                   | 109,869             | 2,100              | 623               | 79               | 122               | 112,793             |
| All Other Commercial          | 77,330              | 6,097              | 5,099             | 67               | 1,011             | 89,604              |
| <b>Residential</b>            |                     |                    |                   |                  |                   |                     |
| First Liens                   | 113,234             | 5,175              | 19,895            | 1,318            | 218,118           | 357,740             |
| Home Equity                   | 13,613              | 520                | 671               | 19               | 30,278            | 45,101              |
| Junior Liens                  | 11,887              | 714                | 783               | 968              | 27,105            | 41,457              |
| Multifamily                   | 35,837              | 3,911              | 6,224             | 606              | 258               | 46,836              |
| All Other Residential         | 4,658               | 445                | 53                |                  | 9,310             | 14,466              |
| <b>Consumer</b>               |                     |                    |                   |                  |                   |                     |
| Motor Vehicle                 | 12,988              | 330                | 501               | 59               | 249,018           | 262,896             |
| All Other Consumer            | 6,120               | 57                 | 141               | 12               | 20,491            | 26,821              |
| <b>TOTAL</b>                  | <b>\$ 1,116,244</b> | <b>\$ 77,626</b>   | <b>\$ 122,735</b> | <b>\$ 14,596</b> | <b>\$ 563,440</b> | <b>\$ 1,894,641</b> |

3. Securities

The amortized cost and fair value of the Corporation's investments are shown below. All securities are classified as available-for-sale.

|  | (000 s)           |                     |                      |                    | Fair Value |
|--|-------------------|---------------------|----------------------|--------------------|------------|
|  | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | September 30, 2012 |            |
| U.S. Government agencies                   | \$ 1,810          | \$ 74               | \$                   | \$ 1,884           |            |
| Mortgage Backed Securities - Residential   | 265,685           | 16,834              |                      | 282,519            |            |
| Mortgage Backed Securities -<br>Commercial | 48                | 1                   |                      | 49                 |            |
| Collateralized Mortgage Obligations        | 162,047           | 3,141               | (113)                | 165,075            |            |
| State and Municipal Obligations            | 188,493           | 13,361              | (33)                 | 201,821            |            |
| Collateralized Debt Obligations            | 13,106            | 486                 | (8,787)              | 4,805              |            |
| Equity Securities                          | 320               | 33                  |                      | 353                |            |
| <b>TOTAL</b>                               | <b>\$ 631,509</b> | <b>\$ 33,930</b>    | <b>\$ (8,933)</b>    | <b>\$ 656,506</b>  |            |

|                          | (000 s)           |                     |                      |                   | Fair Value |
|--------------------------|-------------------|---------------------|----------------------|-------------------|------------|
|                          | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | December 31, 2011 |            |
| U.S. Government agencies | \$ 3,979          | \$ 34               | \$                   | \$ 4,013          |            |

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|  |            |           |            |            |
|--|------------|-----------|------------|------------|
| Mortgage Backed Securities-residential | 296,646    | 15,142    |            | 311,788    |
| Mortgage Backed Securities-commercial  | 98         | 3         |            | 101        |
| Collateralized mortgage obligations    | 144,850    | 3,097     |            | 147,947    |
| State and municipal                    | 183,854    | 11,738    | (11)       | 195,581    |
| Collateralized debt obligations        | 14,031     | 150       | (9,410)    | 4,771      |
| Equities                               | 1,596      | 490       |            | 2,086      |
| TOTAL                                  | \$ 645,054 | \$ 30,654 | \$ (9,421) | \$ 666,287 |

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Contractual maturities of debt securities at September 30, 2012 were as follows. Securities not due at a single maturity or with no maturity date, primarily mortgage-backed and equity securities are shown separately.

| (Dollar amounts in thousands)           | September 30, 2012 |                   |
|---|--------------------|-------------------|
|   | Amortized Cost     | Fair Value        |
| Due in one year or less                 | \$ 8,880           | \$ 8,997          |
| Due after one but within five years     | 39,691             | 41,556            |
| Due after five but within ten years     | 84,482             | 89,991            |
| Due after ten years                     | 232,403            | 233,041           |
|   | 365,456            | 373,585           |
| Mortgage-backed securities and equities | 266,053            | 282,921           |
| <b>TOTAL</b>                            | <b>\$ 631,509</b>  | <b>\$ 656,506</b> |

There were \$683 thousand in gains and \$6 thousand in losses from investment sales, and \$11 thousand in losses from OTTI realized by the Corporation for the nine months ended September 30, 2012. For the three months ended September 30, 2012 the gains were \$19 thousand and losses were \$2 thousand. The \$11 thousand of OTTI was realized in the second quarter of 2012. There were \$7 thousand in gains from investment sales and \$110 thousand in losses from OTTI realized by the Corporation for the nine months ended September 30, 2011.

The following tables show the securities gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in continuous unrealized loss position, at September 30, 2012 and December 31, 2011.

| (Dollar amounts in thousands)         | September 30, 2012  |                     | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Total Unrealized Losses |
|---------------------------------------|---------------------|---------------------|------------|-------------------|------------|-------------------|-------------------------|
|                                       | Less Than 12 Months | More Than 12 Months |            |                   |            |                   |                         |
| Collateralized Mortgage Obligations   | \$ 35,579           | \$ (113)            | \$ 35,579  | \$ (113)          | \$ 35,579  | \$ (113)          | \$ (113)                |
| State and municipal obligations       | 2,369               | (33)                | 2,369      | (33)              | 2,369      | (33)              | (33)                    |
| Collateralized Debt Obligations       |                     |                     | 3,423      | (8,787)           | 3,423      | (8,787)           | (8,787)                 |
| Total temporarily impaired securities | \$ 37,948           | \$ (146)            | \$ 3,423   | \$ (8,787)        | \$ 41,371  | \$ (8,933)        | \$ (8,933)              |

| (Dollar amounts in thousands)         | December 31, 2011   |                     | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Total Unrealized Losses |
|---------------------------------------|---------------------|---------------------|------------|-------------------|------------|-------------------|-------------------------|
|                                       | Less Than 12 Months | More Than 12 Months |            |                   |            |                   |                         |
| State and municipal obligations       | \$ 1,110            | \$ (11)             | \$ 1,110   | \$ (11)           | \$ 1,110   | \$ (11)           | \$ (11)                 |
| Collateralized Debt Obligations       |                     |                     | 3,603      | (9,410)           | 3,603      | (9,410)           | (9,410)                 |
| Total temporarily impaired securities | \$ 1,110            | \$ (11)             | \$ 3,603   | \$ (9,410)        | \$ 4,713   | \$ (9,421)        | \$ (9,421)              |

Management evaluates securities for other-than-temporary impairment ( OTTI ) at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. The investment securities portfolio is evaluated for OTTI by segregating the portfolio into two general segments and applying the appropriate OTTI model. Investment securities are generally evaluated for OTTI under FASB ASC 320, *Investments - Debt and Equity Securities*. However, certain purchased beneficial interests, including non-agency mortgage-backed securities, asset-backed securities, and collateralized debt obligations, that had credit ratings at the time of purchase of below AA are evaluated

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using the model outlined in FASB ASC 325-40, *Beneficial Interests in Securitized Financial Assets*.

In determining OTTI under the FASB ASC 320 model, 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 entity has the intent to sell the security or more likely than not will be required to sell the security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

The second segment of the portfolio uses the OTTI guidance provided by FASB ASC 325 that is specific to purchased beneficial interests that, on the purchase date, were rated below AA. Under the FASB ASC 325 model, the Company compares the present value of the remaining cash flows as estimated at the preceding evaluation date to the current expected remaining cash flows. An OTTI is deemed to have occurred if there has been an adverse change in the remaining expected future cash flows.

When OTTI occurs under either model, the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or it is more likely than not it will be required to sell the security

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before recovery of its amortized cost basis, less any current-period credit loss. If an entity intends to sell or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss, the OTTI shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the OTTI shall be separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized in earnings. The amount of the total OTTI related to other factors is recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment.

Gross unrealized losses on investment securities were \$8.9 million as of September 30, 2012 and \$9.4 million as of December 31, 2011. A majority of these losses represent negative adjustments to market value relative to the illiquidity in the markets on the securities and not losses related to the creditworthiness of the issuer. Based upon our review of the issuers, we do not believe these investments to be other than temporarily impaired. Management does not intend to sell these securities and it is not more likely than not that we will be required to sell them before their anticipated recovery.

A significant portion of the total unrealized loss in investment securities relates to collateralized debt obligations that were separately evaluated under FASB ASC 325-40, Beneficial Interests in Securitized Financial Assets. Based upon qualitative considerations, such as a down grade in credit rating or further defaults of underlying issuers during the quarter, and an analysis of expected cash flows, we have determined that three of the CDOs included in collateralized debt obligations were other-than-temporarily impaired, though no impairment was identified during the first three quarters of 2012. Those three CDOs have a contractual balance of \$28.0 million at September 30, 2012 which has been reduced to \$4.2 million by \$0.9 million of interest payments received, \$14.9 million of cumulative OTTI charges recorded through earnings to date, and \$8.0 million recorded in other comprehensive income (\$4.8 million after tax effect). The severity of the OTTI recorded varies by security, based on the analysis described below, and ranges at September 30, 2012 from 28% to 87%. The OTTI recorded in other comprehensive income represents OTTI due to factors other than credit loss, mainly current market illiquidity. The issuers in these securities are primarily banks, but some of the pools do include a limited number of insurance companies. The market for these securities has become very illiquid, there are very few new issuances of trust preferred securities and the credit spreads implied by current prices have increased dramatically and remain very high, resulting in significant non-credit related impairment. The Company uses the OTTI evaluation model to compare the present value of expected cash flows to the previous estimate to ensure there are no adverse changes in cash flows during the quarter. The OTTI model considers the structure and term of the CDO and the financial condition of the underlying issuers. Specifically, the model details interest rates, principal balances of note classes and underlying issuers, the timing and amount of interest and principal payments of the underlying issuers, and the allocation of the payments to the note classes. Cash flows are projected using a forward rate LIBOR curve, as these CDOs are variable rate instruments. An average rate is then computed using this same forward rate curve to determine an appropriate discount rate (3 month LIBOR plus margin ranging from 160 to 180 basis points). The current estimate of expected cash flows is based on the most recent trustee reports and any other relevant market information including announcements of interest payment deferrals or defaults of underlying trust preferred securities. Assumptions used in the model include expected future default rates and prepayments. In addition we use the model to stress each CDO, or make assumptions more severe than expected activity, to determine the degree to which assumptions could deteriorate before the CDO could no longer fully support repayment of the Company's note class.

Collateralized debt obligations include an investment in a CDO consisting of pooled trust preferred securities in which the issuers are primarily banks. This CDO with an amortized cost of \$830 thousand and a fair value of \$572 thousand is rated BAA3 and is the senior tranche, is not in the scope of FASB ASC 325, as it was rated high investment grade at purchase, and is not considered to be other-than-temporarily impaired based on its credit quality. Its fair value is negatively impacted by the factors described above.

Management has consistently used Standard & Poors pricing to value these investments. There are a number of other pricing sources available to determine fair value for these investments. These sources utilize a variety of methods to determine fair value. The result is a wide range of estimates of fair value for these securities. The Standard & Poors pricing ranges from 2.8 to 68.9 while Moody Investor Service pricing ranges

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from 0.64 to 94.77, with others falling somewhere in between. We recognize that the Standard & Poors pricing utilized is an estimate, but have been consistent in using this source and its estimate of fair value.

Equity securities relate to investments in bank stocks held at the holding company. In the second quarter the Corporation recognized other-than-temporary impairment on an equity security in the amount of \$11 thousand. Bank stock values have been negatively impacted by the current economic environment and market pessimism.

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The table below presents a rollforward of the credit losses recognized in earnings for the three and nine month periods ended September 30, 2012 and 2011:

| (Dollar amounts in thousands)  | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|--|-------------------------------------|-----------|------------------------------------|-----------|
|  | 2012                                | 2011      | 2012                               | 2011      |
| Beginning balance  | \$ 14,983                           | \$ 15,167 | \$ 15,180                          | \$ 15,070 |
| Amounts related to credit loss for which an other-than-temporary impairment was not previously recognized              |                                     |           |                                    |           |
| Increases to the amount related to the credit loss for which other-than-temporary impairment was previously recognized |                                     | 13        | 11                                 | 110       |
| Amounts realized for securities sold during the period   |                                     |           | (208)                              |           |
| Ending balance   | \$ 14,983                           | \$ 15,180 | \$ 14,983                          | \$ 15,180 |

4. Fair Value

FASB ASC No. 820-10 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level 1: Quoted prices (unadjusted) of 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 I 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 fair value of most securities available for sale is determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

For those securities that cannot be priced using quoted market prices or observable inputs a Level 3 valuation is determined. These securities are primarily trust preferred securities, which are priced using Level 3 due to current market illiquidity and certain investments in bank equities and state and municipal securities. The fair value of the trust preferred securities is obtained from a third party provider without adjustment. As described previously, management obtains values from other pricing sources to validate the Standard & Poors pricing that they currently utilize. The fair value of certain investments in bank equities is based on the prices of recent stock trades and is considered Level 3 because these stocks are not publicly traded. The fair value of state and municipal obligations are derived by comparing the securities to current market rates plus an appropriate credit spread to determine an estimated value. Illiquidity spreads are then considered. Credit reviews are performed on each of the issuers. The significant unobservable inputs used in the fair value measurement of the Corporation's state and municipal obligations are credit spreads related to specific issuers. Significantly higher credit spread assumptions would result in significantly lower fair value measurement. Conversely, significantly lower credit spreads would result in a significantly higher fair value measurement.





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The fair value of derivatives is based on valuation models using observable market data as of the measurement date (Level 2 inputs).

| <b>September 30, 2012</b>  |                |                |                |                |                  |
|--|----------------|----------------|----------------|----------------|------------------|
| <b>Fair Value Measurements Using Significant Unobservable Inputs (Level 3)</b> |                |                |                |                |                  |
| <b>(Dollar amounts in thousands)</b>   | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b>   |                  |
| U.S. Government agencies   | \$             | \$ 1,884       | \$             | \$             | 1,884            |
| Mortgage Backed Securities-residential   |                | 282,519        |                |                | 282,519          |
| Mortgage Backed Securities-commercial  |                | 49             |                |                | 49               |
| Collateralized mortgage obligations  |                | 165,075        |                |                | 165,075          |
| State and municipal  |                | 191,910        |                | 9,911          | 201,821          |
| Collateralized debt obligations  |                |                |                | 4,805          | 4,805            |
| Equities   |                | 353            |                |                | 353              |
| <b>TOTAL</b>   | <b>\$</b>      | <b>353</b>     | <b>\$</b>      | <b>641,437</b> | <b>\$ 14,716</b> |
| Derivative Assets  |                |                |                |                | 2,220            |
| Derivative Liabilities   |                |                |                |                | (2,220)          |

| <b>December 31, 2011</b>   |                |                |                |                |                  |
|--|----------------|----------------|----------------|----------------|------------------|
| <b>Fair Value Measurements Using Significant Unobservable Inputs (Level 3)</b> |                |                |                |                |                  |
| <b>(Dollar amounts in thousands)</b>   | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b>   |                  |
| U.S. Government agencies   | \$             | \$ 4,013       | \$             | \$             | 4,013            |
| Mortgage Backed Securities-residential   |                | 311,788        |                |                | 311,788          |
| Mortgage Backed Securities-commercial  |                | 101            |                |                | 101              |
| Collateralized mortgage obligations  |                | 147,947        |                |                | 147,947          |
| State and municipal  |                | 186,056        |                | 9,525          | 195,581          |
| Collateralized debt obligations  |                |                |                | 4,771          | 4,771            |
| Equities   |                | 375            |                | 1,711          | 2,086            |
| <b>TOTAL</b>   | <b>\$</b>      | <b>375</b>     | <b>\$</b>      | <b>649,905</b> | <b>\$ 16,007</b> |
| Derivative Assets  |                |                |                |                | 2,447            |
| Derivative Liabilities   |                |                |                |                | (2,447)          |

There were no transfers between Level 1 and Level 2 during 2012 and 2011.

The table below presents a reconciliation and income statement classification of gains and losses for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and nine months ended September 30, 2012 and the year ended December 31, 2011.

| <b>Fair Value Measurements Using Significant Unobservable Inputs (Level 3)</b> |                 |  |  |              |        |
|--|-----------------|--|--|--------------|--------|
| <b>Three months ended September 30, 2012</b>                                   |                 |  |  |              |        |
|  | <b>Equities</b> | <b>State and municipal obligations</b> | <b>Collateralized debt obligations</b> | <b>Total</b> |        |
| Beginning balance, July 1  | \$              | \$ 10,066                              | \$ 4,379                               | \$           | 14,445 |
| Total realized/unrealized gains or losses                                      |                 |  |  |              |        |
| Included in earnings   |                 |  |  |              |        |
| Included in other comprehensive income   |                 |  | 426                                    |              | 426    |
| Transfers & Purchases  |                 |  |  |              |        |

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|                              |    |    |       |    |       |           |
|------------------------------|----|----|-------|----|-------|-----------|
| Settlements                  |    |    | (155) |    |       | (155)     |
| Ending balance, September 30 | \$ | \$ | 9,911 | \$ | 4,805 | \$ 14,716 |

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| Fair Value Measurements Using Significant Unobservable Inputs (Level 3) |          |                                 |                                 |           |
|---|----------|---------------------------------|---------------------------------|-----------|
| Nine months ended September 30, 2012                                    |          |                                 |                                 |           |
|   | Equities | State and municipal obligations | Collateralized debt obligations | Total     |
| Beginning balance, January 1  | \$ 1,711 | \$ 9,525                        | \$ 4,771                        | \$ 16,007 |
| Total realized/unrealized gains or losses                               |          |                                 |                                 |           |
| Included in earnings  | 435      |                                 | (285)                           | 150       |
| Included in other comprehensive income                                  | (446)    |                                 | 655                             | 209       |
| Transfers & Purchases   |          | 1,186                           |                                 | 1,186     |
| Settlements   | (1,700)  | (800)                           | (336)                           | (2,836)   |
| Ending balance, September 30  | \$ 1,711 | \$ 9,911                        | \$ 4,805                        | \$ 14,716 |

| Fair Value Measurements Using Significant Unobservable Inputs (Level 3) |          |                                 |                                 |           |
|---|----------|---------------------------------|---------------------------------|-----------|
| December 31, 2011   |          |                                 |                                 |           |
|   | Equities | State and municipal obligations | Collateralized debt obligations | Total     |
| Beginning balance, January 1  | \$ 1,518 | \$ 9,525                        | \$ 2,190                        | \$ 3,708  |
| Total realized/unrealized gains or losses                               |          |                                 |                                 |           |
| Included in earnings  |          |                                 |                                 |           |
| Included in other comprehensive income                                  | 193      |                                 | 2,581                           | 2,774     |
| Transfers & Purchases   |          | 9,672                           |                                 | 9,672     |
| Settlements   |          | (147)                           |                                 | (147)     |
| Ending balance, December 31   | \$ 1,711 | \$ 9,525                        | \$ 4,771                        | \$ 16,007 |

The following table presents quantitative information about recurring and non-recurring Level 3 fair value measurements at September 30, 2012.

|                                 | Fair Value | Valuation Technique(s)           | Unobservable Input(s)                                    | Range             |
|---------------------------------|------------|----------------------------------|--|-------------------|
| State and municipal obligations | \$ 9,911   | Discounted cash flow             | Discount rate<br>Probability of default                  | 3.05%-5.50%<br>0% |
| Other real estate               | \$ 8,670   | Sales comparison/income approach | Discount rate for age of appraisal and market conditions | 5.00%-20.00%      |
| Impaired Loans                  | 28,984     | Sales comparison/income approach | Discount rate for age of appraisal and market conditions | 0.00%-50.00%      |

All impaired loans disclosed in footnote 2 are valued at Level 3 and are carried at a fair value of \$29.0 million, net of a valuation allowance of \$5.7 million at September 30, 2012. At December 31, 2011 impaired loans valued at Level 3 were carried at a fair value of \$28.4 million, net of a valuation allowance of \$4.3 million. The impact to the provision for loan losses was \$1.1 million and \$1.8 million for the three and nine months ended September 30, 2012, and was \$3.3 million for the year ended December 31, 2011. Fair value is measured based on the value of the collateral securing those loans, and is determined using several methods. Generally the fair value of real estate is determined based on appraisals by qualified licensed appraisers. Appraisals for real estate generally use three methods to derive value: cost, sales or market comparison and income approach. The cost method bases value on the cost to replace current property. The market comparison evaluates the sales price of similar properties in the same market area. The income approach considers net operating income generated by the property and the investor's required return. The final fair value is based on a reconciliation of these three approaches. If an appraisal is not available, the fair value may be determined by using a cash flow analysis, a broker's opinion of value, the net present value of future cash flows, or an observable market price from an active market. Fair value of other real estate is based upon the current appraised values of the properties as determined by qualified

licensed appraisers and the Company's judgment of other relevant market conditions. Appraisals are obtained annually and reductions in value are recorded as a valuation through a charge to expense. The primary unobservable input used by management in estimating fair value are additional discounts to the appraised value to consider selling costs and the age of the appraisal, which are based on management's past experience in resolving these types of properties. These discounts range from 5% to 20% for costs to sell and marketability. Other real estate and impaired loans carried at fair value are primarily comprised of smaller balance properties. One impaired loan has an estimated fair value of \$5.3 million. The collateral securing this loan is a hotel and was appraised based on income and sales comparison approaches. Given the current distressed market, it was difficult for the appraiser to identify recent and relevant comparable sales, therefore the value was based predominantly on the income method which applied a 9.5% capitalization rate to projected net operating income.

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The following tables presents loans identified as impaired by class of loans as of September 30, 2012 and December 31, 2011, which are all considered Level 3.

| (Dollar amounts in thousands) | Unpaid<br>Principal<br>Balance | September 30, 2012                           |    | Fair Value |
|-------------------------------|--------------------------------|--|----|------------|
|                               |                                | Allowance<br>for Loan<br>Losses<br>Allocated |    |            |
| Commercial                    |                                |  |    |            |
| Commercial & Industrial       | \$ 17,885                      | \$ 3,925                                     | \$ | 13,960     |
| Farmland                      | 891                            | 49   |    | 842        |
| Non Farm, Non Residential     | 7,581                          | 182  |    | 7,399      |
| Agriculture                   |                                |  |    |            |
| All Other Commercial          | 1,315                          | 56   |    | 1,259      |
| Residential                   |                                |  |    |            |
| First Liens                   | 1,255                          | 190  |    | 1,065      |
| Home Equity                   | 197                            |  |    | 197        |
| Junior Liens                  |                                |  |    |            |
| Multifamily                   | 5,540                          | 1,278  |    | 4,262      |
| All Other Residential         |                                |  |    |            |
| Consumer                      |                                |  |    |            |
| Motor Vehicle                 |                                |  |    |            |
| All Other Consumer            |                                |  |    |            |
| TOTAL                         | \$ 34,664                      | \$ 5,680                                     | \$ | 28,984     |

| (Dollar amounts in thousands) | Unpaid<br>Principal<br>Balance | December 31, 2011                            |    | Fair Value |
|-------------------------------|--------------------------------|--|----|------------|
|                               |                                | Allowance<br>for Loan<br>Losses<br>Allocated |    |            |
| Commercial                    |                                |  |    |            |
| Commercial & Industrial       | \$ 17,890                      | \$ 2,664                                     | \$ | 15,226     |
| Farmland                      | 891                            | 49   |    | 842        |
| Non Farm, Non Residential     | 9,260                          | 957  |    | 8,303      |
| Agriculture                   |                                |  |    |            |
| All Other Commercial          | 1,517                          | 66   |    | 1,451      |
| Residential                   |                                |  |    |            |
| First Liens                   | 1,963                          | 190  |    | 1,773      |
| Home Equity                   |                                |  |    |            |
| Junior Liens                  | 879                            | 347  |    | 532        |
| Multifamily                   | 250                            |  |    | 250        |
| All Other Residential         |                                |  |    |            |
| Consumer                      |                                |  |    |            |
| Motor Vehicle                 |                                |  |    |            |
| All Other Consumer            |                                |  |    |            |
| TOTAL                         | \$ 32,650                      | \$ 4,273                                     | \$ | 28,377     |

| (Dollar amounts in thousands)   | Carrying Value | September 30, 2012           |         |          |
|---------------------------------|----------------|------------------------------|---------|----------|
|                                 |                | Fair Value Measurement Using |         |          |
|                                 |                | Level 1                      | Level 2 | Level 3  |
| Other real estate - commercial  | \$ 6,198       | \$                           | \$      | \$ 6,198 |
| Other real estate - residential | 2,472          |                              |         | 2,472    |
| TOTAL                           | \$ 8,670       | \$                           | \$      | \$ 8,670 |



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| (Dollar amounts in thousands)   | Carrying Value  | December 31, 2011            |           |                 |
|---------------------------------|-----------------|------------------------------|-----------|-----------------|
|                                 |                 | Fair Value Measurement Using |           |                 |
|                                 |                 | Level 1                      | Level 2   | Level 3         |
| Other real estate - commercial  | \$ 2,080        | \$                           | \$        | \$ 2,080        |
| Other real estate - residential | 2,884           |                              |           | 2,884           |
| <b>TOTAL</b>                    | <b>\$ 4,964</b> | <b>\$</b>                    | <b>\$</b> | <b>\$ 4,964</b> |

The carrying amounts and estimated fair value of financial instruments at September 30, 2012 and December 31, 2011, are shown below. Carrying amount is the estimated fair value for cash and due from banks, federal funds sold, short-term borrowings, accrued interest receivable and payable, demand deposits, short-term debt and variable-rate loans or deposits that reprice frequently and fully. Security fair values were described previously. For fixed-rate, non-impaired loans or deposits, variable rate loans or deposits with infrequent repricing or repricing limits, and for longer-term borrowings, fair value is based on discounted cash flows using current market rates applied to the estimated life and considering credit risk. The valuation of impaired loans was described previously. Loan fair value estimates do not necessarily represent an exit price. Fair values of loans held for sale are based on market bids on the loans or similar loans. It was not practicable to determine the fair value of Federal Home Loan Bank stock due to restrictions placed on its transferability. For the FDIC indemnification asset the carrying value is the estimated fair value as it represents amounts to be received from the FDIC in the near term. Fair value of debt is based on current rates for similar financing. The fair value of off-balance sheet items is not considered material.

| (Dollar amounts in thousands)   | Carrying Value | September 30, 2012 |             |           |             | Total |
|---------------------------------|----------------|--------------------|-------------|-----------|-------------|-------|
|                                 |                | Fair Value         |             |           |             |       |
|                                 |                | Level 1            | Level 2     | Level 3   |             |       |
| Cash and due from banks         | \$ 63,638      | \$ 18,484          | \$ 45,154   | \$        | \$ 63,638   |       |
| Federal funds sold              | 55,773         |                    | 55,773      |           | 55,773      |       |
| Securities available for sale   | 656,506        | 353                | 641,437     | 14,716    | 656,506     |       |
| Restricted stock                | 21,296         | n/a                | n/a         | n/a       | n/a         |       |
| Loans, net                      | 1,836,704      |                    |             | 1,929,537 | 1,929,537   |       |
| FDIC Indemnification Asset      | 1,602          |                    | 1,602       |           | 1,602       |       |
| Accrued interest receivable     | 12,785         |                    | 4,041       | 8,744     | 12,785      |       |
| Deposits                        | (2,259,670)    |                    | (2,264,791) |           | (2,264,791) |       |
| Short term borrowings           | (43,997)       |                    | (43,997)    |           | (43,997)    |       |
| Federal Home Loan Bank advances | (119,814)      |                    | (126,065)   |           | (126,065)   |       |
| Other borrowings                | (6,049)        |                    | (6,049)     |           | (6,049)     |       |
| Accrued interest payable        | (1,211)        |                    | (1,211)     |           | (1,211)     |       |

| (Dollar amounts in thousands)   | December 31, 2011 |             |
|---------------------------------|-------------------|-------------|
|                                 | Carrying Value    | Fair Value  |
| Cash and due from banks         | 134,280           | 134,280     |
| Federal funds sold              | 11,725            | 11,725      |
| Securities available for sale   | 666,287           | 666,287     |
| Restricted stock                | 22,282            | n/a         |
| Loans, net                      | 1,874,438         | 1,888,263   |
| FDIC Indemnification Asset      | 2,384             | 2,384       |
| Accrued interest receivable     | 12,947            | 12,947      |
| Deposits                        | (2,274,499)       | (2,279,739) |
| Short term borrowings           | (100,022)         | (100,022)   |
| Federal Home Loan Bank advances | (140,231)         | (144,089)   |
| Other borrowings                | (6,196)           | (6,196)     |
| Accrued interest payable        | (1,829)           | (1,829)     |





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Period end short-term borrowings were comprised of the following:

|                                | (000 s)               |                      |
|--------------------------------|-----------------------|----------------------|
|                                | September 30,<br>2012 | December 31,<br>2011 |
| Federal Funds Purchased        | \$ 3,945              | \$ 43,167            |
| Repurchase Agreements          | 40,052                | 56,855               |
| Note Payable - U.S. Government | 0                     | 0                    |
|                                | \$ 43,997             | \$ 100,022           |

6. Other Borrowings

Other borrowings at period-end are summarized as follows:

|   | (000 s)               |                      |
|---|-----------------------|----------------------|
|   | September 30,<br>2012 | December 31,<br>2011 |
| FHLB Advances   | \$ 119,814            | \$ 140,231           |
| Junior subordinated debentures (variable rate) Maturing December 2037 | 6,049                 | 6,196                |
|   | \$ 125,863            | \$ 146,427           |

7. Components of Net Periodic Benefit Cost

|  | Three Months Ended September 30,<br>(000 s) |        |                                    |        | Nine Months Ended September 30,<br>(000 s) |          |                                    |        |
|--|---|--------|------------------------------------|--------|--|----------|------------------------------------|--------|
|  | Pension Benefits                            |        | Post-Retirement<br>Health Benefits |        | Pension Benefits                           |          | Post-Retirement<br>Health Benefits |        |
|  | 2012  | 2011   | 2012                               | 2011   | 2012                                       | 2011     | 2012                               | 2011   |
| Service cost                           | \$ 1,218                                    | \$ 775 | \$ 15                              | \$ 27  | \$ 3,654                                   | \$ 2,325 | \$ 45                              | \$ 82  |
| Interest cost                          | 917   | 824    | 43                                 | 60     | 2,750                                      | 2,472    | 130                                | 180    |
| Expected return on plan assets         | (815)                                       | (964)  |                                    |        | (2,444)                                    | (2,893)  |                                    |        |
| Amortization of transition obligation  |   |        | 15                                 | 15     |  |          | 45                                 | 45     |
| Net amortization of prior service cost | 41  | (4)    |                                    |        | 124  | (13)     |                                    |        |
| Net amortization of net (gain) loss    | 567   | 161    |                                    |        | 1,702                                      | 482      |                                    |        |
| Net Periodic Benefit Cost              | \$ 1,928                                    | \$ 792 | \$ 73                              | \$ 102 | \$ 5,786                                   | \$ 2,373 | \$ 220                             | \$ 307 |

Employer Contributions

First Financial Corporation previously disclosed in its financial statements for the year ended December 31, 2011 that it expected to contribute \$3.8 and \$1.5 million respectively to its Pension Plan and ESOP and \$225,000 to the Post Retirement Health Benefits Plan in 2011. Contributions of \$2.9 million and \$156 thousand have been made through the first nine months of 2012 for the Pension Plan and the Post Retirement Health Benefits plan, respectively.

8. New accounting standards

Update Number 2011-04 Fair Value Measurement (Topic 820): *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*. This update to Fair Value Measurement (Topic 820) results in common fair value measurement and disclosure requirements in U.S. GAAP and IFRS. The amendments in this update explain how to measure fair value. They do not require additional fair value measurements and are not intended to establish valuation standards or affect valuation practices outside of financial reporting. The amendments in this update are to be applied prospectively and are effective during interim and annual periods beginning after December 15, 2011. The Corporation has adopted this update as of January 1, 2012. Adoption had not resulted in any changes in valuation techniques nor related inputs.

Update Number 2011-05 Comprehensive Income (Topic 220): *Presentation of Comprehensive Income*. This accounting standard update was issued to increase the prominence of items reported in other comprehensive income and to facilitate the convergence of U.S. GAAP and IFRS. U.S. GAAP had allowed the Corporation to present other comprehensive income as part

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of the statement of changes in stockholders' equity. This accounting standard update eliminates that option and requires consecutive presentation of the statement of net income and the statement of comprehensive income. The requirement to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements are effective for public entities for reporting periods beginning after December 15, 2011 and will be applied retrospectively.

Update Number 2012-06 Business Combinations (Topic 805): *Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution* This update to Business Combinations (Topic 805) specifies that when an entity recognizes an indemnification asset as a result of a government-assisted acquisition of a financial institution and subsequently a change in the cash flows expected to be collected on the indemnification asset occurs, the entity should subsequently account for the change in the measurement of the indemnification asset on the same basis as the change in the assets subject to indemnification. Any amortization of changes in value should be limited to the contractual term of the indemnification agreement (the lesser of the term of the indemnification agreement and the remaining life of the indemnified assets). This update becomes effective for interim and annual periods beginning on or after December 15, 2012, and is not expected to have a material impact on the consolidated financial statements.

9. Acquisitions and FDIC Indemnification Asset

On December 30, 2011, the Bank completed a purchase and assumption agreement with PNB Holding Co (PNB), an Illinois corporation, to purchase all of the issued and outstanding stock of Freestar Bank, National Association, and assume certain liabilities of PNB (the Transaction). Immediately following the acquisition of the stock of Freestar Bank, First Financial merged Freestar Bank with and into its wholly-owned subsidiary, First Financial Bank, National Association.

The acquisition provided a strategic entry into the Champaign-Urbana, Bloomington-Normal and Pontiac, Illinois markets. Each of these markets are characterized by higher growth rates.

First Financial paid PNB cash in the amount of \$47 million and assumed certain liabilities of PNB in the aggregate amount of approximately \$8.2 million. The acquisition consisted of assets and liabilities with a fair value of approximately \$413.0 million, including \$245.3 million of loans, \$95.5 million of investment securities, \$62.0 million of cash and cash equivalents and \$361.2 million of deposits. A customer related core deposit intangible asset of \$2.1 million was also recorded. Based upon the acquisition date fair values of the net assets acquired, goodwill of \$29.8 million was recorded, all of which is expected to be tax deductible. \$715 thousand was added to goodwill in the second quarter as a result of the determination that the terms of a land lease required rents in excess of current market rents. A liability was recorded which will result in rent expense being recorded at market rates. As required by the acquisition accounting rules, this adjustment is reflected retrospectively, at December 31, 2011. During the second quarter of 2012, management also completed their analysis of acquired loans and the determination of which loans were purchased credit impaired (PCI). As a result of that analysis, PCI loans were determined to have a fair value of \$22.0 million and a contractual amount due of \$29.0 million. The finalization of the loan analysis did not result in a change in loan fair value or goodwill. These factors, purchase premium paid, holding company debt assumed and amount paid in excess of the loans fair values are the primary components of goodwill.

On July 2, 2009, the Bank entered into a purchase and assumption agreement with the Federal Deposit Insurance Corporation (FDIC) to assume all of the deposits (excluding brokered deposits) and certain assets of The First National Bank of Danville, a full-service commercial bank headquartered in Danville, Illinois, that had failed and been placed in receivership with the FDIC. The acquisition consisted of assets worth a fair value of approximately \$151.8 million, including \$77.5 million of loans, \$24.2 million of investment securities, \$31.0 million of cash and cash equivalents and \$146.3 million of liabilities, including \$145.7 million of deposits. A customer related core deposit intangible asset of \$4.6

million was also recorded. In addition to the excess of liabilities over assets, the Bank received approximately \$14.6 million in cash from the FDIC. Based upon the acquisition date fair values of the net assets acquired, no goodwill was recorded. The transaction resulted in a gain of \$5.1 million, which is included in non-interest income in the December 31, 2009 Consolidated Statement of Operations. Under the loss-sharing agreement ( LSA ), the Bank will share in the losses on assets covered under the agreement (referred to as covered assets). On losses up to \$29 million, the FDIC has agreed to reimburse the Bank for 80 percent of the losses. On losses exceeding \$29 million, the FDIC has agreed to reimburse the Bank for 95 percent of the losses. The loss-sharing agreement is subject to following servicing procedures as specified in the agreement with the FDIC. Loans acquired that are subject to the loss-sharing agreement with the FDIC are referred to as covered loans for disclosure purposes. Since the acquisition date the Bank has been reimbursed \$17.8 million for losses and carrying expenses and currently carries a balance of \$1.6 million. Included in the current balance is the estimate of \$481 thousand for 80% of the loans subject to the loss-sharing agreement identified in the allowance for loan loss evaluation as future potential losses.

FASB ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*, applies to a loan with evidence of deterioration of credit quality since origination, acquired by completion of a transfer for which it is probable, at acquisition, that the investor will be unable to collect all contractually required payments receivable. FASB ASC 310-30 prohibits carrying over or creating an allowance for loan losses upon initial recognition. The carrying amount of covered assets at September 30, 2012 and December 31, 2011, consisted of loans accounted for in accordance with FASB ASC 310-30, loans not subject to FASB ASC 310-30 and other assets as shown in the following table:

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## September 30, 2012

| (Dollar amounts in thousands) | ASC 310-30<br>Loans | Non ASC 310-30<br>Loans | Other    | Total     |
|-------------------------------|---------------------|-------------------------|----------|-----------|
| Loans                         | \$ 4,607            | \$ 24,432               | \$       | \$ 29,039 |
| Foreclosed Assets             |                     |                         | 1,392    | 1,392     |
| Total Covered Assets          | \$ 4,607            | \$ 24,432               | \$ 1,392 | \$ 30,431 |

## December 31, 2011

| (Dollar amounts in thousands) | ASC 310-30<br>Loans | Non ASC 310-30<br>Loans | Other    | Total     |
|-------------------------------|---------------------|-------------------------|----------|-----------|
| Loans                         | \$ 6,875            | \$ 28,173               | \$       | \$ 35,048 |
| Foreclosed Assets             |                     |                         | 1,665    | 1,665     |
| Total Covered Assets          | \$ 6,875            | \$ 28,173               | \$ 1,665 | \$ 36,713 |

The rollforward of the FDIC Indemnification asset is as follows:

| (Dollar amounts in thousands)            | Quarter Ended<br>September 30,<br>2012 | Nine Months<br>Ended<br>September 30,<br>2012 | Year Ended<br>December 31,<br>2011 |
|--|--|---|------------------------------------|
| Beginning balance                        | \$ 1,608                               | \$ 2,384                                      | \$ 3,977                           |
| Accretion                                |  |   | 38                                 |
| Net changes in losses and expenses added | 145                                    | 1,232   | (192)                              |
| Reimbursements from the FDIC             | (151)                                  | (2,014)                                       | (1,439)                            |
| TOTAL                                    | \$ 1,602                               | \$ 1,602                                      | \$ 2,384                           |

On the acquisition date, the preliminary estimate of the contractually required payments receivable for all FASB ASC310-30 loans acquired in the acquisition were \$31.6 million, the cash flows expected to be collected were \$18.4 million including interest, and the estimated fair value of the loans was \$16.7 million. These amounts were determined based upon the estimated remaining life of the underlying loans, which include the effects of estimated prepayments. At September 30, 2012, a majority of these loans were valued based on the liquidation value of the underlying collateral, because the expected cash flows are primarily based on the liquidation of underlying collateral and the timing and amount of the cash flows could not be reasonably estimated. There was a \$567 thousand allowance for credit losses related to these loans at September 30, 2012. On the acquisition date, the preliminary estimate of the contractually required payments receivable for all non FASB ASC310-30 loans acquired in the acquisition was \$58.4 million and the estimated fair value of the loans was \$60.7 million. The impact to the Corporation from the amortization and accretion of premiums and discounts was immaterial.

ITEMS 2. and 3. Management's Discussion and Analysis of Financial Condition and Results of Operations and Quantitative and Qualitative Disclosures About Market Risk

The purpose of this discussion is to point out key factors in the Corporation's recent performance compared with earlier periods. The discussion should be read in conjunction with the financial statements beginning on page three of this report. All figures are for the consolidated entities. It is presumed the readers of these financial statements and of the following narrative have previously read the Corporation's financial statements for 2011 in the 10-K filed for the fiscal year ended December 31, 2011.

## Edgar Filing: FIRST FINANCIAL CORP /IN/ - Form 10-Q

This Quarterly Report on Form 10-Q contains forward-looking statements. Forward-looking statements provide current expectations or forecasts of future events and are not guarantees of future performance, nor should they be relied upon as representing management's views as of any subsequent date. The forward-looking statements are based on management's expectations and are subject to a number of risks and uncertainties. Although management believes that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from those expressed or implied in such statements. Risks and uncertainties that could cause actual results to differ materially include, without limitation, the Corporation's ability to effectively execute its business plans; changes in general economic and financial market conditions; changes in interest rates; changes in the competitive environment; continuing consolidation in the financial services industry; new litigation or changes in existing litigation; losses, customer bankruptcy, claims and assessments; changes in banking regulations or other regulatory or legislative requirements affecting the Corporation's business; and changes in accounting policies or procedures as may be required by the Financial Accounting Standards Board or other regulatory agencies. Additional information concerning factors that could cause actual results to differ materially from those expressed or implied in the forward-looking statements is available in the Corporation's Form 10-K for the year ended December 31, 2011, and subsequent filings with the United States Securities and Exchange Commission (SEC). Copies of these filings are available at no cost on the SEC's Web site at [www.sec.gov](http://www.sec.gov) or on the Corporation's Web site at [www.first-online.com](http://www.first-online.com). Management may elect to update forward-looking statements at some future point; however, it specifically disclaims any obligation to do so.

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Critical Accounting Policies

Certain of the Corporation's accounting policies are important to the portrayal of the Corporation's financial condition and results of operations, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Estimates associated with these policies are susceptible to material changes as a result of changes in facts and circumstances. Facts and circumstances which could affect these judgments include, without limitation, changes in interest rates, in the performance of the economy or in the financial condition of borrowers. Management believes that its critical accounting policies include determining the allowance for loan losses and the valuation of goodwill and valuing investment securities. See further discussion of these critical accounting policies in the 2011 Form 10-K.

Summary of Operating Results

Net income for the three and nine months ended September 30, 2012 was \$8.1 and \$24.2 million respectively compared to \$9.8 and \$27.0 million for the same period of 2011. Basic earnings per share decreased to \$0.61 for the third quarter of 2012 compared to \$0.75 for same period of 2011. Year to date earnings per share at September 30, 2012 is \$1.83 compared to \$2.06 for the same period of 2011. Return on Assets and Return on Equity were 1.16% and 9.35% respectively, for the three months ended September 30, 2012 compared to 1.57% and 11.32% for the three months ended September 30, 2011. Return on Assets and Equity were 1.12% and 9.06% respectively, for the nine months ended September 30, 2012 compared to 1.44% and 10.65% for the nine months ended September 30, 2011.

The primary components of income and expense affecting net income are discussed in the following analysis. The first nine months of 2012 include income and expense associated with the purchase of Freestar Bank on December 30, 2011 that were not part of the results for the first nine months of 2011.

Net Interest Income

The Corporation's primary source of earnings is net interest income, which is the difference between the interest earned on loans and other investments and the interest paid for deposits and other sources of funds. Net interest income increased \$2.5 million in the three months ended September 30, 2012 to \$27.4 million from \$24.9 million in the same period in 2011. The net interest margin for the three months ended September 30, 2012 is 4.55% compared to 4.50% for the same period of 2011, a 1.1% increase, driven by a greater decline in the costs of funding than the decline in income realized on earning assets. Net interest income for the nine months ended September 30, 2012 is increased 9.9% or \$7.4 million to \$82.2 million from the \$74.8 million for the nine months ended September 30, 2011.

Non-Interest Income

Non-interest income for the three months ended September 30, 2012 was \$9.7 million, an increase of \$0.8 million from the \$8.9 million for the same period of 2011. Gains from the sale of mortgage loans increased \$0.8 million over the same period of 2011. Non-interest income for the nine months ended September 30, 2012 was \$3.9 million higher than the same period of 2011. Gains from the sale of mortgage loans increased

\$1.8 million and other service fees which include income from electronic banking were increased \$0.8 million over the results from the same period of 2011.

#### Non-Interest Expenses

The Corporation's non-interest expense for the quarter ended September 30, 2012 increased by \$4.4 million to \$23.0 million compared to the same period in 2011. Salaries and fringe benefits increased \$2.2 million and account for most of this increase. For the nine months ended September 30, 2012 non-interest expense of \$69.5 million was increased \$12.6 million over the same period of 2011. Salaries and employee benefits contributed \$7.6 million to this increase. Salaries include the addition of personnel in the acquisition of Freestar Bank whose salaries are not included in the first nine months of 2011. Fringe benefits, primarily driven by increased pension expense, increased \$3.7 million for the nine months ended September 30, 2012 compared to the same period of 2011.

#### Allowance for Loan Losses

The Corporation's provision for loan losses increased \$3.4 million to \$7.3 million for the first nine months of 2012 compared to \$3.9 million for the same period of 2011 and was \$2.6 million for the third quarter of 2012 compared to \$1.4 million in 2011. Net charge offs for the third quarter of 2012 were \$1.3 million compared to \$1.1 million for the same period of 2011. Net charge offs for the nine months ended September 30, 2012 were \$6.1 million compared to \$4.3 million for the same period of 2011. During 2012, the volume of impaired loans and specific allocations for these loans increased. The allowance for loan losses has increased to \$21.5 million at September 30, 2012 compared to \$19.2 million at December 31, 2011. Based on management's analysis of the current portfolio, an evaluation that includes consideration of historical loss experience, non-performing loans trends, and probable incurred losses on identified problem loans, management believes the allowance is adequate.

#### Non-performing Loans

Non-performing loans consist of (1) non-accrual loans on which the ultimate collectability of the full amount of interest is uncertain, (2) loans which have been renegotiated to provide for a reduction or deferral of interest or principal because of a deterioration in the financial position of the borrower, and (3) loans past due ninety days or more as to principal or interest. Non-



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performing loans increased to \$65.7 million at September 30, 2012 compared to \$56.4 million at December 31, 2011. A summary of non-performing loans at September 30, 2012 and December 31, 2011 follows:

|  | (000 s)               |                      |
|--|-----------------------|----------------------|
|  | September 30,<br>2012 | December 31,<br>2011 |
| Non-accrual loans  | \$ 41,913             | \$ 38,102            |
| Restructured loans   | 20,045                | 16,275               |
| Accruing loans past due over 90 days   | 3,772                 | 2,047                |
|  | \$ 65,730             | \$ 56,424            |
| Ratio of the allowance for loan losses as a percentage of non-performing loans | 32.6%                 | 34.1%                |

The following loan categories comprise significant components of the nonperforming loans:

|                                 | (000 s)               |                      |
|---------------------------------|-----------------------|----------------------|
|                                 | September 30,<br>2012 | December 31,<br>2011 |
| <u>Non-accrual loans</u>        |                       |                      |
| Commercial loans                | \$ 24,560             | \$ 26,590            |
| Residential loans               | 15,642                | 9,477                |
| Consumer loans                  | 1,711                 | 2,035                |
|                                 | \$ 41,913             | \$ 38,102            |
| <u>Past due 90 days or more</u> |                       |                      |
| Commercial loans                | \$ 2,636              | \$ 610               |
| Residential loans               | 1,031                 | 1,358                |
| Consumer loans                  | 105                   | 79                   |
|                                 | \$ 3,772              | \$ 2,047             |

The following table is information on the non-accrual loans at September 30, 2012 and December 31, 2011 that were from the acquisition of assets from The First National Bank of Danville and are included in non-accrual loans above.

|                          | (000 s)               |                      |
|--------------------------|-----------------------|----------------------|
|                          | September 30,<br>2012 | December 31,<br>2011 |
| <u>Non-accrual loans</u> |                       |                      |
| Commercial loans         | \$ 4,019              | \$ 5,086             |
| 1-4 family residential   | 280                   | 506                  |
| Installment loans        | \$ 4,299              | \$ 5,592             |

Interest Rate Sensitivity and Liquidity

First Financial Corporation has established risk measures, limits and policy guidelines for managing interest rate risk and liquidity. Responsibility for management of these functions resides with the Asset Liability Committee. The primary goal of the Asset Liability Committee is to maximize net interest income within the interest rate risk limits approved by the Board of Directors.

Interest Rate Risk

Management considers interest rate risk to be the Corporation's most significant market risk. Interest rate risk is the exposure to changes in net interest income as a result of changes in interest rates. Consistency in the Corporation's net interest income is largely dependent on the effective management of this risk.

The Asset Liability position is measured using sophisticated risk management tools, including earning simulation and market value of equity sensitivity analysis. These tools allow management to quantify and monitor both short-term and long-term exposure to interest rate risk. Simulation modeling measures the effects of changes in interest rates, changes in the shape of the yield curve and the effects of embedded options on net interest income. This measure projects earnings in the various environments over the next three years. It is important to note that measures of interest rate risk have limitations and are dependent on various assumptions. These assumptions are inherently uncertain and, as a result, the model cannot precisely predict the impact of interest rate fluctuations on net interest income. Actual results will differ from simulated results due to timing, frequency and amount of interest rate changes as well as overall market conditions. The Committee has performed a thorough analysis of these assumptions and believes them to be valid and theoretically sound. These assumptions are continuously monitored for behavioral changes.

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

The table below shows the Corporation's estimated sensitivity profile as of September 30, 2012. The change in interest rates assumes a parallel shift in interest rates of 100 and 200 basis points. Given a 100 basis point increase in rates, net interest income would increase 4.64% over the next 12 months and increase 7.87% over the following 12 months. Given a 100 basis point decrease in rates, net interest income would decrease 1.34% over the next 12 months and decrease 3.88% over the following 12 months. These estimates assume all rate changes occur overnight and management takes no action as a result of this change.

| Basis Point<br>Interest Rate Change | Percentage Change in Net Interest Income |           |           |
|-------------------------------------|--|-----------|-----------|
|                                     | 12 months                                | 24 months | 36 months |
| Down 200                            | -2.61%                                   | -7.23%    | -10.29%   |
| Down 100                            | -1.34                                    | -3.88     | -5.58     |
| Up 100                              | 4.64                                     | 7.87      | 10.88     |
| Up 200                              | 5.35                                     | 11.04     | 17.00     |

Typical rate shock analysis does not reflect management's ability to react and thereby reduce the effect of rate changes, and represents a worst-case scenario.

Liquidity Risk

Liquidity represents an institution's ability to provide funds to satisfy demands from depositors, borrowers, and other creditors by either converting assets into cash or accessing new or existing sources of incremental funds. Generally the Corporation relies on deposits, loan repayments and repayments of investment securities as its primary sources of funds. The Corporation has \$9.9 million of investments that mature throughout the next 12 months. The Corporation also anticipates \$112.7 million of principal payments from mortgage-backed securities. Given the current rate environment, the Corporation anticipates \$7.5 million in securities to be called within the next 12 months. The Corporation also has unused borrowing capacity available with the Federal Home Loan Bank of Indianapolis and several correspondent banks. With these many sources of funds, the Corporation currently anticipates adequate liquidity to meet the expected obligations of its customers.

Financial Condition

Comparing the first nine months of 2012 to the same period in 2011, loans, net of unearned discount, have increased to \$1.86 billion from \$1.66 billion. Deposits also increased to \$2.3 billion at September 30, 2012 from \$1.9 billion at September 30, 2011. Shareholders' equity increased 3.4% or \$12.2 million. This financial performance increased book value per share 2.8% to \$27.86 at September 30, 2012 from \$27.11 at September 30, 2011. Book value per share is calculated by dividing the total shareholders' equity by the number of shares outstanding.

Capital Adequacy

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As of September 30, 2012, the most recent notification from the respective regulatory agencies categorized the subsidiary banks as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the banks must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the bank's category. Below are the capital ratios for the Corporation and lead bank.

|                                  | September 30, 2012 | December 31, 2011 | To Be Well Capitalized |
|----------------------------------|--------------------|-------------------|------------------------|
| <b>Total risk-based capital</b>  |                    |                   |                        |
| Corporation                      | 16.12%             | 15.08%            | N/A                    |
| First Financial Bank             | 15.71%             | 14.71%            | 10.00%                 |
| <b>Tier I risk-based capital</b> |                    |                   |                        |
| Corporation                      | 15.15%             | 14.21%            | N/A                    |
| First Financial Bank             | 14.85%             | 13.96%            | 6.00%                  |
| <b>Tier I leverage capital</b>   |                    |                   |                        |
| Corporation                      | 12.17%             | 12.73%            | N/A                    |
| First Financial Bank             | 11.88%             | 12.51%            | 5.00%                  |

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ITEM 4. Controls and Procedures

First Financial Corporation's management is responsible for establishing and maintaining effective disclosure controls and procedures, as defined under Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. As of September 30, 2012, an evaluation was performed under the supervision and with the participation of management, including the principal executive officer and principal financial officer, of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures. Based on that evaluation, management, including the principal executive officer and principal financial officer, concluded that the Corporation's disclosure controls and procedures as of September 30, 2012 were effective in ensuring material information required to be disclosed in this Quarterly Report on Form 10-Q was recorded, processed, summarized, and reported on a timely basis. Additionally, there was no change in the Corporation's internal control over financial reporting that occurred during the quarter ended September 30, 2012 that has materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

PART II Other Information

ITEM 1. Legal Proceedings.

There are no material pending legal proceedings, other than routine litigation incidental to the business of the Corporation or its subsidiaries, to which the Corporation or any of the subsidiaries is a party or of which any of their respective property is subject. Further, there is no material legal proceeding in which any director, officer, principal shareholder, or affiliate of the Corporation or any of its subsidiaries, or any associate of such director, officer, principal shareholder or affiliate is a party, or has a material interest, adverse to the Corporation or any of its subsidiaries.

ITEM 1 A. Risk Factors.

There have been no material changes in the risk factors from those disclosed in the Corporation's 2011 financial statements in the Form 10-K filed for December 31, 2011.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds.

(a) None.

(b) Not applicable.

(c) Purchases of Equity Securities

The Corporation periodically acquires shares of its common stock directly from shareholders in individually negotiated transactions. The Corporation has not adopted a formal policy or adopted a formal program for repurchases of shares of its common stock. There were no shares purchased by the Corporation during the quarter covered by this report.

ITEM 3. Defaults upon Senior Securities.

Not applicable.

ITEM 4. Mine Safety Disclosures

ITEM 5. Other Information.

Not applicable.

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#### ITEM 6. Exhibits.

| <b>Exhibit No.:</b> | <b>Description of Exhibit:</b>  |
|---------------------|---|
| 3.1                 | Amended and Restated Articles of Incorporation of First Financial Corporation, incorporated by reference to Exhibit 3(i) of the Corporation's Form 10-Q filed for the quarter ended September 30, 2002.   |
| 3.2                 | Code of By-Laws of First Financial Corporation, incorporated by reference to Exhibit 3(ii) of the Corporation's Form 8-K filed on July 27, 2009.  |
| 10.1*               | Employment Agreement for Norman L. Lowery, dated and effective December 1, 2011, incorporated by reference to Exhibit 10.01 of the Corporation's Form 8-K filed on February 23, 2012.   |
| 10.2*               | 2001 Long-Term Incentive Plan of First Financial Corporation, incorporated by reference to Exhibit 10.3 of the Corporation's Form 10-Q filed for the quarter ended September 30, 2002.  |
| 10.3*               | 2012 Schedule of Director Compensation, incorporated by reference to Exhibit 10.3 of the Corporation's Form 10-K filed for the fiscal year ended December 31, 2011.   |
| 10.4*               | 2012 Schedule of Named Executive Officer Compensation, incorporated by reference to Exhibit 10.4 of the Corporation's Form 10-K filed for the fiscal year ended December 31, 2011.  |
| 10.5*               | 2005 Long-Term Incentive Plan of First Financial Corporation, incorporated by reference to Exhibit 10.7 of the Corporation's Form 8-K filed on September 4, 2007.   |
| 10.6*               | 2005 Executives Deferred Compensation Plan, incorporated by reference to Exhibit 10.5 of the Corporation's Form 8-K filed on September 4, 2007.   |
| 10.7*               | 2005 Executives Supplemental Retirement Plan, incorporated by reference to Exhibit 10.6 of the Corporation's Form 8-K filed on September 4, 2007.   |
| 10.9*               | First Financial Corporation 2010 Long-Term Incentive Compensation Plan incorporated by reference to Exhibit 10.9 of the Corporation's Form 10-K filed for the fiscal year ended December 31, 2010.  |
| 10.10*              | First Financial Corporation 2011 Short-Term Incentive Compensation Plan incorporated by reference to Exhibit 10.10 of the Corporation's Form 10-K filed for the fiscal year ended December 31, 2010.  |
| 10.11*              | First Financial Corporation 2011 Omnibus Equity Incentive Plan incorporated by reference to Exhibit 10.11 of the Corporation's Form 10-Q for the quarter ended March 31, 2011 filed on May 9, 2011.   |
| 10.12*              | Form of Restricted Stock Award Agreement under the First Financial Corporation 2011 Omnibus Equity Incentive Plan incorporated by reference to Exhibit 10.12 of the Corporation's Form 10-Q for the quarter ended March 31, 2012 filed on May 10, 2012. |
| 31.1                | Sarbanes-Oxley Act 302 Certification for Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 by Principal Executive Officer, dated November 6, 2012  |
| 31.2                | Sarbanes-Oxley Act 302 Certification for Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 by Principal Financial Officer, dated November 6, 2012.   |
| 32.1                | Certification, dated November 6, 2012, of Principal Executive Officer and Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2005 on Form 10-Q for the quarter ended September 30, 2012.                                  |
| 101.1               | The following financial information from the Corporation's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, formatted in XBRL: (i) Consolidated Balance Sheets at September 30, 2012 and December 31, 2011;                      |

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(ii) Consolidated Statements of Income and Comprehensive Income for the three months and nine months ended September 30, 2012 and 2011; (iii) Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2011; (iv) Consolidated Statements of Shareholders' Equity for the three and nine months ended September 30, 2012 and 2011; and (v) Notes to Consolidated Financial Statements.\*\*

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\*Management contract or compensatory plan or arrangement.

\*\*Furnished, not filed, for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.



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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.



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