

FIRST MERCHANTS CORP  
Form 10-Q  
August 10, 2009  
**FORM 10-Q**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

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QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended **June 30, 2009**

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

**Commission File Number 0-17071**

**FIRST MERCHANTS CORPORATION**

(Exact name of registrant as specified in its charter)

**Indiana 35-1544218**

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

**200 East Jackson Street, Muncie, IN 47305-2814**

(Address of principal executive offices) (Zip code)

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

**Not Applicable**

(Former name, former address and former fiscal year,  
if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if smaller reporting company)

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

As of July 30, 2009, there were 21,167,630 outstanding common shares, of the registrant.



**FIRST MERCHANTS CORPORATION**

**FORM 10Q**

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## FIRST MERCHANTS CORPORATION

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## PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

## CONSOLIDATED CONDENSED BALANCE SHEETS

(Dollars in thousands)

	<b>June 30, 2009 (Unaudited)</b>	<b>December 31, 2008</b>
<b>ASSETS</b>		
Cash and due from banks	\$ 73,668	\$ 84,249
Federal funds sold		66,237
Cash and cash equivalents	73,668	150,486
Interest-bearing time deposits	44,595	38,823
Investment securities available for sale	610,731	459,636
Investment securities held to maturity	20,227	22,348
Mortgage loans held for sale	23,070	4,295
Loans, net of allowance for loan losses of \$77,119 and \$49,543	3,477,110	3,672,409
Premises and equipment	58,692	59,641
Federal Reserve and Federal Home Loan Bank stock	34,441	34,319
Interest receivable	20,778	23,976
Core deposit intangibles	19,937	22,492
Goodwill	141,357	143,482
Cash surrender value of life insurance	93,876	93,222
Other real estate owned	20,227	18,458
Other assets	78,336	40,568
<b>TOTAL ASSETS</b>	<b>\$ 4,717,045</b>	<b>\$ 4,784,155</b>
<b>LIABILITIES</b>		
Deposits:		
Noninterest-bearing	\$ 512,368	\$ 460,519
Interest-bearing	3,078,555	3,258,292
<b>Total Deposits</b>	<b>3,590,923</b>	<b>3,718,811</b>
Borrowings:		
Federal funds purchased	15,042	
Securities sold under repurchase agreements	115,011	122,311
Federal Home Loan Bank advances	268,938	360,217
Subordinated debentures, revolving credit lines and term loans	194,783	135,826
<b>Total Borrowings</b>	<b>593,774</b>	<b>618,354</b>
Interest payable	7,351	8,844
Other liabilities	51,619	42,243

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<b>Total Liabilities</b>	4,243,667	4,388,252
<b>STOCKHOLDERS' EQUITY</b>		
Preferred Stock, no-par value:		
Authorized -- 500,000 shares		
Series A, Issued and outstanding -- 116,000 shares	112,009	
Cumulative Preferred Stock, \$1,000 par value, \$1,000 liquidation value:		
Authorized -- 600 shares		
Issued and outstanding -- 125 shares	125	125
Common Stock, \$.125 stated value:		
Authorized -- 50,000,000 shares		
Issued and outstanding -- 21,067,477 and 21,178,123 shares	2,633	2,647
Additional paid-in capital	204,403	202,299
Retained earnings	172,688	206,496
Accumulated other comprehensive loss	(18,480 )	(15,664 )
<b>Total Stockholders' Equity</b>	473,378	395,903
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	\$ 4,717,045	\$ 4,784,155

See notes to consolidated condensed financial statements.

## FIRST MERCHANTS CORPORATION

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## CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

(Dollars in thousands, except per share amounts)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2009	2008	June 30, 2009	2008
<b>INTEREST INCOME</b>				
Loans receivable:				
Taxable	\$ 52,843	\$49,023	\$ 106,636	\$ 100,124
Tax exempt	247	178	462	343
Investment securities:				
Taxable	3,261	2,947	7,024	6,196
Tax exempt	2,362	1,452	4,131	2,965
Federal funds sold	42	3	54	11
Deposits with financial institutions	116	133	218	415
Federal Reserve and Federal Home Loan Bank stock	199	370	672	705
<b>Total Interest Income</b>	<b>59,070</b>	<b>54,106</b>	<b>119,197</b>	<b>110,759</b>
<b>INTEREST EXPENSE</b>				
Deposits	15,569	16,297	32,280	35,730
Federal funds purchased		577	22	1,246
Securities sold under repurchase agreements	507	632	974	1,448
Federal Home Loan Bank advances	2,447	2,825	5,396	5,861
Subordinated debentures, revolving credit lines and term loans	2,113	1,602	3,592	3,492
<b>Total Interest Expense</b>	<b>20,636</b>	<b>21,933</b>	<b>42,264</b>	<b>47,777</b>
<b>NET INTEREST INCOME</b>	<b>38,434</b>	<b>32,173</b>	<b>76,933</b>	<b>62,982</b>
Provision for loan losses	58,995	7,070	71,916	10,893
<b>NET INTEREST INCOME (LOSS) AFTER PROVISION FOR LOAN LOSSES</b>	<b>(20,561 )</b>	<b>25,103</b>	<b>5,017</b>	<b>52,089</b>
<b>OTHER INCOME</b>				
Service charges on deposit accounts	3,888	3,157	7,430	6,088
Fiduciary activities	1,680	2,126	3,739	4,268
Other customer fees	1,946	1,767	3,949	3,446
Commission income	1,698	1,427	3,757	3,096
Earnings on cash surrender value of life insurance	331	606	654	1,344
Net gains and fees on sales of loans	1,678	668	3,108	1,311
Net realized gains on sales of available for sale securities	1,154	13	3,946	86
Other-than-temporary impairment on available for sale securities	(5,710 )		(4,489 )	
Portion of loss recognized in other comprehensive income before taxes	3,665		1,966	
Net impairment losses recognized in earnings	(2,045 )		(2,523 )	
Other income	1,160	570	1,901	1,222
<b>Total Other Income</b>	<b>11,490</b>	<b>10,334</b>	<b>25,961</b>	<b>20,861</b>



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**OTHER EXPENSES**

Salaries and employee benefits	19,685	15,698	39,700	31,796
Net occupancy	2,443	1,750	5,012	3,555
Equipment	1,909	1,643	3,785	3,297
Marketing	564	612	1,113	1,096
Outside data processing fees	1,405	1,009	3,338	1,891
Printing and office supplies	397	291	760	572
Core deposit amortization	1,278	808	2,555	1,598
FDIC assessments	3,494	141	4,070	270
Other expenses	7,017	4,452	12,573	8,602
<b>Total Other Expenses</b>	<b>38,192</b>	<b>26,404</b>	<b>72,906</b>	<b>52,677</b>
<b>INCOME (LOSS) BEFORE INCOME TAX</b>	<b>(47,263 )</b>	<b>9,033</b>	<b>(41,928 )</b>	<b>20,273</b>
Income tax expense (benefit)	(17,534 )	2,491	(16,316 )	5,605
<b>NET INCOME (LOSS)</b>	<b>(29,729 )</b>	<b>6,542</b>	<b>(25,612 )</b>	<b>14,668</b>
Preferred stock dividends and discount accretion	1,450		2,078	
<b>NET INCOME (LOSS) AVAILABLE TO COMMON STOCKHOLDERS</b>	<b>\$ (31,179 )</b>	<b>\$6,542</b>	<b>\$ (27,690 )</b>	<b>\$ 14,668</b>
<b>Per Share Data:</b>				
Basic Net Income (Loss) Available to Common Stockholders	\$ (1.49 )	\$0.37	\$ (1.32 )	\$0.82
Diluted Net Income (Loss) Available to Common Stockholders	\$ (1.49 )	\$0.36	\$ (1.32 )	\$0.81
Cash Dividends Paid	\$ 0.08	\$0.23	\$0.31	\$0.46
Average Diluted Shares Outstanding (in thousands)	21,120	18,159	21,108	18,108

See notes to consolidated condensed financial statements.

## FIRST MERCHANTS CORPORATION

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## CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Dollars in thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Net income (loss)	\$ (29,729 )	\$ 6,542	\$ (25,612 )	\$ 14,668
Other comprehensive losses net of tax:				
Unrealized holding losses arising during the period, net of income tax benefit of \$379, \$3,188, \$38 and \$1,364	(703 )	(5,920 )	(70 )	(2,532 )
Unrealized gain (loss) on securities available for sale for which a portion of an other than temporary impairment has been recognized in income, net of tax expense of \$1,283, \$0, \$688 and \$0	(2,382 )		(1,277 )	
Unrealized gains/(losses) on cash flow hedges:				
Unrealized gains/(losses) arising during the period, net of income tax expense/(benefit) of \$153, \$243, \$622 and \$(939).	(229 )	(365 )	(933 )	1,409
Amortization of items previously recorded in accumulated other comprehensive income/(losses), net of income tax expense/(benefit) of \$(161), \$94, \$(259), and \$179	242	(141 )	389	(268 )
Reclassification adjustment for gains/(losses) included in net income net of income tax expense of \$(312), \$5, \$498, and \$34	579	(8 )	(925 )	(52 )
	(2,493 )	(6,434 )	(2,816 )	(1,443 )
Comprehensive income (loss)	\$ (32,222 )	\$ 108	\$ (28,428 )	\$ 13,225

See notes to consolidated condensed financial statements

The components of accumulated other comprehensive income/(loss), included in stockholders' equity, are as follows:

	June 30, 2009
Net unrealized gain /(loss) on securities available for sale	\$ (1,854 )

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Net unrealized gain/(loss) on securities available for sale for which a portion of an other-than-temporary impairment has been recognized in income	(1,277 )
Defined Benefit Plans, net of deferred tax items	(15,349)
	\$ (18,480)

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## FIRST MERCHANTS CORPORATION

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## CONSOLIDATED CONDENSED STATEMENTS OF STOCKHOLDERS' EQUITY

(Dollars in thousands)

(Unaudited)

	<b>2009</b>	<b>June 30,</b>	<b>2008</b>
Balances, January 1	\$ 395,903		\$ 339,936
Net income (loss)	(25,612 )		14,668
Cash dividends on common stock	(6,564 )		(8,358 )
Cash dividends on preferred stock	(1,377 )		
Other comprehensive income (loss), net of tax	(2,816 )		(1,443 )
Stock issued under dividend reinvestment and stock purchase plan	332		547
Stock options exercised, net of tax			1,595
Tax benefit from stock compensation	61		137
Stock redeemed	(190 )		(2,180 )
Issuance of stock related to acquisition			1,463
Adjustment to issuance of stock related to acquisition	(3,451 )		
Warrants issued under Capital Purchase Program	3,991		
Cumulative preferred stock issued			125
Cumulative preferred stock issued under Capital Purchase Program	112,009		
Share-based compensation	1,092		902
Balances, June 30	\$ 473,378		\$ 347,392

See notes to consolidated condensed financial statements

## FIRST MERCHANTS CORPORATION

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## CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	<b>Six Months ended June 30,</b>	
	<b>2009</b>	<b>2008</b>
Cash Flow From Operating Activities:		
Net income (loss)	\$ (25,612 )	\$ 14,668
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Provision for loan losses	71,916	10,893
Depreciation and amortization	2,918	2,258
Share-based compensation	1,092	902
Tax benefits from stock compensation	(61 )	(137 )
Mortgage loans originated for sale	(148,363 )	(58,050 )
Proceeds from sales of mortgage loans	129,588	58,551
Gains on sales of securities available for sale	3,946	86
Recognized loss on other-than-temporary-impairment	(2,523 )	
Change in interest receivable	3,198	3,722
Change in interest payable	(1,493 )	(1,667 )
Other adjustments	(29,345 )	(2,900 )
Net cash provided by operating activities	\$ 5,261	\$ 28,326
Cash Flows from Investing Activities:		
Net change in interest-bearing deposits	\$ (5,772 )	\$ 17,664
Purchases of:		
Securities available for sale	(326,516 )	(21,136 )
Securities held to maturity	(20,444 )	(1,840 )
Proceeds from sales of securities available for sale	95,215	
Proceeds from maturities of:		
Securities available for sale	78,433	60,876
Securities held to maturity	22,519	913
Purchase of Federal Reserve and Federal Home Loan Bank stock	(122 )	(205 )
Purchase of bank owned life insurance		(706 )
Net cash paid in acquisitions		(237 )
Net change in loans	108,182	(172,946 )
Other adjustments	(1,969 )	(2,048 )
Net cash used by investing activities	\$ (50,474 )	\$ (119,665 )
Cash Flows from Financing Activities:		
Net change in:		
Demand and savings deposits	\$ 80,058	\$ 23,209
Certificates of deposit and other time deposits	(207,946 )	(3,695 )

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Proceeds from the sale of other real estate owned	12,601	8,795
Borrowings	95,904	269,506
Repayment of borrowings	(120,484 )	(252,029 )
Cash dividends on common stock	(6,564 )	(8,358 )
Cash dividends on preferred stock	(1,377 )	
Stock issued under dividend reinvestment and stock purchase plans	332	547
Stock options exercised		1,595
Cumulative preferred stock issued	116,000	125
Tax benefit from stock options exercised	61	137
Stock redeemed	(190 )	(2,180 )
Net cash provided by (used in) financing activities	\$ (31,605 )	\$ 37,652
Net Change in Cash and Cash Equivalents	(76,818 )	(53,687 )
Cash and Cash Equivalents, January 1	150,486	134,683
Cash and Cash Equivalents, June 30	\$ 73,668	\$ 80,996
Additional cash flow information:		
Interest paid	\$ 43,757	\$ 49,444
Income tax paid	5,148	10,471
Loans transferred to other real estate owned	15,201	23,669

See notes to consolidated condensed financial statements.

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**FIRST MERCHANTS CORPORATION**

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**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**

(Table dollars in thousands)

(Unaudited)

**NOTE 1. General**

Financial Statement Preparation

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

The consolidated condensed balance sheet of the Corporation as of December 31, 2008 has been derived from the audited consolidated balance sheet of the Corporation as of that date. Certain information and note disclosures normally included in the Corporation's annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. These consolidated condensed financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Corporation's Form 10-K annual report filed with the Securities and Exchange Commission. The results of operations for the three and six months ended June 30, 2009 are not necessarily indicative of the results to be expected for the year.

**NOTE 2. Share-Based Compensation**

Stock options and restricted stock awards ("RSAs") have been issued to directors, officers and other management employees under the Corporation's 1994 Stock Option Plan, the 1999 Long-term Equity Incentive Plan and the 2009 Long-term Equity Incentive Plan. The stock options, which have a ten-year life, become 100 percent vested ranging from three months to two years and are fully exercisable when vested. Option exercise prices equal the Corporation's common stock closing price on NASDAQ on the date of grant. RSAs provide for the issuance of shares of the Corporation's common stock at no cost to the holder and generally vest after three years. The RSAs vest only if the employee is actively employed by the Corporation on the vesting date and, therefore, any unvested shares are forfeited. Deferred stock units ("DSUs") have been credited to non-employee directors who have elected to defer payment of compensation under the Corporation's 2008 Equity Compensation Plan for Non-employee Directors. DSUs credited are equal to the restricted shares that the non-employee director would have received under the plan. As of June 30, 2009, there were 2,031 DSUs credited to the non-employee directors.

The Corporation's 2009 Employee Stock Purchase Plan ("ESPP") provides eligible employees of the Corporation and its subsidiaries an opportunity to purchase shares of common stock of the Corporation through quarterly offerings financed by payroll deductions. The price of the

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stock to be paid by the employees shall be equal to 85% of the average of the closing price of the Corporation's common stock on each trading day during the offering period.

However, in no event shall such purchase price be less than the lesser of an amount equal to 85% of the market price of the Corporation's stock on the offering date or an amount equal to 85% of the market value on the date of purchase. Common stock purchases are made quarterly and are paid through advance payroll deductions up to a calendar year maximum of \$25,000.

SFAS No. 123(R) requires the Corporation to record compensation expense related to unvested share-based awards by recognizing the unamortized grant date fair value of these awards over the remaining service periods of those awards, with no change in historical reported fair values and earnings. Awards are valued at fair value in accordance with provisions of SFAS No. 123(R) and are recognized on a straight-line basis over the service periods of each award. To complete the exercise of vested stock options, RSA's and ESPP options, the Corporation generally issues new shares from its authorized but unissued share pool. Share-based compensation for the three and six months ended June 30, 2009 were \$549,000 and \$1,092,000, respectively, compared to \$464,000 and \$902,000 for the three and six months ended June 30, 2008. Share-based compensation has been recognized as a component of salaries and benefits expense in the accompanying Consolidated Condensed Statements of Operations.



**FIRST MERCHANTS CORPORATION****FORM 10Q****NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**

(Table dollars in thousands)

(Unaudited)

**NOTE 2. Share-Based Compensation continued**

The estimated fair value of the stock options granted during 2009 and in prior years was calculated using a Black Scholes option pricing model. The following summarizes the assumptions used in the 2009 Black Scholes model:

Risk-free interest rate	2.03	%
Expected price volatility	35.19	%
Dividend yield	3.72	%
Forfeiture rate	4.00	%
Weighted-average expected life, until exercise	6.57	years

The Black Scholes model incorporates assumptions to value share-based awards. The risk-free rate of interest, for periods equal to the expected life of the option, is based on a zero-coupon U.S. government instrument over a similar contractual term of the equity instrument. Expected price volatility is based on historical volatility of the Corporation's common stock. In addition, the Corporation generally uses historical information to determine the dividend yield and weighted-average expected life of the options until exercise. Separate groups of employees that have similar historical exercise behavior with regard to option exercise timing and forfeiture rates are considered separately for valuation and attribution purposes.

Share-based compensation expense recognized in the Consolidated Condensed Statements of Income is based on awards ultimately expected to vest and is reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods, if actual forfeitures differ from those estimates. Pre-vesting forfeitures were estimated to be approximately 4 percent for the six months ended June 30, 2009, based on historical experience.

The following table summarizes the components of the Corporation's share-based compensation awards recorded as expense:

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	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Stock and ESPP Options:				
Pre-tax compensation expense	\$ 225	\$ 141	\$ 433	\$ 321
Income tax benefit	(20 )	(6 )	(40 )	(22 )
Stock and ESPP option expense, net of income taxes	\$ 205	\$ 135	\$ 393	\$ 299
Restricted Stock Awards:				
Pre-tax compensation expense	\$ 324	\$ 323	\$ 659	\$ 581
Income tax benefit	(112 )	(113 )	(232 )	(203 )
Restricted stock awards expense, net of income taxes	\$ 212	\$ 210	\$ 427	\$ 378
Total Share-Based Compensation:				
Pre-tax compensation expense	\$ 549	\$ 464	\$ 1,092	\$ 902
Income tax benefit	(132 )	(119 )	(272 )	(225 )
Total share-based compensation expense, net of income taxes	\$ 417	\$ 345	\$ 820	\$ 677

As of June 30, 2009, unrecognized compensation expense related to stock options and RSAs totaling \$810,000 and \$2,159,000, respectively, is expected to be recognized over weighted-average periods of 1.30 and 1.80 years, respectively.

## FIRST MERCHANTS CORPORATION

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## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Table dollars in thousands)

(Unaudited)

## NOTE 2. Share-Based Compensation continued

Stock option activity under the Corporation's stock option plans as of June 30, 2009 and changes during the six months ended June 30, 2009 were as follows:

	Number of Shares	Weighted-Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2009	951,322	\$ 24.70		
Granted	183,571	17.60		
Exercised				
Cancelled	(10,476 )	24.40		
Outstanding June 30, 2009	1,124,417	\$ 23.54	5.61	0
Vested and Expected to Vest at June 30, 2009	1,124,417	\$ 23.54	5.58	0
Exercisable at June 30, 2009	871,746	\$ 24.44	4.53	0

The weighted-average grant date fair value was \$4.68 for stock options granted during the six months ended June 30, 2009.

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Corporation's closing stock price on the last trading day of the first six months of 2009 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their stock options on June 30, 2009. The amount of aggregate intrinsic value will change based on the fair market value of the Corporation's common stock. There were no stock options exercised during the six months of 2009.

The following table summarizes information on unvested RSAs outstanding as of June 30, 2009:

	<b>Number of Shares</b>	<b>Weighted-Average Grant Date Fair Value</b>
Unvested RSAs at January 1, 2009	162,494	\$ 26.20
Granted	80,818	\$ 12.32
Forfeited	(44,406 )	\$ 25.21
Vested	(2,699 )	\$ 22.45
Unvested RSAs at June 30, 2009	196,207	\$ 20.76

The grant date fair value of ESPP options was estimated at the beginning of the July 1, 2008 offering period and approximates \$240,000. The ESPP options vested during the twelve month period ending June 30, 2009. At June 30, 2009, there was no unrecognized compensation expense related to unvested ESPP options.

### **NOTE 3. Derivative Financial Instruments**

The Corporation offers interest rate derivative products (e.g. interest rate swaps) to certain of its high-quality commercial borrowers. This product allows customers to enter into an agreement with the Corporation to swap their variable rate loan to a fixed rate. These derivative products are designed to reduce, eliminate or modify the risk of changes in the borrower's interest rate or market price risk. The extension of credit incurred through the execution of these derivative products is subject to the same approvals and underwriting standards as the related traditional credit product. The Corporation limits its risk exposure to these products by entering into a mirror-image, offsetting swap agreement with a separate, well-capitalized and rated counterparty previously approved by the Asset Liability Committee. By using these interest rate swap arrangements, the Corporation is also better insulated from the interest rate risk associated with underwriting fixed-rate loans. These derivative contracts are not designated against specific assets or liabilities under SFAS No. 133 and, therefore, do not qualify for hedge

## FIRST MERCHANTS CORPORATION

## FORM 10Q

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Table dollars in thousands)

(Unaudited)

## NOTE 3. Derivative Financial Instruments continued

accounting. The derivatives are recorded on the balance sheet at fair value and changes in fair value of both the customer and the offsetting swaps agreements are recorded (and essentially offset) in non-interest income. The fair value of the derivative instruments incorporates a consideration of credit risk (in accordance with SFAS No. 157), resulting in some insignificant volatility in earnings each period. The notional amounts of the interest rate swaps were \$70,442,000 at June 30, 2009.

The tables summarize the fair value of derivative financial instruments utilized by the Corporation:

	Asset Derivatives		Liability Derivatives	
	June 30, 2009 Balance Sheet Location	Fair Value	June 30, 2009 Balance Sheet Location	Fair Value
Derivatives not designated as hedging instruments under Statement 133:				
Interest rate contracts			Other Liabilities	
	Other assets	\$ 2,886		\$(2,726 )
		\$ 2,886		\$(2,726 )

The effect of derivative instruments on the consolidated statement of operations for the three and six months ended June 30, 2009 and 2008 is as follows:

Derivatives Not Designated as Hedging Instruments under Statement 133	Location of Gain (Loss) Recognized Income on Derivative	Amount of Gain (Loss) Recognized	Amount of Gain (Loss)
		Income on Derivative	Recognized Income on Derivative
		Three Months Ended June 30, 2009	Six Months Ended June 30, 2009
Interest rate contracts	Other income	\$ 261	\$ 290

Derivatives Not Designated as Hedging Instruments under	Location of Gain (Loss) Recognized Income on Derivative	Amount of Gain (Loss) Recognized	Amount of Gain (Loss)
		Income on Derivative	Recognized Income on

Statement 133

		Three Months Ended June 30, 2008	Derivative Six Months Ended June 30, 2008
Interest rate contracts	Other income	\$ 186	\$ 186

**Note 4. Disclosures About Fair Value of Assets and Liabilities**

Effective January 1, 2008, the Corporation adopted Statement of Financial Accounting Standards No. 157, Fair Value Measurements (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements.

FAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. FAS 157 also 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 in active markets for identical assets or liabilities

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in active markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

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**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**

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(Unaudited)

**Note 4. Disclosures About Fair Value of Assets and Liabilities continued**

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying balance sheet, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Available-for-sale securities

Where quoted, market prices are available in an active market and securities are classified within Level 1 of the valuation hierarchy. There are no securities classified within Level 1 of the hierarchy. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities include agencies, mortgage backs, state and municipal and corporate obligations. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy and include corporate obligations. Level 3 fair value on corporate obligations was determined using a discounted cash flow model that incorporated market estimates of interest rates and volatility in markets that have not been active.

Third party vendors compile prices from various sources and may apply such techniques as matrix pricing to determine the value of identical or similar investment securities (Level 2). Matrix pricing is a mathematical technique widely used in the banking industry to value investment securities without relying exclusively on quoted prices for specific investment securities but rather relying on the investment securities' relationship to other benchmark quoted investment securities. Any investment security not valued based upon the methods above are considered Level 3.

Interest rate swap agreements

The Corporation offers interest rate derivative products (e.g. interest rate swaps) to certain of its high-quality commercial borrowers. This product allows customers to enter into an agreement with the Corporation to swap their variable rate loan to a fixed rate. These derivative products are designed to reduce, eliminate or modify the risk of changes in the borrower's interest rate or market price risk. The extension of credit incurred through the execution of these derivative products is subject to the same approvals and underwriting standards as the related traditional credit product. The Corporation limits its risk exposure to these products by entering into a mirror-image, offsetting swap agreement with a separate, well-capitalized and rated counterparty previously approved by the Asset Liability Committee. By using these interest rate swap

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arrangements, the Corporation is also better insulated from the interest rate risk associated with underwriting fixed-rate loans. These derivative contracts are not designated against specific assets or liabilities under SFAS No. 133 and, therefore, do not qualify for hedge accounting. The derivatives are recorded on the balance sheet at fair value and changes in fair value of both the customer and the offsetting swaps agreements are recorded (and essentially offset) in non-interest income. The fair value of the derivative instruments incorporates a consideration of credit risk (in accordance with SFAS No. 157), resulting in some insignificant volatility in earnings each period.

The fair value is estimated by a third party using inputs that are primarily unobservable and cannot be corroborated by observable market data and, therefore, are classified within Level 3 of the valuation hierarchy.



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## NOTE 4. Disclosures About Fair Value of Assets and Liabilities continued

The following table presents the fair value measurements of assets and liabilities recognized in the accompanying balance sheet measured at fair value on a recurring basis and the level within the FAS 157 fair value hierarchy in which the fair value measurements fall at June 30, 2009.

	Fair Value Measurements Using		
	Fair Value (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available for sale securities:			
U.S. Government-sponsored agency securities	\$ 10,228	\$ 10,228	
State and municipal	272,922	272,922	
Mortgage-backed securities	318,520	318,520	
Corporate obligations	7,231	5,209	\$ 2,022
Marketable equity securities	1,830	1,830	
Interest rate swap asset	2,886		2,886
Interest rate swap liability	(2,726 )		(2,726)

The following table presents the fair value measurements of assets and liabilities recognized in the accompanying balance sheet measured at fair value on a recurring basis and the level within the FAS 157 fair value hierarchy in which the fair value measurements fall at December 31, 2008.

	Fair Value Measurements Using		
	Fair Value (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

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Available for sale securities	\$459,636	\$451,707	7,929	
Interest rate swap asset	4,094		4,094	
Interest rate swap liability	(4,224 )		(4,224 )	

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## NOTE 4. Disclosures About Fair Value of Assets and Liabilities continued

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the accompanying balance sheet using significant unobservable Level 3 inputs for the three and six months ended June 30, 2009.

	Three Months Ended			Six Months Ended		
	June 30, 2009 Available for Sale Securities	Interest Rate Swap Asset	Interest Rate Swap Liability	June 30, 2009 Available for Sale Securities	Interest Rate Swap Asset	Interest Rate Swap Liability
Balance at beginning of the period	\$ 1,550	\$ 3,872	\$(3,973 )	\$ 7,929	\$ 4,094	\$(4,224 )
Total realized and unrealized gains and losses:						
Included in net income (loss)	(2,045 )	(986 )	1,247	(2,522 )	(1,208 )	1,498
Included in other comprehensive income	2,377			(151 )		
Purchases, issuances and settlements		964			1,797	
Transfers in/(out) of Level 3				(3,460 )		
Principal payments	144	(963 )		230	(1,796 )	
Ending balance at June 30, 2009	\$ 2,026	\$ 2,887	\$(2,726 )	\$ 2,026	\$ 2,887	\$(2,726 )

	Three Months Ended			Six Months Ended		
	June 30, 2008 Available for Sale Securities	Interest Rate Swap Asset	Interest Rate Swap Liability	June 30, 2009 Available for Sale Securities	Interest Rate Swap Asset	Interest Rate Swap Liability
Balance at beginning of the period	\$ 11,161			\$ 12,023		
Total realized and unrealized gains and losses:						
Included in net income (loss)		\$229	\$(201 )		\$229	\$(201 )
Included in other comprehensive income	(1,661 )			(3,391 )		
Purchases, issuances and settlements		24			24	

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Transfers in/(out) of Level 3				975			
Principal payments		(24	)	(107	)	(24	)
Ending balance at June 30, 2008	\$ 9,500	\$229	\$ (201	)	\$ 9,500	\$229	\$ (201

Following is a description of valuation methodologies used for instruments measured at fair value on a non-recurring basis and recognized in the accompanying balance sheet, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Impaired Loans and Other Real Estate Owned

Loan impairment is reported when scheduled payments under contractual terms are deemed uncollectible. Impaired loans are carried at the present value of estimated future cash flows using the loan's existing rate, or the fair value of collateral if the loan is collateral dependent. A portion of the allowance for loan losses is allocated to impaired loans if the value of such loans is deemed to be less than the unpaid balance. If these allocations cause the allowance for loan losses to increase, such increase is reported as a component of the provision for loan losses. Loan losses are charged against the allowance when management believes the uncollectability of the loan is confirmed. During the second quarter of 2009, certain impaired loans were partially charged-off or re-evaluated. The valuation would be considered Level 3, consisting of appraisals of underlying collateral and discounted cash flow analysis.

The fair value for impaired loans and other real estate owned is measured based on the value of the collateral securing those loans/real estate and is determined using several methods. The fair value of real estate is generally determined based on

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## NOTE 4. Disclosures About Fair Value of Assets and Liabilities continued

appraisals by qualified licensed appraisers. The appraisers typically determine the value of the real estate by utilizing an income or market valuation approach. If an appraisal is not available, the fair value may be determined by using a cash flow analysis. Fair value on other collateral such as business assets is typically calculated by using the financial information such as financial statements and aging reports provided by the borrower and is discounted as considered appropriate.

	Fair Value Measurements Using		Significant Other	Significant
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Impaired loans	\$ 60,196			\$ 60,196
Other Real Estate Owned	\$ 20,227			\$ 20,227

The estimated fair values of the Corporation's financial instruments are as follows:

	June 30, 2009	
	Carrying Amount	Fair Value
Assets:		
Cash and due from banks	\$ 73,668	\$ 73,668
Interest-bearing time deposits	44,595	44,595
Investment securities available for sale	610,731	610,731
Investment securities held to maturity	20,227	20,094
Mortgage loans held for sale	23,070	23,070
Loans	3,477,110	3,486,077
FRB and FHLB stock	34,441	34,441
Interest receivable	20,778	20,778
Liabilities:		

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Deposits	\$ 3,590,923	\$ 3,533,004
Borrowings:		
Federal funds purchased	15,042	15,042
Securities sold under repurchase agreements	115,011	115,011
FHLB Advances	268,938	280,910
Subordinated debentures, revolving credit lines and term loans	194,783	200,999
Interest Payable	7,351	7,351

Cash and Due from Banks: The fair value of cash and cash equivalents approximates carrying value.

Interest-Bearing Time Deposits: The fair value of interest-bearing time deposits approximates carrying value.

Investment Securities: See Fair Value of Financial Instruments above.

Mortgage Loans Held for Sale: The fair value of mortgage loans held for sale approximates carrying value.

Loans: For both short-term loans and variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair value for other loans is estimated using discounted cash flow analysis, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. See Impaired Loans above.

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**NOTE 4. Disclosures About Fair Value of Assets and Liabilities continued**

Loan commitments and letters-of-credit generally have short-term, variable-rate features and contain clauses which limit the Corporation's exposure to changes in customer credit quality. Accordingly, their carrying values, which are immaterial at the respective balance sheet dates, are reasonable estimates of fair value.

Federal Reserve and Federal Home Loan Bank Stock: The fair value of FRB and FHLB stock is based on the price at which it may be resold to the FRB and FHLB.

Interest Receivable and Interest Payable: The fair values of interest receivable/payable approximates carrying value.

Deposits: The fair values of noninterest-bearing demand accounts, interest-bearing demand accounts and savings deposits are equal to the amount payable on demand at the balance sheet date. The carrying amounts for variable rate, fixed-term certificates of deposit approximate their fair values at the balance sheet date. Fair values for fixed-rate certificates of deposit and other time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on such time deposits.

Borrowings: The fair value of borrowings is estimated using a discounted cash flow calculation, based on current rates for similar debt, except for short-term and adjustable rate borrowing arrangements. At June 30, the fair value for these instruments approximates carrying value.

**NOTE 5. Investment Securities**

The amortized cost and approximate fair values of securities are as follows:

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	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
Available for sale at June 30, 2009				
U.S. Government-sponsored agency securities	\$ 10,150	\$ 100	\$ 22	\$ 10,228
State and municipal	272,183	3,331	2,592	272,922
Mortgage-backed securities	314,566	5,044	1,090	318,520
Corporate obligations	16,818	112	9,699	7,231
Marketable equity securities	1,830			1,830
Total available for sale	615,547	8,587	13,403	610,731
Held to maturity at June 30, 2009				
U.S. Treasury	11,248		1	11,247
State and municipal	8,974	62	194	8,842
Mortgage-backed securities	5			5
Total held to maturity	20,227	62	195	20,094
Total Investment Securities	\$ 635,774	\$ 8,649	\$ 13,598	\$ 630,825



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## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

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## NOTE 5. Investment Securities continued

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale at December 31, 2008				
U.S. Government-sponsored agency securities	\$ 15,451	\$ 218		\$ 15,669
State and municipal	156,426	3,220	\$ 107	159,539
Mortgage-backed securities	265,820	4,472	215	270,077
Corporate obligations	19,822		8,978	10,844
Marketable equity securities	3,507			3,507
Total available for sale	461,026	7,910	9,300	459,636
Held to maturity at December 31, 2008				
U.S. Treasury	11,675		1	11,674
State and municipal	10,666	93	264	10,495
Mortgage-backed securities	7			7
Total held to maturity	22,348	93	265	22,176
Total Investment Securities	\$ 483,374	\$ 8,003	\$ 9,565	\$ 481,812

The amortized cost and fair value of available for sale securities and held to maturity securities at June 30, 2009, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available for Sale		Held to Maturity	Fair Value
	Amortized Cost	Fair Value	Amortized Cost	
Maturity Distribution at June 30, 2009:				
Due in one year or less	\$ 34,515	\$ 34,733	\$ 11,356	\$ 11,356
Due after one through five years	61,255	62,986	395	410
Due after five through ten years	41,448	42,256	3,775	3,607
Due after ten years	161,933	150,406	4,696	4,716
	\$ 299,151	\$ 290,381	\$ 20,222	\$ 20,089

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Mortgage-backed securities	314,566	318,520	5	5
Marketable equity securities	1,830	1,830		
Total Investment Securities	\$ 615,547	\$ 610,731	\$ 20,227	\$ 20,094

The carrying value of securities pledged as collateral, to secure public deposits and for other purposes, was \$215,088,000 at June 30, 2009.

The book value of securities sold under agreements to repurchase amounted to \$115 million at June 30, 2009.

Gross gains of \$3,946,000 resulting from sales and redemptions of available for sale securities were realized for 2009. There were no losses recognized from the sales of available for sale securities in 2009. The Corporation has recognized a loss of \$2,045,000 in the second quarter of 2009, equal to the credit loss, establishing a new, lower amortized cost basis. The credit loss was calculated by comparing expected discounted cash flows based on performance indicators of the underlying assets in the security to the carrying value of the investment. Because the Corporation does not intend to sell the investment and it is not more likely than not the Corporation will be required to sell the investment before recovery of its new, lower amortized cost basis, which may be maturity, it does not consider the remainder of the investment securities to be other-than-temporarily impaired at June 30, 2009.

Gross gains of \$13,000 and \$86,000 resulting from sales of available for sale securities were realized in the three and six months ended June 30, 2008. There were no losses recognized from the sales of available for sale securities in the first six months of 2008. No other-than-temporary impairment losses were recognized in the first six months of 2008.

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## NOTE 5. Investment Securities continued

Certain investments in debt (and marketable equity) securities are reported in the financial statements at an amount less than their historical cost. Total fair value of these investments at June 30, 2009, was \$235,017,000 and \$60,343,000, which is approximately 37.3 and 12.5 percent of the Corporation's available for sale and held to maturity investment portfolio at June 30, 2009 and December 31, 2008.

Except as discussed below, management believes the declines in fair value for these securities are temporary.

Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other-than-temporary impairment is identified.

The following table shows the Corporation's investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2009 and December 31, 2008:

	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	Less than 12 Months		12 Months or Longer		Total	
Temporarily Impaired Investment Securities at June 30, 2009						
U.S. Treasury	\$ 7,498	\$ (1 )			\$ 7,498	\$ (1 )
U.S. Government-sponsored agency securities	3,095	(22 )			3,095	(22 )
State and municipal	105,726	(2,774 )	\$ 263	\$ (12 )	105,989	(2,786 )
Mortgage-backed securities	113,754	(1,090 )	36		113,790	(1,090 )
Corporate obligations	3,747	(1,240 )	898	(8,459 )	4,645	(9,699 )
Total Temporarily Impaired Investment Securities	\$ 233,820	\$ (5,127 )	\$ 1,197	\$ (8,471 )	\$ 235,017	\$ (13,598 )

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	<b>Fair Value</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>	<b>Gross Unrealized Losses</b>
	<b>Less than 12 Months</b>		<b>12 Months or Longer</b>		<b>Total</b>	
Temporarily Impaired Investment Securities at December 31, 2008						
U.S. Treasury	\$ 11,374	\$ (1 )			\$ 11,374	\$ (1 )
U.S. Government-sponsored agency securities						
State and municipal	10,274	(124 )	\$ 3,582	\$ (247 )	13,856	(371 )
Mortgage-backed securities	13,315	(47 )	11,755	(168 )	25,070	(215 )
Corporate obligations	7,302	(69 )	2,741	(8,909 )	10,043	(8,978 )
Total Temporarily Impaired Investment Securities	\$ 42,265	\$ (241 )	\$ 18,078	\$ (9,324 )	\$ 60,343	\$ (9,565 )

Mortgage-backed Securities

The unrealized losses on the Corporation's investment in mortgage-backed securities were a result of interest rate increases. The Corporation expects to recover the amortized cost basis over the term of the securities. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Corporation does not intend to sell the investments and it is not more likely than not the Corporation will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Corporation does not consider those investments to be other-than-temporarily impaired at June 30, 2009.

State and Political Subdivisions

The unrealized losses on the Corporation's investments in securities of state and political subdivisions were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the

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**NOTE 5. Investment Securities continued**

amortized cost basis of the investments. Because the Corporation does not intend to sell the investments and it is not more likely than not the Corporation will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Corporation does not consider those investments to be other-than-temporarily impaired at June 30, 2009.

**Other Securities**

The Corporation's unrealized losses on pooled trust preferred securities total \$9.1 million on a book value of \$11.1 million. The decline in value is attributable to temporary illiquidity and the financial crisis affecting these markets and not the expected cash flows of the individual securities. Due to the illiquidity in the market, it is unlikely that the Corporation would be able to recover its investment in these securities if the Corporation sold the securities at this time. The Corporation has analyzed the cash flow characteristics of the securities and this analysis included utilizing the most recent trustee reports and any other relevant market information including announcements of deferrals or defaults of trust preferred securities. The Corporation has recognized a loss of \$2,045,000 in the second quarter of 2009, equal to the credit loss, establishing a new, lower amortized cost basis. The credit loss was calculated by comparing expected discounted cash flows based on performance indicators of the underlying assets in the security to the carrying value of the investment. Because the Corporation does not intend to sell the investment and it is not more likely than not the Corporation will be required to sell the investment before recovery of its new, lower amortized cost basis, which may be maturity, it does not consider the remainder of the investment securities to be other-than-temporarily impaired at June 30, 2009. The Corporation previously recognized other-than-temporary impairment of \$477,000 in the first quarter of 2009 equal to the credit loss.

**Credit Losses Recognized on Investments**

Certain debt securities have experienced fair value deterioration due to credit losses, as well as due to other market factors, but are not otherwise other-than-temporarily impaired.

The following table provides information about debt securities for which only a credit loss was recognized in income and other losses are recorded in other comprehensive income.

	<b>Accumulated Credit Losses in 2009</b>
Credit losses on debt securities held:	
January 1, 2009	
Additions related to other-than-temporary losses not previously recognized	\$ 2,523
June 30, 2009	\$ 2,523

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## NOTE 6. Loans and Allowance

	June 30, 2009	December 31, 2008
Loans:		
Commercial and industrial loans	\$ 874,671	\$ 904,646
Agricultural production financing and other loans to farmers	121,361	135,099
Real estate loans		
Construction	162,765	252,487
Commercial and farm land	1,231,986	1,202,372
Residential	930,714	956,245
Individual's loans for household and other personal expenditures	174,363	201,632
Tax exempt loans	23,596	28,070
Lease financing receivables, net of unearned income	8,095	8,996
Other loans	26,678	32,405
	3,554,229	3,721,952
Allowance for loan losses	(77,119 )	(49,543 )
Total Loans	\$ 3,477,110	\$ 3,672,409

	Six Months Ended	
	June 30, 2009	2008
Allowance for loan losses:		
Balances, January 1	\$ 49,543	\$ 28,228
Provision for losses	71,916	10,893
Adjustment related to acquisition	2,040	
Recoveries on loans	1,606	2,078
Loans charged off	(47,986 )	(9,602 )
Balances, June 30	\$ 77,119	\$ 31,597

See the information regarding the analysis of loan loss experience in the Asset Quality/Provision for Loan Losses section of Management's Discussion and Analysis of Financial Condition and Results of Operations included as ITEM 2 of this Form 10-Q.

**NOTE 7. Net Income (Loss) Per Share**

Basic net income (loss) per share is computed by dividing net income by the weighted-average shares outstanding during the reporting period. Diluted net income per share is computed by dividing net income by the combination of all dilutive common share equivalents, comprised of shares issuable under the Corporation's share-based compensation plans, and the weighted-average shares outstanding during the reporting period.

Dilutive common share equivalents include the dilutive effect of in-the-money share-based awards, which are calculated based on the average share price for each period using the treasury stock method. Under the treasury stock method, the exercise price of share-based awards, the amount of compensation expense, if any, for future service that the Corporation has not yet recognized, and the amount of estimated tax benefits that would be recorded in additional paid-in capital when share-based awards are exercised, are assumed to be used to repurchase common stock in the current period.



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## NOTE 7. Net Income Per Share continued

	Three Months Ended June 30, 2009			2008 Weighted-		
	Net Income	Weighted- Average Shares	Per Share Amount	Net Income	Average Shares	Per Share Amount
Basic net income (loss) per share:						
	\$ (29,729 )			\$ 6,542		
Less: Preferred stock dividends	1,450					
Net income (loss) available to common stockholders	(31,179 )	21,060,219	\$ (1.49 )	6,542	18,050,956	\$ 0.37
Effect of dilutive stock options and warrants					108,251	
Diluted net income (loss) per share:						
Net income (loss) available to common stockholders and assumed conversions	\$ (31,179 )	21,060,219	\$ (1.49 )	\$ 6,542	18,159,207	\$ 0.36

Stock options to purchase 1,124,456 and 671,394 shares for the three months ended June 30, 2009 and 2008, respectively, were not included in the earnings per share calculation because the exercise price exceeded the average market price.

	Six Months Ended June 30, 2009			2008 Weighted-		
	Net Income	Weighted- Average Shares	Per Share Amount	Net Income	Average Shares	Per Share Amount
Basic net income (loss) per share:						
	\$ (25,612 )			\$ 14,668		
Less: Preferred stock dividends	2,078					
Net income (loss) available to common stockholders	(27,690 )	21,041,466	\$ (1.32 )	14,668	17,994,699	\$ 0.82
Effect of dilutive stock options and warrants					112,873	
Diluted net income (loss) per share:						
Net income (loss) available to common stockholders and assumed conversions	\$ (27,690 )	21,041,466	\$ (1.32 )	\$ 14,668	18,107,572	\$ 0.81

Stock options to purchase 1,106,500 and 628,599 shares for the six months ended June 30, 2009 and 2008, respectively, were not included in the earnings per share calculation because the exercise price exceeded the average market price.

**Note 8. Goodwill**

The changes in the carrying amount of goodwill from December 31, 2008 to June 30, 2009 were a result of two adjustments in the first quarter regarding the December 31, 2008 acquisition of Lincoln Bancorp. The first adjustment was an increase of \$1,326,000 (\$2,040,000, net of \$714,000 tax) to increase the allowance for loan losses due to the continued evaluation of the credit quality of Lincoln Bank's loan portfolio. The second adjustment was due to an error in the conversion of unallocated shares of Lincoln's Employee Stock Option Plan shares that should have been retired prior to the December 31, 2008 conversion of Lincoln Bancorp stock to Corporation's stock.

Goodwill is reviewed for impairment annually in accordance with SFAS No. 142. Due to the declining stock price, the Corporation engaged a third party to perform the evaluation in the first quarter of 2009. The evaluation included three approaches. The asset approach values each asset and liability separately, which are then summed to produce an indication of the equity value of the business. The market approach compares the subject to similar businesses that have been sold. The income approach determines the value of a business using a discounted cash flow based on expectations of future earnings or cash flows. The review was complete in the first quarter of 2009 and the results of the evaluation showed that, at March 31, 2009, the fair value exceeded the carrying value of First Merchants Corporation by more than \$100 million and therefore management concluded that goodwill was not impaired.

**FIRST MERCHANTS CORPORATION**

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**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**

(Table dollars in thousands)

(Unaudited)

**Note 8. Goodwill continued**

At June 30, 2009, management reviewed the discounted cash flow approach used by the third party with updated information and future earnings assumptions. Management determined that the carrying value of First Merchants Corporation does not exceed the fair value and therefore, management concluded that goodwill was not impaired.

**Note 9. Subsequent Events**

Subsequent events have been evaluated through August 10, 2009, the date the financial statements were available to be issued. There were no items that would have a material impact to the financial statements presented in this Form 10-Q.

**Note 10. Impact of Accounting Changes**

**Statements of Financial Accounting Standards**

*SFAS No. 141, "Business Combinations (Revised 2007)."* SFAS 141R replaces SFAS 141, "Business Combinations," and applies to all transactions and other events in which one entity obtains control over one or more other businesses. SFAS 141R requires an acquirer, upon initially obtaining control of another entity, to recognize the assets, liabilities and any non-controlling interest in the acquiree at fair value as of the acquisition date. Contingent consideration is required to be recognized and measured at fair value on the date of acquisition rather than at a later date when the amount of that consideration may be determinable beyond a reasonable doubt. This fair value approach replaces the cost-allocation process required under SFAS 141 whereby the cost of an acquisition was allocated to the individual assets acquired and liabilities assumed based on their estimated fair value. SFAS 141R requires acquirers to expense acquisition-related costs as incurred rather than allocating such costs to the assets acquired and liabilities assumed, as was previously the case under SFAS 141. Under SFAS 141R, the requirements of SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities," would have to be met in order to accrue for a restructuring plan in purchase accounting. Pre-acquisition contingencies are to be recognized at fair value, unless it is a non-contractual contingency that is not likely to materialize, in which case, nothing should be recognized in purchase accounting and, instead, that contingency would be subject to the probable and estimable recognition criteria of SFAS 5, "Accounting for Contingencies." SFAS 141R is applicable to the Corporation's accounting

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for business combinations closing on or after January 1, 2009.

*SFAS No. 160, "Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB Statement No. 51."* SFAS 160 amends Accounting Research Bulletin (ARB) No. 51, "Consolidated Financial Statements," to establish accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 clarifies that a non-controlling interest in a subsidiary, which is sometimes referred to as minority interest, is an ownership interest in the consolidated entity that should be reported as a component of equity in the consolidated financial statements. Among other requirements, SFAS 160 requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the non-controlling interest. It also requires disclosure, on the face of the consolidated income statement, of the amounts of consolidated net income attributable to the parent and to the non-controlling interest. SFAS 160 became effective for the Corporation on January 1, 2009 and did not have a significant impact on the Corporation's financial statements.

*SFAS No. 161, "Disclosures About Derivative Instruments and Hedging Activities, an Amendment of FASB Statement No. 133."* SFAS 161 amends SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," to amend and expand the disclosure requirements of SFAS 133 to provide greater transparency about (i) how and why an entity uses derivative instruments, (ii) how derivative instruments and related hedge items are accounted for under SFAS 133 and its related interpretations, and (iii) how derivative instruments and related hedged items affect an entity's financial position, results of operations and cash flows. To meet those objectives, SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments and disclosures about credit-risk-related contingent features in derivative agreements. SFAS 161 became effective for the Corporation on January 1, 2009 and the required disclosures are reported in Note 3 Derivative Financial Instruments, included within the Notes to Consolidated Condensed Financial Statements of this Form 10Q.

**FIRST MERCHANTS CORPORATION**

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**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**

(Table dollars in thousands)

(Unaudited)

**Note 10. Impact of Accounting Changes continued**

*SFAS No. 165, Subsequent Events* - The FASB has issued FASB Statement No. 165, *Subsequent Events*. Statement 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Specifically, Statement 165 provides:

- The period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements;
- The circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and
- The disclosures that an entity should make about events or transactions that occurred after the balance sheet date.

Statement 165 was effective for interim or annual financial periods ending after June 15, 2009, and shall be applied prospectively. There was no material impact on any subsequent events through the filing date of this Form 10-Q.

*SFAS No. 167, Amendments to FASB Interpretation No. 46(R) and SFAS No. 166, Accounting for Transfers of Financial Assets* -The FASB has issued the following two standards which change the way entities account for securitizations and special-purpose entities:

- FASB Statement No. 166, Accounting for Transfers of Financial Assets;
- FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R).

Statement 166 is a revision to FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, and will require more information about transfers of financial assets, including securitization transactions, and where entities have continuing exposure to the risks related to transferred financial assets. It eliminates the concept of a “qualifying special-purpose entity,” changes the requirements for derecognizing financial assets, and requires additional disclosures.

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Statement 167 is a revision to FASB Interpretation No. 46 (Revised December 2003), *Consolidation of Variable Interest Entities*, and changes how a reporting entity determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a reporting entity is required to consolidate another entity is based on, among other things, the other entity's purpose and design and the reporting entity's ability to direct the activities of the other entity that most significantly impact the other entity's economic performance.

The new standards will require a number of new disclosures. Statement 167 will require a reporting entity to provide additional disclosures about its involvement with variable interest entities and any significant changes in risk exposure due to that involvement. A reporting entity will be required to disclose how its involvement with a variable interest entity affects the reporting entity's financial statements. Statement 166 enhances information reported to users of financial statements by providing greater transparency about transfers of financial assets and an entity's continuing involvement in transferred financial assets.

The Federal Reserve is reviewing regulatory capital requirements associated with the adoption of the new accounting standards by financial institutions. In conducting this review, the Federal Reserve is considering a broad range of factors including the maintenance of prudent capital levels, the record of recent bank experiences with off-balance sheet vehicles, and the results of the recent Supervisory Capital Assessment Program (SCAP). As part of the SCAP, participating banking organizations' capital adequacy was assessed using assumptions consistent with standards ultimately included in FAS 166 and FAS 167.

Statements 166 and 167 will be effective at the start of a reporting entity's first fiscal year beginning after November 15, 2009, or January 1, 2010, for a calendar year-end entity. Early application is not permitted. The Corporation does not expect this to have a material impact on the Corporation's financial statements.

SFAS No. 168, *"The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles, a Replacement of FASB Statement No. 162."* SFAS 168 replaces SFAS 162, "The Hierarchy of Generally Accepted Accounting Principles" and establishes the FASB Accounting Standards Codification (the "Codification") as the source of authoritative

**FIRST MERCHANTS CORPORATION**

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**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**

(Table dollars in thousands)

(Unaudited)

**Note 10. Impact of Accounting Changes continued**

accounting principles recognized by the FASB to be applied by non-governmental entities in the preparation of financial statements in conformity with generally accepted accounting principles. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative guidance for SEC registrants. All guidance contained in the Codification carries an equal level of authority. All non-grandfathered, non-SEC accounting literature not included in the Codification is superseded and deemed non-authoritative. SFAS 168 will be effective for the Corporation's financial statements for periods ending after September 15, 2009. SFAS 168 is not expected have a significant impact on the Corporation's financial statements.

**Financial Accounting Standards Board Staff Positions and Interpretations**

*FSP EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities."*

FSP EITF 03-6-1 provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. FSP EITF 03-6-1 became effective on January 1, 2009.

*FSP SFAS 132R-1, "Employers' Disclosures about Postretirement Benefit Plan Assets."* FSP SFAS 132R-1 provides guidance related to an employer's disclosures about plan assets of defined benefit pension or other post-retirement benefit plans. Under FSP SFAS 132R-1, disclosures should provide users of financial statements with an understanding of how investment allocation decisions are made, the factors that are pertinent to an understanding of investment policies and strategies, the major categories of plan assets, the inputs and valuation techniques used to measure the fair value of plan assets, the effect of fair value measurements using significant unobservable inputs on changes in plan assets for the period and significant concentrations of risk within plan assets. The disclosures required by FSP SFAS 132R-1 will be included in the Corporation's financial statements beginning with the financial statements for the year-ended December 31, 2009.

**FIRST MERCHANTS CORPORATION**

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**FORWARD-LOOKING STATEMENTS**

From time to time, we include forward-looking statements in our oral and written communication. We may include forward-looking statements in filings with the Securities and Exchange Commission, such as this Form 10-Q, in other written materials and in oral statements made by senior management to analysts, investors, representatives of the media and others. We intend these forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and we are including this statement for purposes of these safe harbor provisions. Forward-looking statements can often be identified by the use of words like "believe", "continue", "pattern", "estimate", "project", "intend", "anticipate", "expect" and similar expressions or future or conditional verbs such as "will", "should", "could", "might", "can", "may", or similar expressions. These forward-looking statements include:

- statements of our goals, intentions and expectations;
- statements regarding our business plan and growth strategies;
- statements regarding the asset quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

These forward-looking statements are subject to significant risks, assumptions and uncertainties, including, among other things, the following important factors which could affect the actual outcome of future events:

- fluctuations in market rates of interest and loan and deposit pricing, which could negatively affect our net interest margin, asset valuations and expense expectations;
- adverse changes in the economy, which might affect our business prospects and could cause credit-related losses and expenses;
- adverse developments in our loan and investment portfolios;



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- competitive factors in the banking industry, such as the trend towards consolidation in our market;
- changes in the banking legislation or the regulatory requirements of federal and state agencies applicable to bank holding companies and banks like our affiliate banks;
- acquisitions of other businesses by us and integration of such acquired businesses;
- changes in market, economic, operational, liquidity, credit and interest rate risks associated with our business; and
- the continued availability of earnings and excess capital sufficient for the lawful and prudent declaration and payment of cash dividends.

Because of these and other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements. In addition, our past results of operations do not necessarily indicate our anticipated future results.

### **CRITICAL ACCOUNTING POLICIES**

Generally accepted accounting principles are complex and require us to apply significant judgments to various accounting, reporting and disclosure matters. We must use assumptions and estimates to apply these principles where actual measurement is not possible or practical. For a complete discussion of our significant accounting policies, see "Notes to the Consolidated Financial Statements" in our Annual Report on Form 10-K for the year ended December 31, 2008. Certain policies are considered critical because they are highly dependent upon subjective or complex judgments, assumptions and estimates. Changes in such estimates may have a significant impact on the financial statements. We have reviewed the application of these policies with the Audit Committee of our Board of Directors.

**FIRST MERCHANTS CORPORATION**

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****continued**

We believe there have been no significant changes during the six months ended June 30, 2009 to the items that we disclosed as our critical accounting policies and estimates in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2008.

**BUSINESS SUMMARY**

The Corporation is a diversified financial holding company headquartered in Muncie, Indiana. Since its organization in 1982, the Corporation has grown to include 80 banking center locations in 24 Indiana and 3 Ohio counties. In addition to its branch network, the Corporation's delivery channels include ATMs, check cards, interactive voice response systems, remote deposit and internet technology.

The Corporation's business activities are currently limited to one significant business segment, which is community banking. As of June 30, 2009, the Corporation's financial service affiliates included four nationally chartered banks: First Merchants Bank, National Association ("First Merchants"), First Merchants Bank of Central Indiana, National Association, Lafayette Bank and Trust Company, National Association ("Lafayette") and Commerce National Bank. The banks provide commercial and retail banking services. In addition, the trust company and multi-line insurance company provide trust asset management services and retail and commercial insurance agency services, respectively.

On August 4, 2009, the Corporation filed an application with the Office of the Comptroller of the Currency to merge these four charters into a single charter under the name, First Merchants Bank, National Association. The pending bank charter combination will preserve the brand names of Lafayette Bank and Trust and Commerce National Bank. Each of these entities will continue to do business in their own name as divisions of First Merchants Bank, N.A. In addition, bank board members will continue their affiliation with their bank franchises, management and communities as regional bank board members.

Management believes that its vision, mission, culture statement and core values produce profitable growth for stockholders. Management also believes it is important to maintain a strong control environment as we continue to grow our businesses. Interest rate and market risks inherent in our asset and liability balances are managed within prudent ranges, while ensuring adequate liquidity and funding. Sound credit policies are maintained and interest rate and market risks inherent in our asset and liability balances are managed within prudent ranges, while ensuring adequate liquidity and funding.

**RESULTS OF OPERATIONS**

**Executive Summary**

First Merchants Corporation had a net loss of \$31.2 million, or \$1.49 per common share, for the quarter ended June 30, 2009, compared to net income of \$6.5 million, or \$.36 per share for the quarter ended June 30, 2008. The Corporation's second quarter contributed to year-to-date loss of \$27.7 million or \$1.32 per share, down from the prior year net income of \$14.7 million or \$.81.

The decline in net income for the quarter was due to a higher-than-normal provision for loan losses of \$59 million. The year-to-date provision for loan losses through June 30, 2009, was \$72 million compared to \$11 million during the first half of 2008. The Corporation's allowance for loan losses, as a percent of total loans, increased to 2.16 percent as of quarter-end from 1.05 percent, as of June 30, 2008, a \$45.5 million increase. The increase in the allowance results from the provision for loan losses exceeding charge-offs by \$34.8 million in the last four quarters coupled with the \$10.7 million allowance from the Lincoln acquisition.

Loan charge-offs were \$40.4 million for the quarter. Commercial real estate charge-offs totaled \$6.6 million, land and lot development loans totaled \$5.1 million, 1-4 family residential properties totaled \$3.1 million, commercial and industrial loans totaled \$24.4 million and consumer loans totaled \$1.2 million. The single largest charge-off, totaling \$10.2 million, was taken as a result of fraudulent financial statements provided by a large commercial and industrial borrower and the absence of adequate collateral and guarantees. The Corporation is pursuing all legal actions to recover our exposure. Other losses for the quarter are primarily policy compliant loans where borrowers are suffering from economic pressures in our franchise.

Non-performing loans were \$116 million at quarter-end. Of these non-performing loans, commercial real estate loans totaled \$42 million, land and lot development loans totaled \$26 million, 1-4 family residential properties totaled \$17 million, commercial and industrial loans totaled \$24 million and other loans totaled \$7 million. Other real estate owned ("OREO") declined at quarter-end by \$1.8 million to \$20 million. In addition, loans past due 90 days or more fell by more than half from the prior quarter to \$3.6 million.

## FIRST MERCHANTS CORPORATION

## FORM 10Q

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**continued

Assets decreased by \$67 million during the six months ended June 30, 2009. Federal funds sold decreased by \$66 million as these funds were redeployed in reducing borrowings by \$25 million and providing additional funds to support the increase in investments of \$149 million. Loans decreased by \$168 million as demand decreased during the period in nearly all categories except residential mortgages. Loans held for sale, which is made up exclusively with residential mortgages, increased during the six months ended June 30, 2009, due to the low interest rate environment.

As of June 30, 2009, the Corporation continued to exceed the regulatory well capitalized targets, as seen in the chart below.

	June 30, 2009		Well-Capitalized	
Capital Ratios:				
Total risk-based capital	12.56	%	10.00	%
Tier 1 risk-based capital	10.01	%	6.00	%
Tier 1 leverage	8.31	%	5.00	%
Tangible common equity	4.42	%	N/A	

**Net Interest Income**

Net interest margin declined slightly by 4 basis points from 3.68 percent in the first quarter of 2009 to 3.64 percent in the second quarter of 2009 as net interest income remained stable at just over \$38 million.

Net interest income is the primary source of our earnings. It is a function of net interest margin and the level of average earning assets. Net interest margin contracted by 16 basis points from 3.80 percent in the second quarter of 2008 to 3.64 percent in the second quarter of 2009 and earning assets increased by \$971 million. Of the \$971 million, Lincoln accounted for \$792 million of the increase. As a result, net interest income in the second quarter increased by \$6.3 million. The table below presents our asset yields, interest expense, and net interest income as a percent of average earning assets for the three and six months ended June 30, 2009 and 2008.

During the six months ended June 30, 2009, asset yields decreased 80 basis points on a fully taxable equivalent basis (FTE) and interest costs decreased 61 basis points, resulting in a 19 basis point (FTE) decrease in net interest income as compared to the same period in 2008.

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(Dollars in thousands)	Three Months Ended				Six Months Ended			
	June 30,		June 30,		June 30,		June 30,	
	2009	2008	2009	2008	2009	2008	2009	2008
Annualized net interest income	\$ 153,735	\$ 125,964	\$ 153,867	\$ 128,691				
Annualized FTE adjustment	5,618	3,562	4,946	3,509				
Annualized net interest income on a fully taxable equivalent basis	\$ 159,353	\$ 129,526	\$ 158,813	\$ 132,200				
Average earning assets	\$ 4,383,570	\$ 3,412,666	\$ 4,341,330	\$ 3,428,960				
Interest income (FTE) as a percent of average earning assets	5.52	% 6.60	% 5.61	% 6.41				
Interest expense as a percent of average earning assets	1.88	% 2.80	% 1.95	% 2.56				
Net interest income (FTE) as a percent of average earning assets	3.64	% 3.80	% 3.66	% 3.85				

Average earning assets include the average balance of securities classified as available for sale, computed based on the average of the historical amortized cost balances without the effects of the fair value adjustment. In addition, annualized amounts are computed utilizing a 30/360 day basis.

### Non-Interest Income

Non-interest income increased by \$1,156,000 during the second quarter of 2009, compared to the second quarter of 2008. Net gains and fees on sales of mortgage loans increased \$1,010,000, or 151.2 percent, as a result of increased mortgage refinancing activity and the Lincoln acquisition on December 31, 2008. Service charges increased \$731,000, or 23.2 percent, due to increased fees and additional service charge income related to the December 31, 2008 acquisition of Lincoln. Fiduciary activities have decreased in the three and six months ended June 30, 2009, compared with the same periods in 2008 due to decreased market values of portfolios management by the trust company.

**FIRST MERCHANTS CORPORATION**

**FORM 10Q**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****continued**

During the first six months of 2009, non-interest income increased by \$5.1 million, or 24.5%, as compared to the same period in 2008. The sale of investment securities resulted in net gains of approximately \$1,423,000, after other-than-temporary impairment charges of \$2,522,000 were recognized on pooled trust preferred investments. Net gains and fees on sales of mortgage loans increased \$1,797,000, or 137.1 percent, as a result of increased mortgage refinancing activity and the Lincoln acquisition on December 31, 2008. Additionally, service charges increased \$1,342,000, or 22.0 percent, compared to the first six months of 2008.

**Non-Interest Expense**

Total non-interest expense, linked quarter-over-quarter, increased by \$3.5 million as FDIC assessments increased by \$2.9 million, expenses related to OREO write-downs increased by \$1.1 million and professional services related to credit losses increased by just over \$750,000. Absent credit-related costs and FDIC insurance costs, operating expenses decreased by nearly \$1.3 million, reflecting the operational savings related to the Lincoln integration from mid-April. The largest reduction was in base salary expense totaling \$950,000. Other expenses such as premises and equipment and outside data processing expenses have increased in the second quarter of 2009 compared to the second quarter of 2008 due to the Lincoln acquisition.

During the first six months of 2009, non-interest expense increased by \$20.2 million, or 38.4%, compared to the same period in 2008. Salary and benefit expenses increased by \$7.9 million, which included to \$5.1 million additional expense related to the December 31, 2008 acquisition of Lincoln, as well as \$1.9 million of increases in health insurance and retirement plan expenses. The FDIC's special assessment of approximately \$2,220,000, and an increase in costs due to the acquisition of Lincoln, caused FDIC expenses to increase \$3,800,000. Other expenses such as premises and equipment and outside data processing expenses have increased in the six months ended June 30, 2009, compared to the same period of 2008 due to the Lincoln acquisition.

**Income Tax Expense (Benefit)**

The income tax benefit for the six months ended June 30, 2009 was \$16,316,000 with an effective tax rate of 38.9%. For the same period in 2008, the income tax expense was \$5,605,000 with an effective tax rate of 27.7%. The change was due to the loss experienced by the Corporation in the second quarter of 2009.

**CAPITAL**

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Our regulatory capital continues to exceed regulatory "well capitalized" standards. Tier I regulatory capital consists primarily of total stockholders' equity and subordinated debentures issued to business trusts categorized as qualifying borrowings, less non-qualifying intangible assets and unrealized net securities gains. As of June 30, 2009, the Corporation continues to exceed the regulatory well capitalized targets, as seen in the chart below.

	June 30, 2009		Well-Capitalized	
Capital Ratios:				
Total risk-based capital	12.56	%	10.00	%
Tier 1 risk-based capital	10.01	%	6.00	%
Tier 1 leverage	8.31	%	5.00	%
Tangible common equity	4.42	%	N/A	

Regulatory capital guidelines require a Tier I risk-based capital ratio of at least 4.0 percent and a total risk-based capital ratio of at least 8.0 percent.

Our GAAP capital ratio, defined as total stockholders' equity to total assets, equaled 10.04 percent at June 30, 2009 and 8.27 percent at December 31, 2008. When we acquire other companies for stock, GAAP capital increases by the entire amount of the purchase price.

Our tangible capital ratio, defined as total stockholders' equity less intangibles net of tax to total assets less intangibles net of tax, equaled 4.42 percent as of June 30, 2009, and 5.01 percent at December 31, 2008.

We believe that all of the above capital ratios are meaningful measurements for evaluating our safety and soundness. Additionally, we believe the following table is also meaningful when considering our performance measures. The table details and reconciles tangible earnings per share, return on tangible capital and tangible assets to traditional GAAP measures.

## FIRST MERCHANTS CORPORATION

## FORM 10Q

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**continued

(Dollars in thousands, except per share amounts)

	<b>June 30, 2009</b>		<b>December 31, 2008</b>	
Average goodwill	\$ 141,712		\$ 124,403	
Average core deposit intangible (CDI)	21,214		11,388	
Average deferred tax on CDI	(2,250)	)	(2,867)	)
Intangible adjustment	\$ 160,676		\$ 132,924	
Average stockholders' equity (GAAP capital)	\$ 479,226		\$ 349,594	
Average cumulative preferred stock issued under the Capital Purchase Program	(80,598)	)		
Intangible adjustment	(160,676)	)	(132,924)	)
Average tangible capital	\$ 237,952		\$ 216,670	
Average assets	\$ 4,767,145		\$ 3,811,166	
Intangible adjustment	(160,676)	)	(132,924)	)
Average tangible assets	\$ 4,606,469		\$ 3,678,242	
Net income (loss) available to common stockholders	\$ (27,690)	)	\$ 20,638	
CDI amortization, net of tax	1,548		1,919	
Tangible net income (loss) available to common stockholders	\$ (26,142)	)	\$ 22,557	
Diluted earnings per share	\$(1.32)	)	\$ 1.14	
Diluted tangible earnings per share	\$(1.24)	)	\$ 1.24	
Return on average GAAP capital	(11.56)	)%	5.90	%
Return on average tangible capital	(21.97)	)%	10.41	%
Return on average assets	(1.16)	)%	0.54	%
Return on average tangible assets	(1.14)	)%	0.61	%

**ASSET QUALITY/PROVISION FOR LOAN LOSSES**

Our primary business focus is middle market commercial and residential real estate, auto and small consumer lending, which results in portfolio diversification. We ensure that appropriate methods to understand and underwrite risk are utilized. Commercial loans are individually underwritten and judgmentally risk rated. They are periodically monitored and prompt corrective actions are taken on deteriorating loans. Retail loans are typically underwritten with statistical decision-making tools and are managed throughout their life cycle on a portfolio basis.

The allowance for loan losses is maintained through the provision for loan losses, which is a charge against earnings. The amount provided for loan losses and the determination of the adequacy of the allowance are based on a continuous review of the loan portfolio, including an internally administered loan "watch" list and an ongoing loan review. The evaluation takes into consideration identified credit problems, as well as the possibility of losses inherent in the loan portfolio that are not specifically identified.



Non-performing loans will increase or decrease going forward due to portfolio growth, routine problem loan recognition and resolution through collections, sales or charge-offs. The performance of any loan can be affected by external factors such as economic conditions, or factors particular to a borrower, such as actions of a borrower's management.

At June 30, 2009, non-performing assets, which includes nonaccrual loans, restructured loans, and other real estate owned, plus 90 days delinquent totaled \$140,259,000, an increase of \$28,143,000 from December 31, 2008 as noted in the table below. Other real estate owned increased \$3.6 million from December 31, 2008, to March 31, 2009 but decreased \$1.9 million from March 31, 2009 to June 30, 2009. The decline in the second quarter of 2009 was a result of property sales and write downs of \$805,000. Current appraisals are obtained to determine value as management continues to aggressively market these real estate assets. While loans 90 days past due increased to \$7.7 million at March 31, 2009, the balance declined at June 30, 2009 to \$3.6 million.

## FIRST MERCHANTS CORPORATION

## FORM 10Q

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**continued

The composition of the non performing assets and 90 days delinquent loans is made up of 34% commercial real estate, 24% land and lot loans, 19% commercial and industrial with the remainder in consumer and agriculture. Total commercial construction and land development loans in the portfolio declined to \$162 million at June 30, 2009, compared with \$252 million at December 31, 2008.

	<b>June 30, 2009</b>	<b>December 31, 2008</b>
Non-Performing Assets:		
Non-accrual loans	\$ 112,220	\$ 87,546
Renegotiated loans	4,216	130
Non-performing loans (NPL)	116,436	87,676
Real estate owned and repossessed assets	20,227	18,458
Non-performing assets (NPA)	136,663	106,134
90+ days delinquent and still accruing	3,596	5,982
NPAS & 90+ days delinquent	\$ 140,259	\$ 112,116
Impaired Loans (includes substandard, doubtful and loss)	\$ 296,172	\$ 206,126

At June 30, 2009, impaired loans totaled \$296,172,000, an increase of \$90,046,000 from December 31, 2008. At June 30, 2009, an allowance for losses was not deemed necessary for impaired loans totaling \$230,225,000, as there was no identified loss on these credits. An allowance of \$24,818,000 was recorded for the remaining balance of impaired loans of \$65,947,000 and is included in our allowance for loan losses. A loan is deemed impaired when, based on current information or events, it is probable all amounts due of principal and interest according to the contractual terms of the loan agreement will not be collected. All of our criticized loans, including substandard, doubtful and loss credits, are included in the impaired loan total.

At June 30, 2009, the allowance for loan losses was \$77,119,000, an increase of \$27,576,000 from year end 2008. As a percent of loans, the allowance was 2.16 percent at June 30, 2009 and 1.33 percent at December 31, 2008. The provision for loan losses for the first six months of 2009 was \$71,916,000, an increase of \$61,023,000 from \$10,893,000 for the same period in 2008. Specific reserves on impaired loans increased from \$9.7 million at December 31, 2008 to \$24.8 million at June 30, 2009. The increase from the prior year was a result of an increase in net charge offs and the increase in non-performing loans. In addition, there was an adjustment to the allowance acquired with Lincoln Bancorp on December 31, 2008, as discussed in NOTE 8. Goodwill, included within the Notes to Consolidated Condensed Financial Statements of this Form 10-Q.

Net charge offs for the second quarter of 2009 were \$40,378,000. Of this amount, \$35.2 million was made up of 16 loans with charge offs of more than \$500,000. The two most significant categories, with \$25.8 million, were commercial and industrial and \$6.9 million in land and lot

loans.

The decline in the value of commercial and residential real estate in our market has negatively impacted the underlying collateral value in our commercial, residential, land development and construction loans. This downturn in the real estate market is expected to continue and management is proactive in evaluating loans collateralized by real estate. Management continues to evaluate commercial borrowers by including consideration of specific borrower cash flow analysis and estimated collateral values, types and amounts on non-performing loans, past and anticipated loan loss experience, changes in the composition of the loan portfolio, and the current condition and amount of loans outstanding. The determination of the provision in any period is based on management's continuing review and evaluation of the loan portfolio, and its judgment as to the impact of current economic conditions on the portfolio.

## **LIQUIDITY**

Liquidity management is the process by which we ensure that adequate liquid funds are available for us and our subsidiaries. These funds are necessary in order to meet financial commitments on a timely basis. These commitments include withdrawals by depositors, funding credit obligations to borrowers, paying dividends to stockholders, paying operating expenses, funding capital expenditures, and maintaining deposit reserve requirements. Liquidity is monitored and closely managed by our asset/liability committee.

Our liquidity is dependent upon our receipt of dividends from our bank subsidiaries, which are subject to certain regulatory limitations and access to other funding sources. Liquidity of our bank subsidiaries is derived primarily from core deposit growth,

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FORM 10Q

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**continued

principal payments received on loans, the sale and maturity of investment securities, net cash provided by operating activities, and access to other funding sources.

The most stable source of liability-funded liquidity for both the long-term and short-term is deposit growth and retention in the core deposit base. In addition, we utilized advances from the Federal Home Loan Bank ("FHLB") as funding sources. At June 30, 2009, total borrowings from the FHLB were \$268,938,000. Our bank subsidiaries have pledged certain mortgage loans and investments to the FHLB. The total available remaining borrowing capacity from the FHLB at June 30, 2009 was \$128,210,000.

The principal source of asset-funded liquidity is investment securities classified as available for sale, the market values of which totaled \$610,731,000 at June 30, 2009, an increase of \$151,095,000 or 32.9 percent above December 31, 2008. Securities classified as held to maturity that are maturing within a short period of time can also be a source of liquidity. Securities classified as held to maturity and that are maturing in one year or less totaled \$11,356,000 at June 30, 2009. In addition, other types of assets such as cash and due from banks, federal funds sold and securities purchased under agreements to resell, and loans and interest-bearing deposits with other banks maturing within one year are sources of liquidity.

The Corporation currently has a \$5 million term loan with LaSalle Bank, N.A. that matures on February 15, 2015. The term loan is secured by 100 percent of the common stock of First Merchants and Lafayette. The Agreement contains several restrictive covenants, including the maintenance of various capital adequacy levels, asset quality and profitability ratios and certain restriction on dividends and other indebtedness. At June 30, 2009, the Corporation was in violation of the earnings covenant with LaSalle on this Term Loan. The covenant requires the Corporation to exceed a minimum return on average assets of .35%. The Corporation will be requesting a loan covenant waiver from LaSalle.

In the normal course of business, we are a party to a number of other off-balance sheet activities that contain credit, market and operational risk that are not reflected in whole or in part in our consolidated financial statements. Such activities include: traditional off-balance sheet credit-related financial instruments, commitments under operating leases and long-term debt.

We provide customers with off-balance sheet credit support through loan commitments and standby letters of credit. Summarized credit-related financial instruments at June 30, 2009 are as follows:

(Dollars in thousands)

**June 30,  
2009**

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Amounts of commitments:

Loan commitments to extend credit	\$ 641,341
Standby letters of credit	36, 829
	\$ 678,170

Since many of the commitments are expected to expire unused or be only partially used, the total amount of unused commitments in the preceding table does not necessarily represent future cash requirements.

In addition to owned banking facilities, we have entered into a number of long-term leasing arrangements to support our ongoing activities. The required payments under such commitments and borrowings at June 30, 2009 are as follows:

(Dollars in Thousands)	<b>2009</b>					<b>2014 and</b>	
	<b>Remaining</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>after</b>	<b>Total</b>
Operating leases	\$ 1,117	\$ 2,023	\$ 1,898	\$ 1,498	\$ 848	\$ 1,064	\$ 8,448
Federal funds purchased	15,042						15,042
Securities sold under repurchase agreements	80,761	10,000		14,250		10,000	115,011
Federal Home Loan Bank advances	47,542	85,756	32,107	71,392	7,568	24,573	268,938
Subordinated debentures, revolving credit lines and term loans				78,957		115,826	194,783
<b>Total</b>	<b>\$ 144,462</b>	<b>\$ 97,779</b>	<b>\$ 34,005</b>	<b>\$ 166,097</b>	<b>\$ 8,416</b>	<b>\$ 151,463</b>	<b>\$ 602,222</b>

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**continued

**INTEREST SENSITIVITY AND DISCLOSURES ABOUT MARKET RISK**

Asset/Liability Management ("ALM") has been an important factor in our ability to record consistent earnings growth through periods of interest rate volatility. Management and the Board of Directors monitor our liquidity and interest sensitivity positions at regular meetings to review how changes in interest rates may affect earnings. Decisions regarding investments and the pricing of loan and deposit products are made after analysis of reports designed to measure liquidity, rate sensitivity, exposure to changes in net interest income given various rate scenarios and the economic and competitive environments.

It is our objective to monitor and manage risk exposure to net interest income caused by changes in interest rates. It is the goal of our ALM function to provide optimum and stable net interest income. To accomplish this, we use two ALM tools. GAP/Interest Rate Sensitivity Reports and Net Interest Income Simulation Modeling are constructed, presented, and monitored quarterly.

We believe that our liquidity and interest sensitivity position at June 30, 2009, remained adequate to meet our primary goal of achieving optimum interest margins while avoiding undue interest rate risk.

Net interest income simulation modeling, or earnings-at-risk, measures the sensitivity of net interest income to various interest rate movements. Our asset liability process monitors simulated net interest income under three separate interest rate scenarios; base, rising and falling. Estimated net interest income for each scenario is calculated over a 12-month horizon. The immediate and parallel changes to the base case scenario used in the model are presented on the following page. The interest rate scenarios are used for analytical purposes and do not necessarily represent our view of future market movements. Rather, these are intended to provide a measure of the degree of volatility interest rate movements may introduce into our earnings.

The base scenario is highly dependent on numerous assumptions embedded in the model, including assumptions related to future interest rates. While the base sensitivity analysis incorporates our best estimate of interest rate and balance sheet dynamics under various market rate movements, the actual behavior and resulting earnings impact will likely differ from that projected. For

mortgage-related assets, the base simulation model captures the expected prepayment behavior under changing interest rate environments. Assumptions and methodologies regarding the interest rate or balance behavior of indeterminate maturity products, e.g., savings, money market, NOW and demand deposits, reflect our best estimate of expected future behavior.

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The comparative rising and falling scenarios below assume further interest rate changes in addition to the base simulation discussed above. These changes are immediate and parallel changes to the base case scenario. In addition, total rate movements (beginning point minus ending point) to each of the various driver rates utilized by us in the base simulation are as follows:

<b>Driver Rates</b>	<b>RISING (200 Basis Points)</b>	<b>FALLING (100 Basis Points)</b>
Prime	200	0
Federal Funds	200	0
One-Year CMT	200	(19)
Three-Year CMT	200	(71)
Five-Year CMT	200	(100)
CD's	200	(87)
FHLB Advances	200	(41)

Results for the base, rising and falling interest rate scenarios are listed below, based upon our rate sensitive assets and liabilities at June 30, 2009. The net interest income shown represents cumulative net interest income over a 12-month time horizon. Balance sheet assumptions used for the base scenario are the same for the rising and falling simulations. All results are within the Corporation's policy limits.

<b>Driver Rates</b>	<b>Base</b>	<b>RISING (200 Basis Points)</b>	<b>FALLING (100 Basis Points)</b>
Net Interest Income	\$ 155,440	\$ 166,674	\$ 155,047
Variance from Base		\$ 11,234	\$ (393 )
Percent of change from base	0.00 %	7.23 %	(0.25 )%

## FIRST MERCHANTS CORPORATION

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**continued

The comparative rising and falling scenarios below as of December 30, 2008, assume further interest rate changes in addition to the base simulation discussed above. These changes are immediate and parallel changes to the base case scenario. In addition, total rate movements (beginning point minus ending point) to each of the various driver rates utilized by us in the base simulation are as follows:

	<b>RISING</b>	<b>FALLING</b>
<b>Driver Rates</b>	<b>(200 Basis Points)</b>	<b>(100 Basis Points)</b>
Prime	200	0
Federal Funds	200	0
One-Year CMT	200	(6)
Three-Year CMT	200	(24)
Five-Year CMT	200	(24)
CD's	200	(96)
FHLB Advances	200	(30)

Results for the base, rising and falling interest rate scenarios are listed below, based upon our rate sensitive assets and liabilities at December 31, 2008. The net interest income shown represents cumulative net interest income over a 12-month time horizon. Balance sheet assumptions used for the base scenario are the same for the rising and falling simulations.

		<b>RISING</b>	<b>FALLING</b>
<b>Driver Rates</b>	<b>Base</b>	<b>(200 Basis Points)</b>	<b>(100 Basis Points)</b>
Net Interest Income	\$ 144,038	\$ 154,398	\$ 145,606
Variance from Base		\$ 10,359	\$ 1,568



Percent of change from base	7.19	%	1.09	%
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**EARNING ASSETS**

The following table presents the earning asset mix as of June 30, 2009, and December 31, 2008. Earning assets decreased by \$60,317,000 in the six months ended June 30, 2009, as federal funds sold were redeployed in reducing borrowings and increasing investment securities. Investments increased by \$148,974,000, while loans decreased by \$148,948,000. Nearly all loan segments saw declines with the largest declines in commercial and farmland, commercial and industrial and consumer loans.

<b>(Dollars in thousands)</b>	<b>June 30, 2009</b>	<b>December 31, 2008</b>
Federal funds sold		\$ 66,237
Interest-bearing time deposits	\$ 44,595	38,823
Investment securities available for sale	610,731	459,636
Investment securities held to maturity	20,227	22,348
Mortgage loans held for sale	23,070	4,295
Loans	3,554,229	3,721,952
Federal Reserve and Federal Home Loan Bank stock	34,441	34,319
Total	\$ 4,287,293	\$ 4,347,610

**OTHER**

The Securities and Exchange Commission maintains a Web site that contains reports, proxy and information statements and other information regarding registrants that file electronically with the Commission, including us, and that address is (<http://www.sec.gov>).

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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The information required under this item is included as part of Management's Discussion and Analysis of Financial Condition and Results of Operations, under the headings "LIQUIDITY" and "INTEREST SENSITIVITY AND DISCLOSURES ABOUT MARKET RISK".

**ITEM 4. CONTROLS AND PROCEDURES**

At the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934 are recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

**FIRST MERCHANTS CORPORATION**

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**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

None

**ITEM 1.A. RISK FACTORS**

In addition to the risk factors previously disclosed in the Corporation's December 31, 2008 Annual Report on Form 10-K, the Corporation may suffer losses in its portfolio despite its underwriting practices. In connection with recent negative economic developments, many financial institutions, including the Corporation, have experienced unusual and significant declines in the performance of their loan portfolios, and the values of real estate collateral supporting many loans have declined. If the current trends in the housing and real estate markets continue, loan delinquencies and credit losses may increase. Although the Corporation believes its underwriting and loan review procedures are appropriate for the various kinds of loans originated, loan quality deterioration could adversely affect the Corporation's results of operations and financial condition.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

a. None

b. None

c. None

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

a. The Annual Meeting of Shareholders of the Corporation was held on May 6, 2009.

b. No response is required.

c. The following matters were voted on by shareholders:

(i) Election of Directors - The following directors were elected for a term of three years.

	Vote Count	
	-----	
	Votes For	Votes Withheld
	-----	
Jerry R. Engle	13,506,384	1,195,561
William L. Hoy	14,104,078	597,867
Barry J. Hudson	9,522,302	5,179,644
Patrick A. Sherman	14,154,789	547,157

Election of Directors - The following director was elected for a term of one year.

	Vote Count	
	-----	
	Votes For	Votes Withheld
	-----	
Michael C. Rechin	13,998,529	703,416

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**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS continued**

(ii) Approval the Non-Binding Resolution to Approve Compensation of First Merchants Corporation Executive Officers: Votes For – 13,096,431, Votes Against – 1,451,828, Votes Abstained – 154,384.

(iii) Approval the First Merchants Corporation 2009 Employee Stock Purchase Plan: Votes For – 9,692,816, Votes Against – 429,192, Votes Abstained – 87,981.

(iv) Approval the First Merchants Corporation 2009 Long-Term Equity Incentive Plan: Votes For – 5,289,065, Votes Against – 4,788,768, Votes Abstained – 132,856.

(v) Ratification of the appointment of Independent Public Accounting Firm – BKD, LLP, Indianapolis, Indiana: Votes For – 14,310,506, Votes Against – 323,764, Votes Abstained – 68,373.

**ITEM 5. OTHER INFORMATION**

a. None

b. None



## FIRST MERCHANTS CORPORATION

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**ITEM 6. EXHIBITS**

Exhibit No.:	Description of Exhibit	Form 10-Q No.:
3a	Bylaws of First Merchants Corporation dated July 28, 2009	40
10.1	Letter from Michael L. Cox announcing his retirement as a Director of First Merchants Corporation effective as of the Annual Meeting of the Corporation's shareholders on May 6, 2009. (Incorporated by reference to registrant's Form 8-K filed on May 11, 2009)	
10.2	First Merchants Corporation 2009 Employee Stock Purchase Plan effective July 1, 2009. (Incorporated by reference to registrant's Form 8-K filed on May 11, 2009)	
10.3	First Merchants Corporation 2009 Long-Term Equity Incentive Plan effective May 6, 2009. (Incorporated by reference to registrant's form 8-K filed on May 11, 2009)	
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes - Oxley Act of 20002	50
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes - Oxley Act of 20002	51
32	Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes - Oxley Act of 2002	52

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INDEX TO EXHIBITS

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EXHIBIT-3A

FIRST MERCHANTS CORPORATION

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BYLAWS OF

FIRST MERCHANTS CORPORATION

Following are the Bylaws of First Merchants Corporation (hereinafter referred to as the "Corporation"), a corporation existing pursuant to the provisions of the Indiana Business Corporation Law (hereinafter referred to as the "Act"), as most recently amended effective as of July 28, 2009:

**ARTICLE I**

**Name, Principal Office and Seal**

**Section 1.**      **Name and Principal Office.** The name of the Corporation is First Merchants Corporation. The post office address of the principal office of the Corporation is 200 East Jackson Street, Muncie, Indiana 47305.

**Section 2.**      **Seal.** The seal of the Corporation shall be circular in form and mounted upon a metal die, suitable for impressing the same upon paper. About the upper periphery of the seal shall appear the words "First Merchants Corporation" and about the lower periphery thereof the word "Muncie, Indiana". In the center of the seal shall appear the word "Seal".

**ARTICLE II**

**Fiscal Year**

The fiscal year of the Corporation shall begin each year on the first day of January and end on the last day of December of the same year.

### **ARTICLE III**

#### **Capital Stock**

**Section 1.** **Number of Shares and Classes of Capital Stock.** The total number of shares of capital stock which the Corporation shall have authority to issue shall be as stated in the Articles of Incorporation.

**Section 2.** **Consideration for No Par Value Shares.** The shares of stock of the Corporation without par value shall be issued or sold in such manner and for such amount of consideration as may be fixed from time to time by the Board of Directors. Upon payment of the consideration fixed by the Board of Directors, such shares of stock shall be fully paid and nonassessable.

**Section 3.** **Consideration for Treasury Shares.** Treasury shares may be disposed of by the Corporation for such consideration as may be determined from time to time by the Board of Directors.

**Section 4.** **Payment for Shares.** The consideration for the issuance of shares of capital stock of the Corporation may be paid, in whole or in part, in money, in other property, tangible or intangible, or in labor actually performed for, or services actually rendered to the Corporation; provided, however, that the part of the surplus of the Corporation which is transferred to stated capital upon the issuance of shares as a share dividend shall be deemed to be the consideration for the issuance of such shares. When payment of the consideration for which a share was authorized to be issued shall have been received by the Corporation, or when surplus shall have been transferred to stated capital upon the issuance of a share dividend, such share shall be declared and taken to be fully paid and not liable to any further call or assessment, and the holder thereof shall not be liable for any further payments thereon. In the absence of actual fraud in the transaction, the judgment of the Board of Directors as to the value of such property, labor or services received as consideration, or the value placed by the Board of Directors upon the corporate assets in the event of a share dividend, shall be conclusive. Promissory notes, uncertified checks, or future services shall not be accepted in payment or part payment of the capital stock of the Corporation, except as permitted by the Act.

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**Section 5. Share Certificates.** Shares of the Corporation's stock may but need not be represented by a certificate. The rights and obligations of shareholders of the same class or series of shares are identical whether or not their shares are represented by certificates.

A book entry stock account shall be established in the name of each shareholder who is the beneficial owner of any shares of the Corporation's stock that are not represented by a certificate, which stock account shall set forth the number of such shares credited to the shareholder. A shareholder may request that a stock certificate, representing all or part of the shares credited to his or her stock account, be issued and delivered to the shareholder at any time.

Anyholder of capital stock of the Corporation shall be entitled to a stock certificate, signed by the President or a Vice President and the Secretary or any Assistant Secretary of the Corporation, stating the name of the registered holder, the number of shares represented by such certificate, the par value of each share of stock or that such shares of stock are without par value, and that such shares are fully paid and nonassessable. If such shares are not fully paid, the certificate shall be legibly stamped to indicate the per cent which has been paid, and as further payments are made, the certificate shall be stamped accordingly. The certificate may bear the seal of the Corporation or its facsimile.

If the Corporation is authorized to issue shares of more than one class, every certificate shall state the kind and class of shares represented thereby, and the relative rights, interests, preferences and restrictions of such class, or a summary thereof; provided, that such statement may be omitted from the certificate if it shall be set forth upon the face or back of the certificate that such statement, in full, will be furnished by the Corporation to any shareholder upon written request and without charge.

**Section 6. Facsimile Signatures.** If a certificate is countersigned by the written signature of a transfer agent other than the Corporation or its employee, the signatures of the officers of the Corporation may be facsimiles. If a certificate is countersigned by the written signature of a registrar other than the Corporation or its employee, the signatures of the transfer agent and the officers of the Corporation may be facsimiles. In case any officer, transfer agent, or registrar who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer, transfer agent, or registrar before such certificate is issued, it may be issued by the Corporation with the same effect as if he were such officer, transfer agent, or registrar at the date of its issue.

**Section 7. Transfer of Shares.** The shares of capital stock of the Corporation shall be transferable on the books of the Corporation upon surrender of the certificate or certificates representing the same, properly endorsed by the registered holder or by the holder's duly authorized attorney or accompanied by proper evidence of succession, assignment or authority to transfer. Shares that are not represented by a certificate shall be transferable on the books of the Corporation upon receipt of written direction to do so from the registered holder or the holder's duly authorized attorney or accompanied by proper evidence of succession, assignment or authority to transfer, in a form satisfactory to the Corporation, its transfer agent or registrar.

**Section 8. Cancellation.** Every certificate surrendered to the Corporation for exchange or transfer shall be canceled, and no new certificate or certificates shall be issued in exchange for any existing certificate until such existing certificate shall have been so canceled, except in cases provided for in Section 10 of this Article III.

**Section 9. Transfer Agent and Registrar.** The Board of Directors may appoint a transfer agent and a registrar for each class of capital stock of the Corporation and may require all certificates representing such shares to bear the signature of such transfer agent and registrar. Shareholders shall be responsible for notifying the Corporation or transfer agent and registrar for the class of stock held by such shareholder in writing of any changes in their addresses from time to time, and failure so to do shall relieve the Corporation, its shareholders, Directors, officers, transfer agent and registrar of liability for failure to direct notices, dividends, or other documents or property to an address other than the one appearing upon the records of the transfer agent and registrar of the Corporation.

**Section 10. Lost, Stolen or Destroyed Certificates.** The Corporation may cause a new certificate or certificates to be issued in place of any certificate or certificates theretofore issued by the Corporation alleged to have been lost, stolen or destroyed, upon the making of an affidavit of that fact by the person claiming the certificate of stock to be lost, stolen or destroyed. When authorizing such issue of a new certificate or certificates, the Corporation may, in its discretion and as a condition precedent to the issuance thereof, require the owner of such lost, stolen or destroyed certificate or certificates, or the owner's legal representative, to give the Corporation a bond in such sum and in such form as it may direct to indemnify against any claim that may be made against the Corporation with respect to the certificates alleged to have been lost, stolen or destroyed or the issuance of such new certificate. The Corporation, in its discretion, may authorize the issuance of such new certificates without any bond when in its judgment it is proper to do so.

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**Section 11. Registered Shareholders.** The Corporation shall be entitled to recognize the exclusive right of a person registered on its books as the owner of such shares to receive dividends, to vote as such owner, to hold liable for calls and assessments, and to treat as owner in all other respects, and shall not be bound to recognize any equitable or other claims to or interest in such share or shares on the part of any other person, whether or not it shall have express or other notice thereof, except as otherwise provided by the laws of Indiana.

**Section 12. Options to Officers and Employees.** The issuance, including the consideration, of rights or options to Directors, officers or employees of the Corporation, and not to the shareholders generally, to purchase from the Corporation shares of its capital stock shall be approved by the affirmative vote of the holders of a majority of the shares entitled to vote thereon or shall be authorized by and consistent with a plan approved by such a vote of the shareholders.

**ARTICLE IV**

**Meetings of Shareholders**

**Section 1. Place of Meeting.** Meetings of shareholders of the Corporation shall be held at such place, within or without the State of Indiana, as may from time to time be designated by the Board of Directors, or as may be specified in the notices or waivers of notice of such meetings.

**Section 2. Annual Meeting.** The annual meeting of shareholders for the election of Directors, and for the transaction of such other business as may properly come before the meeting, shall be held at such time as the Board of Directors may set by resolution, following the close of the fiscal year of the Corporation. A failure to hold the annual meeting at the designated time shall not affect the validity of any corporate action.

**Section 3. Special Meetings.** Special meetings of the shareholders, for any purpose or purposes, unless otherwise prescribed by statute or by the Articles of Incorporation, may be called by the Board of Directors or the President and shall be called by the President or Secretary at the request in writing of a majority of the Board of Directors, or at the request in writing of shareholders holding of record not less than one-fourth (1/4) of all the shares outstanding and entitled by the Articles of Incorporation to vote on the business for which the meeting is being called.

**Section 4. Notice of Meetings.** A written or printed notice, stating the place, day and hour of the meeting, and in case of a special meeting, or when required by any other provision of the Act, or of the Articles of Incorporation, as now or hereafter amended, or these Bylaws, the purpose or purposes for which the meeting is called, shall be delivered or mailed by the Secretary, or by the officers or persons calling the meeting, to each shareholder of record entitled by the Articles of Incorporation, as now or hereafter amended, and by the Act to vote at such meeting, at such address as appears upon the records of the Corporation, at least ten (10) days before the date of the meeting. Notice of any such

meeting may be waived in writing by any shareholder, if the waiver sets forth in reasonable detail the purpose or purposes for which the meeting is called, and the time and place thereof. Attendance at any meeting in person, or by proxy, shall constitute a waiver of notice of such meeting. Each shareholder, who has in the manner above provided waived notice of a shareholders' meeting, or who personally attends a shareholders' meeting, or is represented thereat by a proxy authorized to appear by an instrument of proxy, shall be conclusively presumed to have been given due notice of such meeting. Notice of any adjourned meeting of shareholders shall not be required to be given if the time and place thereof are announced at the meeting at which the adjournment is taken except as may be expressly required by law.

**Section 5. Addresses of Shareholders.** The address of any shareholder appearing upon the records of the Corporation shall be deemed to be the latest address of such shareholder appearing on the records maintained by the Corporation or its transfer agent for the class of stock held by such shareholder.

**Section 6. Voting at Meetings.**

(a) **Quorum.** The holders of record of a majority of the issued and outstanding stock of the Corporation entitled to vote at such meeting, present in person or by proxy, shall constitute a quorum at all meetings of shareholders for the transaction of business, except where otherwise provided by law, the Articles of Incorporation or these Bylaws. In the absence of a quorum, any officer entitled to preside at, or act as secretary of, such meeting shall have the power to adjourn the meeting from time to time until a quorum shall be constituted. At any such adjourned meeting at which a quorum shall be present, any business may be transacted which might have been transacted at the original meeting, but only those shareholders entitled to vote at the



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original meeting shall be entitled to vote at any adjournment or adjournments thereof unless a new record date is fixed by the Board of Directors for the adjourned meeting.

(b) **Voting Rights.** Except as otherwise provided by law or by the provisions of the Articles of Incorporation, every shareholder shall have the right at every shareholders' meeting to one vote for each share of stock having voting power, registered in the shareholder's name on the books of the Corporation on the date for the determination of shareholders entitled to vote, on all matters coming before the meeting including the election of directors. At any meeting of shareholders, every shareholder having the right to vote shall be entitled to vote in person, or by proxy executed by the shareholder or a duly authorized attorney in fact, in writing, transmitted by electronic means, or by any other method allowed by law, and bearing a date not more than eleven (11) months prior to its execution, unless a longer time is expressly provided therein.

(c) **Required Vote.** When a quorum is present at any meeting, the vote of the holders of a majority of the stock having voting power present in person or represented by proxy shall decide any question brought before such meeting, unless the question is one upon which, by express provision of the Act or of the Articles of Incorporation or by these Bylaws, a greater vote is required, in which case such express provision shall govern and control the decision of such question.

**Section 7. Voting List.** The Corporation or its transfer agent shall make, at least five (5) business days before each meeting of the shareholders, a complete list of the shareholders entitled by the Articles of Incorporation, as now or hereafter amended, to notice of the meeting, arranged in alphabetical order, with the address of and number of shares held by each, which list shall be on file at the principal office of the Corporation and subject to inspection during regular business hours by any shareholder entitled to vote at the meeting, or by the shareholder's agent or attorney authorized in writing. Such list shall be available continuing through the meeting, at the Corporation's principal office or at a place identified in the meeting notice in the city where the meeting will be held.

**Section 8. Fixing of Record Date to Determine Shareholders Entitled to Vote.** The Board of Directors may fix a record date, not exceeding seventy (70) days prior to the date of any meeting of the shareholders, for the purpose of determining the shareholders entitled to notice of and to vote at the meeting. In the absence of action by the Board of Directors fixing a record date as herein provided, the record date shall be the sixtieth (60<sup>th</sup>) day prior to the date of the meeting. A new record date must be fixed if a meeting of the shareholders is adjourned to a date more than one hundred twenty (120) days after the date fixed for the original meeting.

**Section 9. Nominations for Director.** The Nominating and Governance Committee of the Board of Directors shall have the responsibility for nominating individuals to serve as members of the Board of Directors, including the slate of Directors to be elected each year at the annual meeting of shareholders. In so doing, the Committee shall maintain up-to-date criteria for selecting Directors and a process for identifying and evaluating prospective nominees. Shareholders may suggest a candidate for consideration by the Committee as a Director nominee by submitting the suggestion in writing and delivering or mailing it to the Secretary of the Corporation at the Corporation's principal office. Suggestions for nominees from shareholders must include: (a) the name, address and number of the Corporation's shares owned by the shareholder; (b) the name, address, age and principal occupation of the suggested nominee; (c) such other information concerning the suggested nominee as the shareholder may wish to submit or the Committee may reasonably request. The Committee shall evaluate suggestions for nominees from shareholders in the same manner as other candidates.

Any nominations for election as Directors at any annual or special meeting of shareholders not made in accordance with this Section may be disregarded by the Chairman of the meeting, in the Chairman's discretion; and, upon the Chairman's instructions, the vote tellers or inspectors of shareholder votes may disregard all votes cast for each such nominee.

**ARTICLE V**

**Board of Directors**

**Section 1. Election, Number and Term of Office.** The business and affairs of the Corporation shall be managed in accordance with the Act under the direction of a Board consisting of not less than nine (9) and not more than fifteen (15) Directors, who shall be elected by the holders of the shares of stock entitled by the Articles of Incorporation to elect Directors. The number of Directors shall be fixed or changed from time to time, within this minimum and maximum, by a two-thirds (2/3) vote of the Board of Directors. No decrease in the number of Directors shall have the effect of shortening the term of any incumbent Director.

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The Directors shall be divided into three (3) classes as nearly equal in number as possible, all Directors to serve three (3) year terms except as provided in the third paragraph of this Section. One class shall be elected at each annual meeting of the shareholders, by the holders of the shares of stock entitled by the Articles of Incorporation to elect Directors.

No person shall serve as a Director subsequent to the annual meeting of shareholders following the end of the calendar year in which such person attains the age of seventy (70) years. The term of a Director shall expire as of the annual meeting following which the Director is no longer eligible to serve under the provisions of this paragraph, even if fewer than three (3) years have elapsed since the commencement of the Director's term.

Except in the case of earlier resignation, removal or death, all Directors shall hold office until their respective successors are chosen and qualified.

The Corporation elects not to be governed by IC §23-1-33-6(c).

The provisions of this Section of the Bylaws may not be changed or amended except by a two-thirds (2/3) vote of the Board of Directors.

**Section 2. Vacancies.** Any vacancy occurring in the Board of Directors caused by resignation, death or other incapacity, or an increase in the number of Directors, shall be filled by a majority vote of the remaining members of the Board of Directors, until the next annual meeting of the shareholders, or at the discretion of the Board of Directors, such vacancy may be filled by a vote of the shareholders at a special meeting called for that purpose.

**Section 3. Annual Meeting of Directors.** The Board of Directors shall meet each year immediately after the annual meeting of the shareholders, at the place where such meeting of the shareholders has been held either within or without the State of Indiana, for the purpose of organization, election of officers, and consideration of any other business that may properly come before the meeting. No notice of any kind to either old or new members of the Board of Directors for such annual meeting shall be necessary.

**Section 4. Regular Meetings.** Regular meetings of the Board of Directors shall be held at such times and places, either within or without the State of Indiana, as may be fixed by the Directors. Such regular meetings of the Board of Directors may be held without notice or upon such notice as may be fixed by the Directors.

**Section 5. Special Meetings.** Special meetings of the Board of Directors may be called by the Chairman of the Board, the President, or by not less than a majority of the members of the Board of Directors. Notice of the time and place, either within or without the State of Indiana, of a special meeting shall be delivered personally, telephoned, faxed or sent by other electronic means to each Director at least twenty-four (24) hours, or mailed or delivered by express private delivery service, to each Director at the Director's usual place of business or residence at least forty-eight (48) hours, prior to the time of the meeting. Directors, in lieu of such notice, may sign a written waiver of notice either before the time of the meeting, at the meeting or after the meeting. Attendance by a Director in person at any special meeting shall constitute a waiver of notice.

**Section 6. Quorum.** A majority of the actual number of Directors elected and qualified, from time to time, shall be necessary to constitute a quorum for the transaction of any business except the filling of vacancies, and the act of a majority of the Directors present at the meeting, at which a quorum is present, shall be the act of the Board of Directors, unless the act of a greater number is required by the Act, by the Articles of Incorporation, or by these Bylaws. A Director, who is present at a meeting of the Board of Directors, at which action on any corporate matter is taken, shall be conclusively presumed to have assented to the action taken, unless (a) the Director shall have affirmatively stated the Director's dissent at and before the adjournment of such meeting (in which event the fact of such dissent shall be entered by the secretary of the meeting in the minutes of the meeting), or (b) the Director shall forward such dissent by registered mail to the Secretary of the Corporation immediately after the adjournment of the meeting. The right of dissent provided for by either clause (a) or clause (b) of the immediately preceding sentence shall not be available, in respect of any matter acted upon at any meeting, to a Director who voted at the meeting in favor of such matter and did not change this vote prior to the time that the result of the vote on such matter was announced by the chairman of such meeting.

A member of the Board of Directors may participate in a meeting of the Board by means of a conference telephone or similar communications equipment by which all Directors participating in the meeting can communicate with each other, and participation by these means constitutes presence in person at the meeting.

**Section 7. Consent Action by Directors.** Any action required or permitted to be taken at any meeting of the Board of Directors or of any committee thereof may be taken without a meeting, if prior to such action a written consent to such

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action is signed by all members of the Board of Directors or such committee, as the case may be, and such written consent is filed with the minutes of proceedings of the Board of Directors or committee.

**Section 8. Removal.** Any or all members of the Board of Directors may be removed, with or without cause, at a meeting of the shareholders called expressly for that purpose by the affirmative vote of the holders of not less than two-thirds (2/3) of the outstanding shares of capital stock then entitled to vote on the election of Directors, except that if the Board of Directors, by an affirmative vote of at least two-thirds (2/3) of the entire Board of Directors, recommends removal of a Director to the shareholders, such removal may be effected by the affirmative vote of the holders of not less than a majority of the outstanding shares of capital stock then entitled to vote on the election of Directors at a meeting of shareholders called expressly for that purpose.

The provisions in this Section of the Bylaws may not be changed or amended except by a two-thirds (2/3) vote of the Board of Directors.

**Section 9. Dividends.** The Board of Directors shall have power, subject to any restrictions contained in the Act or in the Articles of Incorporation and out of funds legally available therefor, to declare and pay dividends upon the outstanding capital stock of the Corporation as and when they deem expedient. Before declaring any dividend, there may be set aside out of any funds of the Corporation available for dividends such sum or sums as the Board of Directors from time to time in their absolute discretion deem proper for working capital, or as a reserve or reserves to meet contingencies or for such other purposes as the Board of Directors may determine, and the Board of Directors may in their absolute discretion modify or abolish any such reserve in the manner in which it was created.

**Section 10. Fixing of Record Date to Determine Shareholders Entitled to Receive Corporate Benefits.** The Board of Directors may fix a record date with respect to any dividend, including a share dividend, or other distribution to the shareholders of the Corporation, or for a determination of shareholders for any other purpose, as a time for the determination of the shareholders entitled to receive any such dividend, distribution or rights; and in such case only shareholders of record at the time so fixed shall be entitled to receive such dividend, rights or distribution. If no record date is fixed for the determination of shareholders entitled to receive payment of a dividend, the end of the day on which the resolution of the Board of Directors declaring such dividend is adopted shall be the record date for such determination.

**Section 11. Interest of Directors in Contracts.** Any contract or other transaction between the Corporation and any corporation in which this Corporation owns a majority of the capital stock shall be valid and binding, notwithstanding that the Directors or officers of this Corporation and the other corporation are identical or that some or all of the Directors or officers, or both, are also directors or officers of such other corporation.

Any contract or other transaction between the Corporation and one or more of its Directors or members or employees, or between the Corporation and any firm of which one or more of its Directors are members or employees or in which they are interested, or between the Corporation and any corporation or association of which one or more of its Directors are stockholders, members, directors, officers, or employees or in which they are interested, shall be valid for all purposes, notwithstanding the presence of such Director or Directors at the meeting of the Board of Directors of the Corporation which acts upon, or in reference to, such contract or transaction and notwithstanding his or

their participation in such action, if the fact of such interest shall be disclosed or known to the Board of Directors and the Board of Directors shall authorize, approve and ratify such contract or transaction by a vote of a majority of the Directors present, such interested Director or Directors to be counted in determining whether a quorum is present, but not to be counted in calculating the majority of such quorum necessary to carry such vote. This Section shall not be construed to invalidate any contract or other transaction which would otherwise be valid under the common and statutory law applicable thereto.

**Section 12.** **Committees.** The Board of Directors may, by resolution adopted by a majority of the actual number of Directors elected and qualified, from time to time, designate from among its members an Executive Committee and one or more other committees.

During the intervals between meetings of the Board of Directors, any Executive Committee so appointed, unless expressly provided otherwise by law or these Bylaws, shall have and may exercise all the authority of the Board of Directors, including, but not limited to, the authority to issue and sell or approve any contract to issue or sell, securities or shares of the Corporation or designate the terms of a series or class of securities or shares of the Corporation. The terms which may be affixed by the Executive Committee include, but are not limited to, the price, dividend rate, and provisions of redemption, a sinking fund, conversion, voting, or preferential rights or other features of securities or class or series of a class of shares. Such Committee may have full power to adopt a final resolution which sets forth these terms and to authorize a statement of such terms to be filed with the Secretary of State. However, such Executive Committee shall not have the authority to declare dividends or

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distributions, amend the Articles of Incorporation or the Bylaws, approve a plan of merger or consolidation, even if such plan does not require shareholder approval, reduce earned or capital surplus, authorize or approve the reacquisition of shares unless pursuant to a general formula or method specified by the Board of Directors, or recommend to the shareholders a voluntary dissolution of the Corporation or a revocation thereof.

The Board of Directors may, in its discretion, constitute and appoint other committees, in addition to an Executive Committee, to assist in the management and control of the affairs of the Corporation, with responsibilities and powers appropriate to the nature of the several committees and as provided by the Board of Directors in the resolution of appointment or in subsequent resolutions and directives. Such committees may include, but are not limited to, a Nominating and Governance Committee, an Audit Committee, and a Compensation and Human Resources Committee.

No member of any committee appointed by the Board of Directors shall continue to be a member thereof after he ceases to be a Director of the Corporation. The calling and holding of meetings of any committee and its method of procedure shall be determined by the Board of Directors or by the committee itself, except as otherwise provided in these Bylaws. To the extent permitted by law, a member of the Board of Directors serving on any such committee shall not be liable for any action taken by such committee if the Director has acted in good faith and in a manner the Director reasonably believed to be in the best interests of the Corporation. A member of a committee may participate in a meeting of the committee by means of a conference telephone or similar communications equipment by which all members participating in the meeting can communicate with each other, and participation by these means constitutes presence in person at the meeting.

**ARTICLE VI**

**Officers**

**Section 1.**       **Principal Officers.** The principal officers of the Corporation shall be a Chairman of the Board, a Vice Chairman of the Board, a Chief Executive Officer, a President, one (1) or more Vice Presidents (which may include one (1) or more Executive Vice Presidents, Senior Vice Presidents, First Vice Presidents and/or other Vice Presidents), a Treasurer and a Secretary. The Corporation may also have, at the discretion of the Board of Directors, such other subordinate officers as may be appointed in accordance with the provisions of these Bylaws. The Board of Directors may, from time to time, designate a chief operating officer and a chief financial officer from among the principal officers of the Corporation. Any two (2) or more offices may be held by the same person. No person shall be eligible for the office of Chairman of the Board, Vice Chairman of the Board, Chief Executive Officer or President who is not a Director of the Corporation.

**Section 2.**       **Election and Term of Office.** The principal officers of the Corporation shall be chosen annually by the Board of Directors at the annual meeting thereof. Each such officer shall hold office until the officer's successor shall have been duly chosen and qualified, or until the officer's death, or until the officer shall resign, or shall have been removed in the manner hereinafter provided.

**Section 3. Removal.** Any principal officer may be removed, either with or without cause, at any time, by resolution adopted at any meeting of the Board of Directors by a majority of the actual number of Directors elected and qualified from time to time.

**Section 4. Subordinate Officers.** In addition to the principal officers enumerated in Section 1 of this Article VI, the Corporation may have one or more Assistant Treasurers, one or more Assistant Secretaries and such other officers, agents and employees as the Board of Directors may deem necessary, each to hold office for such period, to have such authority, and to perform such duties as the Chief Executive Officer or the Board of Directors may from time to time determine. The Board of Directors may delegate to any principal officer the power to appoint and to remove, either with or without cause, any such subordinate officers, agents or employees.

**Section 5. Resignations.** Any officer may resign at any time by giving written notice to the Chairman of the Board of Directors, the Chief Executive Officer, the President, or the Secretary. Any such resignation shall take effect upon receipt of such notice or at any later time specified therein, and, unless otherwise specified therein, the acceptance of such resignation shall not be necessary to make it effective.

**Section 6. Vacancies.** Any vacancy in any office for any cause may be filled for the unexpired portion of the term in the manner prescribed in these Bylaws for election or appointment to such office for such term.



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**Section 7. Chairman of the Board.** The Chairman of the Board shall preside at all meetings of shareholders and at all meetings of the Board of Directors. The Chairman of the Board shall perform such other duties and have such other powers as, from time to time, may be assigned by the Board of Directors.

**Section 8. Vice Chairman of the Board.** The Vice Chairman of the Board shall act in the absence of the Chairman of the Board. The Vice Chairman of the Board shall perform such other duties and have such other powers as, from time to time, may be assigned by the Board of Directors.

**Section 9. Chief Executive Officer.** The Chief Executive Officer, subject to the control of the Board of Directors, shall have overall responsibility for the affairs of the Corporation, including responsibility for developing and attaining major corporate goals and implementing policies approved by the Board. In general, the Chief Executive Officer shall perform the duties and exercise the powers incident to the office of Chief Executive Officer and all such other duties and powers as, from time to time, may be assigned by the Board of Directors. In the absence or disability of the Chairman of the Board and Vice Chairman of the Board, the Chief Executive Officer shall preside at all meetings of the shareholders and the Board of Directors at which the Chief Executive Officer is in attendance.

**Section 10. President.** The President shall perform the duties and exercise the powers incident to the office of President and all such other duties and powers as, from time to time, may be assigned by the Board of Directors or the Chief Executive Officer. Subject to the control and direction of the Board of Directors and the Chief Executive Officer, the President may enter into, execute and deliver any agreement, instrument or document in the name and on behalf of the Corporation.

**Section 11. Vice Presidents.** The Corporation shall have such Vice Presidents as the Board of Directors shall determine, which may include one (1) or more Executive Vice Presidents, Senior Vice Presidents, First Vice Presidents and/or other Vice Presidents. The Board of Directors shall designate one of the Vice Presidents (an Executive Vice President, if one has been appointed) to perform the duties and exercise the powers of the President in the absence or disability of the President. The Vice Presidents shall perform such duties and have such powers as the Chief Executive Officer, the President, or the Board of Directors may from time to time assign.

**Section 12. Treasurer.** The Treasurer shall have charge and custody of, and be responsible for, all funds and securities of the Corporation and shall deposit all such funds in the name of the Corporation in such banks or other depositories as shall be selected by the Board of Directors. The Treasurer shall upon request exhibit at all reasonable times the Treasurer's books of account and records to any of the Directors of the Corporation during business hours at the office of the Corporation where such books and records shall be kept; shall render upon request by the Board of Directors a statement of the condition of the finances of the Corporation at any meeting of the Board of Directors or at the annual meeting of the shareholders; shall receive, and give receipt for, moneys due and payable to the Corporation from any source whatsoever; and in general, shall perform all duties incident to the office of Treasurer and such other duties as from time to time may be assigned to the Treasurer by the Chief Executive Officer, the President, or the Board of Directors. The Treasurer shall give such bond, if any, for the faithful discharge of the Treasurer's duties as the Board of Directors may require. All acts affecting the Treasurer's duties and responsibilities shall be subject to the review and approval of the Corporation's chief financial officer.

**Section 13. Secretary.** The Secretary shall keep or cause to be kept in the books provided for that purpose the minutes of the meetings of the shareholders and of the Board of Directors; shall duly give and serve all notices required to be given in accordance with the provisions of these Bylaws and by the Act; shall be custodian of the records and of the seal of the Corporation and see that the seal is affixed to all documents, the execution of which on behalf of the Corporation under its seal is duly authorized in accordance with the provisions of these Bylaws; and, in general, shall perform all duties incident to the office of Secretary and such other duties as may, from time to time, be assigned to the Secretary by the Chief Executive Officer, the President, or the Board of Directors.

**Section 14. Voting Corporation's Securities.** Unless otherwise ordered by the Board of Directors, the Chairman of the Board, the Chief Executive Officer, the President and the Secretary, and each of them, are appointed attorneys and agents of the Corporation, and shall have full power and authority in the name and on behalf of the Corporation, to attend, to act, and to vote all stock or other securities entitled to be voted at any meetings of security holders of corporations, or associations in which the Corporation may hold securities, in person or by proxy, as a stockholder or otherwise, and at such meetings shall possess and may exercise any and all rights and powers incident to the ownership of such securities, and which as the owner thereof the Corporation might have possessed and exercised, if present, or to consent in writing to any action by any such other corporation or association. The Board of Directors by resolution from time to time may confer like powers upon any other person or persons.

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**ARTICLE VII**

**Indemnification**

**Section 1. Indemnification of Directors, Officers, Employees and Agents.** Every person who is or was a Director, officer, employee or agent of this Corporation or of any other

corporation for which such person is or was serving in any capacity at the request of this Corporation shall be indemnified by this Corporation against any and all liability and expense that such person may incur in connection with or resulting from or arising out of any claim, action, suit or proceeding, provided that such person is wholly successful with respect thereto or acted in good faith in what such person reasonably believed to be in or not opposed to the best interest of this Corporation or such other corporation, as the case may be, and, in addition, in any criminal action or proceeding in which such person had no reasonable cause to believe that his or her conduct was unlawful. As used herein, "claim, action, suit or proceeding" shall include any claim, action, suit or proceeding (whether brought by or in the right of this Corporation or such other corporation or otherwise), civil, criminal, administrative or investigative, whether actual or threatened or in connection with an appeal relating thereto, in which a Director, officer, employee or agent of this Corporation may become involved, as a party or otherwise,

- (i) by reason of such person's being or having been a Director, officer, employee, or agent of this Corporation or such other corporation or arising out of his or her status as such or
- (ii) by reason of any past or future action taken or not taken by such person in any such capacity, whether or not such person continues to be such at the time such liability or expense is incurred.

The terms "liability" and "expense" shall include, but shall not be limited to, attorneys' fees and disbursements, amounts of judgments, fines or penalties, and amounts paid in settlement by or on behalf of a Director, officer, employee, or agent, but shall not in any event include any liability or expenses on account of profits realized by such person in the purchase or sale of securities of the Corporation in violation of the law. The termination of any claim, action, suit or proceeding, by judgment, settlement (whether with or without court approval) or conviction or upon a plea of guilty or of *nolo contendere*, or its equivalent, shall not create a presumption that a Director, officer, employee, or agent did not meet the standards of conduct set forth in this paragraph.

Any such Director, officer, employee, or agent who has been wholly successful with respect to any such claim, action, suit or proceeding shall be entitled to indemnification as a matter of right. Except as provided in the preceding sentence, any indemnification hereunder shall be made only if

- (i) the Board of Directors acting by a quorum consisting of Directors who are not parties to or who have been wholly successful with respect to such claim, action, suit or proceeding shall find that the Director, officer, employee, or agent has met the standards of conduct set forth in the preceding paragraph; or

- (ii) independent legal counsel shall deliver to the Corporation their written opinion that such Director, officer, employee, or agent has met such standards of conduct.

If several claims, issues or matters of action are involved, any such person may be entitled to indemnification as to some matters even though he is not entitled as to other matters.

The Corporation may advance expenses to or, where appropriate, may at its expense undertake the defense of any such Director, officer, employee, or agent upon receipt of an undertaking by or on behalf of such person to repay such expenses if it should ultimately be determined that such person is not entitled to indemnification hereunder.

The provisions of this Section shall be applicable to claims, actions, suits or proceedings made or commenced after the adoption hereof, whether arising from acts or omissions to act during, before or after the adoption hereof.

The rights of indemnification provided hereunder shall be in addition to any rights to which any person concerned may otherwise be entitled by contract or as a matter of law and shall inure to the benefit of the heirs, executors and administrators of any such person.

The Corporation may purchase and maintain insurance on behalf of any person who is or was a Director, officer, employee or agent of the Corporation or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation against any liability asserted against such person and incurred by such person in any capacity or arising out of his or her status as such, whether or not the Corporation would have the power to indemnify such person against such liability under the provisions of this Section or otherwise.

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**ARTICLE VIII**

**Amendments**

Except as expressly provided herein or in the Articles of Incorporation, the Board of Directors may make, alter, amend or repeal these Bylaws by an affirmative vote of a majority of the actual number of Directors elected and qualified.

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EXHIBIT-31.1

CERTIFICATIONS PURSUANT TO

SECTION 302 OF

THE SARBANES-OXLEY ACT OF 2002

CERTIFICATION

I, Michael C. Rechin, President and Chief Executive Officer of First Merchants Corporation, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of First Merchants Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in the Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

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- c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report, based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
- a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 10, 2009

by /s/ Michael C. Rechin  
Michael C. Rechin  
President and Chief Executive Officer  
(Principal Executive Officer)

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EXHIBIT-31.2

CERTIFICATIONS PURSUANT TO

SECTION 302 OF

THE SARBANES-OXLEY ACT OF 2002

CERTIFICATION

I, Mark K. Hardwick, Executive Vice President and Chief Financial Officer of First Merchants Corporation, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of First Merchants Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in the Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;



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- c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report, based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
- a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 10, 2009

by: /s/ Mark K. Hardwick  
Mark K. Hardwick  
Executive Vice President and  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

**FIRST MERCHANTS CORPORATION**

**FORM 10Q**

EXHIBIT-32

CERTIFICATIONS PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report of First Merchants Corporation (the "Corporation") on Form 10-Q for the period ending June 30, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Michael C. Rechin, President and Chief Executive Officer of the Corporation, do hereby certify, in accordance with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Corporation.

Date: August 10, 2009

by /s/ Michael C. Rechin  
Michael C. Rechin  
President and  
Chief Executive Officer  
(Principal Executive Officer)

A signed copy of this written statement required by Section 906 has been provided to First Merchants Corporation and will be retained by First Merchants Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

In connection with the quarterly report of First Merchants Corporation (the "Corporation") on Form 10-Q for the period ending June 30, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Mark K. Hardwick, Executive Vice President and Chief Financial Officer of the Corporation, do hereby certify, in accordance with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Corporation.

Date: August 10, 2009

by /s/ Mark K. Hardwick  
Mark K. Hardwick  
Executive Vice President and  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

A signed copy of this written statement required by Section 906 has been provided to First Merchants Corporation and will be retained by First Merchants Corporation and furnished to the Securities and Exchange Commission or its staff upon request.