GERMAN AMERICAN BANCORP, INC.
Form 10-Q
November 09, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarterly Period Ended September 30, 2012

Commission File Number 001-15877

German American Bancorp, Inc.

(Exact name of registrant as specified in its charter)

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

711 Main Street, Jasper, Indiana 47546

(Address of Principal Executive Offices and Zip Code)

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

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

YES x NO ¨

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

YES x NO ¨

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

YES ¨ NO x

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

Class	Outstanding at November 1, 2012
Common Shares, no par value	12,630,646

CAUTION REGARDING FORWARD-LOOKING STATEMENTS AND ASSOCIATED RISKS

Information included in or incorporated by reference in this Quarterly Report on Form 10-Q, our other filings with the Securities and Exchange Commission (the "SEC") and our press releases or other public statements, contains or may contain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Please refer to the discussions of our forward-looking statements and associated risks in our annual report on Form 10-K for the year ended December 31, 2011, in Item 1, "Business – Forward-Looking Statements and Associated Risks" and our discussion of risk factors in Item 1A, "Risk Factors" of that annual report on Form 10-K, as updated from time to time in our subsequent SEC filings, including by Item 2 of Part I of this Report ("Management's Discussion and Analysis of Financial Condition and Results of Operations") at the conclusion of that Item 2 under the heading "Forward-Looking Statements and Associated Risks."

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

GERMAN AMERICAN BANCORP, INC.

CONSOLIDATED BALANCE SHEETS

(unaudited, dollars in thousands except share and per share data)

	September 30, 2012	December 31, 2011
ASSETS		
Cash and Due from Banks	$ 33,960	$ 28,366
Federal Funds Sold and Other Short-term Investments	29,828	32,737
Cash and Cash Equivalents	63,788	61,103
Interest-bearing Time Deposits with Banks	2,715	5,986
Securities Available-for-Sale, at Fair Value	612,396	516,844
Securities Held-to-Maturity, at Cost (Fair value of $351 and $697 on September 30, 2012 and December 31, 2011, respectively)	346	690
Loans Held-for-Sale, at Fair Value	18,993	21,485
Loans	1,168,146	1,123,549
Less: Unearned Income	(3,012)	(2,556)
Allowance for Loan Losses	(15,922)	(15,312)
Loans, Net	1,149,212	1,105,681
Stock in FHLB of Indianapolis and Other Restricted Stock, at Cost	8,340	8,340
Premises, Furniture and Equipment, Net	36,730	37,706
Other Real Estate	1,610	2,343
Goodwill	18,865	18,865
Intangible Assets	3,077	4,346
Company Owned Life Insurance	29,975	29,263
Accrued Interest Receivable and Other Assets	16,251	61,115
TOTAL ASSETS	$ 1,962,298	$ 1,873,767
LIABILITIES		
Non-interest-bearing Demand Deposits	$ 327,450	$ 282,335
Interest-bearing Demand, Savings, and Money Market Accounts	933,561	899,584
Time Deposits	358,026	374,279
Total Deposits	1,619,037	1,556,198
FHLB Advances and Other Borrowings	141,074	130,993

Accrued Interest Payable and Other Liabilities	19,218	18,966
TOTAL LIABILITIES	1,779,329	1,706,157
SHAREHOLDERS' EQUITY		
Preferred Stock, no par value; 500,000 shares authorized, no shares issued	—	—
Common Stock, no par value, $1 stated value; 30,000,000 shares authorized	12,631	12,594
Additional Paid-in Capital	95,434	95,039
Retained Earnings	61,996	49,434
Accumulated Other Comprehensive Income	12,908	10,543
TOTAL SHAREHOLDERS' EQUITY	182,969	167,610
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 1,962,298	$ 1,873,767
End of period shares issued and outstanding	12,630,646	12,594,258

See accompanying notes to consolidated financial statements.

GERMAN AMERICAN BANCORP, INC.

CONSOLIDATED STATEMENTS OF INCOME

AND COMPREHENSIVE INCOME

(unaudited, dollars in thousands except share and per share data)

	Three Months Ended September 30,	
	2012	2011
INTEREST INCOME		
Interest and Fees on Loans	$ 15,082	$ 15,933
Interest on Federal Funds Sold and Other Short-term Investments	11	48
Interest and Dividends on Securities:		
Taxable	3,235	3,645
Non-taxable	625	479
TOTAL INTEREST INCOME	18,953	20,105
INTEREST EXPENSE		
Interest on Deposits	1,622	2,823
Interest on FHLB Advances and Other Borrowings	938	1,079
TOTAL INTEREST EXPENSE	2,560	3,902
NET INTEREST INCOME	16,393	16,203
Provision for Loan Losses	640	1,300
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	15,753	14,903
NON-INTEREST INCOME		
Trust and Investment Product Fees	659	602
Service Charges on Deposit Accounts	1,049	1,120
Insurance Revenues	1,469	1,261
Company Owned Life Insurance	213	233
Interchange Fee Income	418	395
Other Operating Income	811	86
Net Gains on Sales of Loans	941	863
Net Gains on Securities	598	—
TOTAL NON-INTEREST INCOME	6,158	4,560
NON-INTEREST EXPENSE		
Salaries and Employee Benefits	7,261	6,687
Occupancy Expense	1,066	1,142
Furniture and Equipment Expense	650	621
FDIC Premiums	271	295
Data Processing Fees	311	321
Professional Fees	585	526

Advertising and Promotion	439	383
Intangible Amortization	405	480
Other Operating Expenses	1,740	1,550
TOTAL NON-INTEREST EXPENSE	12,728	12,005
Income before Income Taxes	9,183	7,458
Income Tax Expense	2,891	2,291
NET INCOME	$ 6,292	$ 5,167
Other Comprehensive Income:		
Changes in Unrealized Gain on Securities Available-for-Sale, Net	1,186	3,427
Total Other Comprehensive Income	$ 1,186	$ 3,427
COMPREHENSIVE INCOME	$ 7,478	$ 8,594
Basic Earnings Per Share	$ 0.50	$ 0.41
Diluted Earnings Per Share	$ 0.50	$ 0.41
Dividends Per Share	$ 0.14	$ 0.14

See accompanying notes to consolidated financial statements.

GERMAN AMERICAN BANCORP, INC.

CONSOLIDATED STATEMENTS OF INCOME

AND COMPREHENSIVE INCOME

(unaudited, dollars in thousands except share and per share data)

	Nine Months Ended September 30,	
	2012	2011
INTEREST INCOME		
Interest and Fees on Loans	$ 46,380	$ 48,620
Interest on Federal Funds Sold and Other Short-term Investments	84	179
Interest and Dividends on Securities:		
Taxable	9,982	10,075
Non-taxable	1,797	1,271
TOTAL INTEREST INCOME	58,243	60,145
INTEREST EXPENSE		
Interest on Deposits	5,523	9,464
Interest on FHLB Advances and Other Borrowings	3,066	3,107
TOTAL INTEREST EXPENSE	8,589	12,571
NET INTEREST INCOME	49,654	47,574
Provision for Loan Losses	1,721	3,900
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	47,933	43,674
NON-INTEREST INCOME		
Trust and Investment Product Fees	2,019	1,561
Service Charges on Deposit Accounts	3,001	3,135
Insurance Revenues	4,218	4,600
Company Owned Life Insurance	723	836
Interchange Fee Income	1,309	1,126
Other Operating Income	1,500	982
Net Gains on Sales of Loans	2,330	1,651
Net Gains on Securities	692	1,045
TOTAL NON-INTEREST INCOME	15,792	14,936
NON-INTEREST EXPENSE		
Salaries and Employee Benefits	21,409	20,810
Occupancy Expense	3,219	3,216
Furniture and Equipment Expense	2,054	2,243
FDIC Premiums	851	1,191
Data Processing Fees	746	1,821
Professional Fees	1,777	1,630

Advertising and Promotion	1,208	1,000
Intangible Amortization	1,269	1,495
Other Operating Expenses	5,211	4,740
TOTAL NON-INTEREST EXPENSE	37,744	38,146
Income before Income Taxes	25,981	20,464
Income Tax Expense	8,120	5,788
NET INCOME	$ 17,861	$ 14,676
Other Comprehensive Income:		
Changes in Unrealized Gain on Securities Available-for-Sale, Net	2,365	9,097
Total Other Comprehensive Income	$ 2,365	$ 9,097
COMPREHENSIVE INCOME	$ 20,226	$ 23,773
Basic Earnings Per Share	$ 1.42	$ 1.17
Diluted Earnings Per Share	$ 1.41	$ 1.17
Dividends Per Share	$ 0.42	$ 0.42

See accompanying notes to consolidated financial statements.

GERMAN AMERICAN BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited, dollars in thousands)

	Nine Months Ended September 30,	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	$17,861	$14,676
Adjustments to Reconcile Net Income to Net Cash from Operating Activities:		
Net Amortization on Securities	3,419	1,491
Depreciation and Amortization	3,584	3,902
Loans Originated for Sale	(125,770)	(71,166)
Proceeds from Sales of Loans Held-for-Sale	130,375	74,658
Loss in Investment in Limited Partnership	—	20
Provision for Loan Losses	1,721	3,900
Gain on Sale of Loans, net	(2,330)	(1,651)
Gain on Securities, net	(692)	(1,045)
Loss (Gain) on Sales of Other Real Estate and Repossessed Assets	(232)	191
Loss (Gain) on Disposition and Impairment of Premises and Equipment	(1)	17
Increase in Cash Surrender Value of Company Owned Life Insurance	(712)	(840)
Equity Based Compensation	463	465
Change in Assets and Liabilities:		
Interest Receivable and Other Assets	3,716	4,068
Interest Payable and Other Liabilities	(1,048)	(2,339)
Net Cash from Operating Activities	30,354	26,347
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from Maturity of Other Short-term Investments	3,236	5,475
Proceeds from Maturities, Calls, Redemptions of Securities Available-for-Sale	100,964	71,619
Redemption of Federal Reserve Bank Stock	—	694
Proceeds from Sales of Securities Available-for-Sale	92,344	—
Purchase of Securities Available-for-Sale	(244,755)	(267,696)
Proceeds from Maturities of Securities Held-to-Maturity	344	815
Proceeds from Redemption of Federal Home Loan Bank Stock	—	1,523
Proceeds from Sales of Loans	7,560	1,364
Loans Made to Customers, net of Payments Received	(55,676)	16,777
Proceeds from Sales of Other Real Estate	3,827	3,461
Property and Equipment Expenditures	(3,091)	(2,377)
Proceeds from Sales of Property and Equipment	1	12
Acquire Capitalized Lease	—	(6)
Acquisition of American Community Bancorp, Inc.	—	55,780
Net Cash from Investing Activities	(95,246)	(112,559)

CASH FLOWS FROM FINANCING ACTIVITIES		
Change in Deposits	62,876	163,950
Change in Short-term Borrowings	30,090	(34,112)
Repayments of Long-term Debt	(20,059)	(5,045)
Issuance of Common Stock	35	12
Employee Stock Purchase Plan	(66)	(25)
Dividends Paid	(5,299)	(5,284)
Net Cash from Financing Activities	67,577	119,496
Net Change in Cash and Cash Equivalents	2,685	33,284
Cash and Cash Equivalents at Beginning of Year	61,103	19,271
Cash and Cash Equivalents at End of Period	$63,788	$52,555
Cash Paid During the Period for		
Interest	$9,411	$13,317
Income Taxes	6,484	5,156
Supplemental Non Cash Disclosures		
Loans Transferred to Other Real Estate	$2,862	$3,409
Accounts Receivable Transferred to Securities	(43,167)	—

See accompanying notes to consolidated financial statements.

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GERMAN AMERICAN BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

(unaudited, dollars in thousands except share and per share data)

Note 1 – Basis of Presentation

German American Bancorp, Inc. operates primarily in the banking industry. The accounting and reporting policies of German American Bancorp, Inc. and its subsidiaries conform to U.S. generally accepted accounting principles. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. All adjustments which are, in the opinion of management, necessary for a fair presentation of the results for the periods reported have been included in the accompanying unaudited consolidated financial statements, and all such adjustments are of a normal recurring nature. Certain prior year amounts have been reclassified to conform with current year classifications. It is suggested that these consolidated financial statements and notes be read in conjunction with the financial statements and notes thereto in the German American Bancorp, Inc. December 31, 2011 Annual Report on Form 10-K.

Note 2 – Per Share Data

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

	Three Months Ended September 30,	
	2012	2011
Basic Earnings per Share:		
Net Income	$6,292	$5,167
Weighted Average Shares Outstanding	12,628,335	12,593,521
Basic Earnings per Share	$0.50	$0.41
Diluted Earnings per Share:		
Net Income	$6,292	$5,167
Weighted Average Shares Outstanding	12,628,335	12,593,521
Potentially Dilutive Shares, Net	20,589	4,691
Diluted Weighted Average Shares Outstanding	12,648,924	12,598,212

Diluted Earnings per Share	$0.50	$0.41

Stock options for 99,275 shares of common stock were not considered in computing diluted earnings per share for the quarter ended September 30, 2011 because they were anti-dilutive. There were no anti-dilutive shares for the quarter ended September 30, 2012.

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

	Nine Months Ended September 30,	
	2012	2011
Basic Earnings per Share:		
Net Income	$17,861	$14,676
Weighted Average Shares Outstanding	12,618,863	12,577,558
Basic Earnings per Share	$1.42	$1.17
Diluted Earnings per Share:		
Net Income	$17,861	$14,676
Weighted Average Shares Outstanding	12,618,863	12,577,558
Potentially Dilutive Shares, Net	15,009	5,719
Diluted Weighted Average Shares Outstanding	12,633,872	12,583,277
Diluted Earnings per Share	$1.41	$1.17

Stock options for 89,275 shares of common stock were not considered in computing diluted earnings per share for the nine months ended September 30, 2011 because they were anti-dilutive. There were no anti-dilutive shares for the nine months ended September 30, 2012.

GERMAN AMERICAN BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

(unaudited, dollars in thousands except share and per share data)

Note 3 – Securities

The amortized cost, unrealized gross gains and losses recognized in accumulated other comprehensive income (loss), and fair value of Securities Available-for-Sale at September 30, 2012 and December 31, 2011, were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available-for-Sale:				
September 30, 2012				
U.S. Treasury and Agency Securities	$ 3,578	$ 47	$ —	$ 3,625
Obligations of State and Political Subdivisions	69,630	5,223	—	74,853
Mortgage-backed Securities - Residential	518,123	15,147	(58)	533,212
Equity Securities	684	22	—	706
Total	$ 592,015	$ 20,439	$ (58)	$ 612,396
December 31, 2011				
U.S. Treasury and Agency Securities	$ 6,340	$ 82	$ —	$ 6,422
Corporate Securities	1,003	2	—	1,005
Obligations of State and Political Subdivisions	60,606	4,195	(2)	64,799
Mortgage-backed Securities - Residential	431,495	12,529	(90)	443,934
Equity Securities	684	—	—	684
Total	$ 500,128	$ 16,808	$ (92)	$ 516,844

Equity securities that do not have readily determinable fair values are included in the above totals, are carried at historical cost and are evaluated for impairment on a periodic basis. All mortgage-backed securities in the above table are residential mortgage-backed securities and guaranteed by government sponsored entities.

The carrying amount, unrecognized gains and losses and fair value of Securities Held-to-Maturity at September 30, 2012 and December 31, 2011, were as follows:

	Carrying Amount	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
Securities Held-to-Maturity:				
September 30, 2012				
Obligations of State and Political Subdivisions	$ 346	$ 5	$ —	$ 351
December 31, 2011				
Obligations of State and Political Subdivisions	$ 690	$ 7	$ —	$ 697

The amortized cost and fair value of Securities at September 30, 2012 by contractual maturity are shown below. Expected maturities may differ from contractual maturities because some issuers have the right to call or prepay certain obligations with or without call or prepayment penalties. Mortgage-backed and Equity Securities are not due at a single maturity date and are shown separately.

	Amortized Cost	Fair Value
Securities Available-for-Sale:		
Due in one year or less	$ 2,372	$ 2,385
Due after one year through five years	14,817	15,273
Due after five years through ten years	26,967	29,072
Due after ten years	29,052	31,748
Mortgage-backed Securities - Residential	518,123	533,212
Equity Securities	684	706
Totals	$ 592,015	$ 612,396

GERMAN AMERICAN BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

(unaudited, dollars in thousands except share and per share data)

Note 3 – Securities (continued)

	Carrying Amount	Fair Value
Securities Held-to-Maturity:		
Due in one year or less	$ —	$ —
Due after one year through five years	346	351
Due after five years through ten years	—	—
Due after ten years	—	—
Totals	$ 346	$ 351

Below is a summary of securities with unrealized losses as of September 30, 2012 and December 31, 2011, presented by length of time the securities have been in a continuous unrealized loss position:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
At September 30, 2012:						
U.S. Treasury and Agency Securities	$ —	$ —	$ —	$ —	$ —	$ —
Corporate Securities	—	—	—	—	—	—
Obligations of State and Political Subdivisions	—	—	—	—	—	—
Mortgage-backed Securities - Residential	5,992	(58)	—	—	5,992	(58)
Equity Securities	—	—	—	—	—	—
Total	$ 5,992	$ (58)	$ —	$ —	$ 5,992	$ (58)

	Less than 12 Months		**12 Months or More**		**Total**	
	Fair Value	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
At December 31, 2011:						
U.S. Treasury and Agency Securities	$ —	$ —	$ —	$ —	$ —	$ —
Corporate Securities	—	—	—	—	—	—

Obligations of State and Political Subdivisions	203	(2)	—	—	203	(2)
Mortgage-backed Securities - Residential	39,947	(90)	—	—	39,947	(90)
Equity Securities	—	—	—	—	—	—
Total	$ 40,150	$ (92)	$ —	$ —	$40,150	$ (92)

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

The Company held a minority interest in American Community Bancorp, Inc., prior to the acquisition on January 1, 2011. For the nine months ended September 30, 2011, the Company recognized a gain of $1.045 million on the stock held of American Community Bancorp, Inc. as a result of the acquisition.

Note 4 – Derivatives

The Company executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. Those interest rate swaps are simultaneously hedged by offsetting interest rate swaps that the Company executes with a third party, such that the Company minimizes its net risk exposure resulting from such transactions. The agreements are considered stand alone derivatives and changes in the fair value of derivatives are reported in earnings as non-interest income. The notional amount of these interest rate swaps was $6.1million at September 30, 2012. The fair value of these contracts combined was $6 as associated gains and losses nearly offset.

GERMAN AMERICAN BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

(unaudited, dollars in thousands except share and per share data)

Note 5 – Loans

Loans were comprised of the following classifications at September 30, 2012 and December 31, 2011:

	September 30, 2012	December 31, 2011
Commercial:		
Commercial and Industrial Loans and Leases	$ 328,058	$ 293,172
Commercial Real Estate Loans	467,666	452,071
Agricultural Loans	165,198	167,693
Retail:		
Home Equity Loans	73,828	77,070
Consumer Loans	42,652	47,409
Residential Mortgage Loans	90,744	86,134
Subtotal	1,168,146	1,123,549
Less: Unearned Income	(3,012)	(2,556)
Allowance for Loan Losses	(15,922)	(15,312)
Loans, Net	$ 1,149,212	$ 1,105,681

The following table presents the activity in the allowance for loan losses by portfolio class for the three months ending September 30, 2012 and 2011:

	Commercial and Industrial Loans and Leases	**Commercial Real Estate Loans**	**Agricultural Loans**	**Home Equity Loans**	**Consumer Loans**	**Residential Mortgage Loans**	**Unallocated**	**Total**
September 30, 2012								
Beginning Balance	$ 4,707	$ 8,732	$ 890	$ 181	$ 227	$ 391	$ 564	$ 15,692
	193	376	21	21	12	(12)	29	640

Provision for Loan Losses								
Recoveries	8	62	—	—	35	2	—	107
Loans Charged-off	(54)	(351)	—	(7)	(63)	(42)	—	(517)
Ending Balance	$ 4,854	$ 8,819	$ 911	$ 195	$ 211	$ 339	$ 593	$15,922

	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated	Total
September 30, 2011								
Beginning Balance	$ 4,292	$ 7,697	$ 733	$ 213	$ 400	$ 746	$ 699	$14,780
Provision for Loan Losses	90	1,120	(5)	108	54	57	(124)	1,300
Recoveries	90	28	—	2	37	—	—	157
Loans Charged-off	(82)	(714)	—	(29)	(85)	(161)	—	(1,071)
Ending Balance	$ 4,390	$ 8,131	$ 728	$ 294	$ 406	$ 642	$ 575	$15,166

GERMAN AMERICAN BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

(unaudited, dollars in thousands except share and per share data)

NOTE 5 – Loans (continued)

The following table presents the activity in the allowance for loan losses by portfolio class for the nine months ending September 30, 2012 and 2011:

	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated	Total
September 30, 2012								
Beginning Balance	$ 3,493	$ 9,297	$ 926	$ 258	$ 190	$ 402	$ 746	$ 15,312
Provision for Loan Losses	1,466	232	(15)	(9)	141	59	(153)	1,721
Recoveries	57	88	—	1	99	11	—	256
Loans Charged-off	(162)	(798)	—	(55)	(219)	(133)	—	(1,367)
Ending Balance	$ 4,854	$ 8,819	$ 911	$ 195	$ 211	$ 339	$ 593	$ 15,922

	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated	Total
September 30, 2011								
Beginning Balance	$ 3,713	$ 7,497	$ 750	$ 220	$ 362	$ 543	$ 232	$ 13,317
Provision for Loan Losses	845	2,007	(22)	194	138	395	343	3,900
Recoveries	96	131	—	5	96	15	—	343
Loans Charged-off	(264)	(1,504)	—	(125)	(190)	(311)	—	(2,394)
Ending Balance	$ 4,390	$ 8,131	$ 728	$ 294	$ 406	$ 642	$ 575	$ 15,166

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio class and based on impairment method as of September 30, 2012 and December 31, 2011:

	Total	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated
September 30, 2012								
Allowance for Loan Losses:								
Ending Allowance Balance Attributable to Loans:								
Individually Evaluated for Impairment	$5,433	$1,281	$4,152	$ —	$ —	$—	$ —	$ —
Collectively Evaluated for Impairment	10,392	3,497	4,646	911	195	211	339	593
Acquired with Deteriorated Credit Quality	97	76	21	—	—	—	—	—
Total Ending Allowance Balance	$15,922	$4,854	$8,819	$ 911	$ 195	$211	$ 339	$ 593
Loans:								
Loans Individually Evaluated for Impairment	$11,817	$2,669	$9,148	$ —	$ —	$—	$ —	$ —
Loans Collectively Evaluated for Impairment	1,149,752	323,974	450,332	167,851	74,068	42,630	90,897	—
Loans Acquired with Deteriorated Credit Quality	11,940	2,324	9,313	—	—	152	151	—
Total Ending Loans Balance (1)	$1,173,509	$328,967	$468,793	$ 167,851	$ 74,068	$42,782	$ 91,048	$ —

(1) Total recorded investment in loans includes $5,363 in accrued interest.

GERMAN AMERICAN BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

(unaudited, dollars in thousands except share and per share data)

NOTE 5 – Loans (continued)

	Total	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated
December 31, 2011								
Allowance for Loan Losses:								
Ending Allowance Balance Attributable to Loans:								
Individually Evaluated for Impairment	$4,834	$466	$4,368	$—	$—	$—	$—	$ —
Collectively Evaluated for Impairment	10,401	3,027	4,852	926	258	190	402	746
Acquired with Deteriorated Credit Quality	77	—	77	—	—	—	—	—
Total Ending Allowance Balance	$15,312	$3,493	$9,297	$926	$258	$190	$402	$ 746
Loans:								
Loans Individually Evaluated for Impairment	$16,613	$3,567	$13,046	$—	$—	$—	$—	$ —
Loans Collectively Evaluated for Impairment	1,096,571	287,924	427,063	170,513	77,323	47,431	86,317	—
Loans Acquired with Deteriorated Credit Quality	16,121	2,596	13,209	—	—	164	152	—
Total Ending Loans Balance [(1)]	$1,129,305	$294,087	$453,318	$170,513	$77,323	$47,595	$86,469	$ —

(1) Total recorded investment in loans includes $5,756 in accrued interest.

The following table presents loans individually evaluated for impairment by class of loans including purchase credit impaired loans that subsequently result in additional allowance for loan losses as of September 30, 2012 and December 31, 2011:

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
September 30, 2012			
With No Related Allowance Recorded:			
Commercial and Industrial Loans and Leases	$ 116	$ 95	$ —
Commercial Real Estate Loans	2,116	2,066	—
Agricultural Loans	—	—	—
With An Allowance Recorded:			
Commercial and Industrial Loans and Leases	2,696	2,683	1,357
Commercial Real Estate Loans	7,123	7,110	4,173
Agricultural Loans	—	—	—
Total	$ 12,051	$ 11,954	$ 5,530

GERMAN AMERICAN BANCORP, INC.

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(unaudited, dollars in thousands except share and per share data)

NOTE 5 – Loans (continued)

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
December 31, 2011			
With No Related Allowance Recorded:			
Commercial and Industrial Loans and Leases	$ 1,084	$ 1,066	$ —
Commercial Real Estate Loans	5,959	5,894	—
Agricultural Loans	—	—	—
With An Allowance Recorded:			
Commercial and Industrial Loans and Leases	2,502	2,501	466
Commercial Real Estate Loans	7,400	7,230	4,445
Agricultural Loans	—	—	—
Total	$ 16,945	$ 16,691	$ 4,911

The following table presents loans individually evaluated for impairment by class of loans including purchase credit impaired loans that subsequently result in additional allowance for loan losses for the three month period ended September 30, 2012 and 2011:

	Average Recorded Investment	Interest Income Recognized	Cash Basis Recognized
September 30, 2012			
With No Related Allowance Recorded:			
Commercial and Industrial Loans and Leases	$ 139	$ 1	$ 1
Commercial Real Estate Loans	3,353	12	12
Agricultural Loans	—	—	—
With An Allowance Recorded:			
Commercial and Industrial Loans and Leases	2,749	4	3
Commercial Real Estate Loans	7,179	6	5
Agricultural Loans	—	—	—

Total	$ 13,420	$ 23	$ 21

	Average Recorded Investment	Interest Income Recognized	Cash Basis Recognized
September 30, 2011			
With No Related Allowance Recorded:			
Commercial and Industrial Loans and Leases	$ 105	$ 6	$ 6
Commercial Real Estate Loans	4,362	14	14
Agricultural Loans	—	—	—
With An Allowance Recorded:			
Commercial and Industrial Loans and Leases	3,467	3	3
Commercial Real Estate Loans	7,777	14	13
Agricultural Loans	—	—	—
Total	$ 15,711	$ 37	$ 36

GERMAN AMERICAN BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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(unaudited, dollars in thousands except share and per share data)

NOTE 5 – Loans (continued)

The following table presents loans individually evaluated for impairment by class of loans including purchase credit impaired loans that subsequently result in additional allowance for loan losses for the nine month period ended September 30, 2012 and 2011:

	Average Recorded Investment	Interest Income Recognized	Cash Basis Recognized
September 30, 2012			
With No Related Allowance Recorded:			
Commercial and Industrial Loans and Leases	$ 298	$ 3	$ 3
Commercial Real Estate Loans	5,023	17	17
Agricultural Loans	49	2	2
With An Allowance Recorded:			
Commercial and Industrial Loans and Leases	2,795	7	6
Commercial Real Estate Loans	7,003	17	14
Agricultural Loans	—	—	—
Total	$ 15,168	$ 46	$ 42

	Average Recorded Investment	Interest Income Recognized	Cash Basis Recognized
September 30, 2011			
With No Related Allowance Recorded:			
Commercial and Industrial Loans and Leases	$ 345	$ 9	$ 9
Commercial Real Estate Loans	3,603	46	46
Agricultural Loans	25	6	6
With An Allowance Recorded:			
Commercial and Industrial Loans and Leases	4,009	9	9
Commercial Real Estate Loans	10,046	50	47

Agricultural Loans	—	—	—
Total	$ 18,028	$ 120	$ 117

The following tables present the recorded investment in non-accrual loans and loans past due 90 days or more still on accrual by class of loans as of September 30, 2012 and December 31, 2011:

	Non-Accrual		Loans Past Due 90 Days or More & Still Accruing	
	2012	2011	2012	2011
Commercial and Industrial Loans and Leases	$2,596	$3,471	$ —	$ —
Commercial Real Estate Loans	8,847	13,289	—	—
Agricultural Loans	—	—	—	—
Home Equity Loans	111	90	—	—
Consumer Loans	168	259	—	—
Residential Mortgage Loans	422	748	—	—
Total	$12,144	$17,857	$ —	$ —

Non-accrual loans and loans past due 90 days or more still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

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GERMAN AMERICAN BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 5 – Loans (continued)

The following table presents the aging of the recorded investment in past due loans by class of loans as of September 30, 2012 and December 31, 2011:

	Total	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Loans Not Past Due
September 30, 2012						
Commercial and Industrial Loans and Leases	$328,967	$ 415	$ 6	$ 447	$ 868	$328,099
Commercial Real Estate Loans	468,793	145	—	3,237	3,382	465,411
Agricultural Loans	167,851	20	99	—	119	167,732
Home Equity Loans	74,068	497	160	110	767	73,301
Consumer Loans	42,782	218	56	8	282	42,500
Residential Mortgage Loans	91,048	2,496	507	421	3,424	87,624
Total (1)	$1,173,509	$ 3,791	$ 828	$ 4,223	$ 8,842	$1,164,667

(1) Total recorded investment in loans includes $5,363 in accrued interest.

	Total	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Loans Not Past Due
December 31, 2011						
Commercial and Industrial Loans and Leases	$294,087	$ 220	$ —	$ 1,141	$ 1,361	$292,726
Commercial Real Estate Loans	453,318	381	148	5,920	6,449	446,869
Agricultural Loans	170,513	10	—	—	10	170,503
Home Equity Loans	77,323	176	6	90	272	77,051
Consumer Loans	47,595	287	117	221	625	46,970

Residential Mortgage Loans	86,469	2,752	893	748	4,393	82,076
Total [1]	$1,129,305	$ 3,826	$ 1,164	$ 8,120	$13,110	$1,116,195

[1] Total recorded investment in loans includes $5,756 in accrued interest.

Troubled Debt Restructurings:

The Company has allocated $195 of specific reserves on $375 in principal to customers whose loan terms have been modified in troubled debt restructurings as of September 30, 2012. The Company had allocated $198 of specific reserves on $409 in principal to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2011. The Company has not committed to lending any additional amounts as of September 30, 2012 and December 31, 2011 to customers with outstanding loans that are classified as troubled debt restructurings.

For the three and nine months ended September 30, 2012, no troubled debt restructurings occurred. For the three months ended September 30, 2011, no troubled debt restructurings occurred. For the nine months ended September 30, 2011, one troubled debt restructuring occurred. Pre-modification and post-modification outstanding recorded investment for this loan totaled $284 and $50, respectively. The modification of the terms of this loan included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

The troubled debt restructurings resulted in no charge-offs for the three and nine months ended September 30, 2012. The troubled debt restructuring resulted in no charge-offs for the three months ended September 30, 2011 and $145 during the nine months ended September 30, 2011.

For the three and nine months ended September 30, 2012 and 2011, there were no payment defaults within the twelve months following modification for troubled debt restructurings.

GERMAN AMERICAN BANCORP, INC.

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NOTE 5 – Loans (continued)

A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without modification. This evaluation is performed under the Company's internal underwriting policy.

Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company classifies loans as to credit risk by individually analyzing loans. This analysis includes commercial and industrial loans, commercial real estate loans, and agricultural loans with an outstanding balance greater than $100. This analysis is typically performed on at least an annual basis. The Company uses the following definitions for risk ratings:

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

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

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

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. Loans listed as not rated are either less than $100 or are included in groups of homogeneous loans. Based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

	Pass	Special Mention	Substandard	Doubtful	Total
September 30, 2012					
Commercial and Industrial Loans and Leases	$297,257	$13,247	$ 18,463	$ —	$328,967
Commercial Real Estate Loans	425,660	20,082	23,051	—	468,793
Agricultural Loans	162,916	2,562	2,373	—	167,851
Total	$885,833	$35,891	$ 43,887	$ —	$965,611

	Pass	Special Mention	Substandard	Doubtful	Total
December 31, 2011					
Commercial and Industrial Loans and Leases	$264,037	$16,188	$ 13,862	$ —	$294,087
Commercial Real Estate Loans	396,057	28,272	28,989	—	453,318
Agricultural Loans	165,153	2,744	2,616	—	170,513
Total	$825,247	$47,204	$ 45,467	$ —	$917,918

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NOTE 5 – Loans (continued)

The Company considers the performance of the loan portfolio and its impact on the allowance for loan losses. For home equity, consumer and residential mortgage loan classes, the Company also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in home equity, consumer and residential mortgage loans based on payment activity as of September 30, 2012 and December 31, 2011:

	Home Equity Loans	Consumer Loans	Residential Mortgage Loans
September 30, 2012			
Performing	$ 73,957	$ 42,614	$ 90,626
Nonperforming	111	168	422
Total	$ 74,068	$ 42,782	$ 91,048

	Home Equity Loans	Consumer Loans	Residential Mortgage Loans
December 31, 2011			
Performing	$ 77,233	$ 47,336	$ 85,721
Nonperforming	90	259	748
Total	$ 77,323	$ 47,595	$ 86,469

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

	September 30, 2012
Commercial and Industrial Loans	$ 2,324
Commercial Real Estate Loans	9,313

Home Equity Loans	—
Consumer Loans	152
Residential Mortgage Loans	151
Total	$ 11,940
Carrying amount, Net of Allowance	$ 11,843

	December 31, 2011
Commercial and Industrial Loans	$ 2,596
Commercial Real Estate Loans	13,209
Home Equity Loans	—
Consumer Loans	164
Residential Mortgage Loans	152
Total	$ 16,121
Carrying amount, Net of Allowance	$ 16,044

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

	September 30, 2012	September 30, 2011
Balance at July 1	$ 389	$ 1,478
New Loans Purchased	—	—
Accretion of Income	(223)	(359)
Reclassifications from Non-accretable Difference	262	129
Charge-off of Accretable Yield	—	(74)
Balance at September 30	$ 428	$ 1,174

GERMAN AMERICAN BANCORP, INC.

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NOTE 5 – Loans (continued)

	September 30, 2012	September 30, 2011
Balance at January 1	$ 967	$ —
New Loans Purchased	—	2,042
Accretion of Income	(1,007)	(923)
Reclassifications from Non-accretable Difference	468	129
Charge-off of Accretable Yield	—	(74)
Balance at September 30	$ 428	$ 1,174

For those purchased loans disclosed above, the Company did not increase the allowance for loan losses during the three and nine months ended September 30, 2012. For those purchased loans disclosed above, the Company increased the allowance for loan losses by $96 and $171 during the three and nine months ended September 30, 2011. No allowances for loan losses were reversed during the same periods.

Note 6 – Segment Information

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

The core banking segment is comprised by the Company’s banking subsidiary, German American Bancorp, which operated through 35 banking offices at September 30, 2012. Net interest income from loans and investments funded by deposits and borrowings is the primary revenue for the core-banking segment. The trust and investment advisory services segment's revenues are comprised primarily of fees generated by German American Financial Advisors & Trust Company. These fees are derived by providing trust, investment advisory, and brokerage services to its customers. The insurance segment primarily consists of German American Insurance, Inc., which provides a full line of personal and corporate insurance products. Commissions derived from the sale of insurance products are the primary source of revenue for the insurance segment.

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

	Core Banking	Trust and Investment Advisory Services	Insurance	Other	Consolidated Totals
Three Months Ended September 30, 2012					
Net Interest Income	$16,909	$ 6	$ 9	$(531)	$ 16,393
Net Gains on Sales of Loans	941	—	—	—	941
Net Gains on Securities	598	—	—	—	598
Trust and Investment Product Fees	—	659	—	—	659
Insurance Revenues	3	5	1,461	—	1,469
Noncash Items:					
Provision for Loan Losses	640	—	—	—	640
Depreciation and Amortization	941	6	101	37	1,085
Income Tax Expense (Benefit)	3,186	(45)	70	(320)	2,891
Segment Profit (Loss)	6,578	(71)	100	(315)	6,292
Segment Assets at September 30, 2012	1,964,276	11,724	7,914	(21,616)	1,962,298

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GERMAN AMERICAN BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 6 – Segment Information (continued)

	Core Banking	Trust and Investment Advisory Services	Insurance	Other	Consolidated Totals
Three Months Ended September 30, 2011					
Net Interest Income	$16,726	$ 7	$ 6	$(536)	$ 16,203
Net Gains on Sales of Loans	863	—	—	—	863
Net Gains on Securities	—	—	—	—	—
Trust and Investment Product Fees	—	603	—	(1)	602
Insurance Revenues	16	7	1,238	—	1,261
Noncash Items:					
Provision for Loan Losses	1,300	—	—	—	1,300
Depreciation and Amortization	1,072	4	103	38	1,217
Income Tax Expense (Benefit)	2,717	(100)	(11)	(315)	2,291
Segment Profit (Loss)	5,595	(151)	(21)	(256)	5,167
Segment Assets at December 31, 2011	1,875,417	11,801	7,948	(21,399)	1,873,767

	Core Banking	Trust and Investment Advisory Services	Insurance	Other	Consolidated Totals
Nine Months Ended September 30, 2012					
Net Interest Income	$51,213	$ 16	$ 26	$(1,601)	$49,654
Net Gains on Sales of Loans	2,330	—	—	—	2,330
Net Gains on Securities	692	—	—	—	692
Trust and Investment Product Fees	3	2,018	—	(2)	2,019
Insurance Revenues	19	32	4,167	—	4,218
Noncash Items:					
Provision for Loan Losses	1,721	—	—	—	1,721
Depreciation and Amortization	3,145	16	311	112	3,584
Income Tax Expense (Benefit)	9,041	(103)	176	(994)	8,120
Segment Profit (Loss)	18,737	(168)	245	(953)	17,861
Segment Assets at September 30, 2012	1,964,276	11,724	7,914	(21,616)	1,962,298

	Core Banking	Trust and Investment Advisory Services	Insurance	Other	Consolidated Totals
Nine Months Ended September 30, 2011					
Net Interest Income	$49,155	$ 14	$ 19	$(1,614)	$ 47,574
Net Gains on Sales of Loans	1,651	—	—	—	1,651
Net Gains on Securities	—	—	—	1,045	1,045
Trust and Investment Product Fees	2	1,562	—	(3)	1,561
Insurance Revenues	56	9	4,551	(16)	4,600
Noncash Items:					
Provision for Loan Losses	3,900	—	—	—	3,900
Depreciation and Amortization	3,392	21	376	113	3,902
Income Tax Expense (Benefit)	6,712	(247)	319	(996)	5,788
Segment Profit (Loss)	14,559	(374)	418	73	14,676
Segment Assets at December 31, 2011	1,875,417	11,801	7,948	(21,399)	1,873,767

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Note 7 – Stock Repurchase Plan

On April 26, 2001 the Company announced that its Board of Directors approved a stock repurchase program for up to 607,754 (as adjusted for subsequent stock dividends) of the outstanding Common Shares of the Company. Shares may be purchased from time to time in the open market and in large block privately negotiated transactions. The Company is not obligated to purchase any shares under the program, and the program may be discontinued at any time before the maximum number of shares specified by the program is purchased. As of September 30, 2012, the Company had purchased 334,965 (as adjusted for subsequent stock dividends) shares under the program. No shares were purchased under the program during the nine months ended September 30, 2012 and 2011.

Note 8 – Equity Plans and Equity Based Compensation

The Company maintains three equity incentive plans under which stock options, restricted stock, and other equity incentive awards can be granted. At September 30, 2012, the Company has reserved 611,548 shares of Common Stock (as adjusted for subsequent stock dividends and subject to further customary anti-dilution adjustments) for the purpose of issuance pursuant to outstanding and future grants of options, restricted stock, and other equity awards to officers, directors and other employees of the Company.

For the nine months ended September 30, 2012 and 2011, the Company granted no options, and accordingly, recorded no stock option expense related to option grants during the three and nine months ended September 30, 2012 and 2011. The Company recorded no other stock compensation expense applicable to options during the quarter and nine months ended September 30, 2012 and 2011 because all outstanding options were fully vested prior to 2007. In addition, there was no unrecognized option expense as all outstanding options were fully vested prior to September 30, 2012 and 2011.

During the periods presented, awards of long-term incentives were granted in the form of restricted stock, granted in tandem with cash credit entitlements. The incentive awards will typically be in the form of 50% restricted stock grants and 50% cash credit entitlements. The restricted stock grants and tandem cash credit entitlements are subject to forfeiture in the event that the recipient of the grant does not continue employment with the Company through December 5 of the year of grant, at which time they generally vest 100 percent. For measuring compensation costs, restricted stock awards are valued based upon the market value of the common shares on the date of grant. During the quarter ended September 30, 2012, the Company granted awards of 118 shares of restricted stock. During the nine months ended September 30, 2012, the Company granted awards of 30,137 shares of restricted stock. During the three and nine months ended September 30, 2011, the Company granted awards of 302 and 37,769 shares of restricted stock, respectively.

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

	Three Months Ended September 30,	
	2012	2011
Restricted Stock Expense	$ 155	$ 158
Cash Entitlement Expense	147	138
Tax Effect	(122)	(120)
Net of Tax	$ 180	$ 176

	Nine Months Ended September 30,	
	2012	2011
Restricted Stock Expense	$ 463	$ 466
Cash Entitlement Expense	440	413
Tax Effect	(365)	(356)
Net of Tax	$ 538	$ 523

Unrecognized expense associated with the restricted stock grants and cash entitlements totaled $304 and $296 as of September 30, 2012 and 2011, respectively.

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Note 8 – Equity Plans and Equity Based Compensation (continued)

The Company maintains an Employee Stock Purchase Plan whereby eligible employees have the option to purchase the Company’s common stock at a discount. The purchase price of the shares under this Plan has been set at 95% of the fair market value of the Company’s common stock as of the last day of the plan year. The plan provides for the purchase of up to 500,000 shares of common stock, which the Company may obtain by purchases on the open market or from private sources, or by issuing authorized but unissued common shares. Funding for the purchase of common stock is from employee and Company contributions.

The Employee Stock Purchase Plan is not considered compensatory. There was no expense recorded for the employee stock purchase plan during the three and nine months ended September 30, 2012 and 2011, nor was there any unrecognized compensation expense as of September 30, 2012 and 2011 for the Employee Stock Purchase Plan.

Note 9 – Fair Value

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

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

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

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

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

Investment Securities: The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). Level 3 pricing is obtained from a third-party based upon similar trades that are not traded frequently without adjustment by the Company. At September 30, 2012, the Company held $12.2 million in Level 3 securities which consist of $11.8 million of non-rated Obligations of State and Political Subdivisions and $353 thousand of equity securities that are not actively traded. Absent the credit rating, significant assumptions must be made such that the credit risk input becomes an unobservable input and thus these securities are reported by the Company in a Level 3 classification.

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

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

GERMAN AMERICAN BANCORP, INC.

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(unaudited, dollars in thousands except share and per share data)

Note 9 – Fair Value (continued)

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

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

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

Assets and Liabilities Measured on a Recurring Basis

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

	Fair Value Measurements at September 30, 2012 Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets:				
U.S. Treasury and Agency Securities	$ —	$ 3,625	$ —	$ 3,625
Corporate Securities	—	—	—	—
Obligations of State and Political Subdivisions	—	63,053	11,800	74,853
Mortgage-backed Securities-Residential	—	533,212	—	533,212
Equity Securities	353	—	353	706
Total Securities	$ 353	$ 599,890	$ 12,153	$ 612,396
Loans Held-for-Sale	$ —	$ 18,993	$ —	$ 18,993
Derivatives	$ —	$ 209	$ —	$ 209
Financial Liabilities Derivatives	$ —	$ 214	$ —	$ 214

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GERMAN AMERICAN BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

(unaudited, dollars in thousands except share and per share data)

Note 9 – Fair Value (continued)

	Fair Value Measurements at December 31, 2011 Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets:				
U.S. Treasury and Agency Securities	$ —	$ 6,422	$ —	$ 6,422
Corporate Securities	—	—	1,005	1,005
Obligations of State and Political Subdivisions	—	60,027	4,772	64,799
Mortgage-backed Securities-Residential	—	443,934	—	443,934
Equity Securities	331	—	353	684
Total Securities	$ 331	$ 510,383	$ 6,130	$ 516,844
Loans Held-for-Sale	$ —	$ 21,485	$ —	$ 21,485