GERMAN AMERICAN BANCORP, INC.
Form 10-K
March 13, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2013

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

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

Securities registered pursuant to Section 12(b) of the Act

Title of Each Class	Name of each exchange on which registered
Common Shares, no par value	The NASDAQ Stock Market LLC

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.	¨ Yes þ No
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.	¨ Yes þ No
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.	þ 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 (§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).	þ Yes ¨ No

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

¨

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 þ Non-accelerated filer ¨ Smaller reporting company ¨

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

The aggregate market value of the registrant's common shares held by non-affiliates as of June 30, 2013 was approximately $260,154,858. This calculation does not reflect a determination that persons are (or are not) affiliates for any other purpose.

As of March 1, 2014, there were outstanding 13,173,793 common shares, no par value, of the registrant.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement of German American Bancorp, Inc., for the Annual Meeting of its Shareholders to be held May 15, 2014, to the extent stated herein, are incorporated by reference into Part III.

GERMAN AMERICAN BANCORP, INC.

ANNUAL REPORT ON FORM 10-K

For Fiscal Year Ended December 31, 2013

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

PART I

Item 1. Business.

General

German American Bancorp, Inc., is a NASDAQ-traded (symbol: GABC) financial services holding company based in Jasper, Indiana. German American, through its banking subsidiary German American Bancorp, operates 37 retail and commercial banking offices in 13 southern Indiana counties. The Company also owns a trust, brokerage, and financial planning subsidiary (German American Financial Advisors & Trust Company) and a full line property and casualty insurance agency (German American Insurance, Inc.).

Throughout this report, when we use the term "Company", we will usually be referring to the business and affairs (financial and otherwise) of German American Bancorp, Inc. and its consolidated subsidiaries as a whole. Occasionally, we will refer to the term "parent company" or "holding company" when we mean to refer to only German American Bancorp, Inc. and the term "Bank" when we mean to refer only to the Company's bank subsidiary.

The Company's lines of business include retail and commercial banking, comprehensive financial planning, full service brokerage and trust administration, and a full range of personal and corporate insurance products. Financial and other information by segment is included in Note 15 – Segment Information of the Notes to the Consolidated Financial Statements included in Item 8 of this Report and is incorporated into this Item 1 by reference. Substantially all of the Company's revenues are derived from customers located in, and substantially all of its assets are located in, the United States.

Subsidiaries

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

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

Business Development

The Company opened a loan production office in Columbus, Indiana, during the second quarter of 2012 as an entry point into the Columbus market. During the fourth quarter of 2013, the Company's opened a full service retail and commercial branch location in Columbus and vacated the loan production office. The Company continues its focus on growing its base of operations in the Columbus, Indiana, market.

The Company acquired by merger (effective October 1, 2013) United Commerce Bancorp and its subsidiary, United Commerce Bank. United Commerce Bank provided a full range of commercial and consumer banking services in the Bloomington, Indiana, market, from two banking offices. During the fourth quarter of 2013, one of those branch locations was consolidated into an existing branch banking location of German American Bancorp. United Commerce had consolidated assets and deposits (unaudited) as of October 1, 2013 that totaled $119.7 million and $106.6 million, respectively. The Company continues its focus on growing its base of operations in the Bloomington, Indiana, market.

The Company expects to continue to evaluate opportunities to expand its business through opening of new banking, insurance or trust, brokerage and financial planning offices, and through acquisitions of other banks, bank branches, portfolios of loans or other assets, and other financial-service-related businesses and assets in the future.

Office Locations

The Indiana map below illustrates the locations of the Company's 39 retail and commercial banking, insurance and investment offices as of March 1, 2014.

Competition

The industries in which the Company operates are highly competitive. The Bank competes for commercial and retail banking business within its core banking segment not only with financial institutions that have offices in the same counties but also with financial institutions that compete from other locations in Southern Indiana and elsewhere. Further, the Bank competes for loans and deposits not only with commercial banks but also with savings and loan associations, savings banks, credit unions, production credit associations, federal land banks, finance companies, credit card companies, personal loan companies, investment brokerage firms, insurance agencies, insurance companies, lease finance companies, money market funds, mortgage companies, and other non-depository financial intermediaries. There are numerous alternative providers (including national providers that advertise extensively via television and the Internet and that provide their services through direct mail, telephone and the Internet) for the insurance products and services offered by German American Insurance, Inc., and the trust, brokerage and financial planning products and services offered by German American Financial Advisors & Trust Company. Many of these competitors have substantially greater resources than the Company.

Employees

At March 1, 2014 the Company and its subsidiaries employed approximately 480 full-time equivalent employees. There are no collective bargaining agreements, and employee relations are considered to be good.

Regulation and Supervision

Overview

The Company is subject to regulation and supervision by the Board of Governors of the Federal Reserve System ("FRB") under the Bank Holding Company Act of 1956, as amended ("BHC Act"), and is required to file with the FRB annual reports and such additional information as the FRB may require. The FRB may also make examinations or inspections of the Company. The Bank is under the supervision of and subject to examination by the Indiana Department of Financial Institutions ("DFI"), and the Federal Deposit Insurance Corporation ("FDIC"). Regulation and examination by banking regulatory agencies are primarily for the benefit of depositors rather than shareholders.

Under FRB policy and the Dodd-Frank Wall Street Reform and Consumer Protection Act, a complex and wide-ranging statute that was enacted by Congress and signed into law during July 2010 (the "Dodd-Frank Act"), the Company is required to act as a source of financial and managerial strength to the Bank, and to commit resources to support the Bank, even in circumstances where the Company might not do so absent such a requirement. Under current federal law, the FRB may require a bank holding company to make capital injections into a troubled subsidiary bank. It may charge the bank holding company with engaging in unsafe and unsound practices if the bank holding company fails to commit resources to such a subsidiary bank or if it undertakes actions that the FRB believes might jeopardize the bank holding company's ability to commit resources to such subsidiary bank.

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

Under the BHC Act, certain well-managed and well-capitalized bank holding companies may elect to be treated as a "financial holding company" and, as a result, be permitted to engage in a broader range of activities that are "financial in nature" and in activities that are determined to be incidental or complementary to activities that are financial in nature. These activities include underwriting and dealing in and making a market in securities (subject to certain limits and compliance procedures required by the so-called Volcker Rule provisions added by the Dodd-Frank Act, described below under "Other Aspects of the Dodd-Frank Act"); insurance underwriting, and merchant banking. Banks may also engage through financial subsidiaries in certain of the activities permitted for financial holding companies, subject to certain conditions. The Company has not elected to become a financial holding company and its subsidiary bank has not elected to form financial subsidiaries.

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

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

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

Capital Requirements Generally

The FRB has issued risk-based capital ratio and leverage ratio guidelines for bank holding companies. Under the guidelines and related policies, bank holding companies must maintain capital sufficient to meet both a risk-based asset ratio test and a leverage ratio test on a consolidated basis. The risk-based ratio is determined by allocating assets and specified off-balance sheet commitments into four weighted categories, with higher weighting assigned to categories perceived as representing greater risk. The risk-based ratio represents total capital divided by total risk-weighted assets. The leverage ratio is core capital divided by total assets adjusted as specified in the guidelines. Our bank subsidiary is subject to substantially similar capital requirements under regulations and policies adopted by the FDIC and the Indiana Department of Financial Institutions. The FRB and FDIC during 2013 issued final rules (or interim final rules) to comprehensively revise the regulatory capital framework for US banking institutions and their affiliates, as discussed below.

Current Capital Requirements

Current guidelines that continue to apply throughout 2014 (prior to the phase-in of the new rules effective January 1, 2015) require all bank holding companies and federally regulated banks to maintain a minimum risk-based total capital ratio equal to 8%, of which at least 4% of risk-weighted assets must be Tier I Capital. Tier I Capital, which includes common shareholders' equity, noncumulative perpetual preferred stock, and a limited amount of cumulative perpetual preferred stock and certain trust preferred securities, less certain goodwill items and other intangible assets, is required to equal at least 4% of risk-weighted assets. The remainder ("Tier II Capital") may consist of (i) an allowance for loan losses of up to 1.25% of risk-weighted assets, (ii) excess of qualifying perpetual preferred stock, (iii) hybrid capital instruments, (iv) perpetual debt, (v) mandatory convertible securities, and (vi) subordinated debt and intermediate-term preferred stock up to 50% of Tier I Capital. Total capital is the sum of Tier I and Tier II Capital less reciprocal holdings of other banking organizations' capital instruments, investments in unconsolidated subsidiaries and any other deductions as determined by the appropriate regulator (determined on a case by case basis or as a matter of policy after formal rule making).

In computing total risk-weighted assets, bank holding company assets are given risk-weights of 0%, 20%, 50% and 100%. In addition, certain off-balance sheet items are given similar credit conversion factors to convert them to asset equivalent amounts to which an appropriate risk-weight will apply. Most loans will be assigned to the 100% risk category, except for performing first mortgage loans fully secured by 1- to 4-family and certain multi-family residential property, which carry a 50% risk rating. Most investment securities (including, primarily, general obligation claims on states or other political subdivisions of the United States) will be assigned to the 20% category, except for municipal or state revenue bonds, which have a 50% risk-weight, and direct obligations of the U.S. Treasury or obligations backed by the full faith and credit of the U.S. Government, which have a 0% risk-weight. In covering off-balance sheet items, direct credit substitutes, including general guarantees and standby letters of credit backing financial obligations, are given a 100% conversion factor. Transaction-related contingencies such as bid bonds, standby letters of credit backing non-financial obligations, and undrawn commitments (including commercial credit lines with an initial maturity of more than one year) have a 50% conversion factor. Short-term commercial letters of credit are converted at 20% and certain short-term unconditionally cancelable commitments have a 0% factor.

The federal bank regulatory authorities have also adopted regulations that supplement the risk-based guidelines. These regulations generally require banks and financial holding companies to maintain a minimum level of Tier I Capital to total assets less goodwill of either 3% or 4%, depending upon factors such as the regulatory ratings, earnings and financial condition of the institution (the "leverage ratio"). Banking organizations experiencing or anticipating significant growth will be required to maintain higher minimum leverage ratios and may be required to commit to achieve or maintain higher minimum ratios (including "tangible Tier I leverage ratios") in order to secure regulatory approvals needed for such organizations to acquire other banks or other businesses or engage in new activities. The tangible Tier I leverage ratio is the ratio of a banking organization's Tier I Capital, less deductions for intangibles otherwise includable in Tier I Capital, to total tangible assets.

New Capital Requirements Applicable to Us in the Future

In July 2013, the federal banking agencies released final rules that will implement in the United States certain regulatory capital reforms based upon international banking supervision principles adopted by the Basel Committee on Banking Supervision and certain changes required by the Dodd-Frank Act. Generally, under these final rules, (a) minimum requirements will increase for both the quality and quantity of capital held by banking organizations, (b) new and stricter criteria for determining the eligibility for inclusion in regulatory capital of capital instruments (other than common equity) will be applied, and (c) the methodology for calculating risk-weighted assets will change. The rules include, among other requirements:

- a new minimum ratio of “Common Equity Tier 1 Capital” to risk-weighted assets of 4.5%
- a new conservation buffer of Common Equity Tier 1 Capital equal to (when fully phased in) an additional 2.5% of risk-weighted assets
- a minimum ratio of Tier 1 Capital to risk-weighted assets (raised from 4% to 6%) plus (when fully phased in) the conservation buffer of an additional 2.5%, resulting in a minimum required total Tier 1 Capital to risk-weighted assets ratio of 8.5%
- a minimum ratio of Total Capital (that is, Tier 1 Capital plus Tier 2 Capital) to risk-weighted assets of at least 8.0%, plus (when fully phased in) the capital conservation buffer (which is added to the 8.0% Total Capital ratio as that buffer is phased-in, effectively resulting in a minimum Total Capital ratio of 10.5% upon full implementation)
- a minimum leverage ratio of 4% (calculated as the ratio of Tier 1 Capital to adjusted average consolidated assets)

The new capital measure “Common Equity Tier 1” (“CET1”) Capital consists of common stock instruments that meet the eligibility criteria in the final rules, retained earnings, accumulated other comprehensive income (“AOCI”) and common equity Tier 1 minority interest. Tier 1 Capital will consist of CET1 and “additional Tier 1 capital” instruments meeting specified requirements, plus, in the case of smaller holding companies like ours, trust preferred securities in accordance with prior requirements for their inclusion in Tier I Capital. A number of deductions from and adjustments to CET1 will apply. Changes will apply to the calculation of Tier 2 Capital and to the types of capital elements that will be eligible for inclusion as Tier 2 capital.

Under current capital standards, the effects of AOCI items included in capital are excluded for the purposes of determining regulatory capital ratios; under the new rules, we and our bank subsidiary will have a one-time election (the “Opt-out Election”) to filter certain AOCI components, comparable to their treatment under the current general risk-based capital rule. The AOCI Opt-out Election must be made in connection with the regulatory financial reports that we and our bank subsidiary will file with banking agencies for our fiscal quarter ended March 31, 2015.

Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer will technically comply with minimum capital requirements, but will face limitations on the payment of dividends, common stock repurchases and discretionary cash payments to executive officers based on the amount of the shortfall.

As applied to us, these rules will generally become effective January 1, 2015; the new Common Equity Tier 1 Capital conservation buffer, however, will be phased in from 2016 through 2019.

Capital Classifications

Federal law and regulations establish a capital-based regulatory framework designed to promote early intervention for troubled banks and require the FDIC to choose the least expensive resolution of bank failures. The capital-based regulatory framework contains five categories of compliance with regulatory capital requirements, including “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized,” and “critically undercapitalized.” T qualify as a “well-capitalized” institution, a bank under current guidelines must have a leverage ratio of no less than 5%, a Tier I Capital ratio of no less than 6%, and a total risk-based capital ratio of no less than 10%, and the bank must not be under any order or directive from the appropriate regulatory agency to meet and maintain a specific capital level. Generally, a financial institution must be “well capitalized” before the Federal Reserve will approve an application by a bank holding company to acquire or merge with a bank or bank holding company.

Under the regulations, the applicable agency can treat an institution as if it were in the next lower category if the agency determines (after notice and an opportunity for hearing) that the institution is in an unsafe or unsound condition or is engaging in an unsafe or unsound practice. The degree of regulatory scrutiny of a financial institution will increase, and the permissible activities of the institution will decrease, as it moves downward through the capital categories. Institutions that fall into one of the three undercapitalized categories may be required to (i) submit a capital restoration plan; (ii) raise additional capital; (iii) restrict their growth, deposit interest rates, and other activities; (iv) improve their management; (v) eliminate management fees; or (vi) divest themselves of all or a part of their operations. Bank holding companies can be called upon to boost the capital of the financial institutions that they control, and to partially guarantee the institutions' performance under their capital restoration plans.

The minimum ratios referred to above are merely guidelines and the bank regulators possess the discretionary authority to require higher capital ratios.

As of December 31, 2013, we exceeded the requirements contained in the applicable regulations, policies and directives pertaining to capital adequacy to be classified as "well capitalized", and are unaware of any material violation or alleged violation of these regulations, policies or directives.

Failure to meet applicable capital guidelines could subject the financial institution to a variety of enforcement remedies available to the federal regulatory authorities. These include limitations on the ability to pay dividends, the issuance by the regulatory authority of a directive to increase capital, and the termination of deposit insurance by the FDIC. In addition, the financial institution could be subject to the measures described below under a regulatory program known as Prompt Corrective Action as applicable to Under-capitalized institutions.

The risk-based capital standards of the FRB and the FDIC specify that evaluations by the banking agencies of a bank's capital adequacy will include an assessment of the exposure to declines in the economic value of a bank's capital due to changes in interest rates. These banking agencies issued a joint policy statement on interest rate risk describing prudent methods for monitoring such risk that rely principally on internal measures of exposure and active oversight of risk management activities by senior management.

The Federal Deposit Insurance Corporation Improvements Act (enacted in 1991) (FDICIA) requires federal banking regulatory authorities to take regulatory enforcement actions known as Prompt Corrective Action with respect to depository institutions that do not meet minimum capital requirements. For these purposes, FDICIA establishes five capital tiers: Well-capitalized, Adequately-capitalized, Under-capitalized, Significantly under-capitalized, and Critically under-capitalized.

Throughout 2013, the Company's consolidated regulatory capital ratios and those of the Bank were in excess of the levels established for Well-capitalized institutions for purposes of the Prompt Corrective Action provisions under FDICIA. An institution is deemed to be Well-capitalized under the current FDICIA tiers if it has a total risk-based capital ratio of 10% or greater, a Tier 1 risk-based capital ratio of 6% or greater, and a Tier 1 leverage ratio of 5% or greater and is not subject to a regulatory order, agreement, or directive to meet and maintain a specific capital level for any capital measure. For a tabular presentation of our regulatory capital ratios and those of the Bank as of December 31, 2013, see Note 8 to the Company's consolidated financial statements that are presented in Item 8 of this Report, which Note 8 is incorporated herein by reference.

FDICIA generally prohibits a depository institution from making any capital distribution, including payment of a cash dividend or paying any management fee to its holding company, if the depository institution would become Under-capitalized after such payment. Under-capitalized institutions are also subject to growth limitations and are required by the appropriate federal banking agency to submit a capital restoration plan. If any depository institution subsidiary of a holding company is required to submit a capital restoration plan, the holding company would be required to provide a limited guarantee regarding compliance with the plan as a condition of approval of such plan.

Depending upon the severity of the under capitalization, the Under-capitalized institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become Adequately-capitalized, requirements to reduce total assets, cessation of receipt of deposits from correspondent banks, and restrictions on making any payment of principal or interest on their subordinated debt. Critically under-capitalized institutions are subject to appointment of a receiver or conservator within 90 days of becoming so classified.

Under FDICIA, a depository institution that is not Well-capitalized is generally prohibited from accepting brokered deposits and offering interest rates on deposits higher than the prevailing rate in its market. Since the Bank is Well-capitalized, the FDICIA brokered deposit rule did not adversely affect its ability to accept brokered deposits. The Bank had no such brokered deposits at December 31, 2013. Further, a depository institution or its holding company that is not Well-capitalized will generally not be successful in seeking regulatory approvals that may be necessary in connection with any plan or agreement to expand its business, such as through the acquisition (by merger or consolidation, purchase or otherwise) of the stock, business or properties of other banks or other companies.

The new Basel capital rules revised the "Prompt Corrective Action" requirements applicable to our bank subsidiary effective January 1, 2015, by (i) introducing a CET1 ratio requirement at each level (other than critically undercapitalized), with the required CET1 ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each category, with the minimum Tier 1 risk-based capital ratio for well-capitalized status being 8.0% (as compared to the current 6.0%); (iii) creating a minimum leverage ratio requirement of 5% for well-capitalized status; and (iv) eliminating the current provision that provides that a bank with a composite supervisory rating of 1 may have a 3.0% leverage ratio and still be well-capitalized.

Future rulemaking and regulatory changes on capital requirements may impact the Company as it continues to grow and evaluate potential mergers and acquisitions.

Restrictions on Bank Dividends or Loans to, or other Transactions with, the Parent Company, and on Parent Company Dividends

German American Bancorp, Inc., which is the publicly-held parent of the Bank (German American Bancorp), is a corporation that is separate and distinct from the Bank and its other subsidiaries. Most of the parent company’s revenues historically have been comprised of dividends, fees, and interest paid to it by the Bank, and this is expected to continue in the future. There are, however, statutory limits under Indiana law on the amount of dividends that the Bank can pay to its parent company without regulatory approval. The Bank may not, without the approval of the DFI, pay a dividend in an amount greater than its undivided profits. In addition, the prior approval of the DFI is required for the payment of a dividend by an Indiana state-chartered bank if the total of all dividends declared in a calendar year would exceed the total of its net income for the year combined with its retained net income for the two preceding years, unless such a payment qualifies under certain exemptive criteria that exempt certain dividend payments by certain qualified banks from the prior approval requirement. At December 31, 2013, the Bank was eligible for payment of dividends under the exemptive criteria established by DFI policy for this purpose, and could have declared and paid to the holding company $39,000,000 of its undivided profits without approval by the DFI in accordance with such criteria. See Note 8 of the Notes to Consolidated Financial Statements included in Item 8 of this Report for further discussion.

In addition, the FRB and other bank regulatory agencies have issued policy statements or advisories that provide that insured banks and bank holding companies should generally only pay dividends out of current operating earnings.

In addition to these statutory restrictions, if, in the opinion of the applicable regulatory authority, a bank under its jurisdiction is engaged in, or is about to engage in, an unsafe or unsound practice, such authority may require, after notice and hearing, that such bank cease and desist from such practice. Accordingly, if the Bank were to experience financial difficulties, it is possible that the applicable regulatory authority could determine that the Bank would be engaged in an unsafe or unsound practice if the Bank were to pay dividends and could prohibit the Bank from doing so, even if availability existed for dividends under the statutory formulae.

Further, the Bank is subject to affiliate transaction restrictions under federal laws, which limit certain transactions generally involving the transfer of funds by a subsidiary bank or its subsidiaries to its parent corporation or any nonbank subsidiary of its parent corporation, whether in the form of loans, extensions of credit, investments, or asset purchases, or otherwise undertaking certain obligations on behalf of such affiliates. Furthermore, covered transactions that are loans and extensions of credit must be secured within specified amounts. In addition, all covered transactions and other affiliate transactions must be conducted on terms and under circumstances that are substantially the same as such transactions with unaffiliated entities.

Other Aspects of the Dodd-Frank Act

The Dodd-Frank Act (in addition to the regulatory changes discussed elsewhere in this “Regulation and Supervision” discussion and below under “Federal Deposit Insurance Premiums and Assessments”) made a variety of changes that will affect the business and affairs of the Company and the Bank in other ways. For instance, the Dodd-Frank Act (or agency regulations adopted and implemented (or to be adopted and implemented) under the Dodd-Frank Act) altered the authority and duties of the federal banking and securities regulatory agencies, implemented certain corporate governance requirements for all public companies including financial institutions with regard to executive compensation, proxy access by shareholders, and certain whistleblower provisions; restricted certain proprietary trading and hedge fund and private equity activities of banks and their affiliates; eliminated the former statutory prohibition against the payment of interest on business checking accounts; limited interchange fees on debit card transactions by certain large processors; and established the Consumer Financial Protection Bureau (“CFPB”).

The CFPB was granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, the Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act and certain other statutes. The CFPB has examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets. Smaller institutions are subject to rules promulgated by the CFPB but continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB has authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. The Dodd-Frank Act authorized the CFPB to establish certain minimum standards for the origination of residential mortgages including a determination of the borrower's ability to repay. In addition, Dodd-Frank allows borrowers to raise certain defenses to foreclosure if they receive any loan other than a "qualified mortgage" as defined by the CFPB. The Dodd-Frank Act permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

The CFPB issued a rule, effective as of January 14, 2014, designed to clarify for lenders how they can avoid monetary damages under the Dodd-Frank Act, which would hold lenders accountable for ensuring a borrower's ability to repay a mortgage. Loans that satisfy this "qualified mortgage" safe-harbor will be presumed to have complied with the new ability-to-repay standard. Under the Consumer Financial Protection Bureau's rule, a "qualified mortgage" loan must not contain certain specified features, and the borrower's total monthly debt-to-income ratio may not exceed a specified percentage. Lenders must also verify and document the income and financial resources relied upon to qualify the borrower for the loan and underwrite the loan based on a fully amortizing payment schedule and maximum interest rate during the first five years, taking into account all applicable taxes, insurance and assessments.

On December 10, 2013, five financial regulatory agencies, including the FRB and FDIC, adopted final rules implementing the so-called Volcker Rule added to banking law by Section 619 of the Dodd-Frank Act. These final rules prohibit banking entities from, among other things, (1) engaging in short-term proprietary trading for their own accounts, and (2) having certain ownership interests in and relationships with hedge funds or private equity funds ("covered funds"). Community banks like us have been afforded some relief under these final rules from onerous compliance obligations created by the rules; if banks are engaged only in exempted proprietary trading, such as trading in U.S. government, agency, state and municipal obligations, they are exempt entirely from compliance program requirements. Moreover, even if a community bank engages in proprietary trading or covered fund activities under the rule, they need only incorporate references to the Volcker Rule into their existing policies and procedures. The Final Rules are effective April 1, 2014, but the conformance period has been extended from its statutory end date of July 21, 2014 until July 21, 2015. We are currently evaluating the Final Rules, which are lengthy and detailed.

Certain Other Laws and Regulations

In November 2009, the FRB amended its Regulation E under the Electronic Fund Transfer Act to prohibit banks from charging overdraft fees for ATM or point-of-sale debit card transactions that overdrew the account unless the customer opt-in to the discretionary overdraft service and to require banks to explain the terms of their overdraft services and their fees for the services. Compliance with this Regulation E amendment was required by July 1, 2010.

The Community Reinvestment Act of 1977, or the CRA, requires depository institutions to assist in meeting the credit needs of their market areas consistent with safe and sound banking practice. Under the CRA, each depository institution is required to help meet the credit needs of its market areas by, among other things, providing credit to low- and moderate-income individuals and communities. These factors are also considered in evaluating mergers, acquisitions and applications to open a branch or facility. The applicable federal regulators regularly conduct CRA examinations to assess the performance of financial institutions and assign one of four ratings to the institution's records of meeting the credit needs of its community. During its last examination, a rating of "satisfactory" was received by the Bank.

In accordance with the Gramm-Leach-Bliley Financial Modernization Act of 1999, or the GLB Act, federal banking regulators adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about consumers to nonaffiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a nonaffiliated third party. The privacy provisions of the GLB Act affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors.

A major focus of governmental policy on financial institutions over the past decade has been combating money laundering and terrorist financing. The USA PATRIOT Act of 2001, or the USA Patriot Act, substantially broadened the scope of United States anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations, creating new crimes and penalties and expanding the extra-territorial jurisdiction of the United States. The U.S. Treasury Department has issued a number of regulations that apply various requirements of the USA Patriot Act to financial institutions such as the Bank. These regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing and to verify the identity of their customers. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal and reputational consequences for the institution.

The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others. These are typically known as the "OFAC" rules based on their administration by the U.S. Treasury Department Office of Foreign Assets Control ("OFAC"). The OFAC-administered sanctions targeting countries take many different forms. Generally, however, they contain one or more of the following elements: (i) restrictions on trade with or investment in a sanctioned country, including prohibitions against direct or indirect imports from and exports to a sanctioned country and prohibitions on "U.S. persons" engaging in financial transactions relating to making investments in, or providing investment-related advice or assistance to, a sanctioned country; and (ii) a blocking of assets in which the government or specially designated nationals of the sanctioned country have an interest, by prohibiting transfers of property subject to U.S. jurisdiction (including property in the possession or control of U.S. persons). Blocked assets (e.g., property and bank deposits) cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC. Failure to comply with these sanctions could have serious legal and reputational consequences.

Federal Deposit Insurance Premiums and Assessments

Our bank subsidiary's deposit accounts are currently insured by the Deposit Insurance Fund, or the DIF, of the FDIC. The insurance benefit generally covers up to a maximum of $250,000 per separately insured depositor. As an FDIC-insured bank, our bank subsidiary is subject to deposit insurance premiums and assessments to maintain the DIF. The Bank's deposit insurance premium assessment rate depends on the capital category and supervisory category to which it is assigned. The FDIC has authority to raise or lower assessment rates on insured banks in order to achieve statutorily required reserve ratios in the DIF and to impose special additional assessments.

Under the current assessment system, the FDIC assigns a banking institution to one of four risk categories designed to measure risk. Total base assessment rates currently range from 0.025% of deposits for an institution in the highest rated sub-category of the highest rated category to 0.45% of deposits for an institution in the lowest rated category. The FDIC may increase or decrease its rates by 2.0 basis points without further rulemaking. In an emergency, the FDIC may also impose a special assessment.

In addition, all FDIC insured institutions are required to pay assessments to the FDIC at an annual rate of approximately six tenths of a basis point of insured deposits to fund interest payments on bonds issued by the Financing Corporation, an agency of the federal government established to recapitalize the predecessor to the Savings Association Insurance Fund. These assessments will continue until the Financing Corporation bonds mature in 2017 through 2019.

Internet Address; Internet Availability of SEC Reports

The Company's Internet address is www.germanamerican.com.

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

Forward-Looking Statements and Associated Risks

The Company from time to time in its oral and written communications makes statements relating to its expectations regarding the future. These types of statements are considered "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements can include statements about the Company's net interest income or net interest margin; adequacy of allowance for loan losses, and the quality of the Company's loans, investment securities and other assets; simulations of changes in interest rates; litigation results; dividend policy; acquisitions or mergers; estimated cost savings, plans and objectives for future operations; and expectations about the Company's financial and business performance and other business matters as well as economic and market conditions and trends. All statements other than statements of historical fact included in this report, including statements regarding our financial position, business strategy and the plans and objectives of our management for future operations, are forward-looking statements. When used in this report, words such as "anticipate", "believe", "estimate", "expect", "intend", and similar expressions, as they relate to us or our management, identify forward-looking statements.

Such forward-looking statements are based on the beliefs of our management, as well as assumptions made by and information currently available to our management, and are subject to risks, uncertainties, and other factors.

Actual results may differ materially and adversely from the expectations of the Company that are expressed or implied by any forward-looking statement. The discussions in Item 1A, "Risk Factors," and in Item 7 of this Form 10-K, "Management's Discussion and Analysis of Financial Condition and Results of Operations," list some of the factors that could cause the Company's actual results to vary materially from those expressed or implied by any forward-looking statements. Other risks, uncertainties, and factors that could cause the Company's actual results to vary materially from those expressed or implied by any forward-looking statement include but not limited to:

- the unknown future direction of interest rates and the timing and magnitude of any changes in interest rates;
- changes in competitive conditions;
- the introduction, withdrawal, success and timing of asset/liability management strategies or of mergers and acquisitions and other business initiatives and strategies;
- changes in customer borrowing, repayment, investment and deposit practices;
- changes in fiscal, monetary and tax policies;
- changes in financial and capital markets;
- continued deterioration in general economic conditions, either nationally or locally, resulting in, among other things, credit quality deterioration;
- capital management activities, including possible future sales of new securities, or possible repurchases or redemptions by the Company of outstanding debt or equity securities;
- risks of expansion through acquisitions and mergers, such as unexpected credit quality problems of the acquired loans or other assets, unexpected attrition of the customer base of the acquired institution or branches, and difficulties in integration of the acquired operations;

- factors driving impairment charges on investments;
- the impact, extent and timing of technological changes;
- litigation liabilities, including related costs, expenses, settlements and judgments, or the outcome of matters before regulatory agencies, whether pending or commencing in the future;
- actions of the FRB;
- changes in accounting principles and interpretations;
- potential increases of federal deposit insurance premium expense, and possible future special assessments of FDIC premiums, either industry wide or specific to the Company's banking subsidiary;
- actions of the regulatory authorities under the Dodd-Frank Act and the Federal Deposit Insurance Act and other possible legislative and regulatory actions and reforms; and
- the continued availability of earnings and excess capital sufficient for the lawful and prudent declaration and payment of cash dividends.

Such statements reflect our views with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to the operations, results of operations, growth strategy and liquidity of the Company. Readers are cautioned not to place undue reliance on these forward-looking statements. It is intended that these forward-looking statements speak only as of the date they are made. We do not undertake any obligation to release publicly any revisions to these forward-looking statements to reflect future events or circumstances or to reflect the occurrence of unanticipated events.

Item 1A. Risk Factors.

While we have a history of profitability and operate with capital that exceeds the requirements of bank regulatory agencies, the financial services industry in which we operate was adversely affected by the severe recession that commenced in 2008, and our industry is continuing to be affected by continuing weak economic conditions throughout the United States. The following describes some of the principal risks and uncertainties to which our industry in general, and we and our assets and businesses specifically, are subject; other risks are briefly identified in our cautionary statement that is included under the heading "Forward-Looking Statements and Associated Risks" in Part I, Item 1, "Business." Although we seek ways to manage these risks and uncertainties and to develop programs to control *those that we can, we ultimately cannot predict the future. Future results may differ materially from past results, and from our expectations and plans.*

Risks Related to the Financial Services Industry

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

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

The Dodd-Frank Act and regulations adopted under that law could materially and adversely affect us by increasing compliance costs and heightening our risk of noncompliance with applicable regulations.

The Dodd-Frank Act (discussed in Item 1 – Business – Regulation and Supervision) has resulted in sweeping changes in the regulation of financial institutions. The Dodd-Frank Act contains numerous provisions that affect all banks and bank holding companies. Many of these provisions remain subject to regulatory rule-making and implementation, the effects of which are not yet known. Accordingly, we cannot predict the specific impact and long-term effects that the Dodd-Frank Act and the regulations promulgated thereunder will have on us and our prospects, our target markets and the financial industry more generally. However, the Dodd-Frank Act and the regulations promulgated thereunder have imposed (and are likely to result in the imposition of) additional administrative and regulatory burdens that will obligate us to incur additional expenses (which adversely affect our margins and profitability) and increase the risk that we might not comply in all respects with the new requirements. Further, the Consumer Financial Protection Bureau’s newly-adopted rule on qualified mortgages could limit our ability or desire to make certain types of loans or loans to certain borrowers, or could make it more expensive and/or time consuming to make these loans, which could adversely impact our growth or profitability.

The new Basel Capital Standards may have an adverse effect on us.

We must begin transitioning to new capital rules, adopted by the federal banking agencies but based on the international Basel guidelines, effective January 1, 2015. See Item 1- Business – Regulation and Supervision. The impact of the new capital rules may require us to maintain higher levels of capital, which could lower our return on equity.

Our FDIC insurance premiums may increase, and special assessments could be made, which might negatively impact our results of operations.

High levels of insured institution failures, as a result of the recent recession, as well as the continuing weak economic conditions in the United States, significantly increased losses to the Deposit Insurance Fund of the FDIC. Further, the Dodd-Frank Act, and the Dodd-Frank Act mandates the FDIC to increase the level of its reserves for future losses in its Deposit Insurance Fund. Since the Deposit Insurance Fund is funded by premiums and assessments paid by insured banks, our FDIC insurance premium could increase in future years depending upon the FDIC’s actual loss experience, changes in our Bank’s financial condition or capital strength, and future conditions in the banking industry.

Risks Related to Our Operations and Business and Financial Strategies

Continuing economic weakness could negatively affect us.

Our performance could be negatively affected to the extent that continuing weaknesses in business and economic conditions have direct or indirect material adverse impacts on us, or on our customers or on the financial institutions with whom we deal as counterparties to financial transactions. These conditions could result in one or more of the following:

- a decrease in the demand for loans and other products and services offered by us;
- a decrease in customer savings generally and in the demand for savings and investment products offered by us; and
- an increase in the number of customers and counterparties who become delinquent, file for protection under bankruptcy laws, or default on their loans or other obligations to us.

Continued weakness or future deterioration in the economy, real estate markets or unemployment rates, particularly in the Southern Indiana markets in which we operate, might place downward pressure on the credit worthiness of our Bank's customers and their inclinations to borrow. A continued or worsening disruption and volatility could negatively impact customers' ability to obtain new loans or to repay existing loans, diminish the values of any collateral securing such loans and could cause increases in the number of the Company's customers experiencing financial distress and in the levels of the Company's delinquencies, non-performing loans and other problem assets, charge-offs and provision for credit losses, all of which could materially adversely affect our financial condition and results of operations. The underwriting and credit monitoring policies and procedures that we have adopted cannot eliminate the risk that we might incur losses on account of factors relating to the economy like those identified above, and those losses could have a material adverse effect on our business, financial condition, results of operations and cash flows.

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

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

We could be adversely affected by changes in interest rates.

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

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

We conduct business from offices that are exclusively located in 13 Southern Indiana counties, from which substantially all of our customer base is drawn. Because of the geographic concentration of our operations and customer base, our results depend largely upon economic conditions in this area. If current levels of market disruption and volatility worsen in our primary service areas, the quality of our loan portfolio, and the demand for our products and services, could be adversely affected, and this could have a material adverse effect on our business, financial condition, results of operations or liquidity.

We face substantial competition.

The banking and financial services business in our markets is highly competitive. We compete with much larger regional, national, and international competitors, including competitors that have no (or only a limited number of) offices physically located within our markets, many of which compete with us via Internet and other electronic product and service offerings. In addition, banking and other financial services competitors (including newly organized companies) that are not currently represented by physical locations within our geographic markets could establish office facilities within our markets, including through their acquisition of existing competitors. Developments increasing the nature or level of our competition, or decreasing the effectiveness by which we compete, could have a material adverse effect on our business, financial condition, results of operations or liquidity. See also Part I, Item 1, of this Report, "Business – Competition," and "Business – Regulation and Supervision."

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

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

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

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

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

Prices and volumes of transactions in the nation’s securities markets can be affected suddenly by economic crises, such as that experienced in the United States and internationally in 2008, or by other national or international crises, such as national disasters, acts of war or terrorism, changes in commodities markets, or instability in foreign governments. Disruptions in securities markets may detrimentally affect the value of securities that we hold in our investment portfolio, such as through reduced valuations due to the perception of heightened credit and liquidity risks. There can be no assurance that declines in market value associated with these disruptions will not result in other than temporary impairments of these assets, which would lead to accounting charges that could have a material adverse effect on our net income and capital levels.

The soundness of other financial institutions could adversely affect us.

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

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

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

Our controls and procedures may fail or be circumvented.

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

We are subject to security and operational risks relating to our use of technology, both internally and with our customers, that could damage our reputation and our business.

We rely heavily on communications and information systems to conduct our business; any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan and other systems. Further, we increasingly offer our customers the ability to bank online with us. Although we believe that our online systems are secure in accordance with best industry standards, our online banking networks or those of our customers could be vulnerable to unauthorized access, computer viruses, phishing schemes and other security problems. We may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by security breaches or viruses. In addition, security breaches and viruses could expose us to claims, litigation and other possible liabilities. Any inability to prevent security breaches or computer viruses could also cause existing customers to lose confidence in our systems and could adversely affect our reputation and our ability to generate deposits.

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

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

Any acquisitions of banks, bank branches, or loans or other financial service assets pose risks to us.

We may buy banks, bank branches and other financial-service-related businesses and assets in the future. Acquiring other banks, businesses, or branches involves various risks commonly associated with acquisitions, including, among other things:

- potential exposure to unknown or contingent liabilities of the acquired assets, operations or company;
- exposure to potential asset quality issues of the acquired assets, operations or company;

- environmental liability with acquired real estate collateral or other real estate;
- difficulty and expense of integrating the operations, systems and personnel of the acquired assets, operations or company;
- potential disruption to our ongoing business, including diversion of our management's time and attention;
- the possible loss of key employees and customers of the acquired operations or company;
- difficulty in estimating the value of the acquired assets, operations or company; and
- potential changes in banking or tax laws or regulations that may affect the acquired assets, operations or company.

We may not be successful in overcoming these risks or any other problems encountered in connection with mergers or acquisitions.

Acquisitions typically involve the payment of a premium over book and market values, and, therefore, some dilution of the Company's tangible book value per common share or net income per common share (or both) may occur in connection with any future transaction.

We may incur substantial costs to expand by acquisition, and such acquisitions may not result in the levels of profits we seek. Integration efforts for any future acquisitions may not be successful and following any future acquisition, after giving it effect, we may not achieve financial results comparable to or better than our historical experience.

We may participate in FDIC-assisted acquisitions, which could present additional risks to our financial condition.

We may make opportunistic whole or partial acquisitions of troubled financial institutions in transactions facilitated by the FDIC. In addition to the risks frequently associated with acquisitions, an acquisition of a troubled financial institution may involve a greater risk that the acquired assets underperform compared to our expectations. Because these acquisitions are structured in a manner that would not allow us the time normally associated with preparing for and evaluating an acquisition, including preparing for integration of an acquired institution, we may face additional risks including, among other things, the loss of customers, strain on management resources related to collection and management of problem loans and problems related to integration of personnel and operating systems. Additionally, while the FDIC may agree to assume certain losses in transactions that it facilitates, there can be no assurances that we would not be required to raise additional capital as a condition to, or as a result of, participation in an FDIC-assisted transaction. Any such transactions and related issuances of stock may have dilutive effect on earnings per share and share ownership.

Item 1B. Unresolved Staff Comments. None.

Item 2. Properties.

The Company's executive offices are located in the main office building of the Bank at 711 Main Street, Jasper, Indiana. The main office building, which is owned by the Bank and also serves as the main office of the Company's other subsidiaries, contains approximately 23,600 square feet of office space. The Bank and the Company's other subsidiaries also conduct their operations from 41 other locations in Southern Indiana of which 32 are owned by the Company and nine are leased from third parties.

Item 3. Legal Proceedings.

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

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

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

Market and Dividend Information

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

	2013			2012		
	High	Low	Cash Dividend	High	Low	Cash Dividend
Fourth Quarter	$30.15	$23.51	$ 0.15	$24.10	$19.98	$ 0.14
Third Quarter	$28.15	$22.86	$ 0.15	$24.89	$19.76	$ 0.14
Second Quarter	$22.69	$19.96	$ 0.15	$20.50	$17.94	$ 0.14
First Quarter	$23.63	$21.54	$ 0.15	$21.74	$18.43	$ 0.14
			$ 0.60			$ 0.56

The Common Stock was held of record by approximately 3,429 shareholders at March 1, 2014.

Cash dividends paid to the Company's shareholders are primarily funded from dividends received by the parent company from its bank subsidiary. The declaration and payment of future dividends will depend upon the earnings and financial condition of the Company and its subsidiaries, general economic conditions, compliance with regulatory requirements affecting the ability of the bank subsidiary and the Company to declare dividends, (for further discussion of such requirements, see Item 1, "Business - Regulation and Supervision - Restrictions on Bank Dividends or Loans to, or other Transactions with, the Parent Company and Parent Company Dividends"), and other factors.

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

(800) 884-4225	(800) 482-1314

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Stock Performance Graph

The following graph compares the Company’s five-year cumulative total returns with those of the Russell 2000 Stock Index, Russell Microcap Stock Index, and the Indiana Bank Peer Group. The Indiana Bank Peer Group (which is a custom peer group identified by Company management) includes all Indiana-based commercial bank holding companies (excluding companies owning thrift institutions that are not regulated as bank holding companies) that have been in existence as commercial bank holding companies throughout the five-year period ended December 31, 2013, the stocks of which have been traded on an established securities market (NYSE, AMEX, NASDAQ) throughout that five-year period. The companies comprising the Indiana Bank Peer Group for purposes of the December 2013 comparison were: 1st Source Corp., Community Bank Shares of IN, First Financial Corp., First Merchants Corp., Lakeland Financial Corp., MainSource Financial Group, Old National Bancorp, Horizon Bancorp, and Tower Financial Corp. The returns of each company in the Indiana Bank Peer Group have been weighted to reflect the company’s market capitalization. The Russell 2000 Stock Index, which is designed to measure the performance of the small-cap segment of the U.S. equity universe, is a subset of the Russell 3000 Index (which measures the performance of the largest 3,000 U.S. companies) that includes approximately 2,000 of the smallest securities in that index based on a combination of their market cap and current index membership, and is annually reconstituted at the end of each June. The Russell Microcap Stock Index is an index representing the smallest 1,000 securities in the small-cap Russell 2000 Index plus the next 1,000 securities, which is also annually reconstituted at the end of each June. The Company’s stock is currently included in the Russell 2000 Index and Russell Microcap Index.

Stock Repurchase Program Information

The following table sets forth information regarding the Company’s purchases of its common shares during each of the three months ended December 31, 2013.

Period	Total Number of Shares (or Units) Purchased	Average Price Paid Per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased **Under the Plans or Programs** (1)
October 2013	—	—	—	272,789
November 2013	—	—	—	272,789
December 2013	—	—	—	272,789

(1) On April 26, 2001, the Company announced that its Board of Directors had approved a stock repurchase program for up to 607,754 of its outstanding common shares, of which the Company had purchased 334,965 common shares through December 31, 2013 (both such numbers adjusted for subsequent stock dividends). The Board of Directors established no expiration date for this program. The Company purchased no shares under this program during the quarter ended December 31, 2013.

Item 6. Selected Financial Data.

The following selected data should be read in conjunction with the consolidated financial statements and related notes that are included in Item 8 of this Report, and "Management's Discussion and Analysis of Financial Condition and Results of Operations," which is included in Item 7 of this Report (dollars in thousands, except per share data). Year-to-year financial information comparability is affected by the acquisition accounting treatment for mergers and acquisitions, including but not limited to the Company's acquisitions of two branches of another bank in May 2010, the Company's acquisition of American Community Bancorp, Inc., effective January 1, 2011 and the Company's acquisition of United Commerce Bancorp, effective October 1, 2013.

	2013	2012	2011	2010	2009
Summary of Operations:					
Interest Income	$75,672	$77,160	$80,161	$64,193	$63,736
Interest Expense	7,155	10,912	16,180	15,522	19,223
Net Interest Income	68,517	66,248	63,981	48,671	44,513
Provision for Loan Losses	350	2,412	6,800	5,225	3,750
Net Interest Income after Provision					
For Loan Losses	68,167	63,836	57,181	43,446	40,763
Non-interest Income	23,615	21,811	21,576	16,943	15,859
Non-interest Expense	54,905	50,923	50,782	41,361	40,391
Income before Income Taxes	36,877	34,724	27,975	19,028	16,231
Income Tax Expense	11,464	10,669	7,726	5,623	4,013
Net Income	$25,413	$24,055	$20,249	$13,405	$12,218
Year-end Balances:					
Total Assets	$2,163,827	$2,006,300	$1,873,767	$1,375,888	$1,242,965
Total Loans, Net of Unearned Income	1,382,382	1,204,866	1,120,993	917,236	877,822
Total Deposits	1,812,156	1,640,931	1,556,198	1,087,286	969,643
Total Long-term Debt	87,237	89,472	90,974	81,016	113,320
Total Shareholders' Equity	200,097	185,026	167,610	121,534	113,549
Average Balances:					
Total Assets	$2,037,236	$1,934,123	$1,823,703	$1,330,540	$1,230,596
Total Loans, Net of Unearned Income	1,272,055	1,147,891	1,114,181	906,127	891,322
Total Deposits	1,695,796	1,618,712	1,521,204	1,046,295	963,928
Total Shareholders' Equity	189,689	177,207	159,765	119,867	109,887
Per Share Data:					
Net Income (1)	$1.98	$1.90	$1.61	$1.21	$1.10
Cash Dividends	0.60	0.56	0.56	0.56	0.56
Book Value at Year-end	15.19	14.64	13.31	10.94	10.25
Other Data at Year-end:					
Number of Shareholders	3,444	3,105	3,221	3,194	3,364

Number of Employees	478	439	417	359	332
Weighted Average Number of Shares (1)	12,807,678	12,637,743	12,587,748	11,104,887	11,068,988
Selected Performance Ratios:					
Return on Assets	1.25 %	1.24 %	1.11 %	1.01 %	0.99 %
Return on Equity	13.40 %	13.57 %	12.67 %	11.18 %	11.12 %
Equity to Assets	9.25 %	9.22 %	8.95 %	8.83 %	9.14 %
Dividend Payout	30.18 %	29.38 %	34.80 %	46.36 %	50.71 %
Net Charge-offs to Average Loans	0.10 %	0.19 %	0.43 %	0.32 %	0.25 %
Allowance for Loan Losses to Loans	1.05 %	1.29 %	1.37 %	1.45 %	1.25 %
Net Interest Margin	3.67 %	3.74 %	3.84 %	3.98 %	3.95 %

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

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

INTRODUCTION

German American Bancorp, Inc., is a NASDAQ-traded (symbol: GABC) financial services holding company based in Jasper, Indiana. German American, through its banking subsidiary German American Bancorp, operates 37 commercial and retail banking offices in 13 southern Indiana counties. The Company also owns a trust, brokerage, and financial planning subsidiary (German American Financial Advisors & Trust Company) and a full line property and casualty insurance agency (German American Insurance, Inc.).

Throughout this Management's Discussion and Analysis, as elsewhere in this report, when we use the term "Company", we will usually be referring to the business and affairs (financial and otherwise) of the Company and its subsidiaries and affiliates as a whole. Occasionally, we will refer to the term "parent company" or "holding company" when we mean to refer to only German American Bancorp, Inc., and the term "Bank" when we mean to refer to only the Company's bank subsidiary.

This Management's Discussion and Analysis includes an analysis of the major components of the Company's operations for the years 2011 through 2013 and its financial condition as of December 31, 2013 and 2012. This information should be read in conjunction with the accompanying consolidated financial statements and footnotes contained elsewhere in this report and with the description of business included in Item 1 of this Report (including the cautionary disclosure regarding "Forward Looking Statements and Associated Risks"). Financial and other information by segment is included in Note 15 to the Company's consolidated financial statements included in Item 8 of this Report and is incorporated into this Item 7 by reference.

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

MANAGEMENT OVERVIEW

The Company’s 2013 net income totaled $25,413,000, or $1.98 per diluted share, which was a record level of earnings for the Company and represented a 4% increase on a per share basis over the Company’s 2012 net income of $24,055,000, or $1.90 per diluted share. The Company’s return on average equity for 2013 was 13.4%, representing the ninth consecutive year the Company has achieved a double-digit return on equity.

The record earnings performance during 2013 was attributable to both an increased level of net interest income, driven by a higher level of earning assets and more specifically the Company’s loan portfolio, increased levels of non-interest income, and a reduced level of provision for loan loss, as the Company’s asset quality remained strong while showing continued improvement. These positive impacts were partially mitigated by an increased level of non-interest expenses.

Net interest income improved by $2,269,000, or approximately 3%, during 2013 compared with 2012. Provision for loan loss declined $2,062,000, or 85%, during 2013 compared with 2012. The Company’s 2013 earnings were positively impacted by a $1,804,000, or 8%, increase in the level of non-interest income. The key drivers in the increased level of non-interest income was higher trust and investment product fees, increased insurance revenues, and higher levels of gains related to sales of securities. Non-interest expenses increased $3,982,000, or 8%, during 2013 compared with 2012 largely driven by an increased level of salaries and employees benefits.

The Company completed the acquisition of United Commerce Bancorp and its subsidiary, United Commerce Bank effective October 1, 2013. United Commerce Bank provided a full range of commercial and consumer banking services in the Bloomington, Indiana, market, from two banking offices. United Commerce had total loans and deposits (unaudited) as of October 1, 2013 that totaled $79.6 million and $106.6 million, respectively. The impact of the acquisition on the Company’s overall financial performance during 2013 was not significant given that only a single quarter of performance was included in operating results of the Company.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The financial condition and results of operations for German American Bancorp, Inc. presented in the Consolidated Financial Statements, accompanying Notes to the Consolidated Financial Statements, and selected financial data appearing elsewhere within this Report, are, to a large degree, dependent upon the Company’s accounting policies. The selection of and application of these policies involve estimates, judgments, and uncertainties that are subject to change. The critical accounting policies and estimates that the Company has determined to be the most susceptible to change in the near term relate to the determination of the allowance for loan losses, the valuation of securities available for sale, and the valuation allowance on deferred tax assets.

Allowance for Loan Losses

The Company maintains an allowance for loan losses to cover probable incurred credit losses at the balance sheet date. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management’s judgment, should be charged-off. A provision for loan losses is charged to operations based on management’s periodic evaluation of the necessary allowance balance. Evaluations are conducted at least quarterly and more often if deemed necessary. The ultimate recovery of all loans is susceptible to future market factors beyond the Company’s control.

The Company has an established process to determine the adequacy of the allowance for loan losses. The determination of the allowance is inherently subjective, as it requires significant estimates, including the amounts and timing of expected future cash flows on impaired loans, estimated losses on other classified loans and pools of homogeneous loans, and consideration of past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors, all of which may be susceptible to significant change. The allowance consists of two components of allocations, specific and general. These two components represent the total allowance for loan losses deemed adequate to cover losses inherent in the loan portfolio.

Commercial and agricultural loans are subject to a standardized grading process administered by an internal loan review function. The need for specific reserves is considered for credits when graded substandard or when: (a) the customer’s cash flow or net worth appears insufficient to repay the loan; (b) the loan has been criticized in a regulatory examination; (c) the loan is on non-accrual; or, (d) other reasons where the ultimate collectibility of the loan is in question, or the loan characteristics require special monitoring. Specific allowances are established in cases where management has identified significant conditions or circumstances related to an individual credit that we believe indicates the loan is impaired. Specific allocations on impaired loans are determined by comparing the loan balance to the present value of expected cash flows or expected collateral proceeds. Allocations are also applied to categories of loans not considered individually impaired but for which the rate of loss is expected to be greater than historical averages, including those graded substandard and non-performing consumer or residential real estate loans. Such allocations are based on past loss experience and information about specific borrower situations and estimated collateral values.

General allocations are made for other pools of loans, including non-classified loans, homogeneous portfolios of consumer and residential real estate loans, and loans within certain industry categories believed to present unique risk of loss. General allocations of the allowance are primarily made based on a three-year historical average for loan losses for these portfolios, judgmentally adjusted for economic factors and portfolio trends.

Due to the imprecise nature of estimating the allowance for loan losses, the Company’s allowance for loan losses includes a minor unallocated component. The unallocated component of the allowance for loan losses incorporates the Company’s judgmental determination of inherent losses that may not be fully reflected in other allocations, including factors such as economic uncertainties, lending staff quality, industry trends impacting specific portfolio segments, and broad portfolio quality trends. Therefore, the ratio of allocated to unallocated components within the total allowance may fluctuate from period to period.

Securities Valuation

Securities available-for-sale are carried at fair value, with unrealized holding gains and losses reported separately in accumulated other comprehensive income (loss), net of tax. The Company obtains market values from a third party on a monthly basis in order to adjust the securities to fair value. Equity securities that do not have readily determinable fair values are carried at cost. Additionally, when securities are deemed to be other than temporarily impaired, a charge will be recorded through earnings; therefore, future changes in the fair value of securities could have a significant impact on the Company’s operating results. In determining whether a market value decline is other than temporary, management considers the reason for the decline, the extent of the decline, the duration of the decline and whether the Company intends to sell or believes it will be required to sell the securities prior to recovery. As of December 31, 2013, gross unrealized losses on the securities available-for-sale portfolio totaled approximately $13,938,000 and gross unrealized gains totaled approximately $5,885,000. As of December 31, 2013, held-to-maturity securities had a gross unrecognized gain of approximately $3,000.

Income Tax Expense

Income tax expense involves estimates related to the valuation allowance on deferred tax assets and loss contingencies related to exposure from tax examinations.

A valuation allowance reduces deferred tax assets to the amount management believes is more likely than not to be realized. In evaluating the realization of deferred tax assets, management considers the likelihood that sufficient taxable income of appropriate character will be generated within carryback and carryforward periods, including consideration of available tax planning strategies. Tax related loss contingencies, including assessments arising from tax examinations and tax strategies, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. In considering the likelihood of loss, management considers the nature of the contingency, the progress of any examination or related protest or appeal, the views of legal counsel and other advisors, experience of the Company or other enterprises in similar matters, if any, and management's intended response to any assessment.

RESULTS OF OPERATIONS

NET INCOME

Net income for the year ended December 31, 2013 totaled $25,413,000 or $1.98 per diluted share, an increase of $1,358,000 or approximately 4% on a per share basis, from the year ended December 31, 2012 net income of $24,055,000 or $1.90 per diluted share. For 2013, the improvement in earnings was attributable to an increased level of net interest income, improved non-interest income, and a reduced level of provision for loan loss partially offset by a higher level of non-interest expense.

Net income for the year ended December 31, 2012 totaled $24,055,000 or $1.90 per diluted share, an increase of $3,806,000 or approximately 18% on a per share basis, from the year ended December 31, 2011 net income of $20,249,000 or $1.61 per diluted share. For 2012, the improvement in earnings was attributable to both an increased level of net interest income, driven by a higher level of earning assets within both the Company's loan portfolio and securities portfolio, and a reduced level of provision for loan loss.

NET INTEREST INCOME

Net interest income is the Company's single largest source of earnings, and represents the difference between interest and fees realized on earning assets, less interest paid on deposits and borrowed funds. Several factors contribute to the determination of net interest income and net interest margin, including the volume and mix of earning assets, interest rates, and income taxes. Many factors affecting net interest income are subject to control by management policies and actions. Factors beyond the control of management include the general level of credit and deposit demand, Federal Reserve Board monetary policy, and changes in tax laws.

Net interest income increased $2,269,000 or 3% (an increase of $2,500,000 or 4% on a tax-equivalent basis) during the year ended December 31, 2013 compared with 2012. The increased net interest income during 2013 compared with 2012 was largely driven by an increased level of earning assets primarily attributable to average loan growth and an overall decline in the Company's cost of funds partially mitigated by a decline in the accretion of loan discounts on acquired loans and a lower net interest margin (expressed as a percentage of average earning assets).

The tax equivalent net interest margin was 3.67% for 2013 compared to 3.74% during 2012. The yield on earning assets totaled 4.04% during 2013 compared to 4.34% in 2012 while the cost of funds (expressed as a percentage of average earning assets) totaled 0.37% during 2013 compared to 0.60% in 2012.

The decline in the net interest margin in 2013 compared with 2012 was largely attributable to the continued downward pressure on earning asset yields being driven by a historically low market interest rate environment and a competitive marketplace for lending opportunities. Also contributing to the lower net interest margin was a decline in the accretion of loan discounts on certain acquired loans. Accretion contributed approximately 8 basis points on an annualized basis to the net interest margin during 2013 compared to approximately 12 basis points during 2012. The decline in the Company's cost of funds by approximately 23 basis points during 2013 compared to 2012 was largely driven by a continued decline in deposit rates and also attributable to the repayment of $19.3 million of subordinated debentures with an interest rate of 8% that occurred in the second quarter of 2013.

Average earning assets increased by approximately $103.7 million, or 6%, during 2013 compared with 2012. Average loans outstanding increased $124.2 million, or 11%, during 2013 compared with 2012. Average federal funds sold and other short-term investments decreased by $29.5 million, or 66%, during 2013 compared with 2012. The average securities portfolio remained relatively stable increasing approximately $9.0 million, or 1%, in 2013 compared to 2012. The funding for the increased level of earning assets was largely driven through an increase level of average core deposits (core deposits defined as demand deposits - both interest and non-interest bearing, savings, money market and time deposits in denominations of less than $100,000). The increase in average core deposits totaled $62.3 million, or approximately 4%, during 2013 compared with 2012.

Net interest income increased $2,267,000 or 4% (an increase of $2,617,000 or 4% on a tax-equivalent basis) during the year ended December 31, 2012 compared with 2011. The increased net interest income during 2012 compared with 2011 was driven by a higher level of earning assets including both average loan growth and growth in the securities portfolio which resulted from growth of the Company's deposit base.

The tax equivalent net interest margin was 3.74% for the year ended December 31, 2012 compared to 3.84% in 2011. The yield on earning assets totaled 4.34% in 2012 compared to 4.79% in 2011 while the cost of funds (expressed as a percentage of average earning assets) totaled 0.60% during 2012 compared to 0.95% in 2011.

The decline in the net interest margin in 2012 compared with 2011 was largely attributable to the continued downward pressure on earning asset yields. Accretion of loan discounts on certain acquired loans contributed approximately 12 basis points to the net interest margin in 2012 compared with 13 basis points in 2011. The decline in the Company's cost of funds by 35 basis points during 2012 compared to 2011 was driven by a continued decline in deposit rates.

The following table summarizes net interest income (on a tax-equivalent basis) for each of the past three years. For tax-equivalent adjustments, an effective tax rate of 35% was used for all years presented [(1)].

Average Balance Sheet

(Tax-equivalent basis, dollars in thousands)

	Twelve Months Ended December 31, 2013			Twelve Months Ended December 31, 2012			Twelve Months Ended December 31, 2011		
	Principal Balance	Income / Expense	Yield / Rate	Principal Balance	Income / Expense	Yield / Rate	Principal Balance	Income / Expense	Yield / Rate
ASSETS									
Federal Funds Sold and Other Short-term Investments	$15,507	$30	0.19%	$44,999	$91	0.20%	$85,217	$216	0.25%
Securities:									
Taxable	541,478	11,091	2.05%	547,949	12,946	2.36%	450,099	13,677	3.04%
Non-taxable	87,471	4,491	5.13%	71,961	3,743	5.20%	49,260	2,805	5.69%
Total Loans and Leases (2)	1,272,055	61,862	4.86%	1,147,891	61,951	5.40%	1,114,181	64,684	5.81%
TOTAL INTEREST EARNING ASSETS	1,916,511	77,474	4.04%	1,812,800	78,731	4.34%	1,698,757	81,382	4.79%
Other Assets	136,170			137,594			139,658		
Less: Allowance for Loan Losses	(15,445)			(16,271)			(14,712)		
TOTAL ASSETS	$2,037,236			$1,934,123			$1,823,703		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Interest-bearing Demand Deposits	$534,095	$856	0.16%	$512,232	$972	0.19%	$478,486	$2,374	0.50%
Savings Deposits	466,391	717	0.15%	435,475	792	0.18%	392,166	1,940	0.49%
Time Deposits	339,469	3,124	0.92%	357,193	5,194	1.45%	394,008	7,672	1.95%
FHLB Advances and Other Borrowings	136,569	2,458	1.80%	118,201	3,954	3.35%	126,922	4,194	3.30%

TOTAL INTEREST-BEARING LIABILITIES	1,476,524	7,155	0.48%	1,423,101	10,912	0.77%	1,391,582	16,180	1.16%
Demand Deposit Accounts	355,841			313,812			256,544		
Other Liabilities	15,182			20,003			15,812		
TOTAL LIABILITIES	1,847,547			1,756,916			1,663,938		
Shareholders' Equity	189,689			177,207			159,765		
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$2,037,236			$1,934,123			$1,823,703		
COST OF FUNDS			0.37%			0.60%			0.95%
NET INTEREST INCOME		$70,319			$67,819			$65,202	
NET INTEREST MARGIN			3.67%			3.74%			3.84%

(1) Effective tax rates were determined as though interest earned on the Company's investments in municipal bonds and loans was fully taxable.

(2) Loans held-for-sale and non-accruing loans have been included in average loans. Interest income on loans includes loan fees of $2,055, $3,164 and $3,335 for 2013, 2012 and 2011, respectively.

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

Net Interest Income – Rate / Volume Analysis

(Tax-Equivalent basis, dollars in thousands)

	2013 compared to 2012			2012 compared to 2011		
	Increase / (Decrease) Due to [1]			**Increase / (Decrease) Due to [1]**		
	Volume	Rate	Net	Volume	Rate	Net
Interest Income:						
Federal Funds Sold and Other Short-term Investments	$ (57)	$ (4)	$ (61)	$ (88)	$ (37)	$ (125)
Taxable Securities	(151)	(1,704)	(1,855)	2,646	(3,377)	(731)
Non-taxable Securities	797	(49)	748	1,199	(261)	938
Loans and Leases	6,354	(6,443)	(89)	1,916	(4,649)	(2,733)
Total Interest Income	6,943	(8,200)	(1,257)	5,673	(8,324)	(2,651)
Interest Expense:						
Savings and Interest-bearing Demand	94	(285)	(191)	352	(2,903)	(2,551)
Time Deposits	(247)	(1,823)	(2,070)	(667)	(1,810)	(2,477)
FHLB Advances and Other Borrowings	543	(2,039)	(1,496)	(291)	51	(240)
Total Interest Expense	390	(4,147)	(3,757)	(606)	(4,662)	(5,268)
Net Interest Income	$ 6,553	$ (4,053)	$ 2,500	$ 6,279	$ (3,662)	$ 2,617

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

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

PROVISION FOR LOAN LOSSES

The Company provides for loan losses through regular provisions to the allowance for loan losses. The provision is affected by net charge-offs on loans and changes in specific and general allocations required on the allowance for loan losses. Provisions for loan losses totaled $350,000, $2,412,000, and $6,800,000 in 2013, 2012, and 2011, respectively.

The provision for loan loss declined $2,062,000, or 85%, during 2013 compared to 2012. The decline in the provision for loan losses during 2013 compared with 2012 was attributable to a reduced level of net charge-offs, lower levels of non-performing loans, and a lower level of adversely classified loans. During 2013, the provision for loan loss represented approximately 3 basis points of average outstanding loans while net charge-offs represented approximately 10 basis points of average outstanding loans.

The Company's allowance for loan losses represented 1.05% of total loans at year-end 2013 compared with 1.29% at year-end 2012. The decline in the allowance compared with total loans at year-end 2013 compared with year-end 2012 was in part attributable to the improvement in the Company's asset quality and also in part attributable to the acquisition of United Commerce Bank. Under acquisition accounting, loans are recorded at fair value which includes a credit risk component, and therefore the allowance on loans acquired is not carried over from the seller.

The provision for loan loss declined $4,388,000, or 65%, during 2012 compared to 2011. During 2012, the provision for loan loss represented approximately 21 basis points of average outstanding loans while net charge-offs represented approximately 19 basis points of average outstanding loans. The significant decline in the Company's provision for loan loss during 2012 compared with 2011 was largely attributable to a lower level of net charge-offs and overall improvement in the level of adversely classified and non-performing loans. The Company's allowance for loan losses represented 1.29% of total loans at year-end 2012 compared with 1.37% at year-end 2011.

Provisions for loan losses in all periods were made at a level deemed necessary by management to absorb estimated, probable incurred losses in the loan portfolio. A detailed evaluation of the adequacy of the allowance for loan losses is completed quarterly by management, the results of which are used to determine provisions for loan losses. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other qualitative factors. Refer also to the sections entitled CRITICAL ACCOUNTING POLICIES AND ESTIMATES and "RISK MANAGEMENT – Lending and Loan Administration" for further discussion of the provision and allowance for loan losses.

NON-INTEREST INCOME

During 2013, non-interest income increased $1,804,000 or 8% compared with 2012 and during 2012 increased $235,000 or 1% compared with 2011.

Non-interest Income (dollars in thousands)	Years Ended December 31,			% Change From Prior Year	
	2013	2012	2011	2013	2012
Trust and Investment Product Fees	$3,358	$2,657	$2,145	26 %	24 %
Service Charges on Deposit Accounts	4,144	4,076	4,154	2	(2)
Insurance Revenues	6,217	5,524	5,819	13	(5)
Company Owned Life Insurance	965	974	1,100	(1)	(11)
Interchange Fee Income	1,854	1,724	1,501	8	15
Other Operating Income	2,003	1,955	1,452	2	35
Subtotal	18,541	16,910	16,171	10	5
Net Gains on Sales of Loans	2,645	3,234	2,381	(18)	36
Net Gain on Securities	2,429	1,667	3,024	46	(45)
TOTAL NON-INTEREST INCOME	$23,615	$21,811	$21,576	8	1

Trust and investment product fees increased $701,000, or 26%, during 2013 compared with 2012 following an increase of $512,000, or 24%, during 2012 compared with 2011. The increase during 2013 compared to 2012 was attributable to a 35% increase in trust revenues and a 19% increase in brokerage revenues. The increase during 2012 compared to 2011 was primarily attributable to a 50% increase in trust revenues supplemented by a 7% increase in retail brokerage revenues.

Insurance revenues increased $693,000, or 13%, during 2013 as compared to 2012 primarily as a result of increased commercial insurance revenue and to a lesser extent increased contingency revenue. Contingency revenue totaled $246,000 during 2013 compared to $88,000 in 2012. Insurance revenues decreased approximately $295,000 or 5% during 2012 as compared to 2011 as a result of lower contingency revenue. Contingency revenue totaled $88,000 during 2012 compared to $872,000 in 2011. The decline in contingency revenue was partially offset by an increased level of commercial insurance revenues during 2012 compared with 2011.

Net gain on sales of residential loans decreased $589,000, or 18%, during 2013 compared with 2012. During 2012, the net gain on sales of residential loans increased $853,000, or 36%, compared with 2011. Loan sales for 2013, 2012, and 2011 totaled $166.6 million, $186.8 million, and $134.2 million, respectively.

During 2013, the Company realized net gains on the sale of securities of $2,429,000 related to the sale of $90.5 million of securities. Included in the gain during 2013 was a $343,000 gain the Company realized related to the acquisition accounting treatment of the existing equity ownership position the Company held in United Commerce at the time of acquisition. During 2012, the Company realized net gains on the sale of securities of $1,667,000 related to the sale of approximately $94.3 million of securities. During 2011, the Company realized net gains on securities of $3,024,000 related to the sale of approximately $59.3 million of securities. Included in the gain during 2011 was a $1,045,000 gain related to the acquisition accounting treatment of the existing equity ownership position the Company held in American Community Bancorp, Inc. at the time of acquisition of American Community.

NON-INTEREST EXPENSE

During 2013, non-interest expense increased $3,982,000, or 8%, compared with 2012. During 2012, non-interest expense remained very stable compared with 2011, increasing by less than 1%.

Non-interest Expense (dollars in thousands)	Years Ended December 31,			% Change From Prior Year	
	2013	2012	2011	2013	2012
Salaries and Employee Benefits	$31,482	$29,086	$27,992	8 %	4 %
Occupancy, Furniture and Equipment Expense	7,741	7,064	7,198	10	(2)
FDIC Premiums	1,050	1,116	1,473	(6)	(24)
Data Processing Fees	1,765	1,071	2,092	65	(49)
Professional Fees	2,577	2,247	2,056	15	9
Advertising and Promotion	1,863	1,714	1,525	9	12
Intangible Amortization	1,416	1,655	1,956	(14)	(15)
Other Operating Expenses	7,011	6,970	6,490	1	7
TOTAL NON-INTEREST EXPENSE	$54,905	$50,923	$50,782	8	n/m (1)

(1) n/m = not meaningful

Salaries and employee benefits increased $2,396,000, or 8%, during 2013 compared with 2012. The increase was primarily the result of an increased number of full-time equivalent employees due in part to an increased number of banking locations including the acquisition of United Commerce, increased costs related to the Company’s health insurance plan, and the termination of a frozen defined benefit pension plan. Also contributing to the increase was approximately $287,000 of merger-related salary and benefit costs related to the acquisition of United Commerce. Salaries and employee benefits increased $1,094,000 or 4% during 2012 compared with 2011. The increase in salaries and benefits during 2012 compared with 2011 was primarily the result of an increased number of full-time equivalent employees, increased costs related to the Company’s partially self-insured health insurance plan and increased commission payout related to higher levels of mortgage loan sales revenues in the secondary market and increased insurance revenues.

Occupancy, furniture and equipment expense increased $677, or approximately 10%, during 2013 compared with 2012 following a 2% decrease in 2012 compared with 2011. The increase during 2013 was largely attributable to service contracts related to equipment and software, additional branch banking locations, and the acquisition of United Commerce Bancorp. The costs associated with United Commerce totaled $127,000 during 2013.

Data processing fees increased $694,000, or 65%, during 2013 compared with 2012. The increase was largely related to the resolution of a contractual dispute during 2012 related to the acquisition of American Community Bancorp. An expense for the cancellation of a data processing contract was recorded in the first half of 2011, and upon resolution of the contractual dispute, a portion of that accrued expense was reversed during 2012. Also contributing to the increase was $261,000 in data processing charges for United Commerce Bancorp. Data processing fees declined $1,021,000, or 49%, during 2012 compared with 2011. This decline was largely related to running the Bank of Evansville's separate core processing system during the first four months of 2011 and aforementioned contractual issues.

Professional fees increased $330,000, or 15%, during 2013 compared with 2012 following an increase of $191,000, or 9%, during 2012 compared with 2011. The increase during 2013 compared with 2012 was largely related to professional fees associated with the acquisition of United Commerce Bancorp and related to fees associated with the Company's review of its overall operating effectiveness and efficiency. The increase during 2012 compared with 2011 was attributable to increased professional fees related to strategic customer service and leadership development initiatives and increased legal fees.

Advertising and promotion increased $149,000, or 9%, during 2013 compared with 2012 following an increase of $189,000, or 12%, during 2012 compared with 2011. The increase during 2013 compared with 2012 was attributable to increased level of contributions and general advertising expenditures. The increase during 2012 was related to an increased level of contributions to community based organizations in the Company's primary market areas.

Intangible amortization declined $239,000, or 14%, during 2013 compared with 2012 following a decline of $301,000, or 15%, in 2012 compared with 2011. The decline during 2013 compared with 2012 was related to a lower level of core deposit intangible amortization and a lower level of customer list intangible related to the Company's property and casualty insurance operations. The decline during 2012 compared with 2011 was related to a lower level of core deposit intangible amortization.

PROVISION FOR INCOME TAXES

The Company records a provision for current income taxes payable, along with a provision for deferred taxes payable in the future. Deferred taxes arise from temporary differences, which are items recorded for financial statement purposes in a different period than for income tax returns. The Company's effective tax rate was 31.1%, 30.7%, and 27.6%, respectively, in 2013, 2012, and 2011. The effective tax rate in all periods is lower than the blended statutory rate. The lower effective rate in all periods primarily resulted from the Company's tax-exempt investment income on securities, loans, and company owned life insurance, income tax credits generated by investments in affordable housing projects and investments in new market tax credit projects, and income generated by subsidiaries domiciled in a state with no state or local income tax. See Note 10 to the Company's consolidated financial statements included in Item 8 of this Report for additional details relative to the Company's income tax provision.

CAPITAL RESOURCES

The Company and its affiliate bank are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. The prompt corrective action regulations provide five classifications, including well-capitalized, adequately capitalized, under-capitalized, significantly under-capitalized and critically under-capitalized, although these terms are not used to represent overall financial condition. The Company and its affiliate bank at year-end 2013 were categorized as well-capitalized as that term is defined by applicable regulations. See Note 8 to the Company's consolidated financial statements included in Item 8 of this Report for actual and required capital ratios and for additional information regarding capital adequacy.

In July 2013, the two federal banking regulatory agencies that have authority to regulate the Company's capital resources and capital structure (the Board of Governors of the Federal Reserve System (FRB) and Federal Deposit Insurance Corporation (FDIC)) took action to finalize the application to the United States banking industry of new regulatory capital requirements that are established by the international banking framework commonly referred to as "Basel III" and to implement certain other changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. These rules make significant changes to the U.S. bank regulatory capital framework, and generally increase capital requirements for banking organizations. Although the Company believes that these new rules, as they are phased in over a multi-year period commencing January 1, 2015, will in general increase the amount of capital that the Company and the Bank may be required to maintain, the Company does not presently expect that any materially burdensome compliance efforts with these final capital rules will be required of the Company prior to January 1, 2015. For additional information, also see the discussion in Item 1 of this Report.

As of December 31, 2013, shareholders' equity increased by $15.1 million to $200.1 million compared with $185.0 million at year-end 2012. The increase in shareholders' equity was primarily attributable to an increase of $17.7 million in retained earnings and an increase of $12.9 million in common stock and additional paid in capital. The increase in common stock and paid in capital was primarily the result of shares issued in conjunction with the acquisition of United Commerce Bancorp. These increases were partially offset by a decline of $15.6 million in accumulated other comprehensive income primarily related to a decrease in the fair value of the Company's available-for-sale securities portfolio. Shareholders' equity represented 9.3% of total assets at December 31, 2013 and 9.2% of total assets at December 31, 2012. Shareholders' equity included $23.9 million of goodwill and other intangible assets at year-end 2013 compared to $21.6 million of goodwill and other intangible assets at December 31, 2012.

USES OF FUNDS

LOANS

December 31, 2013 loans outstanding increased approximately $177.3 million, or 15% from year-end 2012. The loans acquired from United Commerce Bancorp totaled approximately $76.9 million at year-end 2013. Commercial and industrial loans increased $15.6 million or 5%, commercial real estate loans increased $93.6 million or 19%, agricultural loans increased $13.0 million or 7%, consumer loans increased $15.1 million or 13%, and residential mortgage loans increased $40.1 million or 45% during 2013.

December 31, 2012 loans outstanding increased $84.4 million, or 8% from year-end 2011. The increase in loans during 2012 was broad based including commercial and industrial loans, commercial real estate loans and agricultural loans and with growth occurring across virtually the entire market area of the Company. Commercial and industrial loans increased $42.2 million, or 14%, commercial real estate loans increased $36.4 million, or 8%, agricultural loans increased $12.2 million, or 7%, and residential mortgage loans increased $2.5 million, or 3%, while consumer loans decreased $8.9 million or 7%.

The composition of the loan portfolio has remained relatively stable over the past several years including 2013. The portfolio is most heavily concentrated in commercial real estate loans at 42% of the portfolio. The Company's exposure to non-owner occupied commercial real estate was limited to 21% of the total loan portfolio at year-end 2013. The Company's commercial lending is extended to various industries, including hotel, agribusiness and manufacturing, as well as health care, wholesale, and retail services. The Company has only limited exposure in construction and development lending with this segment representing approximately 3% of the total loan portfolio.

Loan Portfolio (dollars in thousands)	December 31, 2013	 2012	 2011	 2010	 2009
Commercial and Industrial Loans and Leases	$350,955	$335,373	$293,172	$218,443	$188,962
Commercial Real Estate Loans	582,066	488,496	452,071	339,555	334,255
Agricultural Loans	192,880	179,906	167,693	165,166	156,845
Consumer Loans	130,628	115,540	124,479	118,244	114,736
Residential Mortgage Loans	128,683	88,586	86,134	77,310	84,677
Total Loans	1,385,212	1,207,901	1,123,549	918,718	879,475
Less: Unearned Income	(2,830)	(3,035)	(2,556)	(1,482)	(1,653)
Subtotal	1,382,382	1,204,866	1,120,993	917,236	877,822
Less: Allowance for Loan Losses	(14,584)	(15,520)	(15,312)	(13,317)	(11,016)
Loans, Net	$1,367,798	$1,189,346	$1,105,681	$903,919	$866,806
Ratio of Loans to Total Loans					
Commercial and Industrial Loans and Leases	25%	28%	26%	24%	21%
Commercial Real Estate Loans	42%	40%	40%	37%	38%
Agricultural Loans	14%	15%	15%	18%	18%
Consumer Loans	10%	10%	11%	13%	13%
Residential Mortgage Loans	9%	7%	8%	8%	10%
Total Loans	100%	100%	100%	100%	100%

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

The following table indicates the amounts of loans (excluding residential mortgages on 1-4 family residences and consumer loans) outstanding as of December 31, 2013, which, based on remaining scheduled repayments of principal, are due in the periods indicated (dollars in thousands).

	Within One Year	One to Five Years	After Five Years	Total

Commercial and Agricultural	$521,705	$ 514,308	$ 89,888	$1,125,901

	Interest Sensitivity	
	Fixed Rate	Variable Rate
Loans Maturing After One Year	$160,412	$ 443,784

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INVESTMENTS

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

Investment Portfolio, at Amortized Cost	December 31,					
(dollars in thousands)	2013	%	2012	%	2011	%
Federal Funds Sold and Other Short-term Investments	$22,762	3 %	$7,463	1 %	$32,737	6 %
U.S. Treasury and Agency Securities	20,000	3	23,570	4	6,340	1
Corporate Securities	—	—	—	—	1,003	n/m[1]
Obligations of State and Political Subdivisions	112,276	18	71,698	13	61,296	12
Mortgage-backed Securities - Residential	481,724	76	475,452	82	431,495	81
Equity Securities	353	**n/m**[1]	684	n/m[1]	684	n/m[1]
Total Securities Portfolio	$637,115	100 %	$578,867	100 %	$533,555	100 %

[1] n/m = not meaningful

The amortized cost of investment securities, including federal funds sold and short-term investments, increased $58.2 million at year-end 2013 compared with year-end 2012 and increased $45.3 million at year-end 2012 compared with year-end 2011. The largest concentration in the investment portfolio continues to be in mortgage related securities representing 76% of the total securities portfolio at December 31, 2013. The Company's level of obligations of state and political subdivisions increased to $112.3 million or 18% of the portfolio at December 31, 2013.

The Company's equity securities portfolio at year-end 2013 and 2012 consisted of non-controlling common stock investments in unaffiliated banking companies. The decline in 2013 compared with year-end 2012 in the equity securities portfolio was primarily the result of the acquisition of United Commerce Bancorp effective October 1, 2013 in which the Company had a non-controlling common stock investment prior to the acquisition.

Investment Securities, at Carrying Value

(dollars in thousands)

	December 31,		
Securities Held-to-Maturity	2013	2012	2011
Obligations of State and Political Subdivisions	$268	$346	$690
Securities Available-for-Sale			
U.S. Treasury and Agency Securities	$18,952	$23,472	$6,422
Corporate Securities	—	—	1,005
Obligations of State and Political Subdivisions	113,497	76,485	64,799
Mortgage-backed Securities - Residential	473,230	486,912	443,934
Equity Securities	353	733	684
Subtotal of Securities Available-for-Sale	606,032	587,602	516,844
Total Securities	$606,300	$587,948	$517,534

The Company’s $606.0 million available-for-sale portion of the investment portfolio provides an additional funding source for the liquidity needs of the Company’s subsidiaries and for asset/liability management requirements. Although management has the ability to sell these securities if the need arises, their designation as available-for-sale should not necessarily be interpreted as an indication that management anticipates such sales.

The amortized cost of both available for sale and held to maturity debt securities at December 31, 2013 are shown in the following table by expected maturity. Mortgage-backed securities are based on estimated average lives. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations. Equity securities do not have contractual maturities, and are excluded from the table below.

Maturities and Average Yields of Securities at December 31, 2013

(dollars in thousands)

	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
U.S. Treasury and Agency Securities	$—	N/A	$—	N/A	$ 20,000	1.30 %	$—	N/A
Obligations of State and Political Subdivisions	2,935	4.91 %	10,158	3.50 %	49,906	5.16 %	49,277	5.53 %
Mortgage-backed Securities - Residential	12,682	3.70 %	314,260	2.30 %	154,782	2.03 %	—	N/A
Total Securities	$ 15,617	3.93 %	$ 324,418	2.34 %	$ 224,688	2.66 %	$49,277	5.53 %

A tax-equivalent adjustment using a tax rate of 35 percent was used in the above table.

In addition to the other uses of funds discussed previously, the Company had certain long-term contractual obligations as of December 31, 2013. These contractual obligations primarily consisted of long-term borrowings with the Federal Home Loan Bank ("FHLB"), parent company term debt, and junior subordinated debentures assumed as a part of the American Community Bancorp, Inc. acquisition which was completed in 2011, time deposits, and lease commitments for certain office facilities. Scheduled principal payments on long-term borrowings, time deposits, and future minimum lease payments are outlined in the table below.

Contractual Obligations	Payments Due By Period				
(dollars in thousands)	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Long-term Borrowings	$ 83,507	$ 43,039	$ 24,087	$ 10,776	$ 5,605
Time Deposits	349,034	174,109	142,338	32,408	179
Capital Lease Obligation	8,658	495	990	960	6,213
Operating Lease Commitments	3,486	608	957	413	1,508
Total Contractual Obligations	$ 444,685	$ 218,251	$ 168,372	$ 44,557	$ 13,505

SOURCES OF FUNDS

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

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

Funding Sources - Average Balances (dollars in thousands)	December 31,			% Change From Prior Year	
	2013	2012	2011	2013	2012
Demand Deposits					
Non-interest-bearing	$355,841	$313,812	$256,544	13 %	22 %
Interest-bearing	534,095	512,232	478,486	4	7
Savings Deposits	134,283	116,515	95,748	15	22
Money Market Accounts	332,108	318,960	296,418	4	8
Other Time Deposits	223,239	255,722	285,564	(13)	(10)
Total Core Deposits	1,579,566	1,517,241	1,412,760	4	7
Certificates of Deposits of $100,000 or more and Brokered Deposits	116,230	101,471	108,444	15	(6)
FHLB Advances and Other Borrowings	136,569	118,201	126,922	16	(7)
Total Funding Sources	$1,832,365	$1,736,913	$1,648,126	5	5

Maturities of certificates of deposit of $100,000 or more and brokered deposits are summarized as follows:

(dollars in thousands)

	3 Months Or Less	3 Thru 6 Months	6 Thru 12 Months	Over 12 Months	Total
December 31, 2013	$ 44,574	$ 21,219	$ 20,443	$ 38,437	$124,673

CORE DEPOSITS

The Company’s overall level of average core deposits increased approximately $62.3 million, or 4%, during 2013 following a $104.5 million, or 7%, increase during 2012. During both 2013 and 2012, the increase in average core deposits came from across the Company’s branch network and market areas. The acquisition of United Community Bancorp, which occurred in the fourth quarter of 2013, had a relatively minor impact on the average core deposit balances.

The Company’s ability to attract core deposits continues to be influenced by competition and the interest rate environment, as well as the availability of alternative investment products. Core deposits continue to represent a significant funding source for the Company’s operations and represented 86% of average total funding sources during 2013 compared with 87% during 2012 and 86% during 2011.

Demand, savings, and money market deposits have provided a growing source of funding for the Company in each of the periods reported. Average demand, savings, and money market deposits increased 8% during 2013 following 12% growth during 2012. Average demand, savings, and money market deposits totaled $1.356 billion or 86% of core deposits (74% of total funding sources) in 2013 compared with $1.262 billion or 83% of core deposits (73% of total funding sources) in 2012 and $1.127 billion or 80% of core deposits (68% of total funding sources) in 2011.

Other time deposits consist of certificates of deposits in denominations of less than $100,000. These deposits declined by 13% during 2013 following a decrease of 10% in 2012. Other time deposits comprised 14% of core deposits in 2013, 17% in 2012 and 20% in 2011.

OTHER FUNDING SOURCES

Federal Home Loan Bank advances and other borrowings represent the Company's most significant source of other funding. Average borrowed funds increased $18.4 million, or 16%, during 2013 following a decline of $8.7 million, or 7% in 2012. Borrowings comprised approximately 7% of average total funding sources in 2013 and 2012 and 8% in 2011.

Certificates of deposits in denominations of $100,000 or more and brokered deposits are an additional source of other funding for the Company's bank subsidiary. Large denomination certificates and brokered deposits increased $14.8 million, or 15% during 2013 following a decrease of $7.0 million, or 6% during 2012. Large certificates and brokered deposits comprised approximately 6% of average total funding sources in 2013 and 2012 and 7% in 2011. This type of funding is used as both long-term and short-term funding sources.

The bank subsidiary of the Company also utilizes short-term funding sources from time to time. These sources consist of overnight federal funds purchased from other financial institutions, secured repurchase agreements that generally mature within one day of the transaction date, and secured overnight variable rate borrowings from the FHLB. These borrowings represent an important source of short-term liquidity for the Company's bank subsidiary. Long-term debt at the Company's bank subsidiary is in the form of FHLB advances, which are secured by the pledge of certain investment securities, residential and housing-related mortgage loans, and certain other commercial real estate loans. See Note 7 to the Company's consolidated financial statements included in Item 8 of this Report for further information regarding borrowed funds.

PARENT COMPANY FUNDING SOURCES

The parent company is a corporation separate and distinct from its bank and other subsidiaries. For information regarding the financial condition, result of operations, and cash flows of the Company, presented on a parent-company-only basis, see Note 16 to the Company's consolidated financial statements included in Item 8 of this Report.

The Company uses funds at the parent company level to pay dividends to its shareholders, to acquire or make other investments in other businesses or their securities or assets, to repurchase its stock from time to time, and for other general corporate purposes. The parent company does not have access at the parent-company level to the deposits and certain other sources of funds that are available to its bank subsidiary to support its operations. Instead, the parent company has historically derived most of its revenues from dividends paid to the parent company by its bank subsidiary. The Company's banking subsidiary is subject to statutory restrictions on its ability to pay dividends to the parent company. See Note 8, Shareholders' Equity, of the Notes to the Consolidated Financial Statements included in Item 8 of this Report, which is incorporated herein by reference. The parent company has in recent years supplemented the dividends received from its subsidiaries with borrowings, which are discussed in detail below.

At year-end 2013, the Company had an outstanding credit facility pursuant to which the parent company was obligated for a term loan made to the parent company in January 2013 in the original principal amount of $10 million, of which $7 million was outstanding as of year-end 2013. Of the remaining $7 million principal amount of the term loan (which may be prepaid at any time without premium or penalty), $3 million is payable on or before December 31, 2014 and the remaining $4 million of principal is due on or before the maturity of the Term Note on December 30, 2015. Interest is payable quarterly at a floating rate based upon 90-day LIBOR plus a margin.

The Company also has a $10 million revolving line of credit with the same lender that will mature on December 31, 2014. Borrowings are available for general working capital purposes from time to time; no borrowings have yet been made under the revolving line of credit. Quarterly interest payments calculated at the same floating rate as then in effect for the Term Note will be payable in respect of any principal amounts advanced under the revolving line of credit. There was no outstanding balance as of December 31, 2013.

Effective January 1, 2011, and as a result of the acquisition of American Community Bancorp, Inc., the Company assumed long-term debt obligations of American Community in the form of two junior subordinated debentures issued by American Community in the aggregate unpaid principal amount of approximately $8.3 million. The junior subordinated debentures were issued to certain statutory trusts established by American Community (in support of related issuances of trust preferred securities issued by those trusts) and both mature in single installments of principal payable in 2035, and bear interest payable on a quarterly basis at a floating rate, adjustable quarterly based on the 90-day LIBOR plus a specified percentage. These debentures are of a type that are eligible (under current regulatory capital requirements) to qualify as Tier 1 capital (with certain limitations) for regulatory purposes and as of December 31, 2013 approximately $4.9 million of the junior subordinated debentures were treated as Tier 1 capital for regulatory capital purposes.

See Note 7 to the Company’s consolidated financial statements included in Item 8 of this Report for further information regarding the parent company borrowed funds and other indebtedness.

RISK MANAGEMENT

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

LENDING AND LOAN ADMINISTRATION

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

The Company maintains an allowance for loan losses to cover probable, incurred credit losses identified during its loan review process. Management estimates the required level of allowance for loan losses using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed.

The allowance for loan losses is comprised of: (a) specific reserves on individual credits; (b) general reserves for certain loan categories and industries, and overall historical loss experience; and (c) unallocated reserves based on performance trends in the loan portfolios, current economic conditions, and other factors that influence the level of estimated probable losses. The need for specific reserves are considered for credits when: (a) the customer's cash flow or net worth appears insufficient to repay the loan; (b) the loan has been criticized in a regulatory examination; (c) the loan is on non-accrual; or, (d) other reasons where the ultimate collectability of the loan is in question, or the loan characteristics require special monitoring.

Allowance for Loan Losses (dollars in thousands)	Years Ended December 31,				
	2013	2012	2011	2010	2009
Balance of Allowance for Possible Losses at Beginning of Period	$15,520	$15,312	$13,317	$11,016	$9,522
Loans Charged-off:					
Commercial and Industrial Loans	503	162	1,513	345	941
Commercial Real Estate Loans	538	1,789	2,604	2,842	1,248
Agricultural Loans	—	—	—	44	—
Consumer Loans	607	380	575	465	640
Residential Mortgage Loans	24	199	497	518	345
Total Loans Charged-off	1,672	2,530	5,189	4,214	3,174
Recoveries of Previously Charged-off Loans:					
Commercial and Industrial Loans	128	74	98	24	—
Commercial Real Estate Loans	102	97	139	1,089	588
Agricultural Loans	—	—	—	—	17
Consumer Loans	148	125	131	171	192
Residential Mortgage Loans	8	30	16	6	121
Total Recoveries	386	326	384	1,290	918
Net Loans Recovered (Charged-off)	(1,286)	(2,204)	(4,805)	(2,924)	(2,256)
Additions to Allowance Charged to Expense	350	2,412	6,800	5,225	3,750
Balance at End of Period	$14,584	$15,520	$15,312	$13,317	$11,016
Net Charge-offs to Average Loans Outstanding	0.10 %	0.19 %	0.43 %	0.32 %	0.25 %
Provision for Loan Losses to Average Loans Outstanding	0.03 %	0.21 %	0.61 %	0.58 %	0.42 %
Allowance for Loan Losses to Total Loans at Year-end	1.05 %	1.29 %	1.37 %	1.45 %	1.25 %

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

Commercial and Industrial Loans	$3,983	$4,555	$3,493	$3,713	$2,146
Commercial Real Estate Loans	8,335	8,931	9,297	7,497	6,477
Agricultural Loans	946	989	926	750	872
Consumer Loans	427	355	448	582	520
Residential Mortgage Loans	281	186	402	543	545
Unallocated	612	504	746	232	456
Total Allowance for Loan Losses	$14,584	$15,520	$15,312	$13,317	$11,016

The Company's allowance for loan losses totaled $14.6 million at December 31, 2013 representing a decrease of $936,000 or 6% compared with year-end 2012. The significant contributing factors that led to the decrease of the allowance for loan losses included positive trends in the level of non-performing and adversely classified loans as well as a decline in the level of net-charge-offs in 2013 compared with 2012.

The allowance for loan losses represented 1.05% of period end loans at December 31, 2013 compared with 1.29% at December 31, 2012. Under acquisition accounting treatment, loans acquired are recorded at fair value which includes a credit risk component, and therefore the allowance on loans acquired is not carried over from the seller. The Company held a discount on acquired loans of $5.9 million (including $3.9 million attributable to the United Commerce acquisition) as of December 31, 2013 and $3.5 million at year-end 2012.

The allowance for loan loss at year-end 2013 represented 174% of non-performing loans compared to 150% at year-end 2012. Net charge-offs totaled $1.3 million or 0.10% of average loans during 2013 compared with net charge-offs of $2.2 million or 0.19% of average loans outstanding during 2012.

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

NON-PERFORMING ASSETS

Non-performing assets consist of: (a) non-accrual loans; (b) loans which have been renegotiated to provide for a reduction or deferral of interest or principal because of deterioration in the financial condition of the borrower; (c) loans past due 90 days or more as to principal or interest; and, (d) other real estate owned. Loans are placed on non-accrual status when scheduled principal or interest payments are past due for 90 days or more or when the borrower's ability to repay becomes doubtful. Uncollected accrued interest is reversed against income at the time a loan is placed on non-accrual. Loans are typically charged-off at 180 days past due, or earlier if deemed uncollectible. Exceptions to the non-accrual and charge-off policies are made when the loan is well secured and in the process of collection. The following table presents an analysis of the Company's non-performing assets.

Non-performing Assets	December 31,				
(dollars in thousands)	2013	2012	2011	2010	2009
Non-accrual Loans	$8,378	$10,357	$17,857	$10,150	$8,374
Past Due Loans (90 days or more)	8	—	—	671	113
Total Non-performing Loans	8,386	10,357	17,857	10,821	8,487
Other Real Estate	1,029	1,645	2,343	2,095	2,363
Total Non-performing Assets	$9,415	$12,002	$20,200	$12,916	$10,850
Restructured Loans	$2,418	$362	$409	$396	$306
Non-performing Loans to Total Loans	0.61 %	0.86 %	1.59 %	1.18 %	0.97 %
Allowance for Loan Losses to Non-performing Loans	173.91%	149.85%	85.75 %	123.07%	129.80%

Non-performing assets totaled $9.4 million or 0.44% of total assets at December 31, 2013 compared to $12.0 million or 0.60% of total assets at December 31, 2012. Non-performing loans totaled $8.4 million or 0.61% of total loans at December 31, 2013 representing a $2.0 million, or 19%, decline in non-performing loans compared to the $10.4 million of non-performing loans at December 31, 2012.

The improvement in non-performing loans was largely the result of the placement of a commercial and industrial loan to a mechanical contractor back into accrual status based on the performance of the loan and company over an extended period of time. This loan was restructured and placed into non-accrual status in a prior period. After upgrading, because the loan was previously restructured, the Company continues to carry this credit as a restructured loan at December 31, 2013. This resulted in the increase in restructured loans to $2.4 million at December 31, 2013 compared to $0.4 million at December 31, 2012.

Non-accrual commercial real estate loans totaled $6.7 million at December 31, 2013 representing a decline of $0.6 million, or 8%, from the $7.3 million of non-accrual commercial real estate loans at year-end 2012. Non-accrual commercial real estate loans represented 79% of the total non-performing loans at December 31, 2013 compared to 70% of total non-performing loans at year-end 2012. Non-accrual commercial and industrial loans totaled $0.03 million at December 31, 2013 representing a decrease of $2.4 million, or 99%, from the $2.5 million of non-accrual commercial and industrial loans at December 31, 2012. Non-accrual commercial and industrial loans represented less than 1% of the total non-performing loans at December 31, 2013 compared with 24% of total non-performing loans at year-end 2012. Non-accrual residential mortgage loans totaled $1.3 million at December 31, 2013 representing an increase of $1.1 million from the $0.2 million at year-end 2012. Non-accrual residential mortgage loans represented 16% of the total non-performing loans at December 31, 2013 compared to 2% of total non-performing loans at year-end 2012.

At December 31, 2013, two commercial loan relationships represented approximately 47% of the total non-performing loans of the Company and represented the only loan relationships greater than $1.0 million included in non-performing loans. The first relationship was a $2.1 million commercial real estate loan secured by various commercial real estate properties. This loan was in non-performing status as of December 31, 2012. The borrower has made all contractual payments due during 2013 and the principal balance of the loan was reduced by approximately $0.6 million during 2013. The second relationship was a $1.9 million commercial real estate loan secured by a commercial warehouse facility. This loan was in non-performing status as of year-end 2012. The borrower has made all contractual payments due during 2013 and the principal balance of this relationship was reduced by $0.09 million during 2013.

The Company purchases individual loans and groups of loans. Purchased loans that show evidence of credit deterioration since origination are recorded at the amount paid (or allocated fair value in a purchase business combination), such that there is no carryover of the seller’s allowance for loan losses. After acquisition, incurred losses are recognized by an increase in the allowance for loan losses.

Purchased loans that indicated evidence of credit deterioration since origination at the time of acquisition by the Company did not have a material adverse impact on the Company's key credit metrics during 2013 or 2012. The key credit metrics the Company measures generally include non-performing loans, past due loans, and adversely classified loans.

Non-performing purchased loans with evidence of credit deterioration since origination totaled $1,705,000 at December 31, 2013 compared with $148,000 at December 31, 2012. The non-performing purchased loans with evidence of credit deterioration since origination represented approximately 20% of total non-performing loans at December 31, 2013 compared with approximately 1% of total non-performing loans at December 31, 2012.

Past due purchased loans with evidence of credit deterioration since origination totaled $1,250,000 at December 31, 2013 and $118,000 at year-end 2012. Past due purchased loans with evidence of credit deterioration since origination represented approximately 16% of total past due loans at December 31, 2013 and approximately 1% of total past due loans at year-end 2012.

Adversely classified purchased loans with evidence of credit deterioration since origination totaled $9.0 million at December 31, 2013 compared with $7.3 million at December 31, 2012. Adversely classified purchased loans with evidence of credit deterioration since origination represented approximately 25% of total adversely classified loans at December 31, 2013 compared with approximately 19% of total adversely classified loans at year-end 2012.

Loan impairment is reported when full repayment under the terms of the loan is not expected. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate, or at the fair value of collateral if repayment is expected solely from the collateral. Commercial and industrial loans, commercial real estate loans, and agricultural loans are evaluated individually for impairment. Smaller balance homogeneous loans are evaluated for impairment in total. Such loans include real estate loans secured by one-to-four family residences and loans to individuals for household, family and other personal expenditures. Individually evaluated loans on non-accrual are generally considered impaired. Impaired loans, or portions thereof, are charged off when deemed uncollectible. The amount of loans individually evaluated for impairment including purchase credit impaired loans totaled $8.9 million at December 31, 2013. For additional detail on impaired loans, see Note 4 to the Company's consolidated financial statements included in Item 8 of this Report.

Interest income recognized on non-accrual loans for 2013 was $172,000. The gross interest income that would have been recognized in 2013 on non-performing loans if the loans had been current in accordance with their original terms was $675,000. Loans are typically placed on non-accrual status when scheduled principal or interest payments are past due for 90 days or more, unless the loan is well secured and in the process of collection.

LIQUIDITY AND INTEREST RATE RISK MANAGEMENT

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

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

OFF-BALANCE SHEET ARRANGEMENTS

The Company has no off-balance sheet arrangements other than stand-by letters of credit as disclosed in Note 13 to the Company’s consolidated financial statements included in Item 8 of this Report.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

The Company’s exposure to market risk is reviewed on a regular basis by the Asset/Liability Committee and Board of Directors. Primary market risks, which impact the Company’s operations, are liquidity risk and interest rate risk, as discussed above.

As discussed previously, the Company monitors interest rate risk by the use of computer simulation modeling to estimate the potential impact on its net interest income under various interest rate scenarios. Another method by which the Company’s interest rate risk position can be estimated is by computing estimated changes in its net portfolio value (“NPV”). This method estimates interest rate risk exposure from movements in interest rates by using interest rate sensitivity analysis to determine the change in the NPV of discounted cash flows from assets and liabilities. NPV represents the market value of portfolio equity and is equal to the estimated market value of assets minus the estimated market value of liabilities. Computations are based on a number of assumptions, including the relative levels of market interest rates and prepayments in mortgage loans and certain types of investments. These computations do not contemplate any actions management may undertake in response to changes in interest rates, and should not be relied upon as indicative of actual results. In addition, certain shortcomings are inherent in the method of computing NPV. Should interest rates remain or decrease below current levels, the proportion of adjustable rate loans could decrease in future periods due to refinancing activity. In the event of an interest rate change, prepayment levels would likely be different from those assumed in the table. Lastly, the ability of many borrowers to repay their adjustable rate debt may decline during a rising interest rate environment.

The following table provides an assessment of the risk to NPV in the event of sudden and sustained 1% and 2% increases and decreases in prevailing interest rates. The table indicates that as of December 31, 2013 the Company’s estimated NPV might be expected to decrease under either an increase or decrease of 2% in prevailing interest rates (dollars in thousands).

Interest Rate Sensitivity as of December 31, 2013

	Net Portfolio Value	Net Portfolio Value as a % of Present Value of Assets

Changes in Rates	Amount	**% Change**	NPV Ratio	Change
+2%	$191,689	(17.09)%	9.28%	**(139**) b.p.
+1%	211,987	(8.31)%	10.02%	**(65**) b.p.
Base	231,209	—	10.67%	—
-1%	219,248	(5.17)%	9.98%	**(69**) b.p.
-2%	207,280	(10.35)%	9.36%	**(131**) b.p.

The above discussion, and the portions of MANAGEMENT'S DISCUSSION AND ANALYSIS in Item 7 of this Report that are referenced in the above discussion contain statements relating to future results of the Company that are considered "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to, among other things, simulation of the impact on net interest income from changes in interest rates. Actual results may differ materially from those expressed or implied therein as a result of certain risks and uncertainties, including those risks and uncertainties expressed above, those that are described in MANAGEMENT'S DISCUSSION AND ANALYSIS in Item 7 of this Report, and those that are described in Item 1 of this Report, "Business," under the caption "Forward-Looking Statements and Associated Risks," which discussions are incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data.

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders

German American Bancorp, Inc.

Jasper, Indiana

We have audited the accompanying consolidated balance sheets of German American Bancorp, Inc. (the Company) as of December 31, 2013 and 2012 and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2013. We also have audited German American Bancorp, Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in the 1992 *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). German American Bancorp, Inc.'s management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

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

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

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of German American Bancorp, Inc. as of December 31, 2013 and 2012, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2013, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion German American Bancorp, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in the 1992 *Internal Control – Integrated Framework* issued by the COSO.

/s/ Crowe Horwath LLP
Crowe Horwath LLP

Indianapolis, Indiana

March 13, 2014

Consolidated Balance Sheets
Dollars in thousands, except per share data

	December 31,	
	2013	2012
ASSETS		
Cash and Due from Banks	$37,370	$41,624
Federal Funds Sold and Other Short-term Investments	22,762	7,463
Cash and Cash Equivalents	60,132	49,087
Interest-bearing Time Deposits with Banks	100	2,707
Securities Available-for-Sale, at Fair Value	606,032	587,602
Securities Held-to-Maturity, at Cost (Fair value of $271 and $351 on December 31, 2013 and 2012, respectively)	268	346
Loans Held-for-Sale, at Fair Value	9,265	16,641
Loans	1,385,212	1,207,901
Less: Unearned Income	(2,830)	(3,035)
Allowance for Loan Losses	(14,584)	(15,520)
Loans, Net	1,367,798	1,189,346
Stock in FHLB of Indianapolis and Other Restricted Stock, at Cost	9,004	8,340
Premises, Furniture and Equipment, Net	40,430	36,554
Other Real Estate	1,029	1,645
Goodwill	20,536	18,865
Intangible Assets	3,328	2,692
Company Owned Life Insurance	31,178	30,223
Accrued Interest Receivable and Other Assets	14,727	62,252
TOTAL ASSETS	$2,163,827	$2,006,300
LIABILITIES		
Non-interest-bearing Demand Deposits	$400,024	$349,174
Interest-bearing Demand, Savings, and Money Market Accounts	1,063,098	962,574
Time Deposits	349,034	329,183
Total Deposits	1,812,156	1,640,931
FHLB Advances and Other Borrowings	140,770	161,006
Accrued Interest Payable and Other Liabilities	10,804	19,337
TOTAL LIABILITIES	1,963,730	1,821,274
Commitments and Contingencies (Note 13)		

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	13,174	12,637
Additional Paid-in Capital	108,022	95,617
Retained Earnings	84,164	66,421
Accumulated Other Comprehensive Income (Loss)	(5,263)	10,351
TOTAL SHAREHOLDERS' EQUITY	200,097	185,026
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$2,163,827	$2,006,300
End of period shares issued and outstanding	13,173,793	12,636,656

See accompanying notes to consolidated financial statements.

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

	Years Ended December 31,		
	2013	2012	2011
INTEREST INCOME			
Interest and Fees on Loans	$61,632	$61,691	$64,445
Interest on Federal Funds Sold and Other Short-term Investments	30	91	216
Interest and Dividends on Securities:			
Taxable	11,091	12,946	13,677
Non-taxable	2,919	2,432	1,823
TOTAL INTEREST INCOME	75,672	77,160	80,161
INTEREST EXPENSE			
Interest on Deposits	4,697	6,958	11,986
Interest on FHLB Advances and Other Borrowings	2,458	3,954	4,194
TOTAL INTEREST EXPENSE	7,155	10,912	16,180
NET INTEREST INCOME	68,517	66,248	63,981
Provision for Loan Losses	350	2,412	6,800
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	68,167	63,836	57,181
NON-INTEREST INCOME			
Trust and Investment Product Fees	3,358	2,657	2,145
Service Charges on Deposit Accounts	4,144	4,076	4,154
Insurance Revenues	6,217	5,524	5,819
Company Owned Life Insurance	965	974	1,100
Interchange Fee Income	1,854	1,724	1,501
Other Operating Income	2,003	1,955	1,452
Net Gains on Sales of Loans	2,645	3,234	2,381
Net Gain on Securities	2,429	1,667	3,024
TOTAL NON-INTEREST INCOME	23,615	21,811	21,576
NON-INTEREST EXPENSE			
Salaries and Employee Benefits	31,482	29,086	27,992
Occupancy Expense	4,545	4,277	4,264
Furniture and Equipment Expense	3,196	2,787	2,934

FDIC Premiums	1,050	1,116	1,473
Data Processing Fees	1,765	1,071	2,092
Professional Fees	2,577	2,247	2,056
Advertising and Promotion	1,863	1,714	1,525
Intangible Amortization	1,416	1,655	1,956
Other Operating Expenses	7,011	6,970	6,490
TOTAL NON-INTEREST EXPENSE	54,905	50,923	50,782
Income before Income Taxes	36,877	34,724	27,975
Income Tax Expense	11,464	10,669	7,726
NET INCOME	$25,413	$24,055	$20,249
Basic Earnings per Share	$1.99	$1.91	$1.61
Diluted Earnings per Share	$1.98	$1.90	$1.61

See accompanying notes to consolidated financial statements

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

	Years Ended December 31,		
	2013	2012	2011
NET INCOME	$25,413	$24,055	$20,249
Other Comprehensive Income (Loss):			
Unrealized Gains (Losses) on Securities			
Unrealized Holding Gain (Loss) Arising During the Period	(22,169)	1,495	11,830
Reclassification Adjustment for Losses (Gains) Included in Net Income	(2,429)	(1,667)	(3,024)
Tax Effect	8,724	48	(3,129)
Net of Tax	(15,874)	(124)	5,677
Defined Benefit Pension Plans			
Net (Loss) Gain Arising During the Period	749	(155)	14
Reclassification Adjustment for Amortization of Prior Service Cost and Net (Gain) Loss Included in Net Periodic Pension Cost	(373)	78	(7)
Tax Effect	(145)	30	(3)
Net of Tax	231	(47)	4
Postretirement Benefit Obligation			
Net (Loss) Gain Arising During the Period	80	(79)	(122)
Reclassification Adjustment for Amortization of Prior Service Cost and Net (Gain) Loss Included in Net Periodic Pension Cost	(37)	42	57
Tax Effect	(14)	16	27
Net of Tax	29	(21)	(38)
Total Other Comprehensive Income (Loss)	(15,614)	(192)	5,643
COMPREHENSIVE INCOME	$9,799	$23,863	$25,892

See accompanying notes to consolidated financial statements.

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

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances, January 1, 2011	11,105,583	$11,105	$69,297	$36,232	$ 4,900	$ 121,534
Net Income				20,249		20,249
Other Comprehensive Income (Loss)					5,643	5,643
Cash Dividends ($.56 per share)				(7,047)		(7,047)
Issuance of Common Stock for:						
Exercise of Stock Options	1,652	2	10			12
Acquisition of American Community Bancorp, Inc.	1,448,520	1,449	25,123			26,572
Restricted Share Grants	38,503	38	597			635
Employee Stock Purchase Plan			(25)			(25)
Income Tax Benefit From Restricted Share Grant			37			37
Balances, December 31, 2011	12,594,258	12,594	95,039	49,434	10,543	167,610
Net Income				24,055		24,055
Other Comprehensive Income (Loss)					(192)	(192)
Cash Dividends ($.56 per share)				(7,068)		(7,068)
Issuance of Common Stock for:						
Exercise of Stock Options	7,278	8	29			37
Restricted Share Grants	35,120	35	593			628
Employee Stock Purchase Plan			(67)			(67)
Income Tax Benefit From Restricted Share Grant			23			23
Balances, December 31, 2012	12,636,656	12,637	95,617	66,421	10,351	185,026
Net Income				25,413		25,413
Other Comprehensive Income (Loss)					(15,614)	(15,614)
Cash Dividends ($.60 per share)				(7,670)		(7,670)
Issuance of Common Stock for:						
Exercise of Stock Options	1,999	2	18			20
Acquisition of United Commerce Bancorp	502,560	503	12,071			12,574
Restricted Share Grants	32,578	32	297			329
Employee Stock Purchase Plan			(9)			(9)
			28			28

Income Tax Benefit From Restricted Share Grant						
Balances, December 31, 2013	13,173,793	$13,174	$108,022	$84,164	$ (5,263)	$ 200,097

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Cash Flows
Dollars in thousands

	Years Ended December 31,		
CASH FLOWS FROM OPERATING ACTIVITIES	2013	2012	2011
Net Income	$25,413	$24,055	$20,249
Adjustments to Reconcile Net Income to Net Cash from Operating Activities:			
Net Amortization on Securities	2,875	4,567	2,509
Depreciation and Amortization	4,461	4,688	5,139
Loans Originated for Sale	(158,845)	(181,993)	(143,738)
Proceeds from Sales of Loans Held-for-Sale	169,242	189,984	136,364
Loss in Investment in Limited Partnership	—	—	20
Provision for Loan Losses	350	2,412	6,800
Gain on Sale of Loans, net	(2,645)	(3,234)	(2,381)
Gain on Securities, net	(2,429)	(1,667)	(3,024)
Loss (Gain) on Sales of Other Real Estate and Repossessed Assets	291	(221)	165
Loss (Gain) on Disposition and Impairment of Premises and Equipment	(70)	(1)	28
Post Retirement Medical Benefit	17	31	—
Other-than-temporary Impairment on Securities	—	—	110
Increase in Cash Surrender Value of Company Owned Life Insurance	(955)	(960)	(1,107)
Equity Based Compensation	329	628	635
Excess Tax Benefit from Restricted Share Grant	(28)	(23)	(37)
Change in Assets and Liabilities:			
Interest Receivable and Other Assets	6,016	3,433	5,020
Interest Payable and Other Liabilities	(2,376)	298	(136)
Net Cash from Operating Activities	41,646	41,997	26,616
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from Maturity of Other Short-term Investments	2,690	3,236	6,223
Proceeds from Maturities, Calls, Redemptions of Securities Available-for-Sale	136,173	143,253	99,272
Redemption of Federal Reserve Bank Stock	—	—	694
Proceeds from Sales of Securities Available-for-Sale	162,344	92,344	20,061
Purchase of Securities Available-for-Sale	(271,218)	(312,063)	(296,547)
Proceeds from Maturities of Securities Held-to-Maturity	78	344	915
Proceeds from Redemption of Federal Home Loan Bank Stock	—	—	1,523
Purchase of Loans	(744)	—	—
Proceeds from Sales of Loans	3,250	9,560	3,364
Loans Made to Customers, net of Payments Received	(102,722)	(98,620)	3,498
Proceeds from Sales of Other Real Estate	2,081	3,899	4,231
Property and Equipment Expenditures	(3,659)	(3,617)	(3,965)
Proceeds from Sales of Property and Equipment	88	1	12
Acquire Capitalized Lease	(1,455)	—	(7)
Acquisition of United Commerce Bank	5,858	—	—
Acquisition of American Community Bancorp, Inc.	—	—	55,780
Net Cash from Investing Activities	(67,236)	(161,663)	(104,946)

CASH FLOWS FROM FINANCING ACTIVITIES			
Change in Deposits	64,645	84,779	166,416
Change in Short-term Borrowings	(18,000)	31,515	(32,682)
Advances in Long-term Debt	47,000	20,000	—
Repayments of Long-term Debt	(49,379)	(21,569)	(6,549)
Issuance of Common Stock	20	37	12
Income Tax Benefit from Restricted Share Grant	28	23	37
Employee Stock Purchase Plan	(9)	(67)	(25)
Dividends Paid	(7,670)	(7,068)	(7,047)
Net Cash from Financing Activities	36,635	107,650	120,162
Net Change in Cash and Cash Equivalents	11,045	(12,016)	41,832
Cash and Cash Equivalents at Beginning of Year	49,087	61,103	19,271
Cash and Cash Equivalents at End of Year	$60,132	$49,087	$61,103
Cash Paid During the Year for			
Interest	$7,653	$11,521	$16,577
Income Taxes	10,268	8,990	6,693
Supplemental Non Cash Disclosures (See Note 17 for Business Combinations)			
Loans Transferred to Other Real Estate	$851	$2,980	$3,492
Securities Transferred to Accounts Receivable	—	45,803	43,167
Accounts Receivable Transferred to Securities	(45,803)	(43,167)	—

See accompanying notes to consolidated financial statements.

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

NOTE 1 – Summary of Significant Accounting Policies

Description of Business and Basis of Presentation

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

Securities

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

Premium amortization is deducted from, and discount accretion is added to, interest income using the level yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Gains and losses on sales are recorded on trade date and are computed on the identified securities method.

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

Loans Held for Sale

Mortgage loans originated and intended for sale in the secondary market are carried at fair value. Fair value is determined based on collateral value and prevailing market prices for loans with similar characteristics. Net unrealized gains or losses are recorded through earnings.

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

Loans

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

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

NOTE 1 – Summary of Significant Accounting Policies (continued)

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

Certain Purchased Loans

The Company purchases individual loans and groups of loans. Purchased loans that show evidence of credit deterioration since origination are recorded at the amount paid (or allocated fair value in a purchase business combination), such that there is no carryover of the seller's allowance for loan losses. After acquisition, incurred losses are recognized by an increase in the allowance for loan losses.

Such purchased loans are accounted for individually. The Company estimates the amount and timing of expected cash flows for each purchased loan or pool, and the expected cash flows in excess of amount paid is recorded as interest income over the remaining life of the loan or pool (accretable yield). The excess of the loan's or pool's contractual principal and interest over expected cash flows is not recorded (nonaccretable difference).

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

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off. The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or special mention. The general component covers non-classified loans and is based on historical loss experience adjusted for current factors. For 2012 and 2011, the Company utilized a 4 quarter rolling historical loan loss average. Beginning in 2013, management deemed a rolling 12 quarter historical loan loss average to be more indicative of the inherent losses in the Company's loan portfolio in the current economic environment than the 4 quarter average. As the Company continues to monitor the current portfolio, the methodology could change in the future.

Loan impairment is reported when full repayment under the terms of the loan is not expected. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate, or at the fair value of collateral if repayment is expected solely from the collateral. Commercial and industrial loans, commercial real estate loans, and agricultural loans are evaluated individually for impairment. Smaller balance homogeneous loans are evaluated for impairment in total. Such loans include real estate loans secured by one-to-four family residences and loans to individuals for household, family and other personal expenditures. Individually evaluated loans on non-accrual are generally considered impaired. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

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

NOTE 1 – Summary of Significant Accounting Policies (continued)

The general component covers non-impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and risk classifications and is based on the actual loss history experienced by the Company over the most recent twelve quarters. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. The following portfolio segments have been identified: Commercial Loans and Retail Loans. Commercial Loans have been classified according to the following risk characteristics: Commercial and Industrial Loans and Leases, Commercial Real Estate, and Agricultural Loans. Commercial and Industrial loans are primarily based on the cash flows of the business operations and secured by assets being financed and other assets such as accounts receivable and inventory. Commercial Real Estate Loans and Agricultural Loans are primarily based on cash flow of the borrower and their business and further secured by real estate. All types of commercial and agricultural (real estate secured and non-real estate) may also come with personal guarantees of the borrowers and business owners. Retail Loans have been classified according to the following risk characteristics: Home Equity Loans, Consumer Loans and Residential Mortgage Loans. Retail loans are generally dependent on personal income of the customer, and repayment is dependent on borrower's personal cash flow and employment status which can be affected by general economic conditions. Additionally, collateral values may fluctuate based on the impact of economic conditions on residential real estate values and other consumer type assets such as automobiles.

Loans or portions of loans shall be charged off when there is a distinct probability of loss identified. A distinct probability of loss exists when it has been determined that any remaining sources of repayment are insufficient to cover all outstanding principal. The probable loss is immediately calculated based on the value of the remaining sources of repayment and charged to the allowance for loan loss.

Federal Home Loan Bank (FHLB) Stock

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

Premises, Furniture and Equipment

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

Other Real Estate

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

Goodwill and Other Intangible Assets

Goodwill resulting from business combinations prior to January 1, 2009 represents the excess of the purchase price over the fair value of the net assets of businesses acquired. Goodwill resulting from business combinations after January 1, 2009, is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually. The Company has selected December 31 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on the Company’s balance sheet.

Other intangible assets consist of core deposit and acquired customer relationship intangible assets. They are initially measured at fair value and then are amortized over their estimated useful lives, which range from 6 to 10 years.

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

NOTE 1 – Summary of Significant Accounting Policies (continued)

Company Owned Life Insurance

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

Loss Contingencies

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

Loan Commitments and Related Financial Instruments

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

Restrictions on Cash

At December 31, 2013 and 2012, respectively, the Company was required to have $7,431 and $10,752 on deposit with the Federal Reserve, or as cash on hand.

Long-term Assets

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

Stock Based Compensation

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

Comprehensive Income

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

Income Taxes

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

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

Retirement Plans

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

Earnings Per Share

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

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

NOTE 1 – Summary of Significant Accounting Policies (continued)

Cash Flow Reporting

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

Fair Values of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 14. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

New Accounting Pronouncements

In February 2013, the FASB issued an update (ASU No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income) impacting FASB ASC 220, Comprehensive Income. This update requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income. An entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about these amounts. This update became effective for the Company for interim and annual periods beginning after December 15, 2012 and did not have a material impact on the consolidated financial statements.

NOTE 2 – Securities

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

Securities Available-for-Sale:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2013				
U.S. Treasury and Agency Securities	$ 20,000	$ —	$ (1,048)	$ 18,952
Obligations of State and Political Subdivisions	112,008	2,388	(899)	113,497
Mortgage-backed Securities – Residential	481,724	3,497	(11,991)	473,230
Equity Securities	353	—	—	353
Total	$ 614,085	$ 5,885	$ (13,938)	$ 606,032
2012				
U.S. Treasury and Agency Securities	$ 23,570	$ 40	$ (138)	$ 23,472
Obligations of State and Political Subdivisions	71,352	5,145	(12)	76,485
Mortgage-backed Securities - Residential	475,452	11,505	(45)	486,912
Equity Securities	684	49	—	733
Total	$ 571,058	$ 16,739	$ (195)	$ 587,602

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

Securities Held-to-Maturity:	Carrying Amount	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
2013				
Obligations of State and Political Subdivisions	$ 268	$ 3	$ —	$ 271
2012				
Obligations of State and Political Subdivisions	$ 346	$ 5	$ —	$ 351

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

NOTE 2 – Securities (continued)

The amortized cost and fair value of Securities at December 31, 2013 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	$ 2,935	$ 2,996
Due after one year through five years	9,890	10,038
Due after five years through ten years	69,906	69,802
Due after ten years	49,277	49,613
Mortgage-backed Securities - Residential	481,724	473,230
Equity Securities	353	353
Total	$ 614,085	$ 606,032

	Carrying Amount	Fair Value
Securities Held-to-Maturity:		
Due in one year or less	$ —	$ —
Due after one year through five years	268	271
Due after five years through ten years	—	—
Due after ten years	—	—
Total	$ 268	$ 271

Proceeds from the Sales of Securities are summarized below:

	2013 Available-for-Sale	2012 Available-for-Sale	2011 Available-for-Sale
Proceeds from Sales	$ 162,344	$ 92,344	$ 20,061
Gross Gains on Sales	2,086	1,667	2,089
Income Taxes on Gross Gains	730	583	721

The Company held a minority interest in United Commerce Bancorp prior to the acquisition on October 1, 2013. For the year ended December 31, 2013, the Company recognized a gain of $343 on the stock held of United Commerce Bancorp as a result of the acquisition.

The Company held a minority interest in American Community Bancorp, Inc. prior to the acquisition on January 1, 2011. For the year ended December 31, 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.

The carrying value of securities pledged to secure repurchase agreements, public and trust deposits, and for other purposes as required by law was $141,240 and $61,744 as of December 31, 2013 and 2012, respectively.

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

NOTE 2 – Securities (continued)

Below is a summary of securities with unrealized losses as of year-end 2013 and 2012, 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 December 31, 2013						
U.S. Treasury and Agency Securities	$ 18,952	$ (1,048)	$ —	$ —	$ 18,952	$ (1,048)
Obligations of State and Political Subdivisions	38,878	(899)	—	—	38,878	(899)
Mortgage-backed Securities - Residential	346,028	(11,903)	1,735	(88)	347,763	(11,991)
Equity Securities	—	—	—	—	—	—
Total	$ 403,858	$ (13,850)	$ 1,735	$ (88)	$ 405,593	$ (13,938)

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
At December 31, 2012						
U.S. Treasury and Agency Securities	$ 19,862	$ (138)	$ —	$ —	$ 19,862	$ (138)
Obligations of State and Political Subdivisions	1,042	(12)	—	—	1,042	(12)
Mortgage-backed Securities - Residential	18,323	(45)	—	—	18,323	(45)
Equity Securities	—	—	—	—	—	—
Total	$ 39,227	$ (195)	$ —	$ —	$ 39,227	$ (195)

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 doesn't 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’s equity securities consist of non-controlling investments in other banking organizations. When a decline in fair value below cost is deemed to be other-than-temporary, the unrealized loss must be recognized as a charge to earnings. At December 31, 2013 and 2012, none of the Company’s equity securities had an unrealized loss.

NOTE 3 – Derivatives

The Company executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. The notional amounts of these interest rate swaps and the offsetting counterparty derivative instruments were $17.9 million and $6.1 million at December 31, 2013 and 2012, respectively. These interest rate swaps are simultaneously hedged by offsetting interest rate swaps that the Company executes with a third party, such that the Company minimizes its net risk exposure resulting from such transactions with approved, reputable, independent counterparties with substantially matching terms. The agreements are considered stand alone derivatives and changes in the fair value of derivatives are reported in earnings as non-interest income.

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

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

NOTE 3 – Derivatives (continued)

The following table reflects the fair value hedges included in the Consolidated Balance Sheets as of December 31:

	2013 Notional Amount	Fair Value	2012 Notional Amount	Fair Value
Included in Other Assets:				
Interest Rate Swaps	$17,853	$ 866	$6,051	$ 187
Included in Other Liabilities:				
Interest Rate Swaps	$17,853	$ 737	$6,051	$ 178

The following tables present the effect of derivative instruments on the Consolidated Statement of Income for the years ended December 31, 2013, 2012 and 2011 are as follows:

	2013	2012	2011
Interest Rate Swaps:			
Included in Interest Income / (Expense)	$—	$—	$ —
Included in Other Income / (Expense)	528	163	—

NOTE 4 – Loans

Loans were comprised of the following classifications at December 31:

	2013	2012
Commercial:		
Commercial and Industrial Loans and Leases	$350,955	$335,373
Commercial Real Estate Loans	582,066	488,496
Agricultural Loans	192,880	179,906
Retail:		
Home Equity Loans	81,504	74,437
Consumer Loans	49,124	41,103

Residential Mortgage Loans	128,683	88,586
Subtotal	1,385,212	1,207,901
Less: Unearned Income	(2,830)	(3,035)
Allowance for Loan Losses	(14,584)	(15,520)
Loans, net	$1,367,798	$1,189,346

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

NOTE 4 – Loans (continued)

The following tables present the activity in the allowance for loan losses by portfolio class for the years ended December 31, 2013, 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
December 31, 2013								
Beginning Balance	$ 4,555	$ 8,931	$ 989	$ 141	$ 214	$ 186	$ 504	$ 15,520
Provision for Loan Losses	(197)	(160)	(43)	419	112	111	108	350
Recoveries	128	102	—	—	148	8	—	386
Loans Charged-off	(503)	(538)	—	(321)	(286)	(24)	—	(1,672)
Ending Balance	$ 3,983	$ 8,335	$ 946	$ 239	$ 188	$ 281	$ 612	$ 14,584

	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated	Total
December 31, 2012								
Beginning Balance	$ 3,493	$ 9,297	$ 926	$ 258	$ 190	$ 402	$ 746	$ 15,312
Provision for Loan Losses	1,150	1,326	63	(32)	194	(47)	(242)	2,412
Recoveries	74	97	—	2	123	30	—	326
Loans Charged-off	(162)	(1,789)	—	(87)	(293)	(199)	—	(2,530)
Ending Balance	$ 4,555	$ 8,931	$ 989	$ 141	$ 214	$ 186	$ 504	$ 15,520

	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated	Total
December 31, 2011								
Beginning Balance	$ 3,713	$ 7,497	$ 750	$ 220	$ 362	$ 543	$ 232	$ 13,317

Provision for Loan Losses	1,195	4,265	176	287	23	340	514	6,800
Recoveries	98	139	—	6	125	16	—	384
Loans Charged-off	(1,513)	(2,604)	—	(255)	(320)	(497)	—	(5,189)
Ending Balance	$ 3,493	$ 9,297	$ 926	$ 258	$ 190	$ 402	$ 746	$ 15,312

In determining the adequacy of the allowance for loan loss, general allocations are made for pools of loans, including non-classified loans, homogeneous portfolios of consumer and residential real estate loans, and loans within certain industry categories believed to present unique risk of loss. General allocations of the allowance are primarily made based on a three-year historical average for loan losses for these portfolios, judgmentally adjusted for current economic factors and portfolio trends. For 2012 and 2011, the Company utilized a 4 quarter rolling historical loan loss average. Beginning in 2013, management deemed a rolling 12 quarter historical loan loss average to be more indicative of the inherent losses in the Company's loan portfolio in the current economic environment than the 4 quarter average. This change in methodology resulted in an increase to the required loan loss allowance of approximately $280 in 2013.

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

NOTE 4 – Loans (continued)

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

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio class and based on impairment method as of December 31, 2013 and 2012:

December 31, 2013	Total	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Unallocated
Allowance for Loan Losses:								
Ending Allowance Balance Attributable to Loans:								
Individually Evaluated for Impairment	$3,095	$45	$3,050	$—	$—	$—	$—	$ —
Collectively Evaluated for Impairment	11,481	3,938	5,277	946	239	188	281	612
Acquired with Deteriorated Credit Quality	8	—	8	—	—	—	—	—
Total Ending Allowance Balance	$14,584	$3,983	$8,335	$946	$239	$188	$281	$ 612

Loans:

Loans Individually Evaluated for Impairment	$8,458	$2,114	$6,344	$—	$—	$—	$—	$ —
Loans Collectively Evaluated for Impairment	1,367,591	347,808	566,389	195,171	81,812	49,131	127,280	—
Loans Acquired with Deteriorated Credit Quality	14,753	1,981	10,871	—	—	134	1,767	—
Total Ending Loans Balance (1)	$1,390,802	$351,903	$583,604	$195,171	$81,812	$49,265	$129,047	$ —

(1) Total recorded investment in loans includes $5,590 in accrued interest.

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

NOTE 4 – Loans (continued)

December 31, 2012	Total	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	**Residential** Mortgage Loans	Unallocated
Allowance for Loan Losses:								
Ending Allowance Balance Attributable to Loans:								
Individually Evaluated for Impairment	$ 5,323	$ 1,279	$ 3,894	$ 150	$—	$—	$—	$ —
Collectively Evaluated for Impairment	10,109	3,208	5,017	839	141	214	186	504
Acquired with Deteriorated Credit Quality	88	68	20	—	—	—	—	—
Total Ending Allowance Balance	$ 15,520	$ 4,555	$ 8,931	$ 989	$ 141	$ 214	$ 186	$ 504
Loans:								
Loans Individually Evaluated for Impairment	$ 12,520	$ 2,547	$ 7,550	$ 2,423	$—	$—	$—	$ —
Loans Collectively Evaluated for Impairment	1,189,729	331,920	473,209	180,152	74,699	41,083	88,666	—
Loans Acquired with Deteriorated Credit Quality	11,174	1,840	9,037	—	—	148	149	—
Total Ending Loans Balance [1]	$ 1,213,423	$ 336,307	$ 489,796	$ 182,575	$ 74,699	$ 41,231	$ 88,815	$ —

[1] Total recorded investment in loans includes $5,522 in accrued interest.

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2013 and 2012:

	Unpaid Principal **Balance**[(1)]	Recorded Investment	Allowance for Loan Losses Allocated
December 31, 2013			
With No Related Allowance Recorded:			
Commercial and Industrial Loans and Leases	$ 2,163	$ 2,072	$ —
Commercial Real Estate Loans	4,710	2,383	—
Agricultural Loans	—	—	—
Subtotal	6,873	4,455	—
With An Allowance Recorded:			
Commercial and Industrial Loans and Leases	45	45	45
Commercial Real Estate Loans	4,428	4,417	3,058
Agricultural Loans	—	—	—
Subtotal	4,473	4,462	3,103
Total	$ 11,346	$ 8,917	$ 3,103
Loans Acquired With Deteriorated Credit Quality With No Related Allowance Recorded (Included in the Total Above)	$ 987	$ 451	$ —
Loans Acquired With Deteriorated Credit Quality With An Additional Allowance Recorded (Included in the Total Above)	$ 33	$ 8	$ 8

[(1)] Unpaid Principal Balance is the remaining contractual payments inclusive of partial charge-offs.

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

NOTE 4 – Loans (continued)

	Unpaid Principal **Balance**[(1)]	Recorded Investment	Allowance for Loan Losses Allocated
December 31, 2012			
With No Related Allowance Recorded:			
Commercial and Industrial Loans and Leases	$ 108	$ 87	$ —
Commercial Real Estate Loans	4,312	2,154	—
Agricultural Loans	2,126	2,137	—
Subtotal	6,546	4,378	—
With An Allowance Recorded:			
Commercial and Industrial Loans and Leases	2,642	2,581	1,347
Commercial Real Estate Loans	5,579	5,418	3,914
Agricultural Loans	285	286	150
Subtotal	8,506	8,285	5,411
Total	$ 15,052	$ 12,663	$ 5,411
Loans Acquired With Deteriorated Credit Quality With No Related Allowance Recorded (Included in the Total Above)	$ 45	$ 25	$ —
Loans Acquired With Deteriorated Credit Quality With An Additional Allowance Recorded (Included in the Total Above)	$ 155	$ 118	$ 88

(1) Unpaid Principal Balance is the remaining contractual payments inclusive of partial charge-offs.

The following table presents loans individually evaluated for impairment by class of loans for the years ended December 31, 2013 and 2012:

	Average Recorded Investment	Interest Income Recognized	Cash Basis Recognized
December 31, 2013			
With No Related Allowance Recorded:			
Commercial and Industrial Loans and Leases	$ 1,192	$ 65	$ 65
Commercial Real Estate Loans	2,251	5	7
Agricultural Loans	1,420	209	225

Subtotal	4,863	279	297
With An Allowance Recorded:			
Commercial and Industrial Loans and Leases	1,360	3	3
Commercial Real Estate Loans	5,424	22	18
Agricultural Loans	—	—	—
Subtotal	6,784	25	21
Total	$ 11,647	$ 304	$ 318
Loans Acquired With Deteriorated Credit Quality With No Related Allowance Recorded (Included in the Total Above)	$ 30	$ 3	$ 3
Loans Acquired With Deteriorated Credit Quality With An Additional Allowance Recorded (Included in the Total Above)	$ 142	$ 2	$ 2

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

NOTE 4 – Loans (continued)

	Average Recorded Investment	Interest Income Recognized	Cash Basis Recognized
December 31, 2012			
With No Related Allowance Recorded:			
Commercial and Industrial Loans and Leases	$ 252	$ 3	$ 3
Commercial Real Estate Loans	4,506	18	18
Agricultural Loans	535	2	2
Subtotal	5,293	23	23
With An Allowance Recorded:			
Commercial and Industrial Loans and Leases	2,726	9	8
Commercial Real Estate Loans	6,660	23	19
Agricultural Loans	74	—	—
Subtotal	9,460	32	27
Total	$ 14,753	$ 55	$ 50
Loans Acquired With Deteriorated Credit Quality With No Related Allowance Recorded (Included in the Total Above)	$ 26	$ 2	$ 2
Loans Acquired With Deteriorated Credit Quality With An Additional Allowance Recorded (Included in the Total Above)	$ 154	$ 6	$ 4

	Average Recorded Investment	Interest Income Recognized	Cash Basis Recognized
December 31, 2011			
With No Related Allowance Recorded:			
Commercial and Industrial Loans and Leases	$ 1,107	$ 9	$ 9
Commercial Real Estate Loans	4,438	75	75
Agricultural Loans	19	6	6
Subtotal	5,564	90	90
With An Allowance Recorded:			
Commercial and Industrial Loans and Leases	3,642	11	11
Commercial Real Estate Loans	9,390	37	34
Agricultural Loans	—	—	—
Subtotal	13,032	48	45
Total	$ 18,596	$ 138	$ 135
Loans Acquired With Deteriorated Credit Quality With No Related Allowance Recorded (Included in the Total Above)	$ 28	$ 4	$ 4

Loans Acquired With Deteriorated Credit Quality With An Additional Allowance Recorded (Included in the Total Above)	$ 77	$ 1	$ 1

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

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

NOTE 4 – Loans (continued)

The following table presents the recorded investment in non-accrual loans and loans past due 90 days or more still on accrual by class of loans as of December 31, 2013 and 2012:

	Non-Accrual		Loans Past Due 90 Days or More & Still Accruing	
	2013	2012	2013	2012
Commercial and Industrial Loans and Leases	$31	$2,480	$ —	$ —
Commercial Real Estate Loans	6,658	7,275	8	—
Agricultural Loans	—	—	—	—
Home Equity Loans	114	178	—	—
Consumer Loans	236	167	—	—
Residential Mortgage Loans	1,339	257	—	—
Total	$8,378	$10,357	$ 8	$ —
Loans Acquired With Deteriorated Credit Quality (Included in the Total Above)	$1,705	$148	$ —	$ —

The following table presents the aging of the recorded investment in past due loans by class of loans as of December 31, 2013 and 2012:

	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, 2013						
Commercial and Industrial Loans and Leases	$351,903	$ 256	$ 78	$ —	$ 334	$351,569
Commercial Real Estate Loans	583,604	613	62	2,234	2,909	580,695
Agricultural Loans	195,171	62	—	—	62	195,109
Home Equity Loans	81,812	303	33	114	450	81,362
Consumer Loans	49,265	149	66	102	317	48,948
Residential Mortgage Loans	129,047	2,206	192	1,115	3,513	125,534

Total [1]	$1,390,802	$ 3,589	$ 431	$ 3,565	$ 7,585	$1,383,217
Loans Acquired With Deteriorated Credit Quality (Included in the Total Above)	$14,753	$ 148	$ —	$ 1,103	$ 1,251	$13,502

[1] Total recorded investment in loans includes $5,590 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, 2012						
Commercial and Industrial Loans and Leases	$336,307	$ 436	$ 133	$ 448	$ 1,017	$335,290
Commercial Real Estate Loans	489,796	1,352	—	2,063	3,415	486,381
Agricultural Loans	182,575	42	14	—	56	182,519
Home Equity Loans	74,699	177	48	178	403	74,296
Consumer Loans	41,231	431	23	18	472	40,759
Residential Mortgage Loans	88,815	2,070	495	257	2,822	85,993
Total [1]	$1,213,423	$ 4,508	$ 713	$ 2,964	$ 8,185	$1,205,238
Loans Acquired With Deteriorated Credit Quality (Included in the Total Above)	$11,174	$ —	$ 120	$ —	$ 120	$11,054

[1] Total recorded investment in loans includes $5,522 in accrued interest.

Troubled Debt Restructurings:

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

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

NOTE 4 – Loans (continued)

During the years ended December 31, 2013 and 2012, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans 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. There were no troubled debt restructurings for the years ended December 31, 2013 and 2012 for loans acquired with deteriorated credit quality at the time of acquisition.

The following table presents the recorded investment of troubled debt restructurings by class of loans as of December 31, 2013 and 2012:

	Total	Performing	**Non-Accrual**[1]
December 31, 2013			
Commercial and Industrial Loans and Leases	$2,092	$ 2,086	$ 6
Commercial Real Estate Loans	4,325	364	3,961
Total	$6,417	$ 2,450	$ 3,967

	Total	Performing	**Non-Accrual**[1]
December 31, 2012			
Commercial and Industrial Loans and Leases	$2,461	$ 66	$ 2,395
Commercial Real Estate Loans	6,031	304	5,727
Total	$8,492	$ 370	$ 8,122

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

The Company has committed to lending an additional amount of $40 as of December 31, 2013 to customers with outstanding loans that are classified as troubled debt restructurings. The Company had not committed to lending any additional amounts as of December 31, 2012 to customers with outstanding loans that are classified as troubled debt restructurings.

The following table presents loans by class modified as troubled debt restructurings that occurred during the year ending December 31, 2013, 2012 and 2011:

December 31, 2013	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial and Industrial Loans and Leases	1	$ 224	$ 230
Commercial Real Estate Loans	1	81	118
Total	2	$ 305	$ 348

The troubled debt restructurings described above decreased the allowance for loan losses by $210 and resulted in charge-offs of $0 during the year ending December 31, 2013.

December 31, 2012	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial and Industrial Loans and Leases	2	$ 9	$ 9
Commercial Real Estate Loans	—	—	—
Total	2	$ 9	$ 9

The troubled debt restructurings described above increased the allowance for loan losses by $0 and resulted in charge-offs of $0 during the year ending December 31, 2012.

December 31, 2011	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial and Industrial Loans and Leases	4	$ 4,541	$ 4,499
Commercial Real Estate Loans	6	7,099	6,850
Total	10	$ 11,640	$ 11,349

The troubled debt restructurings described above increased the allowance for loan losses by $1,945 and resulted in charge-offs of $834 during the year ending December 31, 2011.

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

NOTE 4 – Loans (continued)

The following tables present loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the years ending December 31, 2013, 2012 and 2011:

Troubled Debt Restructurings That Subsequently Defaulted:	Number of Loans	Recorded Investment
December 31, 2013		
Commercial and Industrial Loans and Leases	—	$ —
Commercial Real Estate Loans	—	—
Total	—	$ —

The troubled debt restructurings that subsequently defaulted described above resulted in no change to the allowance for loan losses and no charge-offs during the year ending December 31, 2013.

Troubled Debt Restructurings That Subsequently Defaulted:	Number of Loans	Recorded Investment
December 31, 2012		
Commercial and Industrial Loans and Leases	1	$ 565
Commercial Real Estate Loans	3	1,377
Total	4	$ 1,942

The troubled debt restructurings that subsequently defaulted described above increased the allowance for loan losses by $12 and resulted in charge-offs of $306 during the year ending December 31, 2012.

Troubled Debt Restructurings That Subsequently Defaulted:	Number of Loans	Recorded Investment
December 31, 2011		
Commercial and Industrial Loans and Leases	1	$ 527
Commercial Real Estate Loans	—	—
Total	1	$ 527

The troubled debt restructurings that subsequently defaulted described above decreased the allowance for loan losses by $500 and resulted in charge-offs of $500 during the year ending December 31, 2011.

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

Credit Quality Indicators:

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

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

NOTE 4 – Loans (continued)

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

	Pass	Special Mention	Substandard	Doubtful	Total
December 31, 2013					
Commercial and Industrial Loans and Leases	$324,685	$15,485	$ 11,733	$ —	$351,903
Commercial Real Estate Loans	539,533	20,168	23,903	—	583,604
Agricultural Loans	192,609	2,357	205	—	195,171
Total	$1,056,827	$38,010	$ 35,841	$ —	$1,130,678
Loans Acquired with Deteriorated Credit Quality (Included in the Total Above)	$3,121	$661	$ 9,070	$ —	$12,852

	Pass	Special Mention	Substandard	Doubtful	Total
December 31, 2012					
Commercial and Industrial Loans and Leases	$307,997	$14,441	$ 13,869	$ —	$336,307
Commercial Real Estate Loans	446,639	21,338	21,819	—	489,796
Agricultural Loans	176,730	2,855	2,990	—	182,575
Total	$931,366	$38,634	$ 38,678	$ —	$1,008,678
Loans Acquired with Deteriorated Credit Quality (Included in the Total Above)	$319	$3,220	$ 7,338	$ —	$10,877

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 December 31, 2013 and 2012:

	Home Equity Loans	Consumer Loans	Residential Mortgage Loans
December 31, 2013			
Performing	$ 81,698	$ 49,029	$ 127,708

Nonperforming	114	236	1,339
Total	$ 81,812	$ 49,265	$ 129,047
Loans Acquired with Deteriorated Credit Quality (Included in the Total Above)	$ —	$ 134	$ 1,767

	Home Equity Loans	Consumer Loans	Residential Mortgage Loans
December 31, 2012			
Performing	$ 74,521	$ 41,064	$ 88,558
Nonperforming	178	167	257
Total	$ 74,699	$ 41,231	$ 88,815
Loans Acquired with Deteriorated Credit Quality (Included in the Total Above)	$ —	$ 148	$ 149

The following table presents financing receivables purchased during the year ended December 31, 2013 by portfolio class (for further discussion, see Note 17 Business Combinations, Goodwill and Intangible Assets):

	Commercial and Industrial Loans and Leases	Commercial Real Estate Loans	Agricultural Loans	Home Equity Loans	Consumer Loans	Residential Mortgage Loans	Total
Purchases	**$ 6,399**	**$ 47,021**	**$ 769**	**$4,536**	**$ 1,666**	**$ 19,184**	**$79,575**

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

NOTE 4 – Loans (continued)

The Company has purchased loans, for which there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected. The recorded investment of those loans at December 31, is as follows:

	2013	2012	2011
Commercial and Industrial Loans	$1,981	$1,840	$2,596
Commercial Real Estate Loans	10,871	9,037	13,209
Home Equity Loans	—	—	—
Consumer Loans	134	148	164
Residential Mortgage Loans	1,767	149	152
Total	$14,753	$11,174	$16,121
Carrying Amount, Net of Allowance	$14,745	$11,086	$16,044

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

	2013	2012	2011
Balance at January 1	$170	$967	$—
New Loans Purchased	2,885	—	2,042
Accretion of Income	(265)	(1,265)	(1,130)
Reclassifications from Non-accretable Difference	—	468	129
Charge-off of Accretable Yield	—	—	(74)
Balance at December 31	$2,790	$170	$967

For those purchased loans disclosed above, the Company increased the allowance for loan losses by $0, $88 and $77 for the years ended December 31, 2013, 2012 and 2011. No allowances for loan losses were reversed during the same period.

Contractually required payments receivable of loans purchased during the years ended December 31:

	2013	2012	2011
Commercial and Industrial Loans	$401	$ —	$4,542
Commercial Real Estate Loans	6,640	—	19,260
Home Equity Loans	—	—	28
Consumer Loans	—	—	217
Residential Mortgage Loans	3,684	—	458
Total	$10,725	$ —	$24,505
Cash Flows Expected to be Collected at Acquisition	$7,642	$ —	$19,695
Fair Value of Acquired Loans at Acquisition	6,252	—	17,653

Certain directors, executive officers, and principal shareholders of the Company, including their immediate families and companies in which they are principal owners, were loan customers of the Company during 2013. A summary of the activity of these loans follows:

Balance January 1, 2013	Additions	Changes in Persons Included	Deductions Collected	Charged-off	Balance December 31, 2013
$ 9,002	$ 5,426	$ 1,290	$(5,387)	$ —	$ 10,331

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

NOTE 5 – Premises, Furniture, and Equipment

Premises, furniture, and equipment was comprised of the following classifications at December 31:

	2013	2012
Land	$8,366	$7,948
Buildings and Improvements	47,677	43,706
Furniture and Equipment	21,544	19,584
Total Premises, Furniture and Equipment	77,587	71,238
Less: Accumulated Depreciation	(37,157)	(34,684)
Total	$40,430	$36,554

Depreciation expense was $2,910, $2,941 and $3,261 for 2013, 2012 and 2011, respectively.

The Company leases three of its branch buildings under a capital lease. These lease arrangements require monthly payments through 2033. The Company has included the leases in buildings and improvements as follows:

	2013	2012
Capital Leases	$3,896	$2,442
Less: Accumulated Depreciation	(483)	(344)
Total	$3,413	$2,098

The following is a schedule of future minimum lease payments under the capitalized leases, together with the present value of net minimum lease payments at year end 2013:

2014	$495
2015	495
2016	495
2017	495

2018	465
Thereafter	6,216
Total minimum lease payments	8,661
Less: Amount representing interest	(4,931)
Present Value of Net Minimum Lease Payments	$3,730

NOTE 6 – Deposits

At year end 2013, stated maturities of time deposits were as follows:

2014	$174,109
2015	66,131
2016	76,207
2017	17,943
2018	14,465
Thereafter	179
Total	$349,034

Time deposits of $100 or more and brokered deposits at December 31, 2013 and 2012 were $124,673 and $95,761, respectively.

Time deposits originated from outside the geographic area, generally through brokers, totaled $1,648 and $0 at December 31, 2013 and 2012, respectively.

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

NOTE 7 – FHLB Advances and Other Borrowings

The Company's funding sources include Federal Home Loan Bank advances, borrowings from other third party correspondent financial institutions, issuance and sale of subordinated debt and other capital securities, and repurchase agreements. Information regarding each of these types of borrowings or other indebtedness is as follows:

	December 31, 2013		2012	
Long-term Advances from Federal Home Loan Bank collateralized by qualifying mortgages, investment securities, and mortgage-backed securities	$	71,483	$	51,526
Term Loans		7,000		1,500
Junior Subordinated Debentures assumed from American Community Bancorp, Inc.		5,024		4,874
Subordinated Debentures		—		29,250
Capital Lease Obligation		3,730		2,322
Long-term Borrowings		87,237		89,472
Overnight Variable Rate Advances from Federal Home Loan Bank collateralized by qualifying mortgages, investment securities, and mortgage-backed securities	$	38,000	$	48,500
Federal Funds Purchased		—		5,400
Repurchase Agreements		15,533		17,634
Short-term Borrowings		53,533		71,534
Total Borrowings	$	140,770	$	161,006

Repurchase agreements, which are classified as secured borrowings, generally mature within one day of the transaction date. Repurchase agreements are reflected at the amount of cash received in connection with the transaction. The Company may be required to provide additional collateral based on the value of the underlying securities.

	2013	2012
Average Daily Balance During the Year	$14,772	$19,813
Average Interest Rate During the Year	0.20 %	0.23 %
Maximum Month-end Balance During the Year	$17,722	$24,220
Weighted Average Interest Rate at Year-end	0.20 %	0.20 %

At December 31, 2013 interest rates on the fixed rate long-term FHLB advances ranged from 0.35% to 7.22% with a weighted average rate of 0.95%. At December 31, 2013, the Company had no advances containing options whereby the FHLB may convert a fixed rate advance to an adjustable rate advance.

At December 31, 2012 interest rates on the fixed rate long-term FHLB advances ranged from 0.39% to 7.22% with a weighted average rate of 2.07%. Of the $51.5 million, $30.0 million or 58% of the advances contained options whereby the FHLB may convert the fixed rate advance to an adjustable rate advance, at which time the Company may prepay the advance without penalty. The options on these advances are subject to a variety of terms including LIBOR based strike rates.

At December 31, 2013, the Company had an outstanding term loan with the balance of $7 million of which the original principal amount was $10 million and borrowed by the parent company in January 2013. At December 31, 2013 interest on the term loan is based upon 90-day LIBOR plus 2.875%. This term loan matures December 31, 2015. At December 31, 2013, the parent company had a $10 million line of credit with no outstanding balance. The line of credit matures December 30, 2014. Interest on the line of credit is based upon 90-day LIBOR plus 2.875% and includes an unused commitment fee of 0.25%.

As of December 31, 2012 long-term borrowings included a $1.5 million outstanding balance on a term loan of which was paid off in January 2013 by the parent company. At December 31, 2012 interest on the term loan was based upon 90-day LIBOR plus 3.00%.

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

NOTE 7 – FHLB Advances and Other Borrowings (continued)

At December 31, 2012, the long-term borrowings shown above included an aggregate of $29.3 million of indebtedness represented by subordinated debentures issued by the Company's parent company in two separate transactions. A $10 million subordinated debenture issued by the parent company to another bank bore interest based upon 90-day LIBOR plus 1.35%. 20% of the subordinated debenture was treated as Tier 2 capital for regulatory capital purposes as of December 31, 2012. This subordinated debenture was paid off in January 2013. The parent company issued $19.3 million principal amount of 8% redeemable subordinated debentures to the Company's shareholders in April 2009. The entire principal amount of these debentures was treated as Tier 2 capital for regulatory capital purposes as of December 31, 2012. These debentures were redeemed on April 1, 2013.

At December 31, 2013, scheduled principal payments on long-term borrowings, excluding the capitalized lease obligation and acquired subordinated debentures (which are discussed below) are as follows:

2014	$43,039
2015	24,042
2016	45
2017	749
2018	10,027
Thereafter	581
Total	$78,483

The Company assumed the obligations of junior subordinated debentures through the acquisition of American Community Bancorp, Inc. The junior subordinated debentures were issued to ACB Capital Trust I and Capital Trust II. The trusts are wholly owned by the Company. In accordance with accounting guidelines, the trusts are not consolidated with the Company's financials, but rather the subordinated debentures are shown as borrowings. The Company guarantees payment of distributions on the trust preferred securities issued by ACB Trust I and ACB Trust II. Interest is payable on a quarterly basis. These securities qualify as Tier 1 capital (with certain limitations) for regulatory purposes. $4,871 of the junior subordinated debentures were treated as Tier 1 capital for regulatory capital purposes as of December 31, 2013. $4,725 of the junior subordinated debentures were treated as Tier 1 capital for regulatory capital purposes as of December 31, 2012. As a result of the acquisition of American Community these liabilities were recorded at fair value at the acquisition date with the discount amortizing into interest expense over the life of the liability, ultimately accreting to the issuance amount disclosed below.

The following table summarizes the terms of each issuance:

	Date of Issuance	Issuance Amount	Carrying Amount at December 31, 2013	Variable Rate	Rate as of December 31, 2013	Rate as of December 31, 2012	M D
ACB Trust I	5/6/2005	$5,155	$3,186	90 day LIBOR + 2.15%	2.40%	2.46%	M 20
ACB Trust II	7/15/2005	3,093	1,838	90 day LIBOR + 1.85%	2.09%	2.16%	Ju

See also Note 5 regarding the capital lease obligation.

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

NOTE 8 – Shareholders' Equity

The Company and affiliate bank are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weightings, and other factors, and the regulators can lower classifications in certain cases. Failure to meet various capital requirements can initiate regulatory action that could have a direct material effect on the financial statements. Management believes as of December 31, 2013, the Company and Bank meet all capital adequacy requirements to which they are subject.

The prompt corrective action regulations provide five classifications, including well-capitalized, adequately capitalized, under-capitalized, significantly under-capitalized, and critically under-capitalized, although these terms are not used to represent overall financial condition. If only adequately capitalized, regulatory approval is required to accept brokered deposits. If under-capitalized, capital distributions are limited, as is asset growth and expansion, and plans for capital restoration are required.

At December 31, 2013, consolidated and affiliate bank actual capital and minimum required levels are presented below:

	Actual		Minimum Required For Capital Adequacy Purposes:		Minimum Required To Be Well-Capitalized Under Prompt Corrective Action Regulations:	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (to Risk Weighted Assets)						
Consolidated	$201,233	13.07%	$ 123,189	8.00 %	N/A	**N/A**
Bank	191,714	12.46	123,099	8.00	$153,874	10.00 %
Tier 1 Capital (to Risk Weighted Assets)						
Consolidated	$186,649	12.12%	$ 61,594	4.00 %	N/A	**N/A**
Bank	177,130	11.51	61,550	4.00	$92,324	6.00 %
Tier 1 Capital (to Average Assets)						
Consolidated	$186,649	8.78 %	$ 85,005	4.00 %	N/A	**N/A**

Bank	177,130	8.37	84,686	4.00	$105,857	5.00 %

At December 31, 2012, consolidated and affiliate bank actual capital and minimum required levels are presented below:

	Actual		Minimum Required For Capital Adequacy Purposes:		Minimum Required To Be Well-Capitalized Under Prompt Corrective Action Regulations:	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (to Risk Weighted Assets)						
Consolidated	$194,990	13.70%	$ 113,859	8.00 %	N/A	N/A
Bank	167,904	11.83	113,523	8.00	$141,904	10.00 %
Tier 1 Capital (to Risk Weighted Assets)						
Consolidated	$158,198	11.12%	$ 56,930	4.00 %	N/A	N/A
Bank	152,384	10.74	56,762	4.00	$85,142	6.00 %
Tier 1 Capital (to Average Assets)						
Consolidated	$158,198	8.18 %	$ 77,317	4.00 %	N/A	N/A
Bank	152,384	7.91	77,025	4.00	$96,281	5.00 %

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

NOTE 8 – Shareholders' Equity (continued)

The Company and the affiliate bank at year end 2013 and 2012 were categorized as well-capitalized. There have been no conditions or events that management believes have changed the classification of the Company or affiliate bank under the prompt corrective action regulations since the last notification from regulators. Regulations require the maintenance of certain capital levels at the affiliate bank, and may limit the dividends payable by the affiliate to the holding company, or by the holding company to its shareholders. At December 31, 2013, the affiliate bank had $39,000 in retained earnings available for payment of dividends to the parent company without prior regulatory approval.

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 December 31, 2013, the Company has reserved 438,813 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.

Stock Options

Options may be designated as "incentive stock options" under the Internal Revenue Code of 1986, or as nonqualified options. While the date after which options are first exercisable is determined by the appropriate committee of the Board of Directors of the Company or, in the case of options granted to directors, by the Board of Directors, no stock option may be exercised after ten years from the date of grant (twenty years in the case of nonqualified stock options). The exercise price of stock options granted pursuant to the plans must be no less than the fair market value of the Common Stock on the date of the grant.

The plans authorize an optionee to pay the exercise price of options in cash or in common shares of the Company or in some combination of cash and common shares. An optionee may tender already-owned common shares to the Company in exercise of an option. Certain of these plans authorize an optionee to surrender the value of an unexercised option in payment of an equivalent amount of the exercise price of the option. The Company typically issues authorized but unissued common shares upon the exercise of options.

The following table presents activity for stock options under the Company's equity incentive plan for 2013:

	Year Ended December 31, 2013			
	Number of Options	Weighted Average Price of Options	Weighted Average Life of Options (in years)	Aggregate Intrinsic Value
Outstanding at Beginning of Period	79,917	$ 16.73		
Granted	—	—		
Exercised	(8,300)	17.35		
Forfeited	—	—		
Expired	(2,100)	18.19		
Outstanding and Exercisable at End of Period	69,517	$ 16.61	3.43	$ 821

The following table presents information related to stock options under the Company's equity incentive plan during the years ended 2013, 2012 and 2011:

	2013	2012	2011
Intrinsic Value of Options Exercised	$ 49	$ 203	$ 28
Cash Received from Option Exercises	$ —	$ —	$ —
Tax Benefit of Option Exercises	$ 20	$ 78	$ 12
Weighted Average Fair Value of Options Granted	$ —	$ —	$ —

The intrinsic value for stock options is calculated based on the exercise price of the underlying awards and the market price of common stock as of the reporting date.

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

NOTE 8 – Shareholders' Equity (continued)

During 2013, 2012 and 2011, the Company granted no options, and accordingly, recorded no stock compensation expense related to option grants. The Company recorded no other stock compensation expense applicable to options during the years ended December 31, 2013, 2012 and 2011 because all outstanding options were fully vested prior to 2007. As of December 31, 2013 and 2012, there was no unrecognized option expense as all outstanding options were fully vested.

Restricted Stock

During the periods presented, awards of long-term incentives were granted in the form of restricted stock. Awards that were granted to management under a management incentive plan were granted in tandem with cash credit entitlements (typically in the form of 50% restricted stock grants and 50% cash credit entitlements). The management restricted stock grants and tandem cash credit entitlements awarded in 2013 will vest in three equal installments of 33.3% with the first annual vesting on December 5th of the year of the grant and on December 5th of the next two succeeding years. The management restricted stock grants and tandem cash credit entitlements awarded in 2012 were subject to forfeiture in the event that the recipient of the grant did not continue employment with the Company through December 5th of the year of grant, at which time they generally vest 100 percent. Awards that were granted to directors as additional retainer for their services in December 2012 do not include any cash credit entitlement. These director restricted stock grants are subject to forfeiture in the event that the recipient of the grant does not continue in service as a director of the Company through December 5th of the year after grant or do not satisfy certain meeting attendance requirements, at which time they generally vest 100 percent. For measuring compensation costs, restricted stock awards are valued based upon the market value of the common shares on the date of grant.

The following table presents expense recorded for restricted stock and cash entitlements as well as the related tax effect for the years ended 2013, 2012 and 2011:

	2013	2012	2011
Restricted Stock Expense	$329	$628	$636
Cash Entitlement Expense	217	588	564
Tax Effect	(221)	(493)	(475)
Net of Tax	**$325**	$723	$725

Unrecognized expense associated with the restricted stock grants and cash entitlements totaled $942 and $101 as of December 31, 2013 and 2012. There was no unrecognized expense associated with the restricted stock grants as of December 31, 2011.

The following table presents information on restricted stock grants outstanding for the period shown:

	Year Ended December 31, 2013	
	Restricted Shares	Weighted Average Market Price at Grant
Outstanding at Beginning of Period	4,983	$ 22.07
Granted	33,031	23.41
Issued and Vested	(14,620)	22.57
Forfeited	(453)	22.07
Outstanding at End of Period	22,941	23.68

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

NOTE 8 – Shareholders' Equity (continued)

Employee Stock Purchase Plan

The Company maintains an Employee Stock Purchase Plan whereby eligible employees have the option to purchase the Company's common stock at a discount. The purchase price of the shares under this Plan has been set at 95% of the fair market value of the Company's common stock as of the last day of the plan year. The plan provided for the purchase of up to 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 in 2013, 2012, and 2011 nor was there any unrecognized compensation expense as of December 31, 2013 and 2012 for the Employee Stock Purchase Plan.

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 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 are purchased. The Board of Directors established no expiration date for this program. As of December 31, 2013, the Company had purchased 334,965 shares under the program. No shares were purchased under the program during the years ended December 31, 2013 and 2012.

NOTE 9 – Employee Benefit Plans

The Company provides a contributory trusteed 401(k) deferred compensation and profit sharing plan, which covers substantially all employees. The Company agrees to match certain employee contributions under the 401(k) portion of the plan, while profit sharing contributions are discretionary and are subject to determination by the Board of

Directors. Company contributions were $882, $777, and $717 for 2013, 2012, and 2011, respectively.

The Company self-insures employee health benefits. Stop loss insurance covers annual losses exceeding $125 per covered family. Management's policy is to establish a reserve for claims not submitted by a charge to earnings based on prior experience. Charges to earnings were $2,599, $1,799, and $1,620 for 2013, 2012, and 2011, respectively.

The Company maintains deferred compensation plans for the benefit of certain directors and officers. Under the plans, the Company agrees in return for the directors and officers deferring the receipt of a portion of their current compensation, to pay a retirement benefit computed as the amount of the compensation deferred plus accrued interest at a variable rate. Accrued benefits payable totaled $1,857 and $2,003 at December 31, 2013 and 2012. Deferred compensation expense was $173, $170, and $183 for 2013, 2012, and 2011, respectively. In conjunction with the plans, the Company purchased life insurance on certain directors and officers.

The Company entered into early retirement agreements with certain officers of the Company during 2008, 2009, 2010, and 2013. Accrued benefits payable as a result of the agreements totaled $337 and $298 at December 31, 2013 and 2012, respectively. Expense associated with these agreements totaled $166, $0, and $72 during 2013, 2012, and 2011, respectively. The benefits under the agreements will be paid through 2017.

The Company acquired through previous bank mergers a noncontributory defined benefit pension plan with benefits based on years of service and compensation prior to retirement. The benefits under the plan were suspended in 1998. This defined benefit plan was terminated in 2013 with all benefits of the plan distributed to the plan's participants prior to December 31, 2013. The costs to terminate the defined benefit plan totaled $378 in 2013.

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

NOTE 9 – Employee Benefit Plans (continued)

Accumulated plan benefit information for the Company's plan as of December 31, 2013 and 2012 was as follows:

Changes in Benefit Obligation:	2013	2012
Obligation at Beginning of Year	$837	$734
Interest Cost	25	27
Benefits Paid	(33)	(33)
Lump Sum Benefits Paid	(809)	—
Actuarial (Gain) Loss	(62)	109
Effect of Settlement/Curtailment	42	—
Obligation at End of Year	$—	$837
Changes in Plan Assets:		
Fair Value at Beginning of Year	399	353
Actual Return on Plan Assets	—	1
Employer Contributions	443	78
Periodic Benefits Paid	(33)	(33)
Lump Sum Benefits Paid	(809)	—
Fair Value at End of Year	$—	$399
Funded Status:		
Funded Status at End of Year	$—	$(438)

Amounts recognized in accumulated other comprehensive income at December 31 consist of:

	2013	2012
Net Loss (Gain)	$—	$360
Prior Service Cost	—	13
	$—	$373

The accumulated benefit obligation was $0 and $837 at year-end 2013 and 2012, respectively.

<u>Components of Net Periodic Benefit Cost and Other Amounts Recognized in Other Comprehensive Income</u>

	2013	2012	2011

Interest Cost	$25	$27	$32
Expected Return on Assets	(1)	(1)	(2)
Amortization of Prior Service Cost	1	1	1
Recognition of Net Loss	46	30	31
Net Periodic Benefit Cost	$71	$57	$62
Net Loss (Gain) During the Period	(19)	110	24
Amortization of Unrecognized Loss	(341)	(30)	(30)
Amortization of Prior Service Cost	(13)	(1)	(1)
Total Recognized in Other Comprehensive Income (Loss)	(373)	79	(7)
Total Recognized in Net Periodic Benefit Cost and Other Comprehensive Income (Loss)	$(302)	$136	$55

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

NOTE 9 – Employee Benefit Plans (continued)

The estimated net loss, prior service costs, and net transition obligation (asset) for the defined benefit pension plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year will be $0 as the defined benefit pension plan terminated in the current year.

Assumptions

Weighted-average assumptions used to determine benefit obligations at year-end:

	2013	2012	2011
Discount Rate	**N/A**	3.25%	3.75%
Rate of Compensation Increase (1)	**N/A**	N/A	N/A

Weighted-average assumptions used to determine net periodic pension cost:

	2013	2012	2011
Discount Rate	3.25%	3.75%	4.60