

FIRST FINANCIAL CORP /IN/
Form 10-K
March 09, 2016

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, 2015

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

For the transition period from _____ to _____

Commission file number 0-16759

FIRST FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

INDIANA

35-1546989

(State of Incorporation)

(I.R.S. Employer Identification Number)

One First Financial Plaza

Terre Haute, Indiana

47807

(Address of Registrant's Principal Executive Offices)

(Zip Code)

(812) 238-6000

(Registrant's Telephone Number, Including Area Code)

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

Title of each class

Name of Exchange on Which Registered

Common Stock, no par value

The NASDAQ Stock Market LLC
(NASDAQ Global Select Market)

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 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 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. Yes No

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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). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of 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. See definition of “accelerated filer”, “large accelerated filer”, and “smaller reporting company” in Rule 12b-2 of the Exchange Act of 1934.

Large accelerated filer Accelerated filer 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 No

As of June 30, 2015 the aggregate market value of the stock held by non-affiliates of the registrant based on the average bid and ask prices of such stock was \$420,248,048. (For purposes of this calculation, the Corporation excluded the stock owned by certain beneficial owners and management and the Corporation’s Employee Stock Ownership Plan.)

Shares of Common Stock outstanding as of March 1, 2016—12,656,606 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Definitive Proxy Statement for the First Financial Corporation Annual Meeting of Shareholders to be held April 20, 2016 are incorporated by reference into Part III.

FIRST FINANCIAL CORPORATION
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FIRST FINANCIAL CORPORATION
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PART I

ITEM 1. BUSINESS

FORWARD-LOOKING STATEMENTS

A cautionary note about forward-looking statements: In its oral and written communication, First Financial Corporation from time to time includes forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements can include statements about estimated cost savings, plans and objectives for future operations and expectations about performance, as well as economic and market conditions and trends. They often can be identified by the use of words such as "expect," "may," "could," "intend," "project," "estimate," "believe" or "anticipate" or words of similar import. By their nature, forward-looking statements are based on assumptions and are subject to risks, uncertainties and other factors. Actual results may differ materially from those contained in the forward-looking statement. First Financial Corporation may include forward-looking statements in filings with the Securities and Exchange Commission, in other written materials such as this Annual Report and in oral statements made by senior management to analysts, investors, representatives of the media and others. It is intended that these forward-looking statements speak only as of the date they are made, and First Financial Corporation undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the forward-looking statement is made or to reflect the occurrence of unanticipated events.

The discussion in Item 1A (Risk Factors) and Item 7 (Management's Discussion and Analysis of Results of Operations and Financial Condition) of this Annual Report on Form 10-K, lists some of the factors which could cause actual results to vary materially from those in any forward-looking statements. Other uncertainties which could affect First Financial Corporation's future performance include the effects of competition, technological changes and regulatory developments; changes in fiscal, monetary and tax policies; market, economic, operational, liquidity, credit and interest rate risks associated with First Financial Corporation's business; inflation; competition in the financial services industry; changes in general economic conditions, either nationally or regionally, resulting in, among other things, credit quality deterioration; and changes in securities markets. Investors should consider these risks, uncertainties and other factors in addition to those mentioned by First Financial Corporation in its other filings from time to time when considering any forward-looking statement.

GENERAL

First Financial Corporation (the "Corporation") is a financial holding company. The Corporation was originally organized as an Indiana corporation in 1984 to operate as a bank holding company.

The Corporation, which is headquartered in Terre Haute, Indiana, offers a wide variety of financial services including commercial, mortgage and consumer lending, lease financing, trust account services, depositor services and insurance services through its four subsidiaries. At the close of business in 2015 the Corporation and its subsidiaries had 896 full-time equivalent employees.

The risk characteristics of each loan portfolio segment are as follows:

Commercial

Commercial loans are predominately loans to expand a business or finance asset purchases. The underlying risk in the Commercial loan segment is primarily a function of the reliability and sustainability of the cash flows of the borrower and secondarily on the underlying collateral securing the transaction. From time to time, the cash flows of borrowers

may be less than historical or as planned. In addition, the underlying collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets financed or other business assets and most commercial loans are further supported by a personal guarantee. However, in some instances, short term loans are made on an unsecured basis. Agriculture production loans are typically secured by growing crops and generally secured by other assets such as farm equipment. Production loans are subject to weather and market pricing risks. The Corporation has established underwriting standards and guidelines for all commercial loan types.

The Corporation strives to maintain a geographically diverse commercial real estate portfolio. Commercial real estate loans are primarily underwritten based upon the cash flows of the underlying real estate or from the cash flows of the business conducted at the real estate. Generally, these types of loans will be fully guaranteed by the principal owners of the real estate and loan amounts must be supported by adequate collateral value. Commercial real estate loans may be adversely affected by factors in the local market, the regional economy, or industry specific factors. In addition, Commercial Construction loans are a specific type of commercial real estate loan which inherently carry more risk than loans for completed projects. Since these types of loans are

underwritten utilizing estimated costs, feasibility studies, and estimated absorption rates, the underlying value of the project may change based upon the inaccuracy of these projections. Commercial construction loans are closely monitored, subject to industry standards, and disbursements are controlled during the construction process.

Residential

Retail real estate mortgages that are secured by 1-4 family residences are generally owner occupied and include residential real estate and residential real estate construction loans. The Corporation typically establishes a maximum loan-to-value ratio and generally requires private mortgage insurance if the ratio is exceeded. The Corporation sells substantially all of its long-term fixed mortgages to secondary market purchasers. Mortgages sold to secondary market purchasers are underwritten to specific guidelines. The Corporation originates some mortgages that are maintained in the bank's loan portfolio. Portfolio loans are generally adjustable rate mortgages and are underwritten to conform to Qualified Mortgage standards. Several factors are considered in underwriting all Mortgages including the value of the underlying real estate, debt-to-income ratio and credit history of the borrower. Repayment is primarily dependent upon the personal income of the borrower and can be impacted by changes in borrower's circumstances such as changes in employment status and changes in real estate property values. Risk is mitigated by the sale of substantially all long-term fixed rate mortgages, the underwriting of portfolio loans to Qualified Mortgage standards and the fact that mortgages are generally smaller individual amounts spread over a large number of borrowers.

Consumer

The consumer portfolio primarily consists of home equity loans and lines (typically secured by a subordinate lien on a 1-4 family residence), secured loans (typically secured by automobiles, boats, recreational vehicles, or motorcycles), cash/CD secured, and unsecured loans. Pricing, loan terms, and loan to value guidelines vary by product line. The underlying value of collateral dependent loans may vary based on a number of economic conditions, including fluctuations in home prices and unemployment levels. Underwriting of consumer loans is based on the individual credit profile and analysis of the debt repayment capacity for each borrower. Payments for consumer loans is typically set-up on equal monthly installments, however, future repayment may be impacted by a change in economic conditions or a change in the personal income levels of individual customers. Overall risks within the consumer portfolio are mitigated by the mix of various loan products, lending in various markets and the overall make-up of the portfolio (small loan sizes and a large number of individual borrowers).

COMPANY PROFILE

First Financial Bank, N.A. (the "Bank") is the largest bank in Vigo County, Ind. It operates 11 full-service banking branches within the county; three in Clay County, Ind.; one in Daviess County, Ind.; one in Gibson County, Ind.; one in Greene County, Ind.; three in Knox County, Ind.; four in Parke County, Ind.; one in Putnam County, Ind., four in Sullivan County, Ind.; one in Vanderburgh, County.; four in Vermillion County, Ind.; five in Champaign County, Illinois; one in Clark County, Ill.; three in Coles County, Ill.; two in Crawford County, Ill.; two in Franklin County, Ill.; one in Jasper County, Ill.; two in Jefferson County, Ill.; one in Lawrence County, Ill.; two in Livingston County, Illinois; two in Marion County, Ill.; one in Montgomery County, Ill.; three in McLean County, Illinois; two in Richland County, Ill.; six in Vermilion County, Ill.; and one in Wayne County, Ill. In addition to its branches, it has a main office in downtown Terre Haute and a 50,000-square-foot commercial building on South Third Street in Terre Haute, which serves as the Corporation's operations center and provides additional office space. The Morris Plan Company of Terre Haute, Inc. ("Morris Plan") has one office and is located in Vigo County. Forrest Sherer Inc. is a regional supplier of insurance, surety and other financial products. Forrest Sherer has more than 58 professionals and over 91 years of service to both businesses and households in their market area. The agency has representation agreements with more than 40 regional and national insurers to market their products of property and casualty insurance, surety bonds, employee benefit plans, life insurance and annuities. FFB Risk Management Co., Inc. located in Las Vegas, Nevada is a captive insurance subsidiary which insures various liability and property damage policies for First Financial Corporation subsidiaries.

COMPETITION

First Financial Bank and Morris Plan face competition from other financial institutions. These competitors consist of commercial banks, a mutual savings bank and other financial institutions, including consumer finance companies, insurance companies, brokerage firms and credit unions.

The Corporation's business activities are centered in west-central Indiana and east-central Illinois. The Corporation has no foreign activities other than periodically investing available funds in time deposits held in foreign branches of domestic banks.

REGULATION AND SUPERVISION

The Corporation and its subsidiaries operate in highly regulated environments and are subject to supervision and regulation by several governmental regulatory agencies, including the Board of Governors of the Federal Reserve System (the “Federal Reserve”), the Office of the Comptroller of the Currency (the “OCC”), the Federal Deposit Insurance Corporation (the “FDIC”), and the Indiana Department of Financial Institutions (the “DFI”). The laws and regulations established by these agencies are generally intended to protect depositors, not shareholders. Changes in applicable laws, regulations, governmental policies, income tax laws and accounting principles may have a material effect on the Corporation’s business and prospects. The following summary is qualified by reference to the statutory and regulatory provisions discussed.

The Dodd-Frank Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act” or “Dodd-Frank”), which was enacted in July 2010, significantly restructured the financial regulatory regime in the United States. Although the Dodd-Frank Act’s provisions that have received the most public attention generally have been those applying to or more likely to affect larger institutions such as bank holding companies with total consolidated assets of \$50 billion or more, it contains numerous other provisions that affect all bank holding companies and banks, including the Corporation, the Bank, and Morris Plan, some of which are described in more detail below.

Because full implementation of the Dodd-Frank Act will occur over several years, it is difficult to anticipate the overall financial impact on the Corporation, its customers or the financial industry generally. However, the impact is expected to be substantial and may have an adverse impact on the Corporation’s financial performance and growth opportunities.

The Volcker Rule

The Dodd-Frank Act requires the federal financial regulatory agencies to adopt rules that prohibit banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (defined as hedge funds and private equity funds). The statutory provision is commonly called the “Volcker Rule”. Although the Corporation is continuing to evaluate the impact of the Volcker Rule and the final rules adopted thereunder, the Corporation does not currently anticipate that the Volcker Rule will have a material effect on the operations of the Bank, Morris Plan, or their respective subsidiaries, as the Corporation does not engage in the businesses prohibited by the Volcker Rule. The Corporation may incur costs to adopt additional policies and systems to ensure compliance with the Volcker Rule, but any such costs are not expected to be material.

Consumer Financial Protection Bureau

The Consumer Financial Protection Bureau (the “CFPB”), created by the Dodd-Frank Act, is responsible for administering federal consumer financial protection laws. The CFPB, which began operations on July 21, 2011, is an independent bureau within the Federal Reserve and has broad rule-making, supervisory and examination authority to set and enforce rules in the consumer protection area over financial institutions that have assets of \$10 billion or more. The CFPB also has data collecting powers for fair lending purposes for both small business and mortgage loans, as well as authority to prevent unfair, deceptive and abusive practices. Abusive acts or practices are defined as those that:

- (1) materially interfere with a consumer’s ability to understand a term or condition of a consumer financial product or service, or
- (2) take unreasonable advantage of a consumer’s:
 - lack of financial savvy,
 - inability to protect himself in the selection or use of consumer financial products or services,

or

reasonable reliance on a covered entity to act in the consumer's interests.

The CFPB has the authority to investigate possible violations of federal consumer financial law, hold hearings and commence civil litigation. The CFPB can issue cease-and-desist orders against banks and other entities that violate consumer financial laws. The CFPB may also institute a civil action against an entity in violation of federal consumer financial law in order to impose a civil penalty or an injunction.

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BASEL III

In July 2013, the federal banking agencies published the Basel III Capital Rules establishing a new comprehensive capital framework for U.S. banking organizations. The rules implement the Basel Committee's December 2010 framework known as "Basel III" for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act.

The Basel III Capital Rules became effective on January 1, 2015 (subject to a phase-in period) and, among other things, introduced a new capital measure known as "Common Equity Tier 1" ("CET1"), which generally consists of common equity Tier 1 capital instruments and related surplus, retained earnings, and common equity Tier 1 minority interests, minus certain adjustments and deductions.

The Basel III Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. Under the former capital standards, the effects of accumulated other comprehensive income items included in capital were excluded for the purposes of determining regulatory capital ratios. Under the Basel III Capital Rules, the effects of certain accumulated other comprehensive items are not excluded; however, non-advanced approaches banking organizations, including the Corporation, may make a one-time permanent election to continue to exclude these items. The Corporation, the Bank and Morris Plan all made this election in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of the Corporation's available-for-sale securities portfolio. The Basel III Capital Rules also preclude certain hybrid securities, such as trust preferred securities, as Tier 1 capital of bank holding companies, subject to phase-out. The Corporation has no trust preferred securities. Implementation of the deductions and other adjustments to CET1 began on January 1, 2015 and will be phased-in over a four-year period (beginning at 40% on January 1, 2015 and an additional 20% per year thereafter).

The Basel III Capital Rules prescribe a standardized approach for risk weightings that expand the risk-weighting categories from the current four Basel I-derived categories (0%, 20%, 50% and 100%) to a much larger and more risk-sensitive number of categories, depending on the nature of the assets, generally ranging from 0% for U.S. government and agency securities, to 600% for certain equity exposures, and resulting in higher risk weights for a variety of asset categories. Specific changes from former capital rules impacting the Corporation's determination of risk-weighted assets include, among other things:

• Applying a 150% risk weight instead of a 100% risk weight for certain high volatility commercial real estate acquisition, development and construction loans;

• Assigning a 150% risk weight to exposures (other than residential mortgage exposures) that are 90 days past due;

• Providing for a 20% credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable (currently set at 0%); and

• Providing for a risk weight, generally not less than 20% with certain exceptions, for securities lending transactions based on the risk weight category of the underlying collateral securing the transaction.

When fully phased in on January 1, 2019, the Basel III Capital Rules will require the Corporation and its banking subsidiaries to maintain:

a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% “capital conservation buffer” (which is added to the 4.5% CET1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7% upon full implementation);

a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation);

a minimum ratio of Total capital (that is, Tier 1 plus Tier 2) to risk-weighted assets of at least 8.0%, plus 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), and

a minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to average assets.

The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer (or below the combined capital conservation buffer and countercyclical capital buffer, when the latter is applied) will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall. The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and will be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019).

Under the Basel III Capital Rules, the minimum capital ratios as of January 1, 2016 are as follows:

- 5.125% CET1 to risk-weighted assets;
- 6.625% Tier 1 capital to risk-weighted assets; and
- 8.625% Total capital to risk-weighted assets.

Certain regulatory capital ratios for the Corporation as of December 31, 2015, are shown below:

- 17.69% CET1 to risk-weighted assets;
- 17.69% Tier 1 capital to risk-weighted assets;
- 18.62% Total capital to risk-weighted assets; and
- 12.92% leverage ratio.

Certain regulatory capital ratios for the Bank as of December 31, 2015, are shown below:

- 17.23% CET1 to risk-weighted assets;
- 17.23% Tier 1 capital to risk-weighted assets;
- 18.05% Total capital to risk-weighted assets; and
- 12.50% leverage ratio.

Certain regulatory capital ratios for Morris Plan as of December 31, 2015, are shown below:

- 30.93% CET1 to risk-weighted assets;
- 30.93% Tier 1 capital to risk-weighted assets;
- 32.22% Total capital to risk-weighted assets; and
- 28.06% leverage ratio.

The Corporation

The Bank Holding Company Act. Because the Corporation owns all of the outstanding capital stock of the Bank, it is registered as a bank holding company under the federal Bank Holding Company Act of 1956 (“Act”) and is subject to periodic examination by the Federal Reserve and required to file periodic reports of its operations and any additional information that the Federal Reserve may require.

In general, the Act limits the business of bank holding companies to banking, managing or controlling banks and other activities that the Federal Reserve has determined to be so closely related to banking as to be a proper incident thereto. In addition, bank holding companies that qualify and elect to be financial holding companies such as the Corporation, may engage in any activity, or acquire and retain the shares of a company engaged in any activity, that is either (i) financial in nature or incidental to such financial activity (as determined by the Federal Reserve in consultation with the Secretary of the Treasury) or (ii) complementary to a financial activity and does not pose a substantial risk to the

safety and soundness of depository institutions or the financial system generally (as solely determined by the Federal Reserve), without prior approval of the Federal Reserve.

Investments, Control, and Activities. With some limited exceptions, the Bank Holding Company Act requires every bank holding company to obtain the prior approval of the Federal Reserve before acquiring another bank holding company or acquiring more than five percent of the voting shares of a bank (unless it already owns or controls the majority of such shares).

Bank holding companies are prohibited, with certain limited exceptions, from engaging in activities other than those of banking or of managing or controlling banks. They are also prohibited from acquiring or retaining direct or indirect ownership or control of voting shares or assets of any company which is not a bank or bank holding company, other than subsidiary companies furnishing services to or performing services for their subsidiaries, and other subsidiaries engaged in activities which the Federal Reserve

determines to be so closely related to banking or managing or controlling banks as to be incidental to these operations. The Bank Holding Company Act does not place territorial restrictions on the activities of such nonbanking-related activities.

Bank holding companies which meet certain management, capital, and Community Reinvestment Act of 1977 (“CRA”) standards may elect to become a financial holding company, which would allow them to engage in a substantially broader range of nonbanking activities than is permitted for a bank holding company, including insurance underwriting and making merchant banking investments in commercial and financial companies.

The Corporation is a financial holding company (“FHC”) within the meaning of the Gramm-Leach-Bliley Financial Modernization Act of 1999 (“GLB Act”). The GLB Act restricts the business of FHC’s to financial and related activities, and provides the following:

- it allows bank holding companies that qualify as “financial holding companies” to engage in a broad range of financial and related activities;
- it allows insurers and other financial services companies to acquire banks;
- it removes various restrictions that applied to bank holding company ownership of securities firms and mutual fund advisory companies; and
- it establishes the overall regulatory structure applicable to bank holding companies that also engage in insurance and securities operations.

As a qualified FHC, the Corporation is eligible to engage in, or acquire companies engaged in, the broader range of activities that are permitted by the GLB Act. These activities include those that are determined to be “financial in nature,” including insurance underwriting, securities underwriting and dealing, and making merchant banking investments in commercial and financial companies. If any of the Corporation’s banking subsidiaries ceases to be “well capitalized” or “well managed” under applicable regulatory standards, the Federal Reserve Board may, among other things, place limitations on the Corporation’s ability to conduct these broader financial activities or, if the deficiencies persist, require the divestiture of the banking subsidiary. In addition, if any of the Corporation’s banking subsidiaries receives a rating of less than satisfactory under the CRA, the Corporation would be prohibited from engaging in any additional activities other than those permissible for bank holding companies that are not financial holding companies. The Corporation’s banking subsidiaries currently meet these capital, management and CRA requirements.

Dividends. The Federal Reserve’s policy is that a bank holding company experiencing earnings weakness should not pay cash dividends exceeding its net income or which could only be funded in ways that weaken the bank holding company’s financial health, such as by borrowing. Additionally, the Federal Reserve possesses enforcement powers over bank holding companies and their non-bank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to proscribe the payment of dividends by banks and bank holding companies.

Source of Strength. In accordance with Federal Reserve policy, the Corporation is expected to act as a source of financial strength to the Bank and Morris Plan and to commit resources to support the Bank and Morris Plan in circumstances in which the Corporation might not otherwise do so.

Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act of 2002 (the “Sarbanes-Oxley Act”) represents a comprehensive revision of laws affecting corporate governance, accounting obligations and corporate reporting. Among other requirements, the Sarbanes-Oxley Act established: (i) requirements for audit committees of public companies, including independence and expertise standards; (ii) additional responsibilities regarding financial statements for the chief executive officers and chief financial officers of reporting companies; (iii) standards for auditors and regulation

of audits; (iv) increased disclosure and reporting obligations for reporting companies regarding various matters relating to corporate governance, and (v) new and increased civil and criminal penalties for violation of the securities laws.

The Bank and Morris Plan

General Regulatory Supervision. The Bank is a national bank organized under the laws of the United States of America and is subject to the supervision of the OCC, whose examiners conduct periodic examinations of the Bank. The Bank must undergo regular on-site examinations by the OCC and must submit quarterly and annual reports to the OCC concerning its activities and financial condition.

Morris Plan is an Indiana-chartered institution and is subject to the supervision of the FDIC and the DFI, whose examiners conduct periodic examinations of Morris Plan. Morris Plan must undergo regular on-site examinations by the FDIC and the DFI and must submit quarterly and annual reports to the FDIC and the DFI concerning its activities and financial condition.

The deposits of the Bank and Morris Plan are insured by the FDIC and are subject to the FDIC's rules and regulations respecting the insurance of deposits. See "Deposit Insurance".

Lending Limits. The total loans and extensions of credit to a borrower outstanding at one time and not fully secured may not exceed 15 percent of the bank's capital and unimpaired surplus. In addition, the total amount of outstanding loans and extensions of credit to any borrower outstanding at one time and fully secured by readily marketable collateral may not exceed 10 percent of the unimpaired capital and unimpaired surplus of the bank (this limitation is separate from and in addition to the above limitation). If a loan is secured by United States obligations, such as treasury bills, it is not subject to this legal lending limit.

Deposit Insurance. The Dodd-Frank Act has permanently increased the maximum amount of deposit insurance for financial institutions per insured depositor to \$250,000.

The deposits of the Bank and Morris Plan are insured up to the applicable limits under the Deposit Insurance Fund ("DIF"). The FDIC maintains the DIF by assessing depository institutions an insurance premium. Pursuant to the Dodd-Frank Act, the FDIC is required to set a DIF reserve ratio of 1.35% of estimated insured deposits and is required to achieve this ratio by September 30, 2020.

In connection with the Dodd-Frank Act's requirement that insurance assessments be based on assets, the FDIC bases assessments on an institution's average consolidated assets (less average tangible equity) as opposed to its deposit level. This may shift the burden of deposit premiums toward larger depository institutions which rely on funding sources other than U.S. deposits.

Under the FDIC's risk-based assessment system, insured institutions are required to pay deposit insurance premiums based on the risk that each institution poses to the DIF. An institution's risk to the DIF is measured by its regulatory capital levels, supervisory evaluations, and certain other factors. An institution's assessment rate depends upon the risk category to which it is assigned. As noted above, pursuant to the Dodd-Frank Act, the FDIC will calculate an institution's assessment level based on its total average consolidated assets during the assessment period less average tangible equity (i.e., Tier 1 capital) as opposed to an institution's deposit level which was the previous basis for calculating insurance assessments. Pursuant to the Dodd-Frank Act, institutions will be placed into one of four risk categories for purposes of determining the institution's actual assessment rate. The FDIC will determine the risk category based on the institution's capital position (well capitalized, adequately capitalized, or undercapitalized) and supervisory condition (based on exam reports and related information provided by the institution's primary federal regulator). The Bank paid a total FDIC assessment of \$1.7 million and Morris Plan paid a total FDIC assessment of \$31 thousand in 2015.

In addition to the FDIC insurance premiums, the Bank and the Morris Plan are required to make quarterly payments on bonds issued by the Financing Corporation ("FICO"), an agency of the Federal government established to recapitalize a predecessor deposit insurance fund. These assessments will continue until the FICO bonds are repaid.

Transactions with Affiliates and Insiders. Pursuant to Sections 23A and 23B of the Federal Reserve Act and Regulation W, the Bank and Morris Plan are subject to limitations on the amount of loans or extensions of credit to, or investments in, or certain other transactions with, affiliates (including the Corporation) and insiders and on the amount of advances to third parties collateralized by the securities or obligations of affiliates. Furthermore, within the

foregoing limitations as to amount, each covered transaction must meet specified collateral requirements. Compliance is also required with certain provisions designed to avoid the taking of low quality assets. The Bank and Morris Plan are also prohibited from engaging in certain transactions with certain affiliates and insiders unless the transactions are on terms substantially the same, or at least as favorable to such institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies.

Extensions of credit by the Bank or Morris Plan to their executive officers, directors, certain principal shareholders, and their related interests must:

- be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties; and
- not involve more than the normal risk of repayment or present other unfavorable features.

The Dodd-Frank Act also included specific changes to the law related to the definition of a “covered transaction” in Sections 23A and 23B and limitations on asset purchases from insiders. With respect to the definition of a “covered transaction,” the Dodd-Frank Act now defines that term to include the acceptance of debt obligations issued by an affiliate as collateral for an institution’s

loan or extension of credit to another person or company. In addition, a “derivative transaction” with an affiliate is now deemed to be a “covered transaction” to the extent that such a transaction causes an institution or its subsidiary to have a credit exposure to the affiliate. A separate provision of the Dodd-Frank Act states that an insured depository institution may not “purchase an asset from, or sell an asset to” a bank insider (or their related interests) unless (1) the transaction is conducted on market terms between the parties and (2) if the proposed transaction represents more than 10 percent of the capital stock and surplus of the insured institution, it has been approved in advance by a majority of the institution’s non-interested directors.

Dividends. Applicable law provides that a financial institution, such as the Bank or Morris Plan, may pay dividends from its undivided profits in an amount declared by its Board of Directors, subject to prior regulatory approval if the proposed dividend, when added to all prior dividends declared during the current calendar year, would be greater than the current year's net income and retained earnings for the previous two calendar years.

Federal law generally prohibits the Bank or Morris Plan from paying a dividend to the Corporation if it would thereafter be undercapitalized. The FDIC may prevent a financial institution from paying dividends if it is in default of payment of any assessment due to the FDIC. In addition, payment of dividends by a bank may be prevented by the applicable federal regulatory authority if such payment is determined, by reason of the financial condition of such bank, to be an unsafe and unsound banking practice.

Community Reinvestment Act. The CRA requires that the federal banking regulators evaluate the records of a financial institution in meeting the credit needs of its local community, including low and moderate income neighborhoods. These factors are also considered in evaluating mergers, acquisitions, and applications to open a branch or facility. Failure to adequately meet these criteria could result in the imposition of additional requirements and limitations on the Bank or on Morris Plan.

Interest Rate and Market Risk. The federal bank regulators also have issued a joint policy statement to provide guidance on sound practices for managing interest rate risk. The statement sets forth the factors the federal regulatory examiners will use to determine the adequacy of a bank's capital for interest rate risk. These qualitative factors include the adequacy and effectiveness of the bank's internal interest rate risk management process and the level of interest rate exposure. Other qualitative factors that will be considered include the size of the bank, the nature and complexity of its activities, the adequacy of its capital and earnings in relation to the bank's overall risk profile, and its earning exposure to interest rate movements. The interagency supervisory policy statement describes the responsibilities of a bank's board of directors in implementing a risk management process and the requirements of the bank's senior management in ensuring the effective management of interest rate risk. Further, the statement specifies the elements that a risk management process must contain.

The federal banking regulators have also issued regulations revising the risk-based capital standards to include a supervisory framework for measuring market risk. The effect of these regulations is that any bank holding company or bank which has significant exposure to market risk must measure such risk using its own internal model, subject to the requirements contained in the regulations, and must maintain adequate capital to support that exposure. These regulations apply to any bank holding company or bank whose trading activity equals 10% or more of its total assets, or whose trading activity equals \$1 billion or more. Examiners may require a bank holding company or bank that does not meet the applicability criteria to comply with the capital requirements if necessary for safety and soundness purposes. These regulations contain supplemental rules to determine qualifying and excess capital, calculate risk-weighted assets, calculate market risk-equivalent assets and calculate risk-based capital ratios adjusted for market risk.

Prompt Corrective Action. The Federal Deposit Insurance Act, as amended (“FDIA”), requires among other things, the federal banking agencies to take “prompt corrective action” in respect of depository institutions that do not meet

minimum capital requirements. The FDIA includes the following five capital tiers: “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” and “critically undercapitalized.” A depository institution’s capital tier will depend upon how its capital levels compare with various relevant capital measures and certain other factors, as established by regulation. The relevant capital measures are the total risk-based capital ratio, the Tier 1 risk-based capital ratio, the common equity Tier 1 risk-based capital ratio and the leverage ratio.

A bank will be (i) “well capitalized” if the institution has a total risk-based capital ratio of 10.0% or greater, a Tier 1 risk-based capital ratio of 8.0% or greater, a common equity tier 1 risk-based capital ratio of 6.5% or greater and a leverage ratio of 5.0% or greater, and is not subject to any order or written directive by any such regulatory authority to meet and maintain a specific capital level for any capital measure; (ii) “adequately capitalized” if the institution has a total risk-based capital ratio of 8.0% or greater, a Tier 1 risk-based capital ratio of 6.0% or greater, a common equity Tier 1 risk-based capital ratio of 4.5% or greater and a leverage ratio of 4.0% or greater and is not “well capitalized”; (iii) “undercapitalized” if the institution has a total risk-based capital ratio that is less than 8.0%, a Tier 1 risk-based capital ratio of less than 6.0%, a common equity Tier 1 risk-based capital ratio of 4.5%, or a leverage ratio of less than 4.0%; (iv) “significantly undercapitalized” if the institution has a total risk-based capital ratio of less than 6.0%, a Tier 1 risk-based capital ratio of less than 4.0%, a common equity Tier 1 risk-based capital ratio of less than

3.0%, or a leverage ratio of less than 3.0%; and (v) “critically undercapitalized” if the institution’s tangible equity is equal to or less than 2.0% of average quarterly tangible assets. An institution may be downgraded to, or deemed to be in, a capital category that is lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. A bank’s capital category is determined solely for the purpose of applying prompt corrective action regulations, and the capital category may not constitute an accurate representation of the bank’s overall financial condition or prospects for other purposes.

The FDIA generally prohibits a depository institution from making any capital distributions (including payment of a dividend) or paying any management fee to its parent holding company if the depository institution would thereafter be “undercapitalized.” “Undercapitalized” institutions are subject to growth limitations and are required to submit a capital restoration plan. The agencies may not accept such a plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution’s capital. In addition, for a capital restoration plan to be acceptable, the depository institution’s parent holding company must guarantee that the institution will comply with such capital restoration plan. The bank holding company must also provide appropriate assurances of performance. The aggregate liability of the parent holding company is limited to the lesser of (i) an amount equal to 5.0% of the depository institution’s total assets at the time it became undercapitalized and (ii) the amount which is necessary (or would have been necessary) to bring the institution into compliance with all capital standards applicable with respect to such institution as of the time it fails to comply with the plan. If a depository institution fails to submit an acceptable plan, it is treated as if it is “significantly undercapitalized.”

“Significantly undercapitalized” depository 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, and cessation of receipt of deposits from correspondent banks. “Critically undercapitalized” institutions are subject to the appointment of a receiver or conservator.

The appropriate federal banking agency may, under certain circumstances, reclassify a well-capitalized insured depository institution as adequately capitalized. The FDIA provides that an institution may be reclassified if the appropriate federal banking agency determines (after notice and opportunity for hearing) that the institution is in an unsafe or unsound condition or deems the institution to be engaging in an unsafe or unsound practice.

The appropriate agency is also permitted to require an adequately capitalized or undercapitalized institution to comply with the supervisory provisions as if the institution were in the next lower category (but not treat a significantly undercapitalized institution as critically undercapitalized) based on supervisory information other than the capital levels of the institution.

The Corporation believes that, as of December 31, 2015, the Bank and Morris Plan were each “well capitalized” based on the aforementioned ratios.

Incentive Compensation. The Dodd-Frank Act requires the federal bank regulatory agencies and the SEC to establish joint regulations or guidelines prohibiting incentive-based payment arrangements at specified regulated entities, such as the Corporation and the Bank, having at least \$1 billion in total assets that encourage inappropriate risks by providing an executive officer, employee, director or principal shareholder with excessive compensation, fees, or benefits or that could lead to material financial loss to the entity. In addition, these regulators must establish regulations or guidelines requiring enhanced disclosure to regulators of incentive-based compensation arrangements. The agencies proposed such regulations in April 2011, but the regulations have not been finalized. If the regulations are adopted in the form initially proposed, they will impose limitations on the manner in which the Corporation may structure compensation for its executives.

The Federal Reserve Board, OCC and FDIC have issued a comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors. These three principles are incorporated into the proposed joint compensation regulations under the Dodd-Frank Act, discussed above.

The Federal Reserve Board will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Corporation, that are not "large, complex banking organizations." These reviews will be tailored to each organization based on the scope and complexity of the organization's activities and the prevalence of

incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the organization's supervisory ratings, which can affect the organization's ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

Ability-to-Repay Requirement and Qualified Mortgage Rule. The Dodd-Frank Act contains additional provisions that affect consumer mortgage lending. First, it significantly expands underwriting requirements applicable to loans secured by 1-4 family residential real property and augments federal law combating predatory lending practices. In addition to numerous new disclosure requirements, the Dodd-Frank Act imposes new standards for mortgage loan originations on all lenders, including banks and savings associations, in an effort to encourage lenders to verify a borrower's ability to repay, while also establishing a presumption of compliance for certain "qualified mortgages." Most significantly, the new standards limit the total points and fees that the Bank and/or a broker may charge on conforming and jumbo loans to 3% of the total loan amount.

The CFPB has issued a final rule that implements the Dodd-Frank Act's ability-to-repay requirements, and clarifies the presumption of compliance for "qualified mortgages." Further, the final rule also clarifies that qualified mortgages do not include "no-doc" loans and loans with negative amortization, interest-only payments, balloon payments, terms in excess of 30 years, or points and fees paid by the borrower that exceed 3% of the loan amount, subject to certain exceptions. In addition, for qualified mortgages, the monthly payment must be calculated on the highest payment that will occur in the first five years of the loan, and the borrower's total debt-to-income ratio generally may not be more than 43%. The final rule also provides that certain mortgages that satisfy the general product feature requirements for qualified mortgages and that also satisfy the underwriting requirements of Fannie Mae and Freddie Mac (while they operate under federal conservatorship or receivership) or the U.S. Department of Housing and Urban Development, Department of Veterans Affairs, or Department of Agriculture or Rural Housing Service are also considered to be qualified mortgages. This second category of qualified mortgages will phase out as the aforementioned federal agencies issue their own rules regarding qualified mortgages, the conservatorship of Fannie Mae and Freddie Mac ends, and, in any event, after seven years.

As set forth in the Dodd-Frank Act, subprime (or higher-priced) mortgage loans are subject to the ability-to-repay requirement, and the final rule provides for a rebuttable presumption of lender compliance for those loans. The final rule also applies the ability-to-repay requirement to prime loans, while also providing a conclusive presumption of compliance (i.e., a safe harbor) for prime loans that are also qualified mortgages. Additionally, the final rule generally prohibits prepayment penalties (subject to certain exceptions) and sets forth a 3-year record retention period with respect to documenting and demonstrating the ability-to-repay requirement and other provisions.

USA Patriot Act. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "USA Patriot Act") is intended to strengthen the ability of U.S. Law Enforcement to combat terrorism on a variety of fronts. The potential impact of the USA Patriot Act on financial institutions is significant and wide-ranging. The USA Patriot Act contains sweeping anti-money laundering and financial transparency laws and requires financial institutions to implement additional policies and procedures with respect to, or additional measures designed to address, any or all of the following matters, among others: money laundering and currency crimes, customer identification verification, cooperation among financial institutions, suspicious activities and currency transaction reporting.

S.A.F.E. Act Requirements. Regulations issued under the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (the "S.A.F.E. Act") require residential mortgage loan originators who are employees of institutions regulated by the foregoing agencies, including national banks, to meet the registration requirements of the S.A.F.E. Act. The

S.A.F.E. Act requires residential mortgage loan originators who are employees of regulated financial institutions to be registered with the Nationwide Mortgage Licensing System and Registry, a database created by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators to support the licensing of mortgage loan originators by the states. Employees of regulated financial institutions are generally prohibited from originating residential mortgage loans unless they are registered.

Other Regulations

Federal law extensively regulates other various aspects of the banking business such as reserve requirements. Current federal law also requires banks, among other things to make deposited funds available within specified time periods. In addition, with certain exceptions, a bank and a subsidiary may not extend credit, lease or sell property or furnish any services or fix or vary the consideration for the foregoing on the condition that (i) the customer must obtain or provide some additional credit, property or services from, or to, any of them, or (ii) the customer may not obtain some other credit, property or service from a competitor, except to the extent reasonable conditions are imposed to assure the soundness of credit extended.

Interest and other charges collected or contracted by the Bank or Morris Plan are subject to state usury laws and federal laws concerning interest rates. The loan operations are also subject to federal and state laws applicable to credit transactions, such as the:

- Truth-In-Lending Act and state consumer protection laws governing disclosures of credit terms and prohibiting certain practices with regard to consumer borrowers;
- Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- Equal Credit Opportunity Act and other fair lending laws, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- Fair Credit Reporting Act of 1978 and Fair and Accurate Credit Transactions Act of 2003, governing the use and provision of information to credit reporting agencies;
- Fair Debt Collection Practices Act, governing the manner in which consumer debts may be collected by collection agencies; and rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws.

The deposit operations also are subject to the:

Customer Information Security Guidelines. The federal bank regulatory agencies have adopted final guidelines (the "Guidelines") for safeguarding confidential customer information. The Guidelines require each financial institution, under the supervision and ongoing oversight of its Board of Directors, to create a comprehensive written information security program designed to ensure the security and confidentiality of customer information, protect against any anticipated threats or hazards to the security or integrity of such information; protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer; and implement response programs for security breaches.

Electronic Funds Transfer Act and Regulation E. The Electronic Funds Transfer Act, which is implemented by Regulation E, governs automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking service.

Gramm-Leach-Bliley Act, Fair and Accurate Credit Transactions Act. The Gramm-Leach-Bliley Act, the Fair and Accurate Credit Transactions Act, and the implementing regulations govern consumer financial privacy, provide disclosure requirements and restrict the sharing of certain consumer financial information with other parties.

The federal banking agencies have established guidelines which prescribe standards for depository institutions relating to internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, asset quality, earnings, compensation fees and benefits, and management compensation. The agencies may require an institution which fails to meet the standards set forth in the guidelines to submit a compliance plan. Failure to submit an acceptable plan or adhere to an accepted plan may be grounds for further enforcement action.

As noted above, the new Bureau of Consumer Financial Protection has authority for amending existing consumer compliance regulations and implementing new such regulations. In addition, the Bureau has the power to examine the compliance of financial institutions with an excess of \$10 billion in assets with these consumer protection rules. The Bank's and Morris Plan's compliance with consumer protection rules will be examined by the OCC and the FDIC, respectively, since neither the Bank nor Morris Plan meet this \$10 billion asset level threshold.

Enforcement Powers. Federal regulatory agencies may assess civil and criminal penalties against depository institutions and certain "institution-affiliated parties", including management, employees, and agents of a financial institution, as well as independent contractors and consultants such as attorneys and accountants and others who

participate in the conduct of the financial institution's affairs.

In addition, regulators may commence enforcement actions against institutions and institution-affiliated parties. Possible enforcement actions include the termination of deposit insurance. Furthermore, regulators may issue cease-and-desist orders to, among other things, require affirmative action to correct any harm resulting from a violation or practice, including restitution, reimbursement, indemnifications or guarantees against loss. A financial institution may also be ordered to restrict its growth, dispose of certain assets, rescind agreements or contracts, or take other actions as determined by the regulator to be appropriate.

Effect of Governmental Monetary Policies. The Corporation's earnings are affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The Federal Reserve Bank's monetary policies have had, and are likely to continue to have, an important impact on the operating results of commercial banks through its power

to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The monetary policies of the Federal Reserve have major effects upon the levels of bank loans, investments and deposits through its open market operations in United States government securities and through its regulation of the discount rate on borrowings of member banks and the reserve requirements against member bank deposits. It is not possible to predict the nature or impact of future changes in monetary and fiscal policies.

Available Information

The Corporation files annual reports on Form 10-K, quarterly reports on Form 10-Q, proxy statements and other information with the Securities and Exchange Commission. Such reports, proxy statements and other information can be read and copied at the public reference facilities maintained by the Securities and Exchange Commission at the Public Reference Room, 100 F Street, NE, Washington, D.C. 20549. Information regarding the operation of the Public Reference Room may be obtained by calling the Securities and Exchange Commission at 1-800-SEC-0330. The Securities and Exchange Commission maintains a web site (<http://www.sec.gov>) that contains reports, proxy statements, and other information. The Corporation's filings are also accessible at no cost on the Corporation's website at www.first-online.com.

ITEM 1A. RISK FACTORS

An investment in the Corporation's common stock is subject to risks inherent to the Corporation's business. The material risks and uncertainties that management believes affect the Corporation are described below. Before making an investment decision, you should carefully consider the risks and uncertainties described below together with all of the other information included or incorporated by reference in this report. The risks and uncertainties described below are not the only ones facing the Corporation. Additional risks and uncertainties that management is not aware of or focused on or that management currently deems immaterial may also impair the Corporation's business operations. This report is qualified in its entirety by these risk factors.

If any of the following risks actually occur, the Corporation's business, financial condition and results of operations could be materially and adversely affected. If this were to happen, the market price of the Corporation's common stock could decline significantly, and you could lose all or part of your investment.

Risks Related to the Corporation's Business

Difficult conditions in the capital markets and the economy generally may materially adversely affect the Corporation's business and results of operations

In recent years, the U.S. economy has faced a severe economic crisis including a major recession. Although the economy has been in the recovery phase since 2009, the recovery is weak and there can be no assurance that the economy will not enter into another recession, whether in the near term or long term. The Corporation's financial performance generally, and in particular the ability of borrowers to pay interest on and repay principal of outstanding loans and the value of collateral securing those loans, as well as demand for loans and other products and services that the Corporation offers, is highly dependent upon the business environment in the markets where the Corporation operates and in the United States as a whole.

New capital rules that were recently issued generally require insured depository institutions and their holding companies to hold more capital. The impact of the new rules on our financial condition and operations is uncertain but could be materially adverse.

The Federal Reserve, the FDIC and the OCC have adopted final rules for the Basel III capital framework which became effective on January 1, 2015. These rules substantially amended the regulatory risk-based capital rules formerly applicable to the Corporation and its banking subsidiaries. The rules phase in overtime beginning in 2015 and will become fully effective in 2019. The rules provide for minimum capital ratios of (i) common equity Tier 1 risk-weighted capital ratio of 4.5%, (ii) Tier 1 risk-based capital ratio (common Tier 1 capital plus Additional Tier 1 capital) of 6%, and (iii) total risk-based capital ratio of 8% (the current requirement). Beginning in 2016, a capital conservation buffer will phase in over three years, ultimately resulting in a requirement of 2.5% on top of the common Tier 1, Tier 1 and total capital requirements, resulting in a required common equity Tier 1 risk-based ratio of 7%, a Tier 1 risk-based ratio of 8.5%, and a total risk-based capital ratio of 10.5%. Failure to satisfy any of these three capital requirements will result in limits on paying dividends, engaging in share repurchases and paying discretionary bonuses. These limitations will establish a maximum percentage of eligible retained income that could be utilized for such actions.

The geographic concentration of the Corporation's markets makes the Corporation's business highly susceptible to local economic conditions

Unlike larger banking organizations that are more geographically diversified, the Corporation's operations are currently concentrated in west central Indiana and east central Illinois. As a result of this geographic concentration, the Corporation's financial results depend largely upon economic conditions in these market areas. Deterioration in economic conditions in the Corporation's market could result in one or more of the following:

- an increase in loan delinquencies;
- an increase in problem assets and foreclosures;
- a decrease in the demand for the Corporation's products and services; and
- a decrease in the value of collateral for loans, especially real estate, in turn reducing customers' borrowing power, the value of assets associated with problem loans and collateral coverage.

The Corporation operates in a highly competitive industry and market area

The Corporation faces substantial competition in all areas of its operations from a variety of different competitors, many of which are larger and may have more financial resources. Such competitors include banks and many other types of financial institutions, including, without limitation, savings and loans, credit unions, finance companies, brokerage firms, insurance companies, factoring companies and other financial intermediaries. The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Banks, securities firms and insurance companies can merge under the umbrella of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting) and merchant banking. Also, technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Many of the Corporation's competitors have fewer regulatory constraints and may have lower cost structures. Additionally, due to their size, many competitors may be able to achieve economies of scale and, as a result, may offer a broader range of products and services as well as better pricing for those products and services than the Corporation can.

The Corporation's ability to compete successfully depends on a number of factors, including, among other things:

- the ability to develop, maintain and build upon long-term customer relationships based on top quality service, and safe, sound assets;
- the ability to expand the Corporation's market position;
- the scope, relevance and pricing of products and services offered to meet customer needs and demands;
- the rate at which the Corporation introduces new products and services relative to its competitors;
- customer satisfaction with the Corporation's level of service; and
- industry and general economic trends.

Failure to perform in any of these areas could significantly weaken the Corporation's competitive position, which could adversely affect the Corporation's growth and profitability, which, in turn, could have a material adverse effect on the Corporation's financial condition and results of operations.

The Corporation is dependent on certain key management and staff

The Corporation relies on key personnel to manage and operate its business. The loss of key staff may adversely affect the Corporation's ability to maintain and manage these portfolios effectively, which could negatively affect the Corporation's revenues. In addition, loss of key personnel could result in increased recruiting and hiring expenses, which could cause a decrease in the Corporation's net income.

Recently enacted and potential further financial regulatory reforms could have a significant impact on our business, financial condition and results of operations

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), enacted in July 2010, instituted major changes to the banking and financial institutions regulatory regimes in light of the recent performance of and government intervention in the financial services sector. Many aspects of the Dodd-Frank Act are subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on the Corporation. The changes resulting from

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the Dodd-Frank Act will impose more stringent capital, liquidity and leverage requirements and may impact the profitability of business activities, require changes to certain business practices, or otherwise adversely affect the Corporation's business.

Further, the Corporation may be required to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements under the Dodd-Frank Act, which may negatively impact results of operations and financial condition. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect the Corporation in substantial and unpredictable ways. Such changes could subject the Corporation to additional costs, limit the types of financial services and products the Corporation may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things.

The Corporation cannot predict whether there will be additional proposed laws or reforms that would affect the U.S. financial system or financial institutions, whether or when such changes may be adopted, how such changes may be interpreted and enforced or how such changes may impact the Corporation's financial condition and results of operations. However, the costs of complying with any additional laws or regulations could have a material adverse effect on the Corporation's financial condition and results of operations.

The Corporation is subject to extensive government regulation and supervision

The Corporation, primarily through the Bank and Morris Plan, is subject to extensive federal regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not shareholders. These regulations affect the Corporation's lending practices, capital structure, investment practices, and growth, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on the Corporation's business, financial condition and results of operations. While the Corporation has policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur.

The Corporation is subject to lending risk

There are inherent risks associated with the Corporation's lending activities. These risks include, among other things, the impact of changes in interest rates and changes in the economic conditions in the markets where the Corporation operates as well as those across Indiana, Illinois and the United States. Increases in interest rates and/or weakening economic conditions could adversely impact the ability of borrowers to repay outstanding loans or the value of the collateral securing these loans.

The Corporation originates commercial real estate loans, commercial loans, consumer loans and residential real estate loans primarily within its market areas. Commercial real estate, commercial, and consumer loans may expose a lender to greater credit risk than loans secured by residential real estate because the collateral securing these loans may not be sold as easily as residential real estate. The Corporation is also subject to various laws and regulations that affect its lending activities. Failure to comply with applicable laws and regulations could subject the Corporation to regulatory enforcement action that could result in the assessment of significant civil money penalties against the Corporation.

The Corporation's allowance for loan losses may be insufficient

The Corporation maintains an allowance for loan losses, which is a reserve established through a provision for loan losses charged to expense, that represents management's best estimate of probable incurred losses that are inherent

within the existing portfolio of loans. The level of the allowance reflects management's continuing evaluation of industry concentrations; specific credit risks; loan loss experience; current loan portfolio quality; present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires the Corporation to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of the Corporation's control, may require an increase in the allowance for loan losses. In addition, bank regulatory agencies periodically review the Corporation's allowance for loan losses and may require an increase in the provision for loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. If charge-offs in future periods exceed the allowance for loan losses, the Corporation will need additional provisions to increase the allowance for loan losses. Any increases in the allowance for loan losses will result in a decrease in net income and, possibly, capital, and may have a material adverse effect on the Corporation's financial condition and results of operations.

The Corporation may foreclose on collateral property and would be subject to the increased costs associated with ownership of real property, resulting in reduced revenues and earnings

The Corporation forecloses on collateral property from time to time to protect its investment and thereafter owns and operates such property, in which case it is exposed to the risks inherent in the ownership of real estate. The amount that the Corporation, as a mortgagee, may realize after a default is dependent upon factors outside of its control, including, but not limited to: (i) general or local economic conditions; (ii) neighborhood values; (iii) interest rates; (iv) real estate tax rates; (v) operating expenses of the mortgaged properties; (vi) environmental remediation liabilities; (vii) ability to obtain and maintain adequate occupancy of the properties; (viii) zoning laws; (ix) governmental rules, regulations and fiscal policies; and (x) natural disasters. Certain expenditures associated with the ownership of real estate, principally real estate taxes, insurance, and maintenance costs, may adversely affect the income from the real estate. Therefore, the cost of operating real property may exceed the income earned from such property, and the Corporation may have to advance funds in order to protect its investment, or it may be required to dispose of the real property at a loss. These expenditures and costs could adversely affect the Corporation's ability to generate revenues, resulting in reduced levels of profitability.

The Corporation is subject to environmental liability risk associated with lending activities

A significant portion of the Corporation's loan portfolio is secured by real property. During the ordinary course of business, the Corporation may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, the Corporation may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require the Corporation to incur substantial expenses and may materially reduce the affected property's value or limit the Corporation's ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase the Corporation's exposure to environmental liability. Environmental reviews of real property before initiating foreclosure actions may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on the Corporation's business, financial condition and results of operations.

The Corporation is subject to interest rate risk

The Corporation's earnings and cash flows are largely dependent upon the Corporation's net interest income. Net interest income is the difference between interest income earned on interest earning assets such as loans and securities and interest expense paid on interest bearing liabilities such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond the Corporation's control, including general economic conditions and policies of various governmental and regulatory agencies. Changes in monetary policy, including changes in interest rates, could influence not only the interest that is received on loans and securities and the interest that is paid on deposits and borrowings, but such changes could also affect (i) the Corporation's ability to originate loans and obtain deposits, and (ii) the fair value of the Corporation's financial assets and liabilities. Currently, the Corporation is in an asset-sensitive position. In a rising interest rate environment, the Corporation may be unable to sell its lower-yielding mortgage loans, thus impacting its ability to generate higher yielding loans which could adversely impact earnings.

The Corporation's accounting estimates and risk management processes rely on analytical and forecasting models

The processes the Corporation uses to estimate its probable loan losses and to measure the fair value of financial instruments, as well as the processes used to estimate the effects of changing interest rates and other market measures on the Corporation's financial condition and results of operations, depends upon the use of analytical and forecasting models. These models reflect assumptions that may not be accurate, particularly in times of market stress or other

unforeseen circumstances. Even if these assumptions are adequate, the models may prove to be inadequate or inaccurate because of other flaws in their design or their implementation. If the models the Corporation uses for interest rate risk and asset-liability management are inadequate, the Corporation may incur increased or unexpected losses upon changes in market interest rates or other market measures. If the models the Corporation uses for determining its probable loan losses are inadequate, the allowance for loan losses may not be sufficient to support future charge-offs. If the models the Corporation uses to measure the fair value financial instruments are inadequate, the fair value of such financial instruments may fluctuate unexpectedly or may not accurately reflect what the Corporation could realize upon sale or settlement of such financial instruments. Any such failure in the Corporation's analytical or forecasting models could have a material adverse effect on the Corporation's business, financial condition and results of operations.

The Corporation's earnings could be adversely impacted by incidences of fraud and compliance failure

The Corporation's internal operations are subject to certain risks, including but not limited to, data processing system failures and errors, customer or employee fraud and catastrophic failures resulting from terrorist acts or natural disasters. Operational risk resulting from inadequate or failed internal processes, people, and systems includes the risk of fraud by employees or persons outside of our company, the execution of unauthorized transactions by employees, errors relating to transaction processing and systems, and breaches of the internal control system and compliance requirements. This risk of loss also includes potential legal actions that could arise as a result of the operational deficiency or as a result of noncompliance with applicable regulatory standards. The Corporation's internal controls, disclosure controls and procedures, and corporate governance policies and procedures are 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 the Corporation's controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on the Corporation's business, financial condition and results of operations.

Risks associated with cyber-security could negatively affect our earnings

The financial services industry has experienced an increase in both the number and severity of reported cyber attacks aimed at gaining unauthorized access to bank systems as a way to misappropriate assets and sensitive information, corrupt and destroy data, or cause operational disruptions. We have established policies and procedures to prevent or limit the impact of security breaches, but such events may still occur or may not be adequately addressed if they do occur. Although we rely on security safeguards to secure our data, these safeguards may not fully protect our systems from compromises or breaches.

We also rely on the integrity and security of a variety of third party processors, payment, clearing and settlement systems, as well as the various participants involved in these systems, many of which have no direct relationship with us. Failure by these participants or their systems to protect our customers' transaction data may put us at risk for possible losses due to fraud or operational disruption.

Our customers are also the target of cyber attacks and identity theft. Large scale identity theft could result in customers' accounts being compromised and fraudulent activities being performed in their name. We have implemented certain safeguards against these types of activities but they may not fully protect us from fraudulent financial losses.

The occurrence of a breach of security involving our customers' information, regardless of its origin, could damage our reputation and result in a loss of customers and business and subject us to additional regulatory scrutiny, and could expose us to litigation and possible financial liability. Any of these events could have a material adverse effect on our financial condition and results of operations.

The Corporation has opened new offices that may not be profitable

The Corporation has placed a strategic emphasis on expanding its banking office network. Executing this strategy carries risks of slower than anticipated growth in the new offices, which require a significant investment of both financial and personnel resources. Lower than expected loan and deposit growth in new offices can decrease anticipated revenues and net income generated by those offices, and opening new offices could result in more additional expenses than anticipated and divert resources from current core operations.

Potential acquisitions may disrupt the Corporation's business and dilute stockholder value

The Corporation generally seeks merger or acquisition partners that are culturally similar and have experienced management and possess either significant market presence or have potential for improved profitability through financial management, economies of scale or expanded services. 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 target company;
- exposure to potential asset quality issues of the target company;
- potential disruption to the Corporation's business;
- potential diversion of the Corporation's management's time and attention;
- the possible loss of key employees and customers of the target company;
- difficulty in estimating the value of the target company; and
- potential changes in banking or tax laws or regulations that may affect the target company.

Acquisitions typically involve the payment of a premium over book and market values, and, therefore, some dilution of the Corporation's tangible book value and net income per common share may occur in connection with any future transaction. Furthermore, failure to realize the expected revenue increases, cost savings, increases in geographic or product presence, and/or other projected benefits from an acquisition could have a material adverse effect on the Corporation's business, financial condition and results of operations.

New lines of business or new products and services may subject the Corporation to additional risks

From time to time, the Corporation may implement new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. In developing and marketing new lines of business and/or new products and services the Corporation may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business or a new product or service. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of the Corporation's system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business or new products or services could have a material adverse effect on the Corporation's business, financial condition and results of operations.

Future growth or operating results may require the Corporation to raise additional capital but that capital may not be available or it may be dilutive

The Corporation is required by federal and state regulatory authorities to maintain adequate levels of capital to support its operations. To the extent the Corporation's future operating results erode capital or the Corporation elects to expand through loan growth or acquisition it may be required to raise capital. The Corporation's ability to raise capital will depend on conditions in the capital markets, which are outside of its control, and on the Corporation's financial performance. Accordingly, the Corporation cannot be assured of its ability to raise capital when needed or on favorable terms. If the Corporation cannot raise additional capital when needed, it will be subject to increased regulatory supervision and the imposition of restrictions on its growth and business. These could negatively impact the Corporation's ability to operate or further expand its operations through acquisitions or the establishment of additional branches and may result in increases in operating expenses and reductions in revenues that could have a material adverse effect on its financial condition and results of operations.

The Corporation is subject to claims and litigation pertaining to Intellectual Property

Banking and other financial services companies, such as the Corporation, rely on technology companies to provide information technology products and services necessary to support the Corporations' day-to-day operations. Technology companies frequently enter into litigation based on allegations of patent infringement or other violations of intellectual property rights. In addition, patent holding companies seek to monetize patents they have purchased or otherwise obtained. Competitors of the Corporation's vendors, or other individuals or companies, have from time to time claimed to hold intellectual property sold to the Corporation by its vendors. Such claims may increase in the future as the financial services sector becomes more reliant on information technology vendors. The plaintiffs in these actions frequently seek injunctions and substantial damages.

Regardless of the scope or validity of such patents or other intellectual property rights, or the merits of any claims by potential or actual litigants, the Corporation may have to engage in protracted litigation. Such litigation is often expensive, time-consuming, disruptive to the Corporation's operations, and distracting to management. If the Corporation is found to infringe upon one or more patents or other intellectual property rights, it may be required to

pay substantial damages or royalties to a third-party. In certain cases, the Corporation may consider entering into licensing agreements for disputed intellectual property, although no assurance can be given that such licenses can be obtained on acceptable terms or that litigation will not occur. These licenses may also significantly increase the Corporation's operating expenses. If legal matters related to intellectual property claims were resolved against the Corporation or settled, the Corporation could be required to make payments in amounts that could have a material adverse effect on its business, financial condition and results of operations.

The value of the Corporation's goodwill and other intangible assets may decline in the future

As of December 31, 2015, the Corporation had \$42.7 million of goodwill and other intangible assets. A significant decline in the Corporation's expected future cash flows, a significant adverse change in the business climate, slower growth rates or a significant and sustained decline in the price of the Corporation's common stock may necessitate taking charges in the future

related to the impairment of the Corporation's goodwill and other intangible assets. If the Corporation were to conclude that a future write-down of goodwill and other intangible assets is necessary, the Corporation would record the appropriate charge, which could have a material adverse effect on the Corporation's business, financial condition and results of operations.

The Corporation's operations rely on certain external vendors

The Corporation relies on certain external vendors to provide products and services necessary to maintain day-to-day operations of the Corporation. Accordingly, the Corporation's operations are exposed to risk that these vendors will not perform in accordance with the contracted arrangements under service level agreements. The failure of an external vendor to perform in accordance with the contracted arrangements under service level agreements, because of changes in the vendor's organizational structure, financial condition, support for existing products and services or strategic focus or for any other reason, could be disruptive to the Corporation's operations, which could have a material adverse impact on the Corporation's business and, in turn, the Corporation's financial condition and results of operations.

The Corporation may be adversely affected by the soundness of other financial institutions

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. The Corporation has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks, and other institutional clients. Many of these transactions expose the Corporation to credit risk in the event of a default by a counterparty or client. In addition, the Corporation's credit risk may be exacerbated when the collateral held by the Corporation cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due to the Corporation. Any such losses could have a material adverse effect on the Corporation's business, financial condition and results of operations.

The Corporation relies on dividends from its subsidiaries for most of its revenue

The Corporation is a separate and distinct legal entity from its subsidiaries. It receives substantially all of its revenue from dividends from its subsidiaries. These dividends are the principal source of funds to pay dividends on the Corporation's common stock and interest and principal on the Corporation's debt. Various federal and state laws and regulations limit the amount of dividends that the Bank and Morris Plan may pay to the Corporation. Also, the Corporation's right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors. In the event the Bank is unable to pay dividends to the Corporation, the Corporation may not be able to service debt, pay obligations or pay dividends on the Corporation's common stock. The inability to receive dividends from the Bank could have a material adverse effect on the Corporation's business, financial condition and results of operations.

Risks Related to the Corporation's Common Stock

The Corporation may not be able to pay dividends in the future in accordance with past practice

The Corporation has historically paid a semi-annual dividend to common stockholders. The payment of dividends is subject to legal and regulatory restrictions. Any payment of dividends in the future will depend, in large part, on the Corporation's earnings, capital requirements, financial condition and other factors considered relevant by the Corporation's Board of Directors.

The price of the Corporation's common stock may be volatile, which may result in losses for investors

General market price declines or market volatility in the future could adversely affect the price of the Corporation's common stock. In addition, the following factors may cause the market price for shares of the Corporation's common stock to fluctuate:

- announcements of developments related to the Corporation's business;
- fluctuations in the Corporation's results of operations;
- sales or purchases of substantial amounts of the Corporation's securities in the marketplace;
- general conditions in the Corporation's banking niche or the worldwide economy;
- shortfall or excess in revenues or earnings compared to securities analysts' expectations;
- changes in analysts' recommendations or projections; and
- the Corporation's announcement of new acquisitions or other projects.

An investment in the Corporation's common stock is not an insured deposit

The Corporation's common stock is not a bank deposit and, therefore, is not insured against loss by the Federal Deposit Insurance Corporation (FDIC), any other deposit insurance fund or by any other public or private entity. Investment in the Corporation's common stock is inherently risky for the reasons described in this "Risk Factors" section and elsewhere in this report and is subject to the same market forces that affect the price of common stock in any company. As a result, if you acquire the Corporation's common stock, you could lose some or all of your investment.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Corporation is located in a four-story office building in downtown Terre Haute, Indiana that was first occupied in June 1988. It is leased to the Bank. The Bank also owns two other facilities in downtown Terre Haute. One is available for lease and the other is a 50,000-square-foot building housing operations and administrative staff and equipment. In addition, the Bank holds in fee six other branch buildings. One of the branch buildings is a single-story 36,000-square-foot building which is located in a Terre Haute suburban area. Four other branch bank buildings are leased by the Bank. The expiration dates on the leases are May 31, 2016, February 14, 2021, May 31, 2017, and December 31, 2019.

Facilities of the Corporation's banking center in Daviess County include an office in Washington, Indiana. This building is held in fee.

Facilities of the Corporation's banking centers in Clay County include two offices in Brazil, Indiana and an office in Clay City, Indiana. All three buildings are held in fee.

Facilities of the Corporation's banking centers in Vermillion County include two offices in Clinton, Indiana and offices in Cayuga and Newport, Indiana. All four buildings are held in fee.

Facilities of the Corporation's banking centers in Sullivan County include offices in Sullivan, Dugger, Farmersburg and Hymera, Indiana. All four buildings are held in fee.

Facilities of the Corporation's banking center in Gibson County include an office in Princeton, Indiana. This building is held in fee.

Facilities of the Corporation's banking center in Greene County include an office in Worthington, Indiana. This building is held in fee.

Facilities of the Corporation's banking centers in Knox County include offices in Sandborn and two in Vincennes, Indiana. All three buildings are held in fee.

Facilities of the Corporation's banking centers in Parke County include two offices in Rockville, Indiana and offices in Marshall and Montezuma, Indiana. All four buildings are held in fee.

Facilities of the Corporation's banking center in Putnam County include an office in Greencastle, Indiana. This building is held in fee.

Facilities of the Corporation's banking center in Vanderburgh County include an office in Evansville, Indiana. This building is held in fee.

Facilities of the Corporation's banking centers in Crawford County include its main office and a drive-up facility in Robinson, Illinois. Both buildings are held in fee.

Facilities of the Corporation's banking centers in Franklin County include an office in Benton, Illinois and an office in West Frankfort, Illinois. Both buildings are held in fee.

Facilities of the Corporation's banking centers in Jefferson County include an office and a drive-up facility in Mt. Vernon, Illinois. Both buildings are held in fee.

Facilities of the Corporation's banking center in Lawrence County include an office in Lawrenceville, Illinois. This building is held in fee.

Facilities of the Corporation's banking centers in Livingston include two offices in Pontiac, Illinois. Both buildings are held in fee.

Facilities of the Corporation's banking centers in Marion County include an office and a drive-up facility in Salem, Illinois. Both buildings are held in fee.

Facilities of the Corporation's banking center in McLean County include two offices in Bloomington, Illinois, and an office in Gridley, Illinois. A banking center in Bloomington is leased and the lease expires on June 30, 2021. The other buildings are held in fee.

Facilities of the Corporation's banking center in Montgomery County include an office in Hillsboro, Illinois. This building is held in fee. The Corporation entered into an agreement to sell this office to First Community Bank of Hillsboro, Hillsboro, Illinois, on February 4, 2016.

Facilities of the Corporation's banking center in Wayne County include an office in Fairfield, Illinois. This building is held in fee.

Facilities of the Corporation's banking center in Jasper County include an office in Newton, Illinois. This building is held in fee.

Facilities of the Corporation's banking centers in Coles County include two offices in Charleston, Illinois and an office in Mattoon, Illinois. These buildings are held in fee.

Facilities of the Corporation's banking center in Clark County include an office in Marshall, Illinois. This building is held in fee.

Facilities of the Corporation's banking center in Champaign County include two offices in Champaign, Illinois, an office in Mahomet, Illinois, and two offices in Urbana, Illinois. One of the banking centers in Champaign is held in fee while the land is leased. The land lease expires September 6, 2036. One of the banking centers in Champaign is leased and the lease expires on December 31, 2017. The banking center in Mahomet is leased and the lease expires on June 4, 2019. One of the banking centers in Urbana is held in fee while the other banking center in Urbana is held in fee while the land is leased and the lease expires on November 30, 2017.

Facilities of the Corporation's banking center in Vermilion County include four offices in Danville, Illinois, an office in Westville, Illinois, and an office in Ridge Farm, Illinois. One of the buildings in Danville is leased and the lease expires on December 31, 2018 and the other five buildings are held in fee.

Facilities of the Corporation's banking centers in Richland County include two offices in Olney, Illinois. One building is held in fee and the other building is leased. The expiration date on the lease is April 30, 2020.

The facility of the Corporation's subsidiary, The Morris Plan Company, includes an office facility in Terre Haute, Indiana. The building is leased by The Morris Plan Company. The expiration date on the lease is October 31, 2020.

Facilities of the Corporation's subsidiary, Forrest Sherer, Inc., include its main office and one satellite office in Terre Haute, Indiana. The buildings are held in fee by Forrest Sherer, Inc.

Facilities of the Corporation's subsidiary, FFB Risk Management Co., Inc., include an office facility in Las Vegas, Nevada. This office facility is leased.

ITEM 3. LEGAL PROCEEDINGS

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

(b) Not applicable.

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

(a) As of March 1, 2016 shareholders owned 12,656,606 shares of the Corporation's common stock. The stock is traded on the NASDAQ Global Select Market under the symbol "THFF". On March 1, 2016, approximately 4,515 shareholders of record held our common stock.

Historically, the Corporation has paid cash dividends semi-annually and currently expects that comparable cash dividends will continue to be paid in the future. The following table gives quarterly high and low trade prices and dividends per share during each quarter for 2015 and 2014.

Quarter ended	2015		Cash Dividends Declared	2014		Cash Dividends Declared
	Trade Price			Trade Price		
	High	Low		High	Low	
March 31	\$35.99	\$32.41		\$35.18	\$30.60	
June 30	\$36.39	\$33.38	\$0.49	\$33.97	\$31.31	\$0.49
September 30	\$35.83	\$32.00		\$33.32	\$30.57	
December 31	\$37.49	\$32.19	\$0.49	\$35.91	\$30.99	\$0.49

The graph below represents the five-year total return of the Corporation's stock. The five year total return for our stock during this time was 10.72%. During this same period, the return on The Russell 2000 Index was 55.18% and the SNL Index of Banks \$1 - \$5 Billion had a return of 91.39%.

Index	Period Ending					
	12/31/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015
First Financial Corporation	100.00	97.56	91.63	112.54	112.83	110.72
Russell 2000	100.00	95.82	111.49	154.78	162.35	155.18
SNL Bank \$1B-\$5B	100.00	91.20	112.45	163.52	170.98	191.39

(b) Not applicable.

(c) The Corporation periodically acquires shares of its common stock directly from shareholders in individually negotiated transactions. On August 25, 2014 First Financial Corporation issued a press release announcing that it's Board of Directors has authorized a stock repurchase program pursuant to which up to 5% of the Corporation's outstanding shares of common stock, or 667,700 shares may be repurchased. There were 257,989 purchases of common stock by the Corporation during the year ended December 31, 2015. The Corporation contributed 36,149 shares of treasury stock to the ESOP in November of 2015. There were no shares of common stock purchased by the Corporation during the fourth quarter of the fiscal year covered by this report.

ITEM 6. SELECTED FINANCIAL DATA

FIVE YEAR COMPARISON OF SELECTED FINANCIAL DATA

(Dollar amounts in thousands, except per share amounts) 2015

	2015	2014	2013	2012	2011
BALANCE SHEET DATA					
Total assets	\$2,979,585	\$3,002,485	\$3,018,718	\$2,895,408	\$2,954,000
Securities	891,082	897,053	914,560	691,000	666,287
Loans, net of unearned fees	1,763,808	1,781,428	1,791,428	1,851,936	1,893,679
Deposits	2,442,369	2,457,197	2,458,791	2,276,134	2,274,499
Borrowings	46,508	60,901	117,880	160,256	246,449
Shareholders' equity	410,316	394,214	386,195	372,122	346,961
INCOME STATEMENT DATA					
Interest income	108,676	113,358	116,221	122,305	116,341
Interest expense	4,169	5,526	8,961	13,393	17,147
Net interest income	104,507	107,832	107,260	108,912	99,194
Provision for loan losses	4,700	5,072	7,860	8,773	5,755
Other income	39,179	40,785	40,455	39,547	33,340
Other expenses	98,398	95,584	94,554	93,056	75,187
Net income	30,196	33,772	31,534	32,812	37,195
PER SHARE DATA:					
Net Income	2.35	2.55	2.37	2.48	2.83
Cash dividends	0.98	0.98	0.96	0.95	0.94
PERFORMANCE RATIOS:					
Net income to average assets	1.01	% 1.12	% 1.06	% 1.13	% 1.49
Net income to average shareholders' equity	7.46	8.37	8.35	9.02	10.88
Average total capital to average assets	14.26	13.99	13.45	13.25	14.57
Average shareholders' equity to average assets	13.60	13.36	12.69	12.55	13.68
Dividend payout	41.51	38.16	40.58	38.40	33.29

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as disclosures found elsewhere in this report are based upon First Financial Corporation's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Corporation to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, securities valuation and goodwill. Actual results could differ from those estimates.

Allowance for loan losses. The allowance for loan losses represents management's estimate of probable incurred losses in the existing loan portfolio. The allowance for loan losses is increased by the provision for loan losses charged to expense and reduced by loans charged off, net of recoveries. The allowance for loan losses is determined based on management's assessment of several factors: reviews and evaluations of specific loans, changes in the nature and volume of the loan portfolio, current economic and nonperforming loans. Loans are considered impaired if, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal or interest according to the contractual terms of the loan agreement. When a loan is deemed impaired, impairment is measured by using the fair value of underlying collateral, for loans deemed to be collateral dependent, the present value of the future cash flows discounted at the effective interest rate stipulated in the loan agreement, or the estimated market value of the loan. In measuring the fair value of the collateral, management uses assumptions (e.g., discount rate) and methodologies (e.g., comparison to the recent selling price of similar assets) consistent with those that would be utilized by unrelated third parties.

Changes in the financial condition of individual borrowers, economic conditions, historical loss experience, or the condition of the various markets in which collateral may be sold may affect the required level of the allowance for loan losses and the associated provision for loan losses. Should cash flow assumptions or market conditions change, a different amount may be recorded for the allowance for loan losses and the associated provision for loan losses.

Securities valuation and potential impairment. 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 Corporation 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, all securities are required to be evaluated for other than temporary impairment (OTTI). In determining whether a fair 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 Corporation intends to sell a security or is more likely than not to be required to sell a security before recovery of its amortized cost. If an entity intends to sell or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis, the OTTI shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the OTTI shall be separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized in earnings.

Changes in credit ratings, financial condition of underlying debtors, default experience and market liquidity affect the conclusions on whether securities are other-than-temporarily impaired. Additional losses may be recorded through

earnings for other than temporary impairment, should there be an adverse change in the expected cash flows for these investments.

Goodwill. The carrying value of goodwill requires management to use estimates and assumptions about the fair value of the reporting unit compared to its book value. An impairment analysis is prepared on an annual basis. Fair values of the reporting units are determined by an analysis which considers cash flows streams, profitability and estimated market values of the reporting unit. The majority of the Corporation's goodwill is recorded at First Financial Bank, N. A.

Management believes the accounting estimates related to the allowance for loan losses, valuation of investment securities and the valuation of goodwill are "critical accounting estimates" because: (1) the estimates are highly susceptible to change from period to period because they require management to make assumptions concerning, among other factors, the changes in the types and volumes of the portfolios, valuation assumptions, and economic conditions, and (2) the impact of recognizing an impairment or loan loss could have a material effect on the Corporation's assets reported on the balance sheet as well as net income.

RESULTS OF OPERATIONS - SUMMARY FOR 2015

COMPARISON OF 2015 TO 2014

Net income for 2015 was \$30.2 million, or \$2.35 per share. This represents a 10.6% decrease in net income and a 7.8% decrease in earnings per share, compared to 2014. Return on assets at December 31, 2015 decreased 9.8% to 1.01% compared to 1.12% at December 31, 2014.

The primary components of income and expense affecting net income are discussed in the following analysis.

NET INTEREST INCOME

The principal source of the Corporation's earnings is net interest income, which represents the difference between interest earned on loans and investments and the interest cost associated with deposits and other sources of funding. Net interest income decreased in 2015 to \$104.5 million compared to \$107.8 million in 2014. Total average interest earning assets decreased to \$2.74 billion in 2015 from \$2.79 billion in 2014. The tax-equivalent yield on these assets decreased to 4.19% in 2015 from 4.28% in 2014. Total average interest-bearing liabilities decreased to \$1.949 billion in 2015 from \$2.035 billion in 2014. The average cost of these interest-bearing liabilities decreased to 0.21% in 2015 from 0.27% in 2014.

The net interest margin decreased from 4.08% in 2014 to 4.04% in 2015. This decrease is primarily the result of the decreased income provided by earning assets. Earning asset yields decreased 9 basis points while the rate on interest-bearing liabilities decreased by 6 basis points.

CONSOLIDATED BALANCE SHEET - AVERAGE BALANCES AND INTEREST RATES

(Dollar amounts in thousands)	December 31,			2014			2013		
	Average Balance	Interest	Yield/Rate	Average Balance	Interest	Yield/Rate	Average Balance	Interest	Yield/Rate
ASSETS									
Interest-earning assets:									
Loans (1) (2)	\$1,761,888	85,529	4.85 %	\$1,795,235	89,011	4.96 %	\$1,807,599	92,207	5.10 %
Taxable investment securities	705,118	15,814	2.24 %	737,566	17,015	2.31 %	641,383	16,157	2.52 %
Tax-exempt investments (2)	259,191	13,518	5.22 %	249,040	13,506	5.42 %	242,484	13,523	5.58 %
Federal funds sold	18,272	52	0.28 %	11,583	34	0.29 %	42,460	32	0.08 %
Total interest-earning assets	2,744,469	114,913	4.19 %	2,793,424	119,566	4.28 %	2,733,926	121,919	4.46 %
Non-interest earning assets:									
Cash and due from banks	73,066			69,522			75,945		
Premises and equipment, net	50,877			51,929			48,625		
Other assets	128,177			124,402			140,227		
Less allowance for loan losses (19,658)				(19,209)			(22,623)		
TOTALS	\$2,976,931			\$3,020,068			\$2,976,100		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Interest-bearing liabilities:									
Transaction accounts	\$1,463,662	1,429	0.10 %	\$1,415,431	1,340	0.09 %	\$1,321,848	1,374	0.10 %
Time deposits	437,961	2,505	0.57 %	519,166	3,284	0.63 %	579,815	4,512	0.78 %
Short-term borrowings	32,644	70	0.21 %	45,743	99	0.22 %	37,968	78	0.21 %
Other borrowings	14,463	165	1.14 %	54,769	803	1.47 %	105,161	2,997	2.85 %
Total interest-bearing liabilities:	1,948,730	4,169	0.21 %	2,035,109	5,526	0.27 %	2,044,792	8,961	0.44 %
Non interest-bearing liabilities:									
Demand deposits	544,708			526,656			479,659		
Other	78,648			54,890			73,963		
	2,572,086			2,616,655			2,598,414		
Shareholders' equity	404,845			403,413			377,686		
TOTALS	\$2,976,931			\$3,020,068			\$2,976,100		
Net interest earnings		\$110,744			\$114,040			\$112,958	
Net yield on interest-earning assets			4.04 %			4.08 %			4.13 %

(1)For purposes of these computations, non-accruing loans are included in the daily average loan amounts outstanding.

(2)Interest income includes the effect of tax equivalent adjustments using a federal tax rate of 35%.

The following table sets forth the components of net interest income due to changes in volume and rate. The table information compares 2015 to 2014 and 2014 to 2013.

(Dollar amounts in thousands)	2015 Compared to 2014 Increase (Decrease) Due to				2014 Compared to 2013 Increase (Decrease) Due to			
	Volume	Rate	Volume/ Rate	Total	Volume	Rate	Volume/ Rate	Total
Interest earned on interest-earning assets:								
Loans (1) (2)	\$(1,653)	\$(1,864)	\$35	\$(3,482)	\$(631)	\$(2,584)	\$18	\$(3,197)
Taxable investment securities	(749)	(473)	21	(1,201)	2,423	(1,361)	(204)	858
Tax-exempt investment securities (2)	551	(517)	(22)	12	366	(372)	(10)	(16)
Federal funds sold	20	(1)	(1)	18	(23)	93	(67)	3
Total interest income	\$(1,831)	\$(2,855)	\$33	\$(4,653)	\$2,135	\$(4,224)	\$(263)	\$(2,352)
Interest paid on interest-bearing liabilities:								
Transaction accounts	46	42	1	89	97	(123)	(9)	(35)
Time deposits	(514)	(316)	51	(779)	(472)	(843)	88	(1,227)
Short-term borrowings	(28)	(1)	—	(29)	16	4	1	21
Other borrowings	(591)	(178)	131	(638)	(1,436)	(1,455)	697	(2,194)
Total interest expense	(1,087)	(453)	183	(1,357)	(1,795)	(2,417)	777	(3,435)
Net interest income	\$(744)	\$(2,402)	\$(150)	\$(3,296)	\$3,930	\$(1,807)	\$(1,040)	\$1,083

(1)For purposes of these computations, non-accruing loans are included in the daily average loan amounts outstanding.

(2)Interest income includes the effect of tax equivalent adjustments using a federal tax rate of 35%.

PROVISION FOR LOAN LOSSES

The provision for loan losses charged to expense is based upon credit loss experience and the results of a detailed analysis estimating an appropriate and adequate allowance for loan losses. The analysis includes the evaluation of impaired loans as prescribed under Accounting Standards Codification (ASC-310), pooled loans as prescribed under ASC 450-10, and economic and other risk factors as outlined in various Joint Interagency Statements issued by the bank regulatory agencies. For the year ended December 31, 2015, the provision for loan losses was \$4.7 million, a decrease of \$372 thousand, or 7.3%, compared to 2014.

Net charge-offs for 2015 were \$3.6 million as compared to \$5.6 million for 2014 and \$8.4 million for 2013.

Non-accrual loans decreased to \$14.6 million at December 31, 2015 from \$15.0 million at December 31, 2014. Loans past due 90 days and still on accrual increased to \$964 thousand compared to \$780 thousand at December 31, 2014.

NON-INTEREST INCOME

Non-interest income of \$39.2 million decreased \$1.6 million from the \$40.8 million earned in 2014. Increased income from interchange income and sale of mortgages partially offset the reduced investment service income and income from the Corporation's insurance agency for 2015.

NON-INTEREST EXPENSES

Non-interest expenses increased to \$98.4 million for 2015 from \$95.6 million for 2014. Employee fringe benefits increased \$4.3 million while most other expenses decreased. Employee benefits increased \$4.3 million due to the lower discount rate and the use of the updated mortality table. The pension plan was frozen for the majority of employees as of December 31, 2012. Occupancy expenses decreased \$240 thousand and equipment expense decreased \$278 thousand for the year ended 2015.

INCOME TAXES

The Corporation's federal income tax provision was \$10.4 million in 2015 compared to \$14.2 million in 2014. The overall effective tax rate in 2015 of 25.6% decreased as compared to a 2014 effective rate of 29.6%, principally due to lower income before income taxes with a similar level of non-taxable earnings as 2014.

COMPARISON OF 2014 TO 2013

Net income for 2014 was \$33.8 million or \$2.55 per share compared to \$31.5 million in 2013 or \$2.37 per share. This increase in net income was driven by the reduced provision for loan losses of \$2.8 million partially offset by a lower net interest margin of 5 basis points from 4.13% to 4.08%.

Net interest income increased \$572 thousand in 2014 compared to 2013 as total average interest-earning assets increased. The provision for loan losses decreased \$2.8 million from \$7.9 million in 2013 to \$5.1 million in 2014. Non-interest expenses increased \$1.0 million while non-interest income increased \$300 thousand. The increase in non-interest income resulted primarily from electronic banking fees and deposit fees. The increase in non-interest expense was primarily occupancy and equipment costs.

The provision for income taxes increased \$422 thousand from 2013 to 2014 and the effective tax rate decreased 81 basis points, or 2.7% in 2014 from 2013.

COMPARISON AND DISCUSSION OF 2015 BALANCE SHEET TO 2014

The Corporation's total assets decreased 0.8% or \$23.0 million at December 31, 2015, from a year earlier. Available-for-sale securities decreased \$6.0 million at December 31, 2015, from the previous year. Loans, net of deferred fees and costs, decreased by \$17.6 million to \$1.76 billion. Deposits decreased \$14.8 million while borrowings decreased by \$14.4 million. Total shareholders' equity increased \$16.1 million to \$410.3 million at December 31, 2015. Net income was partially offset by dividends. There were also 36,149 shares from the treasury with a value of \$1.30 million that were contributed to the ESOP plan in 2015 compared to 36,368 shares with a value of \$1.25 million in 2014.

Following is an analysis of the components of the Corporation's balance sheet.

SECURITIES

The Corporation's investment strategy seeks to maximize income from the investment portfolio while using it as a risk management tool and ensuring safety of principal and capital. During 2015 the portfolio's balance decreased by 0.7%. The average life of the portfolio increased from 4.2 years in 2014 to 4.5 years in 2015. The portfolio structure will continue to provide cash flows to be reinvested during 2016.

(Dollar amounts in thousands)	1 year and less		1 to 5 years		5 to 10 years		Over 10 Years		2015 Total
	Balance	Rate	Balance	Rate	Balance	Rate	Balance	Rate	
U.S. government sponsored entity mortgage-backed securities and agencies (1)	\$5	7.90 %	\$15,267	4.85 %	\$56,178	5.72 %	\$152,416	5.08 %	\$223,866
Collateralized mortgage obligations (1)	—	— %	2,973	5.49 %	582	5.57 %	434,079	2.38 %	437,634
States and political subdivisions	4,649	3.67 %	57,884	3.66 %	98,926	3.50 %	53,248	3.34 %	214,707
Corporate obligations	—	— %	—	— %	—	— %	14,875	— %	14,875
TOTAL	\$4,654	3.67 %	\$76,124	3.97 %	\$155,686	4.31 %	\$654,618	3.03 %	\$891,082

(1) Distribution of maturities is based on the estimated life of the asset.

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(Dollar amounts in thousands)	1 year and less		1 to 5 years		5 to 10 years		Over 10 Years		2014	
	Balance	Rate	Balance	Rate	Balance	Rate	Balance	Rate	Total	
U.S. government sponsored entity mortgage-backed securities and agencies (1)	\$18	3.70 %	\$13,092	5.28 %	\$29,790	5.25 %	\$146,520	5.61 %	\$189,420	
Collateralized mortgage obligations (1)	24	4.99 %	1,813	5.04 %	3,919	4.89 %	478,899	2.40 %	484,655	
States and political subdivisions	7,700	4.22 %	38,891	3.58 %	90,909	3.53 %	70,175	3.60 %	207,675	
Corporate obligations	—	— %	—	— %	—	— %	15,303	— %	15,303	
TOTAL	7,742	4.22 %	53,796	4.04 %	124,618	3.98 %	710,897	3.13 %	897,053	

(1) Distribution of maturities is based on the estimated life of the asset.

LOAN PORTFOLIO

Loans outstanding by major category as of December 31 for each of the last five years and the maturities at year end 2015 are set forth in the following analyses.

(Dollar amounts in thousands)	2015	2014	2013	2012	2011
Loan Category					
Commercial	\$1,043,980	\$1,044,522	\$1,042,138	\$1,088,144	\$1,099,324
Residential	444,447	469,172	482,377	496,237	505,600
Consumer	272,896	266,656	268,033	268,507	289,717
TOTAL	\$1,761,323	\$1,780,350	\$1,792,548	\$1,852,888	\$1,894,641

(Dollar amounts in thousands)	Within One Year	After One But Within Five Years	After Five Years	Total
MATURITY DISTRIBUTION				
Commercial, financial and agricultural		\$374,204	\$526,844	\$1,043,980
TOTAL				
Residential				444,447
Consumer				272,896
TOTAL				\$1,761,323

Loans maturing after one year with:

Fixed interest rates		\$173,305	\$137,303
Variable interest rates		353,539	5,629
TOTAL		\$526,844	\$142,932

ALLOWANCE FOR LOAN LOSSES

The activity in the Corporation's allowance for loan losses is shown in the following analysis:

(Dollar amounts in thousands)	2015	2014	2013	2012	2011	
Amount of loans outstanding at December 31,	\$1,761,323	\$1,780,350	\$1,792,548	\$1,852,888	\$1,894,641	
Average amount of loans by year	\$1,761,888	\$1,795,235	\$1,807,599	\$1,863,014	\$1,637,471	
Allowance for loan losses at beginning of year	\$18,839	\$20,068	\$21,958	\$19,241	\$22,336	
Loans charged off:						
Commercial	2,852	3,522	4,830	4,176	5,336	
Residential	866	1,143	4,942	2,598	2,811	
Consumer	4,810	4,785	3,615	3,640	2,969	
Total loans charged off	8,528	9,450	13,387	10,414	11,116	
Recoveries of loans previously charged off:						
Commercial	2,429	934	3,149	644	938	
Residential	452	798	472	100	95	
Consumer	2,054	2,104	1,401	1,387	1,108	
Total recoveries	4,935	3,836	5,022	2,131	2,141	
Net loans charged off	3,593	5,614	8,365	8,283	8,975	
Provision charged to expense *	4,700	4,385	6,475	11,000	5,880	
Balance at end of year	\$19,946	\$18,839	\$20,068	\$21,958	\$19,241	
	0.20	% 0.31	% 0.46	% 0.44	% 0.55	%

Ratio of net charge-offs during
period to average loans outstanding

31

* In 2014 and 2013 the provision charged to expense was increased by \$687 thousand and \$1.4 million, respectively for the decrease to the FDIC indemnification asset. In 2012, and 2011 the provision was reduced with a corresponding increase in the FDIC indemnification asset by \$2.2 million and \$125 thousand, respectively.

The allowance is maintained at an amount management believes sufficient to absorb probable incurred losses in the loan portfolio. Monitoring loan quality and maintaining an adequate allowance is an ongoing process overseen by senior management and the loan review function. On at least a quarterly basis, a formal analysis of the adequacy of the allowance is prepared and reviewed by management and the Board of Directors. This analysis serves as a point in time assessment of the level of the allowance and serves as a basis for provisions for loan losses. The loan quality monitoring process includes assigning loan grades and the use of a watch list to identify loans of concern.

Included in the \$1.8 billion of loans outstanding at December 31, 2015 are \$6.5 million of covered loans, those loans acquired with the purchase of the First National Bank of Danville from the FDIC that are covered by the loss sharing agreement.

Also included are loans acquired on December 30, 2011 in the Freestar acquisition. The acquired portfolio includes purchased credit impaired loans with a contractual balance due of \$5.4 million and a carrying value of \$5.0 million.

The analysis of the allowance for loan losses includes the allocation of specific amounts of the allowance to individual impaired loans, generally based on an analysis of the collateral securing those loans. Portions of the allowance are also allocated to loan portfolios, based upon a variety of factors including historical loss experience, trends in the type and volume of the loan portfolios, trends in delinquent and non-performing loans, and economic trends affecting our market. These components are added together and compared to the balance of our allowance at the evaluation date. The allowance for loan losses as a percentage of total loans increased to 1.13% at year end 2015 compared to 1.05% at year end 2014. The Corporation's unallocated allowance position of \$1.7 million at December 31, 2015 has decreased from \$2.2 million at December 31, 2014 and decreased from \$2.4 million at December 31, 2013. The calculation of historical losses used in the allowance computation averages the net charge off activity and qualitative factors supplement historical losses and consider internal and external factors that influence management's expectations of loss in the portfolio and the unallocated portion of the allowance reflects management's uncertainty about whether the more modest levels of net charge offs in the recent years, particularly in the commercial segment of the portfolio, are sustainable and representative of the risk in the loan portfolio. Non-performing loans of \$25.5 million at December 31, 2015 decreased from \$30.6 million at December 31, 2014 due in large part to the resolution of certain larger commercial credits, and net charge-offs declined to \$3.6 million in 2015 compared to \$5.6 million in 2014. Management believes the allowance for loan losses balance at year end 2015, including the unallocated portion, is reasonable based on their analysis of specific loans and the credit trends reflected within the loan portfolio. The table below presents the allocation of the allowance to the loan portfolios at year-end.

(Dollar amounts in thousands)	Years Ended December 31,				
	2015	2014	2013	2012	2011
Commercial	\$11,482	\$10,915	\$12,450	\$10,987	\$12,119
Residential	1,834	1,374	1,585	5,426	2,728
Consumer	4,945	4,370	3,650	3,879	3,889
Unallocated	1,685	2,180	2,383	1,666	505
TOTAL ALLOWANCE FOR LOAN LOSSES	\$19,946	\$18,839	\$20,068	\$21,958	\$19,241

NONPERFORMING LOANS

Management monitors the components and status of nonperforming loans as a part of the evaluation procedures used in determining the adequacy of the allowance for loan losses. It is the Corporation's policy to discontinue the accrual of interest on loans where, in management's opinion, serious doubt exists as to collectability. The amounts shown below represent non-accrual loans, loans which have been restructured to provide for a reduction or deferral of interest or principal because of deterioration in the financial condition of the borrower and those loans which are past due more than 90 days where the Corporation continues to accrue interest. Non-accrual restructured loans decreased in 2014 primarily due to the sale in 2014 of two large commercial credits and in 2013 of one large commercial credit. Restructured loans declined in 2015 as there was a lower dollar amount of loans added and there was one large commercial credit that was paid off. Additional information regarding restructured loans is available in the footnotes to the financial statements.

(Dollar amounts in thousands)	2015	2014	2013	2012	2011
Non-accrual loans	\$14,634	\$15,034	\$19,779	\$36,794	\$38,102
Accruing restructured loans	4,851	4,616	4,199	3,831	3,356
Non-accrual restructured loans	5,009	10,142	13,102	17,454	13,981
Accruing loans past due over 90 days	964	780	2,073	3,362	2,047
	\$25,458	\$30,572	\$39,153	\$61,441	\$57,486

The ratio of the allowance for loan losses as a percentage of nonperforming loans was 78% at December 31, 2015, compared to 62% in 2014. The ratio of nonperforming loans excluding covered loans was 80% at December 31, 2015 and 62% at December 31, 2014. There were no covered loans included in restructured loans in 2015 and 2014. In the footnotes to the financial statements the amount reported for nonperforming loans is the recorded investment which includes accrued interest receivable. The following loan categories comprise significant components of the nonperforming loans at December 31, 2015 and 2014:

(Dollar amounts in thousands)	2015		2014			
Non-accrual loans:						
Commercial loans	\$8,146	56	%	\$9,212	61	%
Residential loans	5,481	37	%	4,651	31	%
Consumer loans	1,007	7	%	1,171	8	%
	\$14,634	100	%	\$15,034	100	%
Past due 90 days or more:						
Commercial loans	\$—	—	%	\$—	—	%
Residential loans	820	85	%	624	80	%
Consumer loans	144	15	%	156	20	%
	\$964	100	%	\$780	100	%

(Dollar amounts in thousands)	Covered Loans (also included above)					
	2015		2014			
Non-accrual loans:						
Commercial loans	\$23	9	%	\$35	13	%
Residential loans	220	91	%	239	87	%
Consumer loans	—	—	%	—	—	%
	\$243	100	%	\$274	100	%
Past due 90 days or more:						
Commercial loans	\$—	—	%	\$—	—	%
Residential loans	184	100	%	37	100	%
Consumer loans	—	—	%	—	—	%
	\$184	100	%	\$37	100	%

Management considers the present allowance to be appropriate and adequate to cover probable incurred losses inherent in the loan portfolio based on the current economic environment. However, future economic changes cannot be predicted. Deteriorating economic conditions could result in an increase in the risk characteristics of the loan portfolio and an increase in the potential for loan losses.

DEPOSITS

The information below presents the average amount of deposits and rates paid on those deposits for 2015, 2014 and 2013.

(Dollar amounts in thousands)	2015		2014		2013			
	Amount	Rate	Amount	Rate	Amount	Rate		
Non-interest-bearing demand deposits	\$544,708		\$526,656		\$479,659			
Interest-bearing demand deposits	591,412	0.12	% 567,267	0.11	% 541,235	0.12	%	
Savings deposits	872,250	0.08	% 848,164	0.08	% 780,613	0.09	%	
Time deposits: \$100,000 or more	117,066	0.59	% 142,153	0.73	% 169,567	0.90	%	
Other time deposits	320,895	0.57	% 377,013	0.59	% 410,248	0.73	%	
TOTAL	\$2,446,331		\$2,461,253		\$2,381,322			

The maturities of certificates of deposit of more than \$100 thousand outstanding at December 31, 2015, are summarized as follows:

(Dollar amounts in thousands)

3 months or less	\$8,501
Over 3 through 6 months	32,398
Over 6 through 12 months	39,267
Over 12 months	52,780
TOTAL	\$132,946

OTHER BORROWINGS

Advances from the Federal Home Loan Bank decreased to \$12.7 million in 2015 compared to \$12.9 million in 2014. The Asset/Liability Committee reviews these investments and funding sources and considers the related strategies on a monthly basis. See Interest Rate Sensitivity and Liquidity below for more information.

CAPITAL RESOURCES

Bank regulatory agencies have established capital adequacy standards which are used extensively in their monitoring and control of the industry. These standards relate capital to level of risk by assigning different weightings to assets and certain off-balance-sheet activity. As shown in the footnote to the consolidated financial statements ("Regulatory Matters"), the Corporation's subsidiary banking institutions capital exceeds the requirements to be considered well capitalized at December 31, 2015.

First Financial Corporation's objective continues to be to maintain adequate capital to merit the confidence of its customers and shareholders. To warrant this confidence, the Corporation's management maintains a capital position which they believe is sufficient to absorb unforeseen financial shocks without unnecessarily restricting dividends to its shareholders. The Corporation's dividend payout ratio for 2015 and 2014 was 41.5% and 38.2%, respectively. The Corporation expects to continue its policy of paying regular cash dividends, subject to future earnings and regulatory restrictions and capital requirements.

INTEREST RATE SENSITIVITY AND LIQUIDITY

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

Interest Rate Risk: Management considers interest rate risk to be the Corporation's most significant market risk. Interest rate risk is the exposure to changes in net interest income as a result of changes in interest rates. Consistency in the Corporation's net interest income is largely dependent on the effective management of this risk. The Asset/Liability position is measured using sophisticated risk management tools, including earnings simulation and market value of equity sensitivity analysis. These tools allow management to quantify and monitor both short-and long-term exposure to interest rate risk. Simulation modeling measures the effects of

changes in interest rates, changes in the shape of the yield curve and the effects of embedded options on net interest income. This measure projects earnings in the various environments over the next three years. It is important to note that measures of interest rate risk have limitations and are dependent on various assumptions. These assumptions are inherently uncertain and, as a result, the model cannot precisely predict the impact of interest rate fluctuations on net interest income. Actual results will differ from simulated results due to timing, frequency and amount of interest rate changes as well as overall market conditions. The Committee has performed a thorough analysis of these assumptions and believes them to be valid and theoretically sound. These assumptions are continuously monitored for behavioral changes.

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

The table below shows the Corporation's estimated sensitivity profile as of December 31, 2015. The change in interest rates assumes a parallel shift in interest rates of 100 and 200 basis points. Given a 100 basis point increase in rates, net interest income would increase 3.54% over the next 12 months and increase 7.09% over the following 12 months. Given a 100 basis point decrease in rates, net interest income would decrease 0.45% over the next 12 months and decrease 1.93% over the following 12 months. These estimates assume all rate changes occur overnight and management takes no action as a result of this change.

Basis Point Interest Rate Change	Percentage Change in Net Interest Income			
	12 months	24 months	36 months	
Down 200	-0.66	% -3.02	% -5.10	%
Down 100	-0.45	% -1.93	% -3.24	%
Up 100	3.54	% 7.09	% 11.07	%
Up 200	2.15	% 8.47	% 16.14	%

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

Liquidity Risk Liquidity is measured by the bank's ability to raise funds to meet the obligations of its customers, including deposit withdrawals and credit needs. This is accomplished primarily by maintaining sufficient liquid assets in the form of investment securities and core deposits. The Corporation has \$4.7 million of investments that mature throughout the coming 12 months. The Corporation also anticipates \$129.6 million of principal payments from mortgage-backed securities. Given the current rate environment, the Corporation anticipates \$27.4 million in securities to be called within the next 12 months.

The Corporation also has additional sources of liquidity available through secured and unsecured borrowing capacity. These include upstream correspondents, the Federal Home Loan Bank and the Federal Reserve Bank.

CONTRACTUAL OBLIGATIONS, COMMITMENTS, CONTINGENT LIABILITIES AND OFF-BALANCE SHEET ARRANGEMENTS

The Corporation has various financial obligations, including contractual obligations and commitments that may require future cash payments.

Contractual Obligations: The following table presents, as of December 31, 2015, significant fixed and determinable contractual obligations to third parties by payment date. Further discussion of the nature of each obligation is included in the referenced note to the consolidated financial statements.

Payments Due in

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(Dollar amounts in thousands)	Note Reference	One year or less	One year to Three Years	Three to Five Years	Over Five Years	Total
Deposits without a stated maturity		\$2,030,476	\$—	\$—	\$—	\$2,030,476
Consumer certificates of deposit		221,863	146,566	42,958	506	411,893
Short-term borrowings	11	33,831	—	—	—	33,831
Other borrowings	12	12,545	132	—	—	12,677

The Corporation has obligations under its pension, supplemental executive retirement plan and post-retirement medical benefits plan as described in Note 15 to the consolidated financial statements.

The Corporation has lease obligations on certain branch properties and equipment as described in Note 8 to the consolidated financial statements.

Commitments: The following table details the amount and expected maturities of significant commitments as of December 31, 2015. Further discussion of these commitments is included in Note 14 to the consolidated financial statements.

(Dollar amounts in thousands)	Total Amount Committed	One year or less	Over One Year
Commitments to extend credit:			
Unused loan commitments	\$364,756	\$184,765	\$179,991
Commercial letters of credit	7,195	5,489	1,706

Commitments to extend credit, including loan commitments, standby and commercial letters of credit do not necessarily represent future cash requirements, in that these commitments often expire without being drawn upon.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information contained under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Market Risk” on page 34 of this Form 10-K is incorporated herein by reference in response to this item.

ITEM 8. FINANCIAL STATEMENTS AND
SUPPLEMENTARY DATA

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of First Financial Corporation (the "Corporation") has prepared and is responsible for the preparation and accuracy of the consolidated financial statements and related financial information included in the Annual Report.

The management of the Corporation is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. The Corporation's internal control over financial reporting is 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. The Corporation's internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Corporation; (ii) 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 Corporation are being made only in accordance with authorizations of management and directors of the Corporation; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Corporation'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.

Management assessed the Corporation's system of internal control over financial reporting as of December 31, 2015, in relation to criteria for effective internal control over financial reporting as described in "Internal Control—Integrated Framework," issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in 2013. Based on this assessment, management concluded that, as of December 31, 2015, its system of internal control over financial reporting is effective and meets the criteria of the "Internal Control—Integrated Framework."

Crowe Horwath LLP, independent registered public accounting firm, has audited the Corporation's internal control over financial reporting as of December 31, 2015 and has issued a report dated March 9, 2016.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors of First Financial Corporation:

We have audited the accompanying consolidated balance sheets of First Financial Corporation as of December 31, 2015 and 2014 and the related consolidated statements of income and comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2015. We also have audited First Financial Corporation's internal control over financial reporting as of December 31, 2015, based on criteria established in 2013 in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). First Financial Corporation'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 audits 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 First Financial Corporation as of December 31, 2015 and 2014, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2015, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion First Financial Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based

on criteria established in 2013 in Internal Control —Integrated Framework issued by the COSO.

Crowe Horwath LLP

Indianapolis, Indiana

March 9, 2016

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CONSOLIDATED BALANCE SHEETS

	December 31,	
(Dollar amounts in thousands, except per share data)	2015	2014
ASSETS		
Cash and due from banks	\$88,695	\$78,102
Federal funds sold	9,815	8,000
Securities available-for-sale	891,082	897,053
Loans, net of allowance of \$19,946 in 2015 and \$18,839 in 2014	1,743,862	1,762,589
Restricted Stock	10,838	16,404
Accrued interest receivable	11,733	11,593
Premises and equipment, net	50,531	51,802
Bank-owned life insurance	82,323	80,730
Goodwill	39,489	39,489
Other intangible assets	3,178	3,901
Other real estate owned	3,466	3,965
Other assets	44,573	48,857
TOTAL ASSETS	\$2,979,585	\$3,002,485
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest-bearing	\$563,302	\$556,389
Interest-bearing:		
Certificates of deposit that meet or exceed the FDIC insurance limit	46,753	53,733
Other interest-bearing deposits	1,832,314	1,847,075
	2,442,369	2,457,197
Short-term borrowings	33,831	48,015
Other borrowings	12,677	12,886
Other liabilities	80,392	90,173
TOTAL LIABILITIES	2,569,269	2,608,271
Shareholders' equity		
Common stock, \$.125 stated value per share;		
Authorized shares-40,000,000		
Issued shares-14,557,815 in 2015 and 14,538,132 in 2014		
Outstanding shares-12,740,018 in 2015 and 12,942,175 in 2014	1,817	1,815
Additional paid-in capital	73,396	72,405
Retained earnings	395,633	377,970
Accumulated other comprehensive income (loss)	(9,401)	(14,529)
Less: Treasury shares at cost-1,817,797 in 2015 and 1,595,957 in 2014	(51,129)	(43,447)
TOTAL SHAREHOLDERS' EQUITY	410,316	394,214
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$2,979,585	\$3,002,485

See accompanying notes.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(Dollar amounts in thousands, except per share data)	Years Ended December 31,		
	2015	2014	2013
INTEREST AND DIVIDEND INCOME:			
Loans, including related fees	\$84,022	\$87,530	\$91,242
Securities:			
Taxable	15,815	17,015	16,157
Tax-exempt	7,194	7,084	7,046
Other	1,645	1,729	1,776
TOTAL INTEREST AND DIVIDEND INCOME	108,676	113,358	116,221
INTEREST EXPENSE:			
Deposits	3,934	4,624	5,886
Short-term borrowings	70	99	78
Other borrowings	165	803	2,997
TOTAL INTEREST EXPENSE	4,169	5,526	8,961
NET INTEREST INCOME	104,507	107,832	107,260
Provision for loan losses	4,700	5,072	7,860
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	99,807	102,760	99,400
NON-INTEREST INCOME:			
Trust and financial services	5,586	5,860	6,035
Service charges and fees on deposit accounts	10,145	10,772	10,162
Other service charges and fees	11,798	11,697	11,081
Securities gain (loss), net	17	(3	) 423
Insurance commissions	6,945	7,646	7,750
Gain on sale of mortgage loans	1,998	1,849	3,052
Other	2,690	2,964	1,952
TOTAL NON-INTEREST INCOME	39,179	40,785	40,455
NON-INTEREST EXPENSES:			
Salaries and employee benefits	60,109	55,936	55,097
Occupancy expense	6,978	7,218	6,102
Equipment expense	6,991	7,269	6,348
Federal Deposit Insurance	1,769	1,931	2,052
Other	22,551	23,230	24,955
TOTAL NON-INTEREST EXPENSE	98,398	95,584	94,554
INCOME BEFORE INCOME TAXES	40,588	47,961	45,301
Provision for income taxes	10,392	14,189	13,767
NET INCOME	30,196	33,772	31,534
OTHER COMPREHENSIVE INCOME			
Change in unrealized gains/(losses) on securities, net of reclassifications and taxes	(1,225	) 13,913	(17,066
Change in funded status of post-retirement benefits, net of taxes	6,353	(14,473	) 10,569
COMPREHENSIVE INCOME	\$35,324	\$33,212	\$25,037
EARNINGS PER SHARE:			
BASIC AND DILUTED	\$2.35	\$2.55	\$2.37
Weighted average number of shares outstanding (in thousands)	12,836	13,226	13,310
See accompanying notes.			

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Common	Additional	Retained	Accumulated Other Comprehensive Income/(Loss)	Treasury Stock	Total
(Dollar amounts in thousands, except per share data)	Stock	Capital	Earnings			
Balance, January 1, 2013	\$1,808	\$69,989	\$338,342	\$(7,472)	\$(30,545)	\$372,122
Net income	—	—	31,534	—	—	31,534
Other comprehensive income (loss)	—	—	—	(6,497)	—	(6,497)
Omnibus Equity Incentive Plan, net	3	770	—	—	(162)	611
Contribution of 35,531 shares to ESOP	—	315	—	—	903	1,218
Cash Dividends, \$.96 per share	—	—	(12,793)	—	—	(12,793)
Balance, December 31, 2013	1,811	71,074	357,083	(13,969)	(29,804)	386,195
Net income	—	—	33,772	—	—	33,772
Other comprehensive income (loss)	—	—	—	(560)	—	(560)
Omnibus Equity Incentive Plan, net	4	1,068	—	—	—	1,072
Treasury stock purchase (459,241 shares)	—	—	—	—	(14,633)	(14,633)
Contribution of 36,368 shares to ESOP	—	263	—	—	990	1,253
Cash Dividends, \$.98 per share	—	—	(12,885)	—	—	(12,885)
Balance, December 31, 2014	1,815	72,405	377,970	(14,529)	(43,447)	394,214
Net income	—	—	30,196	—	—	30,196
Other comprehensive income (loss)	—	—	—	5,128	—	5,128
Omnibus Equity Incentive Plan, net	2	713	—	—	—	715
Treasury stock purchases (257,989 shares)	—	—	—	—	(8,698)	(8,698)
Contribution of 36,149 shares to ESOP	—	278	—	—	1,016	1,294
Cash Dividends, \$.98 per share	—	—	(12,533)	—	—	(12,533)
Balance, December 31, 2015	\$1,817	\$73,396	\$395,633	\$(9,401)	\$(51,129)	\$410,316

See accompanying notes.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
(Dollar amounts in thousands, except per share data)	2015	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net Income	\$30,196	\$33,772	\$31,534
Adjustments to reconcile net income to net cash provided by operating activities:			
Net (accretion) amortization on securities	2,940	3,405	2,712
Provision for loan losses	4,700	5,072	7,860
Securities (gains) losses	(17	) 3	(423
Depreciation and amortization	5,490	5,977	5,482
Provision for deferred income taxes	(924	) 2,873	(39
Net change in accrued interest receivable	(140	) (39	) 470
Contribution of shares to ESOP	1,294	1,253	1,218
Stock compensation expense	684	1,072	733
Gain on sale of mortgage loans	(1,998	) (1,849	) (3,052
Loss (gain) on sales of other real estate	116	(357	) 182
Origination of loans held for sale	(72,303	) (66,300	) (112,483
Proceeds from loans held for sale	75,542	68,438	121,092
Other, net	(4,325	) 4,524	7,411
NET CASH FROM OPERATING ACTIVITIES	41,255	57,844	62,697
CASH FLOWS FROM INVESTING ACTIVITIES:			
Sales of securities available-for-sale	3,735	356	5,110
Calls, maturities and principal reductions on securities available-for-sale	150,315	136,141	158,317
Purchases of securities available-for-sale	(149,181	) (99,954	) (417,997
Loans made to customers, net of payments	12,901	325	41,643
Net change in federal funds sold	(1,815	) (3,724	) 16,524
Redemption of restricted stock	5,587	4,670	250
Purchase of restricted stock	(21	) (17	) (15
Purchase of customer list	(103) —	—
Cash received (disbursed) from acquisitions	—	—	177,610
Sale of other real estate	1,638	3,034	4,714
Additions to premises and equipment	(3,393	) (5,296	) (2,522
NET CASH FROM INVESTING ACTIVITIES	19,663	35,535	(16,366)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net change in deposits	(14,899	) (2,151	) (7,544
Net change in short-term borrowings	(14,184	) (11,577	) 19,041
Dividends paid	(12,632	) (12,949	) (12,766
Purchases of treasury stock	(8,698	) (14,633	) (162
Proceeds from other borrowings	36,900	572,000	135,000
Repayments on other borrowings	(36,812	) (617,000	) (196,097
NET CASH FROM FINANCING ACTIVITIES	(50,325)	(86,310)	(62,528)
NET CHANGE IN CASH AND CASH EQUIVALENTS	10,593	7,069	(16,197)
CASH AND DUE FROM BANKS, BEGINNING OF YEAR	78,102	71,033	87,230
CASH AND DUE FROM BANKS, END OF YEAR	\$88,695	\$78,102	\$71,033

Continued

SUPPLEMENTAL DISCLOSURES OF CASH FLOW AND NONCASH
INFORMATION:

Cash paid for the year for:

Interest	\$4,237	\$5,527	\$9,375
Income Taxes	\$12,869	\$9,354	\$13,822

See accompanying notes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES:

BUSINESS

Organization: The consolidated financial statements of First Financial Corporation and its subsidiaries (the Corporation) include the parent company and its wholly-owned subsidiaries, First Financial Bank, N.A. headquartered in Vigo County, Indiana, The Morris Plan Company of Terre Haute (Morris Plan), Forrest Sherer Inc., a full-line insurance agency headquartered in Terre Haute, Indiana, and FFB Risk Management Co., Inc., a captive insurance subsidiary headquartered in Las Vegas, Nevada. Inter-company transactions and balances have been eliminated.

First Financial Bank also has two investment subsidiaries, Portfolio Management Specialists A (Specialists A) and Portfolio Management Specialists B (Specialists B), which were established to hold and manage certain assets as part of a strategy to better manage various income streams and provide opportunities for capital creation as needed. Specialists A and Specialists B subsequently entered into a limited partnership agreement, Global Portfolio Limited Partners. Portfolio Management Specialists B also owns First Financial Real Estate, LLC. At December 31, 2015, \$718.3 million of securities and loans were owned by these subsidiaries. Specialists A, Specialists B, Global Portfolio Limited Partners and First Financial Real Estate LLC are included in the consolidated financial statements.

The Corporation, which is headquartered in Terre Haute, Indiana, offers a wide variety of financial services including commercial, mortgage and consumer lending, lease financing, trust account services and depositor services through its four subsidiaries. The Corporation's primary source of revenue is derived from loans to customers and investment activities.

The Corporation operates 71 branches in west-central Indiana and east-central Illinois. First Financial Bank is the largest bank in Vigo County. It operates 11 full-service banking branches within the county; one in Daviess County, Indiana.; four in Clay County, Indiana; one in Gibson County, Indiana.; one in Greene County, Indiana; three in Knox County, Indiana; five in Parke County, Indiana; one in Putnam County, Indiana; four in Sullivan County, Indiana; one in Vanderburgh County, Indiana.; four in Vermillion County, Indiana; five in Champaign County, Illinois; one in Clark County, Illinois; three in Coles County, Illinois; two in Crawford County, Illinois; two in Franklin County, Illinois; one in Jasper County, Illinois; two in Jefferson County, Illinois; one in Lawrence County, Illinois; two in Livingston County, Illinois; two in Marion County, Illinois; three in McLean County, Illinois; one in Montgomery County, Illinois; two in Richland County, Illinois; seven in Vermilion County, Illinois; and one in Wayne County, Illinois. It also has a main office in downtown Terre Haute and an operations center/office building in southern Terre Haute.

Regulatory Agencies: First Financial Corporation is a multi-bank holding company and as such is regulated by various banking agencies. The holding company is regulated by the Seventh District of the Federal Reserve System. The national bank subsidiary is regulated by the Office of the Comptroller of the Currency. The state bank subsidiary is jointly regulated by the state banking organization and the Federal Deposit Insurance Corporation. FFB Risk Management Company is regulated by the State of Nevada Division of Insurance.

SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates: To prepare financial statements in conformity with U.S. generally accepted accounting principles, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and disclosures provided, and actual results could differ.

Cash Flows: Cash and cash equivalents include cash and demand deposits with other financial institutions. Net cash flows are reported for customer loan and deposit transactions and short-term borrowings. Non-cash transactions include loans transferred to other real estate of \$1.3 million, \$1.4 million and \$2.5 million for the years ended December 31, 2015, 2014 and 2013 respectively.

Securities: The Corporation classifies all securities as "available for sale." Securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value with unrealized holdings gains and losses, net of taxes, reported in other comprehensive income within shareholders' equity.

Interest income includes amortization of purchase premium or discount. Premiums and discounts are amortized on the level yield method without anticipating prepayments. Mortgage-backed securities are amortized over the expected life. Realized gains and losses on sales are based on the amortized cost of the security sold. Management evaluates securities for other-than temporary impairment (OTTI) at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation.

Loans: Loans that management has the intent and ability to hold for the foreseeable future until maturity or pay-off are reported at the principal balance outstanding, net of unearned interest, purchase premiums and discounts, deferred loan fees and costs, and allowance for loan losses. Loans held for sale are reported at the lower of cost or fair value, on an aggregate basis. Interest income is accrued on the unpaid principal balance and includes amortization of net deferred loan fees and costs over the loan term without anticipating prepayments. The recorded investment in loans includes accrued interest receivable and net deferred loan fees and costs. Interest income is not reported when full loan repayment is in doubt, typically when the loan is impaired or payments are significantly past due. Past-due status is based on the contractual terms of the loan.

All interest accrued but not received for loans placed on non-accrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. In all cases, loans are placed on non-accrual or charged-off if collection of principal or interest is considered doubtful. The above policies are consistent for all segments of loans.

Certain Purchased Loans: The Corporation purchases individual loans and groups of loans, some of which have shown evidence of credit deterioration since origination. These purchased loans are recorded at the amount paid, such that there is no carryover of the seller's allowance for loan losses. After acquisition, losses are recognized by an increase in the allowance for loan losses. Such purchased loans are accounted for individually. The Corporation estimates the amount and timing of expected cash flows for each purchased loan, and the expected cash flows in excess of amount paid are recorded as interest income over the remaining life of the loan (accrutable yield). The excess of the loan's contractual principal and interest over expected cash flows is not recorded (nonaccrutable 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 provision for loan 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.

Concentration of Credit Risk: Most of the Corporation's business activity is with customers located within west central Indiana and east central Illinois. Therefore, the Corporation's exposure to credit risk is significantly affected by changes in the economy of this area. A major economic downturn in this area would have a negative effect on the Corporation's loan portfolio.

The risk characteristics of each loan portfolio segment are as follows:

Commercial

Commercial loans are predominately loans to expand a business or finance asset purchases. The underlying risk in the Commercial loan segment is primarily a function of the reliability and sustainability of the cash flows of the borrower and secondarily on the underlying collateral securing the transaction. From time to time, the cash flows of borrowers may be less than historical or as planned. In addition, the underlying collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets financed or other business assets and most commercial loans are further supported by a personal guarantee. However, in some instances, short term loans are made on an unsecured basis. Agriculture production loans are typically secured by growing crops and generally secured by other assets such as farm equipment. Production loans are subject to weather and market pricing risks. The Corporation has established underwriting standards and guidelines for all commercial loan types.

The Corporation strives to maintain a geographically diverse commercial real estate portfolio. Commercial real estate loans are primarily underwritten based upon the cash flows of the underlying real estate or from the cash flows of the business conducted at the real estate. Generally, these types of loans will be fully guaranteed by the principal owners of the real estate and loan amounts must be supported by adequate collateral value. Commercial real estate loans may be adversely affected by factors in the local market, the regional economy, or industry specific factors. In addition, Commercial Construction loans are a specific type of commercial real estate loan which inherently carry more risk

than loans for completed projects. Since these types of loans are underwritten utilizing estimated costs, feasibility studies, and estimated absorption rates, the underlying value of the project may change based upon the inaccuracy of these projections. Commercial construction loans are closely monitored, subject to industry standards, and disbursements are controlled during the construction process.

Residential

Retail real estate mortgages that are secured by 1-4 family residences are generally owner occupied and include residential real estate and residential real estate construction loans. The Corporation typically establishes a maximum loan-to-value ratio and generally requires private mortgage insurance if the ratio is exceeded. The Corporation sells substantially all of its long-term fixed mortgages to secondary market purchasers. Mortgages sold to secondary market purchasers are underwritten to specific guidelines. The Corporation originates some mortgages that are maintained in the bank's loan portfolio. Portfolio loans are generally adjustable rate mortgages and are underwritten to conform to Qualified Mortgage standards. Several factors are considered in underwriting

all Mortgages including the value of the underlying real estate, debt-to-income ratio and credit history of the borrower. Repayment is primarily dependent upon the personal income of the borrower and can be impacted by changes in borrower's circumstances such as changes in employment status and changes in real estate property values. Risk is mitigated by the sale of substantially all long-term fixed rate mortgages, the underwriting of portfolio loans to Qualified Mortgage standards and the fact that mortgages are generally smaller individual amounts spread over a large number of borrowers.

Consumer

The consumer portfolio primarily consists of home equity loans and lines (typically secured by a subordinate lien on a 1-4 family residence), secured loans (typically secured by automobiles, boats, recreational vehicles, or motorcycles), cash/CD secured, and unsecured loans. Pricing, loan terms, and loan to value guidelines vary by product line. The underlying value of collateral dependent loans may vary based on a number of economic conditions, including fluctuations in home prices and unemployment levels. Underwriting of consumer loans is based on the individual credit profile and analysis of the debt repayment capacity for each borrower. Payments for consumer loans is typically set-up on equal monthly installments, however, future repayment may be impacted by a change in economic conditions or a change in the personal income levels of individual customers. Overall risks within the consumer portfolio are mitigated by the mix of various loan products, lending in various markets and the overall make-up of the portfolio (small loan sizes and a large number of individual borrowers).

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. The general component covers non-classified loans as well as non-impaired classified loans and is based on historical loss experience adjusted for current factors.

A loan is impaired when full payment under the loan terms is not expected. Loans for which the terms have been modified, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. Impairment is evaluated in total for smaller-balance loans of similar nature such as residential mortgages and consumer loans, and on an individual basis for other loans. 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. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment and, accordingly, they are not separately identified for impairment disclosures.

The general component covers non-classified loans as well as non-impaired classified loans and is based on historical loss experience adjusted for current factors. The historical loss experience is based on the actual loss history experienced over the most recent four years. This actual loss experience is supplemented with other current factors based on the risks present for each portfolio segment. These current factors include consideration of the following: levels of and trends in delinquent, classified, and impaired loans; levels of and trends in charge-offs and recoveries; national and local economic trends and conditions; changes in lending policies and procedures; trends in volume and terms of loans; experience, ability, and depth of lending management and other relevant staff; credit concentrations; value of underlying collateral for collateral dependent loans; and other external factors such as competition and legal and regulatory requirements. The following portfolio segments have been identified: commercial loans, residential loans and consumer loans. A characteristic of the commercial loan segment is that the loans are for business purchases. A characteristic of the residential loan segment is that the loans are secured by residential properties. A characteristic of the consumer loan segment is that the loans are for automobiles and other consumer purchases.

Commercial loans are generally well secured, which mitigates the risk of loss and has contributed to the low historical loss rate. However, concentrations in commercial real estate, along with the potential impact of rising interest rates to commercial real estate, raises the risk of loss on commercial loans. For these reasons, commercial loans have the highest adjustment to the historical loss rate. Continued weakness in local economic conditions along with declining auto values resulted in consumer loans having the next highest level of adjustment to the historical loss rate. The residential loan portfolio segment had the lowest level of adjustment to the historical loss rate.

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 Corporation determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

FDIC Indemnification Asset: The FDIC indemnification asset results from the loss share agreements in the 2009 FDIC-assisted transaction. The asset is measured separately from the related covered assets as they are not contractually embedded in the assets and are not transferable with the assets should the Corporation choose to dispose of them. It represents the acquisition date fair value of expected reimbursements from the FDIC which was determined to be \$12.1 million. Pursuant to the terms of the loss sharing agreement, covered loans and other real estate are subject to a stated loss threshold whereby the FDIC will reimburse the Corporation for up to 95% of losses incurred. These expected reimbursements do not include reimbursable amounts related to future covered expenditures. These cash flows are discounted to reflect a metric of uncertainty of the timing and receipt of the loss sharing reimbursement from the FDIC. This asset decreases when losses are realized and claims are paid by the FDIC or when customers repay their loans in full and expected losses do not occur. This asset also increases when estimated future losses increase. When estimated future losses increase, the Corporation records a provision for loan losses and increases its allowance for loan losses accordingly. The related increase or decrease in the FDIC indemnification asset is recorded as an (increase) or offset to the provision for loan losses. During 2014 and 2013, the provision for loan losses was (increased)/ offset by (\$687 thousand) and (\$1.4 million) related to the changes in the FDIC indemnification asset. There were not any changes to the provision for loan losses related to the FDIC indemnification asset in 2015. At December 31, 2015 and 2014, the balance of the indemnification asset was not material and is included in other assets.

Foreclosed Assets: Assets acquired through or instead of loan foreclosures are initially recorded at fair value less estimated selling costs when acquired, establishing a new cost basis. Physical possession of residential real estate property collateralizing a consumer mortgage loan occurs when legal title is obtained upon completion of foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or similar legal agreement. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. If fair value declines, a valuation allowance is recorded through expense. Costs after acquisition are expensed.

Premises and Equipment: Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed over the useful lives of the assets, which range from 3 to 5 years for furniture and equipment and 33 to 39 years for buildings and leasehold improvements.

Restricted Stock: Restricted stock includes Federal Home Loan Bank (FHLB) of Indianapolis and Chicago and Federal Reserve stock. This restricted stock is carried at cost and periodically evaluated for impairment. Because this stock is viewed as a long-term investment, impairment is based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Servicing Rights: Servicing rights are recognized separately when they are acquired through sales of loans. When mortgage loans are sold, servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on third-party valuations that incorporate assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, ancillary income, prepayment speeds and default rates and losses. All classes of servicing assets are subsequently measured using the amortization method, which requires servicing rights to be amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual grouping, to the extent that fair value is less than the carrying amount. If the Corporation later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as

an increase to income. Changes in valuation allowances are reported with Other Service Fees on the income statement. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Servicing fee income, which is included in Other Service Fees on the income statement, is for fees earned for servicing loans.

The fees are based on a contractual percentage of the outstanding principal or a fixed amount per loan and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income. Servicing fees totaled \$1.3 million, \$1.4 million and \$1.4 million for the years ended December 31, 2015, 2014 and 2013. Late fees and ancillary fees related to loan servicing are not material.

Stock based compensation: Compensation cost is recognized for restricted stock awards and units issued to employees based on the fair value of these awards at the date of grant. Market price of the Corporation's common stock at the date of grant is used for restricted stock awards. Compensation expense is recognized over the requisite service period.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales, when control over the assets has been

relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Corporation, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Bank-Owned Life Insurance: The Corporation has purchased life insurance policies on certain key executives. Bank-owned life insurance is recorded at its cash surrender value, or the amount that can be realized. Income on the investments in life insurance is included in other interest income.

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 represents the future economic benefits arising from other assets acquired that are not individually identified and separately recognized. 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 Corporation 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 our balance sheet.

Other intangible assets consist of core deposit and acquired customer list intangible assets arising from the whole bank, insurance agency and branch acquisitions. They are initially measured at fair value and then are amortized on an accelerated basis over their estimated useful lives, which are 10 and 12 years, respectively.

Long-Term Assets: Premises and equipment 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.

Benefit Plans: Pension expense is the net of service and interest cost, return on plan assets and amortization of gains and losses not immediately recognized. The amount contributed is determined by a formula as decided by the Board of Directors. Deferred compensation and supplemental retirement plan expense allocates the benefits over years of service.

Employee Stock Ownership Plan: Shares of treasury stock are issued to the ESOP and compensation expense is recognized based upon the total market price of shares when contributed.

Deferred Compensation Plan: Prior to 2011, a deferred compensation plan covered all directors. Under the plan, the Corporation pays each director, or their beneficiary, the amount of fees deferred plus interest over 10 years, beginning when the director achieves age 65. A liability is accrued for the obligation under these plans. The expense incurred for the deferred compensation for each of the last three years was \$142 thousand, \$138 thousand and \$149 thousand, resulting in a deferred compensation liability of \$2.2 million at December 31, 2015 and \$2.4 million at December 31, 2014. There are no deferred compensation plans now in effect for directors.

Incentive Plans: A long-term incentive plan established in 2000 provides for the payment of incentive rewards as a 15-year annuity to all directors and certain key officers. That plan was in place through December 31, 2009, and compensation expense is recognized over the service period. Payments under the plan generally did not begin until the earlier of January 1, 2015, or the January 1 immediately following the year in which the participant reaches age 65. There was no compensation expense related to this plan for 2015, 2014 and 2013. There is a liability of \$13.2 million and \$14.0 million as of year-end 2015 and 2014. In 2011 the Corporation adopted the 2011 Short-term Incentive Plan

and the 2011 Omnibus Equity Incentive Plan designed to reward key officers based on certain performance measures. The short-term portion of the plan is paid out within 75 days of year end and the long-term plan vests over a three year period and is paid out within 75 days of the end of each vesting period. The compensation expense related to the plans in 2015, 2014 and 2013 was \$1.4 million, \$1.7 million and \$1.5 million, respectively, and resulted in a liability of \$816 thousand at December 31, 2015 and \$782 thousand at December 31, 2014.

The Omnibus Equity Incentive Plan is a long term incentive plan that was designed to align the interests of participants with the interest of shareholders. Under the plan, awards may be made based on certain performance measures. The grants are made in restricted stock units that are subject to a vesting schedule.

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. 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

The Corporation recognizes interest and/or penalties related to income tax matters in income tax expense.

Loan Commitments and Related Financial Instruments: Financial instruments include credit instruments, such as commitments to make loans and standby 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.

Earnings Per Share: Earnings per common share is net income divided by the weighted average number of common shares outstanding during the period. The Corporation does not have any potentially dilutive securities as the restricted stock awards are included in outstanding shares.. Earnings and dividends per share are restated for stock splits and dividends through the date of issue of the financial statements.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale and changes in the funded status of the retirement plans, which are also recognized as separate components of equity.

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 there are currently such matters that will have a material effect on the financial statements.

Dividend Restriction: Banking regulations require maintaining certain capital levels and may limit the dividends paid by the bank to the holding company or by the holding company to shareholders.

Fair Value of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. 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 market conditions could significantly affect the estimates.

Operating Segment: While the Corporation's chief decision-makers monitor the revenue streams of the various products and services, the operating results of significant segments are similar and operations are managed and financial performance is evaluated on a corporate-wide basis. Accordingly, all of the Corporation's financial service operations are considered by management to be aggregated in one reportable operating segment, which is banking.

Adoption of New Accounting Standards: In May 2014, the FASB and the International Accounting Standards Board (the "IASB") jointly issued a comprehensive new revenue recognition standard that will supersede nearly all existing revenue recognition guidance under GAAP and International Financial Reporting Standards ("IFRS"). Previous revenue recognition guidance in GAAP comprised broad revenue recognition concepts together with numerous revenue requirements for particular industries or transactions, which sometimes resulted in different accounting for economically similar transactions. In contrast, IFRS provided limited revenue recognition guidance and, consequently, could be difficult to apply to complex transactions. Accordingly, the FASB and the IASB initiated a joint project to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and IFRS that would: (1) Remove inconsistencies and weaknesses in revenue requirements; (2) Provide a more robust

framework for addressing revenue issues; (3) Improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets; (4) Provide more useful information to users of financial statements through improved disclosure requirements; and (5) Simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer. To meet those objectives, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers." The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies generally will be required to use more judgment and make more estimates than under current guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. The standard is effective for public entities for interim and annual periods beginning after December 15, 2017. For financial reporting purposes, the standard allows for either full retrospective adoption, meaning the standard is applied to all of the periods presented, or modified retrospective adoption, meaning the standard is applied only to the most current period presented in the financial statements with the cumulative effect of initially applying the standard recognized at the date of initial application. The Corporation is currently evaluating the

provisions of ASU No. 2014-09 and will be closely monitoring developments and additional guidance to determine the potential impact the new standard will have on the Corporation's Consolidated Financial Statements.

In June 2014, the FASB issued ASU No. 2014-11, "Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures." The new guidance aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as repurchase financings with the accounting for other typical repurchase agreements. Going forward, these transactions would all be accounted for as secured borrowings. The guidance eliminates sale accounting for repurchase-to-maturity transactions and supersedes the guidance under which a transfer of a financial asset and a contemporaneous repurchase financing could be accounted for on a combined basis as a forward agreement, which has resulted in outcomes referred to as off-balance-sheet accounting. The amendments in the ASU require a new disclosure for transactions economically similar to repurchase agreements in which the transferor retains substantially all of the exposure to the economic return on the transferred financial assets throughout the term of the transaction. The amendments in the ASU also require expanded disclosures, effective for the current reporting period of June 30, 2015, about the nature of collateral pledged in repurchase agreements and similar transactions accounted for as secured borrowings (see Note 5 to the Consolidated Financial Statements). The Corporation adopted the amendments in this ASU effective January 1, 2015. As of June 30, 2015, all of the Company's repurchase agreements were typical in nature (i.e., not repurchase-to-maturity transactions or repurchase agreements executed as a repurchase financing) and are accounted for as secured borrowings. As such, the adoption of ASU No. 2014-11 did not have a material impact on the Corporation's Consolidated Financial Statements.

ASU 2015-01, "Income Statement - Extraordinary and Unusual Items - Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items." ASU 2015-01 eliminates from U.S. GAAP the concept of extraordinary items, which, among other things, required an entity to segregate extraordinary items considered to be unusual and infrequent from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. ASU 2015-01 is effective for us beginning January 1, 2016, though early adoption is permitted. ASU 2015-01 did not have a significant impact on our financial statements upon adoption in 2016.

ASU 2015-02, "Consolidation - Amendments to the Consolidation Analysis." ASU 2015-02 implements changes to both the variable interest consolidation model and the voting interest consolidation model. ASU 2015-02 (i) eliminates certain criteria that must be met when determining when fees paid to a decision maker or service provider do not represent a variable interest, (ii) amends the criteria for determining whether a limited partnership is a variable interest entity and (iii) eliminates the presumption that a general partner controls a limited partnership in the voting model. ASU 2015-02 will be effective for us on January 1, 2016 and did not have a significant impact on our financial statements.

ASU 2016-1, "No. 2016-01, Financial Instruments - Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-1, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. ASU 2016-1 will be effective for us on January 1, 2018 and is not expected to have a significant

impact on our financial statements.

2. FAIR VALUES OF FINANCIAL INSTRUMENTS:

Accounting guidance establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

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

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

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

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

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

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

(Dollar amounts in thousands)	December 31, 2015			Carrying Value
	Fair Value Measurement Using			
	Level 1	Level 2	Level 3	
U.S. Government entity mortgage-backed securities	\$—	\$10,693	\$—	\$10,693
Mortgage-backed securities, residential	—	213,164	—	213,164
Mortgage-backed securities, commercial	—	9	—	9
Collateralized mortgage obligations	—	437,634	—	437,634
State and municipal obligations	—	209,982	4,725	214,707
Collateralized debt obligations	—	—	14,875	14,875
TOTAL	\$—	\$871,482	\$19,600	\$891,082
Derivative Assets		\$1,176		
Derivative Liabilities		(1,176)	
	December 31, 2014			
	Fair Value Measurement Using			
	Level 1	Level 2	Level 3	Carrying Value
U.S. Government entity mortgage-backed securities	\$—	\$1,467	\$—	\$1,467
Mortgage-backed securities, residential	—	187,936	—	187,936
Mortgage-backed securities, commercial	—	17	—	17
Collateralized mortgage obligations	—	484,655	—	484,655
State and municipal obligations	—	201,775	5,900	207,675
Collateralized debt obligations	—	—	15,303	15,303
TOTAL	\$—	\$875,850	\$21,203	\$897,053
Derivative Assets		\$1,062		
Derivative Liabilities		(1,062)	

There were no transfers between Level 1 and Level 2 during 2015 and 2014.

The table below presents a reconciliation and income statement classification of gains and losses for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the twelve months ended December 31, 2015 and 2014.

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) December 31, 2015		
	State and municipal obligations	Collateralized debt obligations	Total
Beginning balance, January 1	\$5,900	\$ 15,303	\$ 21,203
Total realized/unrealized gains or losses			
Included in earnings	—	—	—
Included in other comprehensive income	—	(268	) (268
Purchases	—	—	—
Settlements	(1,175	) (160	) (1,335
Ending balance, December 31	\$4,725	\$ 14,875	\$ 19,600

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) December 31, 2014		
	State and municipal obligations	Collateralized debt obligations	Total
Beginning balance, January 1	\$ 4,525	\$ 9,044	\$ 13,569
Total realized/unrealized gains or losses			
Included in earnings	—	—	—
Included in other comprehensive income	—	7,100	7,100
Transfers	4,000	—	4,000
Settlements	(2,625	) (841	) (3,466
Ending balance, December 31	\$ 5,900	\$ 15,303	\$ 21,203

There were no unrealized gains and losses recorded in earnings for the years ended December 31, 2015 or 2014.

Certain local municipal securities with a fair value of \$4.0 million as of December 31, 2014 were purchased and added to Level 3 because we were unable to obtain observable market data from our provider for these investments.

Impaired loans disclosed in footnote 7, which are measured for impairment using the fair value of collateral, are valued at Level 3. They are carried at a fair value of \$2.4 million, after a valuation allowance of \$1.2 million at December 31, 2015 and at a fair value of \$11.5 million, net of a valuation allowance of \$1.9 million at December 31, 2014. The impact to the provision for loan losses for the twelve months ended December 31, 2015 and December 31, 2014 was a \$271 thousand decrease and a \$1.2 million decrease, respectively. Other real estate owned is valued at Level 3. Other real estate owned at December 31, 2015 with a value of \$3.5 million was reduced \$743 thousand for fair value adjustment. At December 31, 2015 other real estate owned was comprised of \$2.8 million from commercial loans and \$655 thousand from residential loans. Other real estate owned at December 31, 2014 with a value of \$4.0 million was reduced \$1.1 million for fair value adjustment. At December 31, 2014 other real estate owned was comprised of \$3.0 million from commercial loans and \$1.0 million from residential loans.

Fair value is measured based on the value of the collateral securing those loans, and is determined using several methods. Generally the fair value of real estate is determined based on appraisals by qualified licensed appraisers. Appraisals for real estate generally use three methods to derive value: cost, sales or market comparison and income

approach. The cost method bases value on the cost to replace current property. The market comparison evaluates the sales price of similar properties in the same market area. The income approach considers net operating income generated by the property and the investor's required return. The final fair value is based on a reconciliation of these three approaches. If an appraisal is not available, the fair value may be determined by using a cash flow analysis, a broker's opinion of value, the net present value of future cash flows, or an observable market price from an active market. Fair value of other real estate is based upon the current appraised values of the properties as determined by qualified licensed appraisers and the Company's judgment of other relevant market conditions. Appraisals are obtained annually

and reductions in value are recorded as a valuation through a charge to expense. The primary unobservable input used by management in estimating fair value are additional discounts to the appraised value to consider market conditions and the age of the appraisal, which are based on management's past experience in resolving these types of properties. These discounts range from 0% to 50%. Values for non-real estate collateral, such as business equipment, are based on appraisals performed by qualified licensed appraisers or the customers financial statements. Values for non real estate collateral use much higher discounts than real estate collateral. Other real estate and impaired loans carried at fair value are primarily comprised of smaller balance properties.

The following tables present quantitative information about recurring and non-recurring Level 3 fair value measurements at December 31, 2015 and 2014.

2015	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range
State and municipal obligations	\$4,725	Discounted cash flow	Discount rate	3.05%-5.50%
			Probability of default	— %
Other real estate	\$3,466	Sales comparison/income approach	Discount rate for age of appraisal and market conditions	5.00%-20.00%
Impaired Loans	\$2,352	Sales comparison/income approach	Discount rate for age of appraisal and market conditions	0.00%-50.00%
2014	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range
State and municipal obligations	\$5,900	Discounted cash flow	Discount rate	3.05%-5.50%
			Probability of default	— %
Other real estate	\$3,965	Sales comparison/income approach	Discount rate for age of appraisal and market conditions	5.00%-20.00%
Impaired Loans	\$11,477	Sales comparison/income approach	Discount rate for age of appraisal and market conditions	0.00%-50.00%

The following tables present impaired collateral dependent loans measured at fair value on a non-recurring basis by class of loans as of December 31, 2015 and 2014.

(Dollar amounts in thousands)	December 31, 2015		
	Carrying Value	Allowance for Loan Losses Allocated	Fair Value
Commercial			
Commercial & Industrial	\$998	\$212	\$786
Farmland	—	—	—
Non Farm, Non Residential	1,415	741	674
Agriculture	—	—	—
All Other Commercial	225	—	225
Residential			
First Liens	873	206	667
Home Equity	—	—	—
Junior Liens	—	—	—
Multifamily	—	—	—

All Other Residential Consumer	—	—	—
Motor Vehicle	—	—	—
All Other Consumer	—	—	—
TOTAL	\$3,511	\$1,159	\$2,352

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(Dollar amounts in thousands)	December 31, 2014		Fair Value
	Carrying Value	Allowance for Loan Losses Allocated	
Commercial			
Commercial & Industrial	\$5,874	\$1,056	\$4,818
Farmland	—	—	—
Non Farm, Non Residential	6,654	753	5,901
Agriculture	—	—	—
All Other Commercial	827	102	725
Residential			
First Liens	33	—	33
Home Equity	—	—	—
Junior Liens	—	—	—
Multifamily	—	—	—
All Other Residential	—	—	—