

FIRST FINANCIAL BANCORP /OH/

Form 10-Q

November 07, 2018

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Table of Contents

**FORM 10-Q**

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington D.C. 20549**

**QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2018

**OR**

**TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-34762

**FIRST FINANCIAL BANCORP.**

(Exact name of registrant as specified in its charter)

Ohio	31-1042001
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

255 East Fifth Street, Suite 700	45202
Cincinnati, Ohio	
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (877) 322-9530

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company, and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes  No

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

Class	Outstanding at 11/6/2018
Common stock, No par value	97,907,701

Table of Contents

**FIRST FINANCIAL BANCORP.**

**INDEX**

	Page No.
<u>Part I - FINANCIAL INFORMATION</u>	
<u>Item 1 - Financial Statements</u>	
<u>Consolidated Balance Sheets - September 30, 2018 (unaudited) and December 31, 2017</u>	<u>1</u>
<u>Consolidated Statements of Income - Three and Nine Months Ended September 30, 2018 and 2017 (unaudited)</u>	<u>2</u>
<u>Consolidated Statements of Comprehensive Income - Three and Nine Months Ended September 30, 2018 and 2017 (unaudited)</u>	<u>3</u>
<u>Consolidated Statements of Changes in Shareholders' Equity - Nine Months Ended September 30, 2018 and 2017 (unaudited)</u>	<u>4</u>
<u>Consolidated Statements of Cash Flows - Nine Months Ended September 30, 2018 and 2017 (unaudited)</u>	<u>5</u>
<u>Notes to Consolidated Financial Statements (unaudited)</u>	<u>6</u>
<u>Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>38</u>
<u>Item 3 - Quantitative and Qualitative Disclosures about Market Risk</u>	<u>53</u>
<u>Item 4 - Controls and Procedures</u>	<u>53</u>
<u>Part II - OTHER INFORMATION</u>	
<u>Item 1 - Legal Proceedings</u>	<u>54</u>
<u>Item 1A - Risk Factors</u>	<u>54</u>
<u>Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>55</u>
<u>Item 6 - Exhibits</u>	<u>56</u>
<u>Signatures</u>	<u>57</u>

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Table of Contents**Glossary of Abbreviations and Acronyms**

First Financial has identified the following list of abbreviations and acronyms that are used in the Notes to Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.

AFS	Available-for-sale	FASB	Financial Accounting Standards Board
ALLL	Allowance for loan and lease losses	FDIC	Federal Deposit Insurance Corporation
AOCI	Accumulated other comprehensive income	FHLB	Federal Home Loan Bank
ASC	Accounting standards codification	First Financial	First Financial Bancorp.
ASU	Accounting standards update	Form 10-K	First Financial Bancorp. Annual Report on Form 10-K
ATM	Automated teller machine	FRB	Federal Reserve Bank
Bank	First Financial Bank	GAAP	U.S. Generally Accepted Accounting Principles
Basel III	Basel Committee regulatory capital reforms, Third Basel Accord	HTM	Held-to-maturity
Bp/bps	Basis point(s)	Insignificant	Less than \$0.1 million
BOLI	Bank Owned Life Insurance	IRLC	Interest Rate Lock Commitment
CDs	Certificates of deposit	MSFG	MainSource Financial Group, Inc.
C&I	Commercial & Industrial	N/A	Not applicable
CRE	Commercial real estate	NII	Net interest income
Company	First Financial Bancorp.	OREO	Other real estate owned
ERM	Enterprise risk management	SEC	U.S. Securities and Exchange Commission
EVE	Economic value of equity	TDR	Troubled debt restructuring
Fair Value Topic	FASB ASC Topic 825, Financial Instruments		

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Table of Contents

**PART I - FINANCIAL INFORMATION**  
**ITEM I - FINANCIAL STATEMENTS**  
**FIRST FINANCIAL BANCORP. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(Dollars in thousands)

	September 30, 2018 (Unaudited)	December 31, 2017
<b>Assets</b>		
Cash and due from banks	\$ 193,288	\$ 150,650
Interest-bearing deposits with other banks	28,989	33,974
Investment securities available-for-sale, at fair value (amortized cost \$2,662,329 at September 30, 2018 and \$1,348,227 at December 31, 2017)	2,626,726	1,349,408
Investment securities held-to-maturity (fair value \$422,638 at September 30, 2018 and \$653,101 at December 31, 2017)	434,369	654,008
Other investments	115,757	53,140
Loans held for sale	13,277	11,502
Loans and leases		
Commercial & industrial	2,426,590	1,912,743
Lease financing	95,317	89,347
Construction real estate	565,077	467,730
Commercial real estate	3,868,143	2,490,091
Residential real estate	932,962	471,391
Home equity	816,133	493,604
Installment	97,413	41,586
Credit card	45,741	46,691
<b>Total loans and leases</b>	<b>8,847,376</b>	<b>6,013,183</b>
Less: Allowance for loan and lease losses	57,715	54,021
<b>Net loans and leases</b>	<b>8,789,661</b>	<b>5,959,162</b>
Premises and equipment	219,940	125,036
Goodwill and other intangibles	934,360	209,379
Accrued interest and other assets	486,300	350,664
<b>Total assets</b>	<b>\$ 13,842,667</b>	<b>\$ 8,896,923</b>
<b>Liabilities</b>		
Deposits		
Interest-bearing demand	\$ 2,284,271	\$ 1,453,463
Savings	3,134,944	2,462,420
Time	1,957,574	1,317,105
<b>Total interest-bearing deposits</b>	<b>7,376,789</b>	<b>5,232,988</b>
Noninterest-bearing	2,375,845	1,662,058
<b>Total deposits</b>	<b>9,752,634</b>	<b>6,895,046</b>
Federal funds purchased	123,452	72,265
FHLB short-term borrowings	1,170,800	742,300
<b>Total short-term borrowings</b>	<b>1,294,252</b>	<b>814,565</b>
Long-term debt	570,037	119,654
<b>Total borrowed funds</b>	<b>1,864,289</b>	<b>934,219</b>
Accrued interest and other liabilities	190,224	136,994
<b>Total liabilities</b>	<b>11,807,147</b>	<b>7,966,259</b>

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**Shareholders' equity**

Common stock - no par value		
Authorized - 160,000,000 shares; Issued - 104,281,794 shares in 2018 and 68,730,731 in 2017	1,633,828	573,109
Retained earnings	564,545	491,847
Accumulated other comprehensive loss	(52,897	) (20,390 )
Treasury stock, at cost, 6,367,268 shares in 2018 and 6,661,644 shares in 2017	(109,956	) (113,902 )
<b>Total shareholders' equity</b>	<b>2,035,520</b>	<b>930,664</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 13,842,667</b>	<b>\$ 8,896,923</b>

See Notes to Consolidated Financial Statements.

Table of Contents**FIRST FINANCIAL BANCORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME**

(Dollars in thousands, except per share data)

(Unaudited)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
<b>Interest income</b>				
Loans and leases, including fees	\$ 123,397	\$ 71,148	\$ 320,607	\$ 205,764
Investment securities				
Taxable	21,801	13,150	56,315	37,356
Tax-exempt	3,807	1,537	9,532	4,347
Total interest on investment securities	25,608	14,687	65,847	41,703
Other earning assets	215	(917 )	499	(2,932 )
<b>Total interest income</b>	149,220	84,918	386,953	244,535
<b>Interest expense</b>				
Deposits	14,672	10,335	39,764	25,939
Short-term borrowings	6,052	2,566	12,847	6,049
Long-term borrowings	5,011	1,538	11,066	4,616
<b>Total interest expense</b>	25,735	14,439	63,677	36,604
<b>Net interest income</b>	123,485	70,479	323,276	207,931
Provision for loan and lease losses	3,238	2,953	9,276	3,787
<b>Net interest income after provision for loan and lease losses</b>	120,247	67,526	314,000	204,144
<b>Noninterest income</b>				
Service charges on deposit accounts	10,316	5,169	24,923	14,585
Trust and wealth management fees	3,728	3,324	11,379	10,476
Bankcard income	5,261	3,272	13,998	9,908
Client derivative fees	3,029	1,779	6,249	4,371
Net gain from sales of loans	1,739	1,455	4,643	3,998
Net gain (loss) on sales of investment securities	(167 )	276	(197 )	1,630
Other	4,778	7,667	12,883	12,792
<b>Total noninterest income</b>	28,684	22,942	73,878	57,760
<b>Noninterest expenses</b>				
Salaries and employee benefits	50,852	33,827	137,485	97,121
Net occupancy	6,765	4,328	17,893	13,145
Furniture and equipment	4,072	2,161	11,410	6,474
Data processing	4,502	3,455	22,478	10,254
Marketing	2,502	649	5,947	2,141
Communication	785	430	2,362	1,345
Professional services	2,621	2,030	10,478	5,257
State intangible tax	1,223	721	3,066	2,163
FDIC assessments	734	1,051	2,951	3,001
Loss (gain) - other real estate owned	538	237	332	423
Other	10,821	5,554	26,056	15,720
<b>Total noninterest expenses</b>	85,415	54,443	240,458	157,044
Income before income taxes	63,516	36,025	147,420	104,860
Income tax expense	12,859	11,199	29,839	32,884
<b>Net income</b>	\$ 50,657	\$ 24,826	\$ 117,581	\$ 71,976

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Net earnings per common share - basic	\$0.52	\$ 0.40	\$1.37	\$ 1.17
Net earnings per common share - diluted	\$0.51	\$ 0.40	\$1.36	\$ 1.16
Cash dividends declared per share	\$0.20	\$ 0.17	\$0.58	\$0.51
Average common shares outstanding - basic	97,411,201	61,577,619	85,602,116	61,507,160
Average common shares outstanding - diluted	98,484,228	62,189,637	86,639,927	62,185,874

See Notes to Consolidated Financial Statements.

2

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Table of Contents**FIRST FINANCIAL BANCORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(Dollars in thousands)  
(Unaudited)**

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Net income	\$50,657	\$24,826	\$117,581	\$71,976
Other comprehensive income (loss), net of tax:				
Unrealized gain (loss) on debt securities arising during the period	(10,185 )	1,501	(28,993 )	7,064
Change in retirement obligation	347	213	1,164	615
Unrealized gain (loss) on derivatives	99	129	414	385
Other comprehensive income (loss)	(9,739 )	1,843	(27,415 )	8,064
<b>Comprehensive income</b>	<b>\$40,918</b>	<b>\$26,669</b>	<b>\$90,166</b>	<b>\$80,040</b>

See Notes to Consolidated Financial Statements.

Table of Contents

**FIRST FINANCIAL BANCORP. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**(Dollars in thousands except per share data)**  
**(Unaudited)**

	Common Stock		Retained Earnings	Accumulated other comprehensive income (loss)	Treasury stock		Total
	Shares	Amount			Shares	Amount	
Balance at January 1, 2017	68,730,731	\$ 570,382	\$ 437,188	\$ (28,443 )	(6,751,179 )	\$(113,903 )	\$ 865,224
Net income			71,976				71,976
Other comprehensive income (loss)				8,064			8,064
Cash dividends declared:							
Common stock at \$0.51 per share			(31,576 )				(31,576 )
Warrant exercises		(82 )			4,848	82	0
Exercise of stock options, net of shares purchased		(885 )			53,303	903	18
Restricted stock awards, net of forfeitures		(1,696 )			23,762	(1,087 )	(2,783 )
Share-based compensation expense		4,031					4,031
Balance at September 30, 2017	68,730,731	\$ 571,750	\$ 477,588	\$ (20,379 )	(6,669,266 )	\$(114,005 )	\$ 914,954
Balance at January 1, 2018	68,730,731	\$ 573,109	\$ 491,847	\$ (20,390 )	(6,661,644 )	\$(113,902 )	\$ 930,664
Impact of cumulative effect of change in accounting principles			5,092	(5,092 )			0
Net income			117,581				117,581
Other comprehensive income (loss)				(27,415 )			(27,415 )
Cash dividends declared:							
Common stock at \$0.58 per share			(49,975 )				(49,975 )
Common stock issued in connection with business combinations	35,551,063	1,045,876					1,045,876
Stock options and warrants acquired and converted in connection with business combinations		16,037					16,037
Warrant exercises		(984 )			57,530	984	0
Exercise of stock options, net of shares purchased		(282 )			32,941	566	284
Restricted stock awards, net of forfeitures		(4,913 )			203,905	2,396	(2,517 )
Share-based compensation expense		4,985					4,985
<b>Balance at September 30, 2018</b>	<b>104,281,794</b>	<b>\$ 1,633,828</b>	<b>\$ 564,545</b>	<b>\$ (52,897 )</b>	<b>(6,367,268 )</b>	<b>\$(109,956 )</b>	<b>\$ 2,035,520</b>

See Notes to Consolidated Financial Statements.

Table of Contents**FIRST FINANCIAL BANCORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS****(Dollars in thousands)****(Unaudited)**

	Nine months ended September 30,	
	2018	2017
<b>Operating activities</b>		
Net income	\$ 117,581	\$ 71,976
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	9,276	3,787
Depreciation and amortization	17,326	9,504
Stock-based compensation expense	4,985	4,031
Pension expense (income)	521	(956 )
Net amortization (accretion) on investment securities	8,209	7,916
Net (gain) loss on sales of investment securities	197	(1,630 )
Originations of loans held for sale	(113,142 )	(123,387 )
Net gains from sales of loans held for sale	(4,643 )	(3,998 )
Proceeds from sales of loans held for sale	112,904	123,415
Deferred income taxes	(349 )	3,977
Decrease (increase) cash surrender value of life insurance	(4,484 )	(563 )
Decrease (increase) in interest receivable	(4,264 )	(4,069 )
Decrease (increase) in indemnification asset	1,900	3,840
(Decrease) increase in interest payable	3,597	(1,052 )
Decrease (increase) in other assets	(25 )	1,247
(Decrease) increase in other liabilities	24,990	(1,046 )
Net cash provided by (used in) operating activities	174,579	92,992
<b>Investing activities</b>		
Proceeds from sales of securities available-for-sale	259,518	179,517
Proceeds from calls, paydowns and maturities of securities available-for-sale	271,597	158,454
Purchases of securities available-for-sale	(566,528 )	(563,172 )
Proceeds from calls, paydowns and maturities of securities held-to-maturity	31,964	98,824
Purchases of securities held-to-maturity	(14,014 )	(15,465 )
Net decrease (increase) in interest-bearing deposits with other banks	4,985	47,663
Net decrease (increase) in loans and leases	(45,783 )	(230,174 )
Proceeds from disposal of other real estate owned	3,138	6,797
Purchases of premises and equipment	(15,544 )	(4,798 )
Net cash acquired from business combinations	64,941	0
Net cash paid for branch divestitures	(41,197 )	0
Net cash provided by (used in) investing activities	(46,923 )	(322,354 )
<b>Financing activities</b>		
Net (decrease) increase in total deposits	(406,450 )	200,302
Net (decrease) increase in short-term borrowings	284,092	55,820
Payments on long-term debt	(52,274 )	(94 )
Proceeds from FHLB borrowings	150,000	0
Cash dividends paid on common stock	(60,670 )	(30,708 )
Proceeds from exercise of stock options	284	284

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Net cash provided by (used in) financing activities	(85,018	) 225,604
Cash and due from banks		
<b>Change in cash and due from banks</b>	42,638	(3,758 )
Cash and due from banks at beginning of period	150,650	121,598
<b>Cash and due from banks at end of period</b>	\$ 193,288	\$ 117,840

**Supplemental schedule for investing activities**

Business combinations

Assets acquired, net of purchase consideration	\$3,341,999	\$0
Liabilities assumed	4,018,948	0
Goodwill	\$676,949	\$0

See Notes to Consolidated Financial Statements.

5

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Table of Contents

**FIRST FINANCIAL BANCORP. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**September 30, 2018**  
**(Unaudited)**

**NOTE 1: BASIS OF PRESENTATION**

The Consolidated Financial Statements of First Financial Bancorp., a financial holding company principally serving Ohio, Indiana, Kentucky and Illinois, include the accounts and operations of First Financial and its wholly-owned subsidiary, First Financial Bank. All significant intercompany transactions and accounts have been eliminated in consolidation. Certain reclassifications of prior periods' amounts have been made to conform to current year presentation. Such reclassifications had no effect on net earnings.

The preparation of financial statements in conformity with GAAP requires management to make estimates, assumptions and judgments that affect the amounts reported in the Consolidated Financial Statements and accompanying Notes. These estimates, assumptions and judgments are inherently subjective and may be susceptible to significant change. Actual realized amounts could differ materially from these estimates.

These interim financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they may not include all of the information and accompanying notes necessary to constitute a complete set of financial statements required by GAAP and should be read in conjunction with the audited consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017. Management believes these unaudited consolidated financial statements reflect all adjustments of a normal recurring nature which are necessary for a fair presentation of the results for the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year or any other interim period. The Consolidated Balance Sheet as of December 31, 2017 has been derived from the audited financial statements in the Company's 2017 Form 10-K.

**NOTE 2: RECENTLY ADOPTED AND ISSUED ACCOUNTING STANDARDS**

In May 2014, the FASB issued an update (ASU 2014-09, Revenue from Contracts with Customers) which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. Under the revised standard, an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU applies to all contracts with customers except those that are within the scope of other topics in the FASB Accounting Standards Codification. Certain of the ASU's provisions also apply to transfers of nonfinancial assets, including in-substance nonfinancial assets that are not an output of an entity's ordinary activities, such as sales of property, plant, and equipment; real estate; or intangible assets. The ASU also requires significantly expanded disclosures about revenue recognition. For further detail, see Note 13 – Revenue Recognition.

In January 2016, the FASB issued an update (ASU 2016-01, Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financial Liabilities) which requires entities to measure many equity investments at fair value and recognize changes in fair value in net income. This update does not apply to equity investments that result in consolidation, those accounted for under the equity method and certain others, and will eliminate use of the available for sale classification for equity securities while providing a new measurement alternative for equity investments that do not have readily determinable fair values and do not qualify for the net asset value practical expedient. This update also requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. The guidance in this ASU became effective

in the first quarter of 2018 and did not have a material impact on the Consolidated Financial Statements. At adoption, an adjustment was made to move \$0.2 million of net unrealized gain on AFS equity securities out of AOCI and into Retained Earnings since changes in fair values are now recognized in net income. Additionally, in accordance with the guidance, the Company measured the fair value of its financial instruments as of September 30, 2018 using an exit price notion. For further detail, see Note 15 – Fair Value Disclosures.

In February 2016, the FASB issued an update (ASU 2016-02, Leases) which requires lessees to record most leases on their balance sheet and recognize leasing expenses in the income statement. Operating leases, except for short-term leases that are subject to an accounting policy election, will be recorded on the balance sheet for lessees by establishing a lease liability and corresponding right-of-use asset. The guidance in this ASU will become effective for interim and annual reporting periods beginning after December 15, 2018, with early adoption permitted. Given operating leases outstanding as of September 30, 2018, First Financial does not expect this ASU to have a material impact on the income statement, but does anticipate an

## Table of Contents

increase in the Company's assets and liabilities. Decisions to repurchase, modify or renew leases prior to the implementation date will impact this level of materiality.

In June 2016, the FASB issued an update (ASU 2016-13, Financial Instruments-Credit Losses: Measurement of Credit Losses on Financial Instruments) which significantly changes how entities are required to measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. This update will replace the current incurred loss approach for estimating credit losses with an expected loss model for instruments measured at amortized cost, including loans and leases. Expected credit losses are required to be based on amortized cost and reflect losses expected over the remaining contractual life of the asset. Management is expected to consider any available information relevant to assessing the collectibility of contractual cash flows, such as information about past events, current conditions, voluntary prepayments and reasonable and supportable forecasts, when developing expected credit loss estimates.

In addition to the new framework for calculating the ALLL, this update requires allowances for available-for-sale debt securities rather than a reduction of the security's carrying amount under the current other-than-temporary impairment model. This update also simplifies the accounting model for purchased credit-impaired debt securities and loans and will require new and updated footnote disclosures.

The guidance in this ASU will become effective for interim and annual reporting periods beginning after December 15, 2019. Early adoption is permitted for all entities for interim and annual reporting periods beginning after December 15, 2018. First Financial has formed an internal management committee and engaged a third party vendor to assist with the transition to the guidance set forth in this update. The committee is currently evaluating the impact of this update on First Financial's Consolidated Financial Statements.

In August 2016, the FASB issued an update (ASU 2016-15 Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments) which may change how an entity classifies certain cash receipts and cash payments on its statement of cash flows to reduce diversity in practice. The update also provides guidance on when an entity should separate cash flows and classify them into more than one class and when an entity should classify the aggregate of those cash flows into a single class based on the predominance principle. The guidance in this ASU became effective in the first quarter of 2018 and did not have a material impact on the Consolidated Financial Statements.

In January 2017, the FASB issued an update (ASU 2017-04, Intangibles - Goodwill and Other (Topic 350), Simplifying the Test for Goodwill Impairment) which simplifies the subsequent measurement of goodwill by eliminating Step 2 from goodwill impairment testing. This update requires an entity to perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount, and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, with any loss recognized not to exceed the total amount of goodwill allocated to that reporting unit. Additionally, the update requires consideration of the income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable, and eliminates the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment. First Financial early adopted the provisions set forth in this update in 2017. Adoption of this update did not have a material impact on First Financial's Consolidated Financial Statements.

In March 2017, the FASB issued an update (ASU 2017-07, Compensation - Retirement Benefits (Topic 715), Improving the Presentation of the Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost) which requires disaggregation of the service cost component from the other components of net benefit cost. This update also provides explicit guidance on how to present the service cost component and the other components of net benefit cost in the income statement and allows only the service cost component of net benefit cost to be eligible for capitalization. The guidance in this ASU became effective in the first quarter of 2018 and did not have a material impact on the

Consolidated Financial Statements.

In March 2017, the FASB issued an update (ASU 2017-08, Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities) which amends the amortization period for certain purchased callable debt securities held at a premium and shortens the amortization period for the premium to the earliest call date rather than as an adjustment of yield over the contractual life of the instrument. This update more closely aligns the amortization period of premiums and discounts to expectations incorporated in market pricing on the underlying securities, as in most cases, market participants price securities to the call date that produces the worst yield when the coupon is above current market rates (that is, the security is trading at a premium) and price securities to maturity when the coupon is below market rates (that is, the security is trading at a discount) in anticipation that the borrower will act in its economic best interest in an attempt to more closely align interest income recorded on bonds held at a premium or a discount with the economics of the underlying instrument. The guidance in this ASU will become effective for reporting periods, beginning after December



Table of Contents

15, 2018, with early adoption permitted. First Financial is currently evaluating the impact of this update on its Consolidated Financial Statements.

In May 2017, the FASB issued an update (ASU 2017-09, Compensation - Stock Compensation (Topic 718), Scope of Modification Accounting), which provides clarity and reduces the diversity in practice, cost and complexity when accounting for a change to the terms or conditions of a share-based payment award. The amendments in this update provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718 clarifying that an entity will not apply modification accounting to a share-based payment award if the award's fair value (or calculated value or intrinsic value), vesting conditions and classification as an equity or liability instrument are the same immediately before and after the change. The guidance in this ASU became effective in the first quarter of 2018 and did not have a material impact on the Consolidated Financial Statements.

In August 2017, the FASB issued an update (ASU 2017-12, Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities) to better align financial reporting for hedging activities with the economic objectives of those activities. This update aligns certain aspects of hedge documentation, effectiveness assessments, accounting and disclosures, and expands permissible hedge strategies as of the date of adoption. The guidance in this ASU will become effective for reporting periods beginning after December 15, 2018, with early adoption permitted, and will require a modified retrospective transition method with recognition of the cumulative effect of the change on the opening balance of each affected component of equity. Amended disclosures will be required prospectively. First Financial is currently evaluating the impact of this update on its Consolidated Financial Statements.

In February 2018, the FASB issued an update (ASU 2018-02, Income statement-Reporting Comprehensive Income: Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income), which allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. Consequently, the amendments eliminated the stranded tax effects resulting from the Tax Cuts and Jobs Act and will improve the usefulness of information reported to financial statement users. The amendments only relate to the reclassification of the income tax effects of the Tax Cuts and Jobs Act, and the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not effected. The amendments in this update also require certain disclosures about stranded tax effects. The guidance in this ASU will become effective for reporting periods beginning after December 15, 2018, with early adoption permitted, and is applied either in the period of adoption or retrospectively to each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act is recognized. First Financial early adopted the provisions set forth in this update in the first quarter of 2018, and as a result, reclassified \$4.9 million from accumulated other comprehensive income to retained earnings. There were no other income tax effects related to the Act that were reclassified as a result of the adoption of the accounting standard.

**NOTE 3: INVESTMENTS**

For the three months ended September 30, 2018, proceeds on the sale of \$43.3 million of AFS securities resulted in gains of \$0.3 million and losses of \$0.4 million. For the three months ended September 30, 2017, proceeds on the sale of \$53.9 million of AFS securities resulted in gains of \$0.4 million and losses of \$0.1 million.

For the nine months ended September 30, 2018, proceeds on the sale of \$259.5 million of AFS securities resulted in gains of \$0.3 million and losses of \$0.5 million. For the nine months ended September 30, 2017, proceeds on the sale of \$179.6 million of AFS securities resulted in gains of \$1.8 million and losses of \$0.2 million.

AFS

Table of Contents

The following is a summary of HTM and AFS investment securities as of September 30, 2018:

<i>(Dollars in thousands)</i>	Held-to-maturity				Available-for-sale			
	Amortized cost	Unrecognized gain	Unrecognized loss	Fair value	Amortized cost	Unrealized gain	Unrealized loss	Fair value
U.S. Treasuries	\$0	\$ 0	\$ 0	\$0	\$99	\$ 0	\$(4)	\$95
Securities of U.S. government agencies and corporations	0	0	0	0	33,438	7	(600)	32,845
Mortgage-backed securities - residential	26,603	0	(1,615)	24,988	581,657	551	(14,262)	567,946
Mortgage-backed securities - commercial	150,223	0	(6,378)	143,845	362,874	118	(5,646)	357,346
Collateralized mortgage obligations	13,182	0	(727)	12,455	864,824	940	(15,436)	850,328
Obligations of state and other political subdivisions	244,361	275	(3,286)	241,350	247,206	1,533	(2,626)	246,113
Asset-backed securities	0	0	0	0	490,685	582	(1,499)	489,768
Other securities	0	0	0	0	81,546	1,039	(300)	82,285
<b>Total</b>	<b>\$434,369</b>	<b>\$ 275</b>	<b>\$(12,006)</b>	<b>\$422,638</b>	<b>\$2,662,329</b>	<b>\$ 4,770</b>	<b>\$(40,373)</b>	<b>\$2,626,726</b>

The following is a summary of held-to-maturity and available-for-sale investment securities as of December 31, 2017:

<i>(Dollars in thousands)</i>	Held-to-maturity				Available-for-sale			
	Amortized cost	Unrecognized gain	Unrecognized loss	Fair value	Amortized cost	Unrealized gain	Unrealized loss	Fair value
U.S. Treasuries	\$0	\$ 0	\$ 0	\$0	\$98	\$ 0	\$(1)	\$97
Securities of U.S. government agencies and corporations	11,168	0	(76)	11,092	15,695	220	0	15,915
Mortgage-backed securities - residential	162,093	2,042	(1,535)	162,600	290,793	849	(2,599)	289,043
Mortgage-backed securities - commercial	255,027	1,372	(3,000)	253,399	150,356	164	(1,417)	149,103
Collateralized mortgage obligations	143,545	354	(1,602)	142,297	306,095	1,158	(1,861)	305,392
Obligations of state and other political subdivisions	82,175	1,804	(266)	83,713	124,269	2,162	(676)	125,755
Asset-backed securities	0	0	0	0	377,655	1,628	(306)	378,977
Other securities	0	0	0	0	83,266	2,147	(287)	85,126
<b>Total</b>	<b>\$654,008</b>	<b>\$ 5,572</b>	<b>\$(6,479)</b>	<b>\$653,101</b>	<b>\$1,348,227</b>	<b>\$ 8,328</b>	<b>\$(7,147)</b>	<b>\$1,349,408</b>

The following table provides a summary of investment securities by contractual maturity as of September 30, 2018, except for residential and commercial mortgage-backed securities, collateralized mortgage obligations and asset-backed securities, which are shown as single totals due to the unpredictability of the timing in principal repayments.

<i>(Dollars in thousands)</i>	Held-to-maturity		Available-for-sale	
	Amortized cost	Fair value	Amortized cost	Fair value
<b>By Contractual Maturity:</b>				
Due in one year or less	\$0	\$0	\$3,932	\$3,922
Due after one year through five years	275	277	72,831	72,633
Due after five years through ten years	18,337	18,274	138,584	139,591
Due after ten years	225,749	222,799	146,942	145,192
Mortgage-backed securities - residential	26,603	24,988	581,657	567,946
Mortgage-backed securities - commercial	150,223	143,845	362,874	357,346
Collateralized mortgage obligations	13,182	12,455	864,824	850,328
Asset-backed securities	0	0	490,685	489,768
<b>Total</b>	<b>\$434,369</b>	<b>\$422,638</b>	<b>\$2,662,329</b>	<b>\$2,626,726</b>



Table of Contents

Unrealized gains and losses on debt securities are generally due to fluctuations in current market yields relative to the yields of the debt securities at their amortized cost. All securities with unrealized losses are reviewed quarterly to determine if any impairment is considered other than temporary, requiring a write-down to fair value. First Financial considers the percentage loss on a security, duration of the loss, average life or duration of the security, credit rating of the security and payment performance, as well as the Company's intent and ability to hold the security to maturity, when determining whether any impairment is other than temporary. At this time First Financial does not intend to sell, and it is not more likely than not that the Company will be required to sell, debt securities temporarily impaired prior to maturity or recovery of the recorded value. First Financial had no other than temporary impairment related to its investment securities portfolio as of September 30, 2018 or December 31, 2017.

As of September 30, 2018, the Company's investment securities portfolio consisted of 1,414 securities, of which 909 were in an unrealized loss position. As of December 31, 2017, the Company's investment securities portfolio consisted of 775 securities, of which 237 were in an unrealized loss position.

The following tables provide the fair value and gross unrealized losses on investment securities in an unrealized loss position, aggregated by investment category and the length of time the individual securities have been in a continuous loss position:

	September 30, 2018					
	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
<i>(Dollars in thousands)</i>						
U.S. Treasuries	\$0	\$0	\$95	\$(4)	\$95	\$(4)
Securities of U.S. Government agencies and corporations	19,546	(411)	5,332	(189)	24,878	(600)
Mortgage-backed securities - residential	431,332	(8,695)	141,519	(7,182)	572,851	(15,877)
Mortgage-backed securities - commercial	281,842	(3,637)	151,185	(8,387)	433,027	(12,024)
Collateralized mortgage obligations	658,749	(10,407)	133,153	(5,756)	791,902	(16,163)
Obligations of state and other political subdivisions	304,298	(3,976)	37,683	(1,936)	341,981	(5,912)
Asset-backed securities	206,708	(1,125)	20,776	(374)	227,484	(1,499)
Other securities	17,901	(192)	4,678	(108)	22,579	(300)
<b>Total</b>	\$1,920,376	\$(28,443)	\$494,421	\$(23,936)	\$2,414,797	\$(52,379)

	December 31, 2017					
	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
<i>(Dollars in thousands)</i>						
U.S. Treasuries	\$97	\$(1)	\$0	\$0	\$97	\$(1)
Securities of U.S. Government agencies and corporations	11,092	(76)	0	0	11,092	(76)
Mortgage-backed securities - residential	175,183	(1,109)	108,782	(3,025)	283,965	(4,134)
Mortgage-backed securities - commercial	132,818	(1,713)	72,139	(2,704)	204,957	(4,417)
Collateralized mortgage obligations	164,909	(1,138)	101,436	(2,325)	266,345	(3,463)
Obligations of state and other political subdivisions	38,450	(507)	21,639	(435)	60,089	(942)
Asset-backed securities	44,941	(200)	24,396	(106)	69,337	(306)
Other securities	2,605	(1)	7,124	(286)	9,729	(287)
<b>Total</b>	\$570,095	\$(4,745)	\$335,516	\$(8,881)	\$905,611	\$(13,626)



Table of Contents

For further detail on the fair value of investment securities, see Note 15 – Fair Value Disclosures.

**NOTE 4: LOANS AND LEASES**

First Financial offers clients a variety of commercial and consumer loan and lease products with distinct interest rates and payment terms. Commercial loan categories include C&I, CRE, construction real estate and lease financing. Consumer loan categories include residential real estate, home equity, installment and credit card.

Lending activities are primarily concentrated in states where the Bank operates banking centers (Ohio, Indiana, Kentucky and Illinois). First Financial also offers two nationwide lending platforms, one that provides equipment and leasehold improvement financing for franchisees in the quick service and casual dining restaurant sector and another that provides loans primarily to insurance agents and brokers that are secured by commissions and cash collateral.

**Credit Quality.** To facilitate the monitoring of credit quality for commercial loans, and for purposes of determining an appropriate ALLL, First Financial utilizes the following categories of credit grades:

*Pass* - Higher quality loans that do not fit any of the other categories described below.

*Special Mention* - First Financial assigns a special mention rating to loans and leases with potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or lease or in First Financial's credit position at some future date.

*Substandard* - First Financial assigns a substandard rating to loans or leases that are inadequately protected by the current sound financial worth and paying capacity of the borrower or of the collateral pledged, if any. Substandard loans and leases have well-defined weaknesses that jeopardize repayment of the debt. Substandard loans and leases are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not addressed.

*Doubtful* - First Financial assigns a doubtful rating to loans and leases with all the attributes of a substandard rating with the added characteristic that the weaknesses make collection or liquidation in full highly questionable and improbable, on the basis of currently existing facts, conditions and values. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors that may work to the advantage and strengthening of the credit quality of the loan or lease, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition or liquidation procedures, capital injection, perfecting liens on additional collateral and refinancing plans.

The credit grades previously described are derived from standard regulatory rating definitions and are assigned upon initial approval of credit to borrowers and updated periodically thereafter.

First Financial considers repayment performance to be the best indicator of credit quality for consumer loans. Consumer loans that have principal and interest payments that are past due by 90 days or more are generally classified as nonperforming. Additionally, consumer loans that have been modified in a TDR are classified as nonperforming. Purchased impaired loans are not classified as nonperforming as the loans are considered to be performing under FASB ASC Topic 310-30.

Commercial and consumer credit exposure by risk attribute was as follows:

	As of September 30, 2018		
	Commercial	Real Estate	Lease
(Dollars in thousands)	Construction	Commercial	financing Total

	&				
	industrial				
Pass	\$2,335,925	\$552,973	\$3,757,627	\$92,551	\$6,739,076
Special Mention	39,060	12,094	49,463	0	100,617
Substandard	51,605	10	61,053	2,766	115,434
Doubtful	0	0	0	0	0
<b>Total</b>	<b>\$2,426,590</b>	<b>\$565,077</b>	<b>\$3,868,143</b>	<b>\$95,317</b>	<b>\$6,955,127</b>

Table of Contents

<i>(Dollars in thousands)</i>	Residential real estate	Home equity	Installment	Credit card	Total
Performing	\$ 919,440	\$ 809,653	\$ 97,097	\$ 45,741	\$ 1,871,931
Nonperforming	13,522	6,480	316	0	20,318
<b>Total</b>	<b>\$ 932,962</b>	<b>\$ 816,133</b>	<b>\$ 97,413</b>	<b>\$ 45,741</b>	<b>\$ 1,892,249</b>

As of December 31, 2017					
<i>(Dollars in thousands)</i>	Commercial & industrial	Real Estate Construction	Commercial	Lease financing	Total
Pass	\$ 1,882,464	\$ 467,687	\$ 2,446,999	\$ 88,078	\$ 4,885,228
Special Mention	6,226	0	4,436	0	10,662
Substandard	24,053	43	38,656	1,269	64,021
Doubtful	0	0	0	0	0
<b>Total</b>	<b>\$ 1,912,743</b>	<b>\$ 467,730</b>	<b>\$ 2,490,091</b>	<b>\$ 89,347</b>	<b>\$ 4,959,911</b>

<i>(Dollars in thousands)</i>	Residential real estate	Home equity	Installment	Credit card	Total
Performing	\$ 463,459	\$ 489,148	\$ 41,331	\$ 46,691	\$ 1,040,629
Nonperforming	7,932	4,456	255	0	12,643
<b>Total</b>	<b>\$ 471,391</b>	<b>\$ 493,604</b>	<b>\$ 41,586</b>	<b>\$ 46,691</b>	<b>\$ 1,053,272</b>

**Delinquency.** Loans are considered past due or delinquent when the contractual principal or interest due in accordance with the terms of the loan agreement remains unpaid after the date of the scheduled payment.



Table of Contents

Loan delinquency, including loans classified as nonaccrual, was as follows:

As of September 30, 2018

<i>(Dollars in thousands)</i>	30 – 59 days past due	60 – 89 days past due	> 90 days past due	Total past due	Current	Subtotal	Purchased impaired	Total	> 90 days past due and still accruing
<b>Loans</b>									
Commercial & industrial	\$ 1,991	\$ 1,613	\$ 2,662	\$ 6,266	\$ 2,414,484	\$ 2,420,750	\$ 5,840	\$ 2,426,590	\$ 0
Lease financing	0	0	0	0	95,317	95,317	0	95,317	0
Construction real estate	283	0	0	283	564,535	564,818	259	565,077	0
Commercial real estate	4,513	407	16,296	21,216	3,789,238	3,810,454	57,689	3,868,143	0
Residential real estate	2,796	1,828	2,825	7,449	888,367	895,816	37,146	932,962	0
Home equity	3,435	1,336	3,153	7,924	804,670	812,594	3,539	816,133	0
Installment	201	21	282	504	96,360	96,864	549	97,413	0
Credit card	301	179	144	624	45,117	45,741	0	45,741	144
<b>Total</b>	<b>\$ 13,520</b>	<b>\$ 5,384</b>	<b>\$ 25,362</b>	<b>\$ 44,266</b>	<b>\$ 8,698,088</b>	<b>\$ 8,742,354</b>	<b>\$ 105,022</b>	<b>\$ 8,847,376</b>	<b>\$ 144</b>

As of December 31, 2017

<i>(Dollars in thousands)</i>	30 – 59 days past due	60 – 89 days past due	> 90 days past due	Total past due	Current	Subtotal	Purchased impaired	Total	> 90 days past due and still accruing
<b>Loans</b>									
Commercial & industrial	\$ 755	\$ 1,657	\$ 5,078	\$ 7,490	\$ 1,901,821	\$ 1,909,311	\$ 3,432	\$ 1,912,743	\$ 0
Lease financing	485	0	0	485	88,862	89,347	0	89,347	0
Construction real estate	234	0	0	234	467,216	467,450	280	467,730	0
Commercial real estate	1,716	201	8,777	10,694	2,419,969	2,430,663	59,428	2,490,091	0
Residential real estate	526	811	1,992	3,329	430,500	433,829	37,562	471,391	0
Home equity	2,716	394	1,753	4,863	485,127	489,990	3,614	493,604	0
Installment	179	29	205	413	40,529	40,942	644	41,586	0
Credit card	285	87	62	434	46,257	46,691	0	46,691	62
<b>Total</b>	<b>\$ 6,896</b>	<b>\$ 3,179</b>	<b>\$ 17,867</b>	<b>\$ 27,942</b>	<b>\$ 5,880,281</b>	<b>\$ 5,908,223</b>	<b>\$ 104,960</b>	<b>\$ 6,013,183</b>	<b>\$ 62</b>

**Nonaccrual.** Loans are classified as nonaccrual when, in the opinion of management, collection of principal or interest is doubtful or when principal or interest payments are 90 days or more past due. Generally, loans are classified as nonaccrual due to the continued failure by the borrower to adhere to contractual payment terms, coupled with other pertinent factors. When a loan is classified as nonaccrual, the accrual of interest income is discontinued and previously accrued but unpaid interest is reversed. Any payments received while a loan is on nonaccrual status are applied as a reduction to the carrying value of the loan. A loan classified as nonaccrual may return to accrual status if collection of future principal and interest payments is no longer doubtful.

Purchased impaired loans are classified as performing, even though they may be contractually past due, as any nonpayment of contractual principal or interest is considered in the periodic re-estimation of expected cash flows and is included in the resulting recognition of current period provision for loan and lease losses or prospective yield adjustments.

**Troubled Debt Restructurings.** A loan modification is considered a TDR when the borrower is experiencing financial difficulty and concessions are made by the Company that would not otherwise be considered for a borrower with similar credit characteristics. The most common types of modifications include interest rate reductions, maturity extensions and modifications to principal amortization, including interest-only structures. Modified terms are

dependent upon the financial position and needs of the individual borrower. If the modification agreement is violated, the loan is managed by the Company's credit administration group for resolution, which may result in foreclosure in the case of real estate.

TDRs are generally classified as nonaccrual for a minimum period of six months and may qualify for return to accrual status once they have demonstrated performance with the restructured terms of the loan agreement.

Table of Contents

First Financial had 187 TDRs totaling \$25.0 million at September 30, 2018, including \$20.3 million on accrual status and \$4.7 million classified as nonaccrual. First Financial had an insignificant amount of commitments outstanding to lend additional funds to borrowers whose loan terms have been modified through TDRs, and the ALLL included reserves of \$2.3 million related to TDRs at September 30, 2018. For the three months ended September 30, 2018 and 2017, the Company charged off \$0.7 million and \$0.1 million, respectively, for the portion of TDRs determined to be uncollectible. For the nine months ended September 30, 2018 and 2017, the Company charged off \$0.8 million and \$0.2 million, respectively, for the portion of TDRs determined to be uncollectible. Additionally, as of September 30, 2018, \$12.6 million of accruing TDRs have been performing in accordance with the restructured terms for more than one year.

First Financial had 214 TDRs totaling \$23.9 million at December 31, 2017, including \$17.5 million of loans on accrual status and \$6.4 million classified as nonaccrual. First Financial had an insignificant amount of commitments outstanding to lend additional funds to borrowers whose loan terms had been modified through TDRs. At December 31, 2017, the ALLL included reserves of \$1.3 million related to TDRs, and \$17.2 million of the accruing TDRs had been performing in accordance with the restructured terms for more than one year.

The following tables provide information on loan modifications classified as TDRs during the three and nine months ended September 30, 2018 and 2017:

	Three months ended September 30, 2018			September 30, 2017		
	Number of loans	Pre-modification loan balance	Period end balance	Number of loans	Pre-modification loan balance	Period end balance
<i>(Dollars in thousands)</i>						
Commercial & industrial	0	\$ 0	\$ 0	1	\$ 45	\$ 37
Construction real estate	0	0	0	0	0	0
Commercial real estate	0	0	0	1	285	285
Residential real estate	1	148	143	6	416	315
Home equity	1	10	10	1	39	39
Installment	0	0	0	0	0	0
<b>Total</b>	<b>2</b>	<b>\$ 158</b>	<b>\$ 153</b>	<b>9</b>	<b>\$ 785</b>	<b>\$ 676</b>

	Nine months ended September 30, 2018			September 30, 2017		
	Number of loans	Pre-modification loan balance	Period end balance	Number of loans	Pre-modification loan balance	Period end balance
<i>(Dollars in thousands)</i>						
Commercial & industrial	12	\$ 7,149	\$ 7,096	7	\$ 5,724	\$ 5,661
Construction real estate	0	0	0	0	0	0
Commercial real estate	6	2,119	2,088	7	1,791	1,734
Residential real estate	4	442	437	6	416	315
Home equity	1	10	10	1	39	39
Installment	0	0	0	0	0	0
<b>Total</b>	<b>23</b>	<b>\$ 9,720</b>	<b>\$ 9,631</b>	<b>21</b>	<b>\$ 7,970</b>	<b>\$ 7,749</b>

Table of Contents

The following table provides information on how TDRs were modified during the three and nine months ended September 30, 2018 and 2017:

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
<i>(Dollars in thousands)</i>				
Extended maturities	\$143	\$0	\$3,031	\$3,261
Adjusted interest rates	0	0	52	2,767
Combination of rate and maturity changes	0	285	0	465
Forbearance	0	354	6,199	1,181
Other <sup>(1)</sup>	10	37	349	75
<b>Total</b>	<b>\$153</b>	<b>\$676</b>	<b>\$9,631</b>	<b>\$7,749</b>

<sup>(1)</sup> Includes covenant modifications and other concessions, or combination of concessions, that do not consist of interest rate adjustments, forbearance and maturity extensions

First Financial considers repayment performance as an indication of the effectiveness of the Company's loan modifications. Borrowers that are 90 days or more past due on any principal or interest payments, or who prematurely terminate a restructured loan agreement without paying the contractual principal balance (for example, in a deed-in-lieu arrangement), are considered to be in payment default of the terms of the TDR agreement.

For the nine months ended September 30, 2018, there was one TDR, insignificant in amount, for which there was a payment default during the period that occurred within twelve months of the loan modification. There were no TDRs for which there was a payment default during the period that occurred within twelve months of the loan modification for the three months ended September 30, 2018 or the three or nine month periods ended September 30, 2017.

**Impaired Loans.** Loans classified as nonaccrual and loans modified as TDRs are considered impaired. The following table provides information on impaired loans, excluding purchased impaired loans:

	September 30, December 31,	
<i>(Dollars in thousands)</i>	2018	2017
<b>Impaired loans</b>		
Nonaccrual loans <sup>(1)</sup>		
Commercial & industrial	\$ 4,310	\$ 5,229
Lease financing	0	82
Construction real estate	10	29
Commercial real estate	20,338	10,616
Residential real estate	11,365	4,140
Home equity	6,018	3,743
Installment	327	243
Nonaccrual loans	42,368	24,082
Accruing troubled debt restructurings	20,313	17,545
<b>Total impaired loans</b>	<b>\$ 62,681</b>	<b>\$ 41,627</b>

<sup>(1)</sup> Nonaccrual loans include nonaccrual TDRs of \$4.7 million and \$6.4 million as of September 30, 2018 and December 31, 2017, respectively.

Table of Contents

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
<i>(Dollars in thousands)</i>				
<b>Interest income effect on impaired loans</b>				
Gross amount of interest that would have been recorded under original terms	\$1,192	\$761	\$3,126	\$2,735
Interest included in income				
Nonaccrual loans	169	140	395	445
Troubled debt restructurings	187	168	500	563
Total interest included in income	356	308	895	1,008
<b>Net impact on interest income</b>	<b>\$836</b>	<b>\$453</b>	<b>\$2,231</b>	<b>\$1,727</b>

First Financial individually reviews all impaired commercial loan relationships, as well as consumer loan TDRs, greater than \$250,000, to determine if a specific allowance is necessary based on the borrower's overall financial condition, payment record, support from guarantors and the realizable value of any collateral. Specific allowances are based on discounted cash flows using the loan's initial effective interest rate or the fair value of the collateral for certain collateral dependent loans.

Table of Contents

First Financial's investment in impaired loans was as follows:

	As of September 30, 2018			As of December 31, 2017		
<i>(Dollars in thousands)</i>	Current balance	Contractual principal balance	Related allowance	Current balance	Contractual principal balance	Related allowance
<b>Loans with no related allowance recorded</b>						
Commercial & industrial	\$9,209	\$ 13,034	\$ 0	\$7,162	\$ 8,460	\$ 0
Lease financing	0	0	0	82	82	0
Construction real estate	10	27	0	29	60	0
Commercial real estate	26,722	32,706	0	18,423	20,837	0
Residential real estate	14,277	17,083	0	6,876	8,145	0
Home equity	6,554	7,337	0	4,356	5,399	0
Installment	332	639	0	255	422	0
<b>Total</b>	<b>57,104</b>	<b>70,826</b>	<b>0</b>	<b>37,183</b>	<b>43,405</b>	<b>0</b>
<b>Loans with an allowance recorded</b>						
Commercial & industrial	2,776	2,776	1,562	169	169	169
Lease financing	0	0	0	0	0	0
Construction real estate	0	0	0	0	0	0
Commercial real estate	1,668	2,322	66	3,119	3,120	448
Residential real estate	1,033	1,033	160	1,056	1,063	160
Home equity	100	100	2	100	100	2
Installment	0	0	0	0	0	0
<b>Total</b>	<b>5,577</b>	<b>6,231</b>	<b>1,790</b>	<b>4,444</b>	<b>4,452</b>	<b>779</b>
<b>Total</b>						
Commercial & industrial	11,985	15,810	1,562	7,331	8,629	169
Lease financing	0	0	0	82	82	0
Construction real estate	10	27	0	29	60	0
Commercial real estate	28,390	35,028	66	21,542	23,957	448
Residential real estate	15,310	18,116	160	7,932	9,208	160
Home equity	6,654	7,437	2	4,456	5,499	2
Installment	332	639	0	255	422	0
<b>Total</b>	<b>\$62,681</b>	<b>\$ 77,057</b>	<b>\$ 1,790</b>	<b>\$41,627</b>	<b>\$ 47,857</b>	<b>\$ 779</b>

Table of Contents

First Financial's average impaired loans by class and interest income recognized by class was as follows:

	Three months ended			
	September 30, 2018		September 30, 2017	
	Average Interest	Average Interest	Average Interest	Average Interest
	Recorded Income	Recorded Income	Recorded Income	Recorded Income
	Investment Recognized	Investment Recognized	Investment Recognized	Investment Recognized
<b>Loans with no related allowance recorded</b>				
Commercial & industrial	\$10,033	\$ 63	\$13,730	\$ 63
Lease financing	0	0	91	1
Construction real estate	17	0	950	0
Commercial real estate	28,689	136	23,187	147
Residential real estate	13,247	86	7,569	55
Home equity	6,463	31	3,791	26
Installment	318	1	290	1
<b>Total</b>	<b>58,767</b>	<b>317</b>	<b>49,608</b>	<b>293</b>
<b>Loans with an allowance recorded</b>				
Commercial & industrial	1,578	28	1,832	2
Lease financing	0	0	0	0
Construction real estate	0	0	0	0
Commercial real estate	1,012	3	652	5
Residential real estate	1,036	7	1,067	7
Home equity	100	1	101	1
Installment	0	0	0	0
<b>Total</b>	<b>3,726</b>	<b>39</b>	<b>3,652</b>	<b>15</b>
<b>Total</b>				
Commercial & industrial	11,611	91	15,562	65
Lease financing	0	0	91	1
Construction real estate	17	0	950	0
Commercial real estate	29,701	139	23,839	152
Residential real estate	14,283	93	8,636	62
Home equity	6,563	32	3,892	27
Installment	318	1	290	1
<b>Total</b>	<b>\$62,493</b>	<b>\$ 356</b>	<b>\$53,260</b>	<b>\$ 308</b>

Table of Contents

	Nine months ended			
	September 30, 2018		September 30, 2017	
	Average Interest	Average Interest	Recorded Income	Recorded Income
(Dollars in thousands)	Recorded	Recorded	Investment	Investment
	Income	Income	Recognized	Recognized
<b>Loans with no related allowance recorded</b>				
Commercial & industrial	\$8,950	\$ 162	\$14,669	\$ 259
Lease financing	21	0	120	3
Construction real estate	22	2	744	0
Commercial real estate	25,044	375	21,563	451
Residential real estate	9,875	209	7,801	147
Home equity	5,339	78	3,951	77
Installment	299	2	351	4
Total	49,550	828	49,199	941
<b>Loans with an allowance recorded</b>				
Commercial & industrial	891	34	1,463	26
Lease financing	0	0	0	0
Construction real estate	0	0	0	0
Commercial real estate	1,376	9	2,513	18
Residential real estate	1,043	21	1,126	20
Home equity	100	3	101	3
Installment	0	0	0	0
Total	3,410	67	5,203	67
<b>Total</b>				
Commercial & industrial	9,841	196	16,132	285
Lease financing	21	0	120	3
Construction real estate	22	2	744	0
Commercial real estate	26,420	384	24,076	469
Residential real estate	10,918	230	8,927	167
Home equity	5,439	81	4,052	80
Installment	299	2	351	4
<b>Total</b>	<b>\$52,960</b>	<b>\$ 895</b>	<b>\$54,402</b>	<b>\$ 1,008</b>

**Acquired loans.** Acquired loans are recorded at their estimated fair value at the time of acquisition. Estimated fair values for acquired loans are based on a discounted cash flow methodology that considers various factors including the type of loan and related collateral, classification status, interest rate, term of loan, whether or not the loan was amortizing and a discount rate reflecting the Company's assessment of risk inherent in the cash flow estimates. Acquired loans are grouped together according to similar characteristics and treated in the aggregate when applying various valuation techniques.

First Financial evaluates acquired loans for impairment in accordance with the provisions of FASB ASC Topic 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality. Acquired loans with evidence of credit deterioration since origination are accounted for under FASB ASC Topic 310-30 and are referred to as purchased impaired loans. Interest income, through accretion of the difference between the carrying value of the loans and the expected cash flows (accretable difference) is recognized on all purchased impaired loans. First Financial had purchased impaired loans totaling \$105.0 million at September 30, 2018, which included \$18.0 million acquired in the



merger with MSFG.

19

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Table of Contents

**OREO.** OREO consists of properties acquired by the Company primarily through the loan foreclosure or repossession process, that results in partial or total satisfaction of problem loans.

Changes in OREO were as follows:

	Three months ended September 30,		Nine months ended September 30,	
<i>(Dollars in thousands)</i>	2018	2017	2018	2017
Balance at beginning of period	\$1,853	\$5,961	\$2,781	\$6,284
Additions				
Commercial & industrial	79	1,559	1,269	1,731
Residential real estate	739	235	1,723	2,313
Total additions	818	1,794	2,992	4,044
Disposals				
Commercial & industrial	(181 )	(3,684 )	(2,611 )	(5,291 )
Residential real estate	(117 )	(821 )	(527 )	(1,506 )
Total disposals	(298 )	(4,505 )	(3,138 )	(6,797 )
Valuation adjustment				
Commercial & industrial	(258 )	(102 )	(355 )	(264 )
Residential real estate	(197 )	(32 )	(362 )	(151 )
Total valuation adjustment	(455 )	(134 )	(717 )	(415 )
<b>Balance at end of period</b>	<b>\$1,918</b>	<b>\$3,116</b>	<b>\$1,918</b>	<b>\$3,116</b>

**NOTE 5: ALLOWANCE FOR LOAN AND LEASE LOSSES**

Management maintains the ALLL at a level that it considers sufficient to absorb probable incurred loan and lease losses inherent in the portfolio. Management determines the adequacy of the ALLL based on historical loss experience as well as other significant factors such as composition of the portfolio, economic conditions, geographic footprint, the results of periodic internal and external evaluations of delinquent, nonaccrual and classified loans and any other adverse situations that may affect a specific borrower's ability to repay, including the timing of future payments.

The ALLL is increased by provision expense and decreased by charge-offs, net of recoveries of amounts previously charged-off. First Financial's policy is to charge-off all or a portion of a loan when, in management's opinion, it is unlikely to collect the principal amount owed in full either through payments from the borrower or from the liquidation of collateral.

Table of Contents

Changes in the ALLL by loan category were as follows:

Three months ended September 30, 2018

<i>(Dollars in thousands)</i>	Real Estate							Total
	Commercial and industrial	Lease financing	Construction	Commercial	Residential	Home Equity	Installment Credit card	
<b>Allowance for loan and lease losses:</b>								
Balance at beginning of period	\$ 17,528	\$ 797	\$					