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PRESENTATION

Operator

Good afternoon, and welcome to the First Merchants Second Quarter 2019 Earnings Conference Call. (Operator Instructions) This presentation contains forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act. Such forward-looking statements can often be identified by the use of words like believe, expect or may, and include statements relating to First Merchants goals, business plan, growth strategies, loan and investment portfolio, asset quality, risks and future costs and benefits. These statements are subject to significant uncertainties that may cause results to differ materially from those set forth in such statements, including changes in economic and business conditions; the ability of First Merchants to integrate recent acquisitions and attract new customers; changes in laws, regulations and requirements of the company's regulators; the cost and other effects of legal and administrative cases; changes in the creditworthiness of customers and the impairment of collectability of loans; fluctuations in market rates of interest and other risks and factors identified in First Merchants filings with the Securities and Exchange Commission.

First Merchants undertakes no obligation to update any forward-looking statement, whether written or oral, relating to the matters discussed in this presentation or press release. In addition, the company's past results of operations do not necessarily indicate it's anticipated future results. Please note this event is being recorded.

I would now like to turn the conference over to Michael Rechin, President and Chief Executive Officer. Please go ahead.

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

Thank you, Gary, and welcome, everyone, to our earnings conference call and webcast for the second quarter ending June 30, 2019.

Joining me today, as in most of our calls, Mark Hardwick, our Chief Financial Officer and Chief Operating Officer; John Martin, our Chief Credit Officer.

First Merchants released their earnings in a press release this morning, approximately 8:00 Eastern Time. And the presentation, we're going to cover it with you this afternoon, speaks to material from that release.

The directions that point to the webcast were also contained in the back end of that release. And my comments are going to begin on page 4, the slide titled Second Quarter 2019 Highlights.

Our key highlights included earnings per share of $0.83, a 3.8% increase over the second quarter of 2018. $41.1 million of net income after tax, a 3.6% increase over the second quarter of 2018. The strong quarter of growth for us with total assets of $10.7 billion, which grew 10.3% over the second quarter of 2018.

Our annualized quarterly organic loan and deposit growth of 11.8% and 13.5%, respectively. In addition to that, the bank produced strong fee growth covered in the release, and that Mark will cover here shortly. And our asset quality continues with strong metrics. Results and portfolio trends remained positive, and you'll hear John Martin's thoughts on that soon as well.

All told, high performance measures, 11 -- 1.56% return on average assets, 11.10% return on average equity with a 51% efficiency ratio.

Mark, would you pick up from here?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

Yes. Thanks, Mike. My comments will begin on Slide 6. Total assets on Line 7 increased by $853 million or 17.3% on an annualized basis this year. Organic growth and total loans on Line 2 equaled $288 million or 8% on an annualized basis. Since you're in 2018, all investments on Line 1 increased by $460 million or an annualized 56%. The composition of our $7.5 billion loan portfolio, shown on the left side of Slide 7, it continues to produce strong loan yields totaling 5.32% for the quarter.

As the graph on the right illustrates, 69% of our loans are variable, demonstrating the asset sensitivity of our bank. The growth in yields created by our variable rate loan base will prove challenging if short-term index rates continues to decline in the future as anticipated.

On Slide 8, our longer-than-normal duration investment portfolio is a good offset to our variable rate loan portfolio. During the year, we have increased the portfolio to $2.1 billion from $1.6 billion as protection against falling rates. As rates in 2019 have started to fall, our unrealized loss of $8 million as of December 31, 2008, flipped to an unrealized gain of $55.5 million. And most of the growth in this investment portfolio is really the outcome of the deposit growth that I'll talk about in a moment.

Now on Slide 9, total deposits increased by $564 million during the first 6 months of the year by an annualized 14.5%. Much of the growth came from higher-cost institutional accounts and money market and CD specials. Approximately half of the growth is variable rate funding while the other half is fixed for a period of approximately 12 to 15 months.

On Slide 10, second quarter deposit costs totaled 1.32%, up from the first quarter of 2019 rate of 1.20%. Controlling future growth and actually reducing interest from deposit -- interest expense on deposits for the remained of the year will be an imperative for the remainder of 2018 and into 2020.

Now on Slide 11, you noticed a couple of investor write-ups, focusing on demand deposit trends. And it seemed appropriate for us to share a tactic we started deploying back in 2017. Through multiple acquisitions, we have acquired and maintained 22 different free checking accounts, that were frozen and/or grandfathered at the time of each integration. We made the decision to migrate these grandfathered free accounts, of which, we do not sell into our current product set for a variety of operational and strategic reasons. The migration is going as expected, and we're pleased with the reduced risk and simplicity of the current product set. The outcome of the migration is shown in the chart and materially impacts any review of demand deposit inflows or outflows dating back to 2017.

Now on Slide 12, all regulatory capital ratios are above the regulatory definition of well-capitalized. In our internal targets, we believe the strength of our 10%-plus tangible common equity ratio and 14.5% total risk-based capital ratio will continue to provide optimal capital flexibility into the future.

The corporation's net interest margin on Slide 13 is our biggest financial challenge to overcome for the remainder of this year and next. We do continue to outpace the compression in net interest margin by growing our balance sheet or earning asset base enough to allow for growth in net interest income. As you can see on Line 1. However, the core cost of our funding base has exceeded our internal forecast in 2019 and the portfolio growth driven by institutional funding, as discussed in the investment section of Slide 8, accounted for 10 basis points of compression.

Fair value accretion continues to run behind all prior periods, as it accounted for just 9 basis points again this quarter. Looking ahead, our interest rate simulation suggests that we will lose 3 to 4 basis points for each 25 basis point decline in the Fed funds rate or primary, on a go-forward basis.

On the way up, we have gained about 5 basis points for every 25 basis point Fed move. So we believe that even though the simulation says 3 or 4 basis points, we think that we'll probably lose a similar amount on the way down that we did on the way up for each FOMC reduction, and we're expecting one in July.

Given the continued upward pressure on deposits, at least that we're experiencing currently, we're anticipating that next quarter's margin may be under pressure by 9 or 10 basis points. As usual, we'll find a way to win despite these headwinds.

One area of financials -- of our financials is countercyclical, is noninterest income on Slide 14. Total noninterest income reached $21.6 million, our strongest quarter in recent memory. $1.4 million of the improvements over first quarter of 2019 came from customer-specific categories. And additionally, $800,000 of the increase is a result of gains on the sale of securities as we harvested some of the recent pickup in valuation.

Noninterest expense on Slide 15 performed as planned, and totaled $57.6 million for the quarter. Included in the quarter was an extraordinary $1.3 million of expense related to our fair lending settlement. $1.2 million was expensed in Line 8 under marketing expense, while $100,000 was recorded in Line 4 under professional services.

On Slide 16, EPS totaled $0.83 for the quarter and the efficiency ratio totaled 51%.

Now on Slide 17. It highlights our positive trend lines, including a tangible book value of over $21 per share as of quarter end -- second quarter end 2019.

On Slide 18, we highlight our May 17 second quarter dividend increase to $0.26 per share, and our double-digit compound annual growth rate of tangible book value per share dating back to 2010.

Thanks for your attention. And now John Martin will discuss our loan portfolio composition and related asset quality trends.

John J. Martin - *First Merchants Corporation - Executive VP & Chief Credit Officer*

All right. Thanks, Mark, and good afternoon. I'll begin my walk-through of the deck on Slide 20, with changes in the loan portfolio, review asset quality and the asset quality roll forward. Cover the allowance and provisioning and then close with some summary remarks on the portfolio.

Turning to Slide 20 then. The loan portfolio grew in the second quarter, as Mark just mentioned, 3% or 12% annualized with commercial, industrial and owner-occupied commercial real estate on Lines 1 and 2 increasing a combined $100 million or 4% in the linked quarter. We continue to see robust credit demand in the structured finance area with both sponsor and public finance.

Construction loan balances were up $83 million on Line 3 with the investment real estate portfolio down $23 million on Line 4. I mentioned this on the earlier calls, our approach to construction investment real estate lending, includes financing, construction projects with the expectation that they will likely move to the permanent market where terms are frequently more favorable. This leads to a build in construction loans with fluctuation in nonowner occupied real estate as projects stabilize and move to the secondary market.

The agricultural lending environment continues to be challenging with the portfolio on Lines 5 and 6, remaining mostly unchanged in the quarter, while public financing and other commercial loans grew $36 million or 8.4%. And finishing out this slide, residential mortgage and consumer lending on Lines 9 and 10, both increased 2%, while other consumer loans declined $11 million in the quarter. That's primarily resulting from a reclassification of a roughly $8.5 million Private Banking loan that moved into the C&I portfolio representing the change there.

We continue to grow the portfolio in a balanced way. The portfolio is roughly 1/3 C&I, 1/3 construction and investment real estate, 1/3 are the commercial and consumer. Our construction concentrations continue to hover at around 50% of risk-based capital with the investment real estate concentrations hovering around 220% of risk-based capital.

Now these levels give us concentration and room for real estate growth as opportunities arise balanced by C&I and consumer lending.

Turning to the asset quality, summary on Line -- on Slide 21. Asset quality remains stable and healthy at this point. On Lines 1 and 2, nonaccrual loans and other real estate loans decreased $2.4 million and $800,000, respectively, for the quarter. There are currently 4 nonaccrual relationships greater than $1 million, leaving a fairly granular remaining nonperforming loan portfolio.

With renegotiated loans unchanged and a $100,000 increase in 90 days past due, the NPAs and 90-plus days past due on Line 5 were down $3.1 million or roughly 10%.

Turning to Slide 22, which reconciles the migration of nonperforming assets. We started the quarter in the far right column, titled Q2 '19, with $31 million in NPAs and 90-day delinquencies. We added $1.6 million of new nonaccrual loans in the quarter, resolved $2.5 million of the same on Line 3 with no new ORE on Line 4, and only $1.5 million of gross charge-offs on Line 5. This netted to a $2.4 million decrease in nonaccrual loans on Lines 6. Dropping down to other real-estate owned changes on Lines 7 through 9, which we sold $500,000 of ORE and have $300,000 of ORE write-downs, which resulted in a decrease in ORE of $800,000.

Finishing out this slide, 90-plus days delinquent loans increased $100,000, which led to an overall decrease in total NPAs and 90-plus days delinquent of $3.1 million ending the quarter at $27.6 million.

Moving to Slide 23, which highlights the ALLL, the allowance and fair value summary. We began the quarter with an allowance of $80.9 million or 1.1% of loans. In the quarter, provision expense offset charge-offs on Lines 2 and 3 by $400,000, resulting in an increase and ending allowance to $81.3 million. The dollar increase in the allowance and the 3 basis point change or 3 basis point coverage decline from 1.11x to 1.08x on Line 7 reflects stable and modestly improving credit quality with additions for a growing loan portfolio and allowance coverage of nonaccrual loans on Line 5 in excess of 300%.

Then summarizing on Slide 24. I guess I'll just say, we had a good quarter of loan growth, as Mark mentioned and you can see. We had strong credit demand across the bank from commercial to mortgage and consumer. Asset quality remains stable with most measures improving, including nonaccrual loans and ORE and overall NPAs and 90 days past due ending the quarter at 36 basis points of loans.

Net charge-offs were only $100,000 with provision expense, supporting increases in loan growth. Overall, solid results.

Thanks for your attention. I'll turn the call back over to Mike Rechin.

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

Okay. Thanks, John. Good coverage there of a productive quarter for First Merchants in several regards. I really like the balance we're demonstrating across all of First Merchants markets in terms of originations, in terms of loan types. We're really achieving a little bit more balance than what we might had 4 or 5 years ago. So as we look forward, organic growth protocol is job 1 for us. And we're going to look to continue to manage our market presence, our core banking business, margin and fee generation. And on the fee part, Mark spent a lot of his remarks talking about the net interest margin. So we're going to look to, as the bullet point offers, optimize our retail and commercial deposit strategy, managing our margin and obviously a changing environment. Smart rates, vis-a-vis the market forces with whom we compete and with a really clear awareness of what the Feds rate direction appears to be.

So we go into that with a -- just a terrifically strong balance sheet and flexibility as it relates to liquidity and capital. And credit condition, that John spent some minutes describing, with an ample reserve for -- should we have an eventual slowdown.

We're excited to continue to work on our revised integration scheduled marketing plan for Michigan. Now we're working with regulators towards a closing before the end of the third quarter. And as we offered a few weeks ago in our press release, we're targeting now an integration for the back half of the fourth quarter. We think that's a -- continues to be a great opportunity. We're working with Doug Chaffin and his team up there.

Last point on here, we're trying to -- we see an opportunity to be an even better company by being better at banking, the underbanked, that would include the entirety of a corporate social responsibility playbook, kind of telling our story around philanthropy and volunteerism more consistently around the company. We look forward to executing on that.

All told, it's an economy that's good for First Merchants. The employment is strong. I was talking earlier with some of our colleagues, almost a growth constraint. It's so strong to some of our commercial customers. But the consumers are doing well, retail sales are strong like they are throughout the country. Kind of a nice low growth consistent feeling to the Midwest, much like you might measure in a national GMP kind of level. Commercial activity may be slowing just a tiny bit, don't know if it's tariff-related or not. But all told, a really good environment for First Merchants to continue to post high-quality results.

At this point, Gary, I'm ready for questions, if you've got people in the queue.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Will Curtiss with Hovde Group.

William Davis Curtiss - *Hovde Group, LLC, Research Division - Director*

Mark, if you don't mind, can you go back through kind of your margin outlook? I got the part about, I think the model suggests 3 to 4 basis points for each 25 basis point cut, but I just want to make sure I understand -- I missed some of the rest of your comments. So if you can go back to that, that'd be great.

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

The model is more static and it's really just what you'll see when we run our interest rate risk simulation and it's published in 10-Qs. And I guess, it was a little more conservative or I guess optimistic on maybe what we think could happen just in the coming quarter. That's a 100 basis point move and it suggest that we'll have 3 to 4 basis points decline for every Fed move. When rates were going up, we were pretty consistently communicating and delivering on 5 basis points of expansion for every 25. And I was saying that's -- if rates are going to go down next week, we think that, that's at least the starting point. And we have spent time looking closely at just the next -- this 90-day period. And we anticipate that the Fed move is a negative to interest income. And that we are continuing to fight some upward pressure in the deposit base. And hopefully, our kind of expectation is that this quarter we just published, or next quarter, end up being the kind of the peak of those numbers. And so maybe more clearly, the guidance we're giving for next quarter is that we expect compression of around 9 to 10 basis points in Q3 compared to Q2.

William Davis Curtiss - *Hovde Group, LLC, Research Division - Director*

Okay. And then any sense for where accretion levels will go with the addition of MBTF? I know they've been pretty stable the last couple of quarters, but just curious if you have kind of an early sense as to what to expect?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

I could pull up our model and see what we looked at. But in terms of the acceleration, typically what we do in our M&A models is just average it out over the life of the portfolio. And historically, based on payoffs it ends up accelerating early and then being a little bit less in the out years. And so I could pull that up and get it back to you here in just a minute. And I'll have it right at my fingertips.

William Davis Curtiss - *Hovde Group, LLC, Research Division - Director*

All right. No problem. And then maybe the last one for me. Maybe this is for Mark, for your again. I think, I guess in the past you kind of guided to flash expenses excluding MBTF. And just curious if that holds true as we -- excluding MBTF, if you still think you can hold the expense base kind of where it is now? And then if you don't mind to remind us in terms of the cost saves with the integration in the fourth quarter, do you expect to get the majority of the saves out by the end of the year?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

Yes. We have $9.5 million built into cost savings at Monroe. We've been watching their financials closely and communicating with their management team really closely. And we still feel good about those levels. And they should all be completed by the end of the year. So we should start 2020 with a really clean Monroe financial statement. And in terms of our core numbers, we feel -- felt really good about this quarter. Obviously, we had $1.3 million of extraordinary that should be able to back out of the numbers on a go-forward basis. But we feel good about our ability to continue to streamline the franchise and maintain a really low single-digit growth rate in noninterest expenses, like 1% or 2%.

Operator

The next question comes from Nathan Race with Piper Jaffray.

Nathan James Race - *Piper Jaffray Companies, Research Division - VP & Senior Research Analyst*

Just going back to that last question, just in terms of expenses, that $1.3 million that you just called out, is it assumed that, that's going to come out of the run rate after 2Q here? I guess what should we anticipate in terms of ongoing recurring expenses associated with the activities that you'll be undertaking in the wake of that settlement?

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

Yes. Nate, it's a good question. We really kind of recognized the majority of the hard costs in the current quarter. And so if you read the settlement, you will see there was one lump sum payment in there that was $0.5 million, maybe slightly more. We had a couple of 3-year obligation items that we're going to get started on right away and took those in the quarter. And so on an ongoing basis, if you saw the handful of activities that we've committed to, we think they are going really do a nice job for the market. But they're around, what I would call, traditional marketing opportunities, directed towards the Marion County area. So to answer your question, the majority of it's going to be recognized in the current quarter.

Nathan James Race - *Piper Jaffray Companies, Research Division - VP & Senior Research Analyst*

Okay. Understood. I appreciate that color. And impressed to see the gears a little bit and looking at the noninterest income run rates from here, and I guess, curious when do you guys expect to close MBTF? And then just how we should kind of think about back half of this year? Noninterest income levels with MBTF in the fold and obviously, given the strength that we saw here in the second quarter also?

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

Yes. We've gotten a lot of conversation rightfully so on the margin. But when you think about your question, I feel good about the second half of the year with and without Monroe. So the Monroe, we would anticipate to being part of the company in the fourth quarter. And as Mark alluded to and myself briefly, their run rate seems to be really consistent with what we have modeled to be in our plan, which was for a longer part of 2019. As it relates to First Merchants alone, numbers that I'm more familiar with. There are some offsets to pressure on the margin, for instance, earnings credit rates have the chance to be reduced, which drives a marginally higher fee income number. And like you saw in the second quarter with our hedge activity. The hedge activity is actually a client activity, it doesn't have to do with First Merchants balance sheet per se. It's us asking as a fee generator for commercial customers and managing their obligations. And so the lower interest rate environment, not only did it show itself well for the hedge category within noninterest income in the second quarter, we would expect based on what we see for their current period in the fourth quarter to be stronger as well.

Nathan James Race - *Piper Jaffray Companies, Research Division - VP & Senior Research Analyst*

Okay. That's great to hear. And so just to clarify, you guys are thinking early 4Q close?

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

We're actually hoping to close by the end of the Q3 with an integration in the fourth quarter.

Operator

The next question comes from Terry McEvoy with Stephens.

Terence James McEvoy - *Stephens Inc., Research Division - MD and Research Analyst*

A question for Mark. I guess direct question. Can you grow or do you think you can grow net interest income quarter-over-quarter in the third quarter with 9 to 10 basis points of margin compression?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

Well, we do. And part of it is the fact that a lot of our growth this quarter came late. And so we feel good about adding those earnings assets in a way that would outpace the anticipated reduction in margin.

Terence James McEvoy - *Stephens Inc., Research Division - MD and Research Analyst*

And within that 9 to 10 basis points, what are your thoughts on deposit costs? I guess it went from 120 to 132? Would you expect continued kind of repricing higher in the third quarter and then stabilize in Q4? Or do you think that pressure continues throughout the year, excluding the acquisition, obviously?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

Well, we've run the models multiple ways. And we have some strategies where we're going to be reducing some of our interest expense on variable rate categories. The institutional money is the most variable category that we have. So there is a chance that we reduce interest expense and it's -- it all kind of depends how retail plays out through the remainder of this third quarter, as we have some accounts migrating out of lower cost categories into more expensive categories like CD specials and money market specials because the rates are still attractive on the -- in the retail front. So I -- really I'm not sure. It's going to be close one way or the other. But we think we're really close to this being kind of the craft of our interest expense on a go-forward basis if rates move down like we expect.

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

I -- Terry, this is Mick Rechin. It calls from our frequent ALCO discussions are a really thorough look at the marketplace and the balance between retaining all the deposits that we work so hard to gather with just trying to access how high our liquidity needs to be, as you can see from the balance sheet, it's pretty steep right now. So it's a great question and an interesting topic for banking. We'd rather start with the position of having a really ample deposit base and kind of managing it market smart as we go.

Terence James McEvoy - *Stephens Inc., Research Division - MD and Research Analyst*

And then just one last question. The 9 to 10 basis points of NIM compression, that is -- assumes 125 basis point rate cut in the third quarter?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

It does with -- and I wouldn't anticipate the same answer for the second rate cut given some time, because we do think deposits will normalize, so.

Operator

(Operator Instructions) The next question comes from Damon DelMonte with KBW.

Damon Paul DelMonte - *Keefe, Bruyette, & Woods, Inc., Research Division - SVP and Director*

So just a question on the outlook for the provision. Obviously, credit trends continue to perform very well. Just wondering, if you could give some perspective as to what you think is a reasonable range for a quarterly provision?

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

The -- I think what we've looked at in the past is in the range of between $1 million and $2 million. And it really is obviously just dependent upon what we see. But with asset quality, where it is today, it's probably at the maybe the lower end of that range. But we budget for something closer to $2 million.

Damon Paul DelMonte - *Keefe, Bruyette, & Woods, Inc., Research Division - SVP and Director*

Okay. All right. And then from a loan growth perspective, I apologize, Mike, if you touched on this in your comments. But just given the trends you're seeing in your pipelines, are you feeling comfortable in that kind of mid-ish or so single-digit range for that remainder of the year?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

Yes, I really am. If you looked at -- so we referenced annualization of the second quarter in the 12% and 13% loans and deposits. And on the loans side, which I think is the superior to your question, that seems to me to be a little high when we talk about to your point of your question, 6% to 8% on an annualized basis. I still like that number. We had a pretty slow first quarter. I think through the first 2 quarters on a combined basis, we're right in that range. And I think we're going to stay there. But to be more specific, our pipeline is strong. So I think at the last quarterly call, I might have referenced a $360 million kind of commercial pipeline. It's a $100 million higher than that right now. And so that gives us reason to believe that some of the strength we saw in the second half of the second quarter could continue. All of that is apart from construction projects that leave in terms of payouts. The pipeline includes the closing of full commitments, which obviously aren't fully drawn on the front end. So it's not appropriate to completely draw hard-line correlation between the pipeline. But as to the fact that you get a larger translation of the pipeline into a closed loan, that holds true. So we think the back half of the year ought to be strong. Maybe not quite as strong as the second quarter.

Damon Paul DelMonte - *Keefe, Bruyette, & Woods, Inc., Research Division - SVP and Director*

Okay. Great. And then Mark, you touched on the noninterest-bearing deposits and the reasoning behind the visual outflow on the quarter-over-quarter percentages. So you're down about $1.350 billion in noninterest bearing. How far do you see that runoff going down to?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

Well, the account migration is complete. So we feel like we have a great baseline from here to continue to build, that will primarily come from commercial growth in deposits, kind of treasury management type accounts instead of retail. This was really a retail migration where we had free accounts and moved them into an account structure with balances or transactions, et cetera. They have the ability to still have a free account but that it's not just automatically free.

Operator

The next question comes from Brian Martin with Janney Montgomery Scott.

Brian Joseph Martin - *Janney Montgomery Scott LLC, Research Division - Director of Banks and Thrifts*

So the -- just a couple for me, Mike. I guess just from a -- you talked about kind of evaluating capital, just kind of what's that and the profitability taking. You just talk about how you expect to manage that here post the -- how you're thinking about doing that post the MB acquisition?

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

Yes. So I think we might have even spoken at the last call, given the delayed close of the opportunity. And we haven't been able to enact a buyback. And yet, it's a ripe environment for that. So discussions with our Board are supportive of that. It's just that it's not on the table right now. That's clearly a tool we're going to continue to evaluate. I doubt we would have any other dividend activity this year. But in M&A, post-Monroe, obviously we like to have cash on hand to be have the greatest flexibility for purchase consideration. But of those couple of variables, clearly, buyback when it's an available tool is the quickest way to normalize that because you followed us for a while Brian, and you can see that we're -- kind of have a significant gap above our targeted levels.

Brian Joseph Martin - *Janney Montgomery Scott LLC, Research Division - Director of Banks and Thrifts*

Right. Okay. And as far as the buyback, I guess that can occur post the close of the transaction. Is that what the soonest it could come into place?

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

Correct.

Brian Joseph Martin - *Janney Montgomery Scott LLC, Research Division - Director of Banks and Thrifts*

Okay. All right. And just from an M&A perspective, I mean, I guess, are you in a position today, I guess, once you close MBTF. I guess how quickly would you be willing to consider something as you work to integrate Monroe?

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

Well, integrate is the more appropriate term than the closing because we feel like integration is really the sign that you've merged the companies. And so clearly for 2019 purpose is our singular priority is getting Monroe closed.

Brian Joseph Martin - *Janney Montgomery Scott LLC, Research Division - Director of Banks and Thrifts*

Okay. Understood. Okay. And just -- as you talked about the pipeline, so just -- as I was jotting it down, Mike, the pipelines today, given the strong growth you have this quarter, are still pretty healthy going in the second half? Are they kind of assume they're down a bit from last quarter?

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

No, no. They're actually about $100 million higher than the last quarter. We entered the second quarter with a 360 -- actually a $358 million pipeline, we're $100 million higher than that. And I might have said a moment ago that, that was commercial. It's actually the entirety of the business lines that we capture, which would include consumer and mortgage as well. But it's dominated by commercial.

Brian Joseph Martin - *Janney Montgomery Scott LLC, Research Division - Director of Banks and Thrifts*

Got it. Okay. And then just the last 2 for me. Just kind of marks, you talked in your remarks about the accretion being a bit lower than it has been, I guess. Do you expect that to continue to tail off? Or I guess are you still comfortable kind of where it's at right now as you think about the next couple of quarters?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

Yes. I'm still comfortable with where it is at. We've had 2 quarters where it's effectively just the amortization levels. We haven't had any extraordinaries, although at some point, it runs off. And back to the question of Monroe, it looks like we're around $14 million, $14.5 million of credit marks that we're anticipating. And then when we ran the models, this has been a while. But we had interest rate marks of $7 million that clearly we'll have to kind of reevaluate. But typically, anticipate seeing those come in over 4-year period, unless you end up with a real credit challenge or you have a pay down in the portfolio. So we typically just model it as amortizing and over time.

Brian Joseph Martin - *Janney Montgomery Scott LLC, Research Division - Director of Banks and Thrifts*

Okay. All right. And the biggest I guess offset to margin pressures you guys sit today, I guess, where you -- if you kind of rank the offsets in magnitude? I mean where are the biggest offsets in your mind today on managing the rate environment that everyone's challenged by?

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

The question -- I think you're saying within net interest margin or just overall?

Brian Joseph Martin - *Janney Montgomery Scott LLC, Research Division - Director of Banks and Thrifts*

Just overall. I mean I think kind of...

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

Yes, well some of these countercyclical measures that we've taken we think are positive, like growing the bond portfolio and it's a fixed rate portfolio by $600 million helps, as rates begin to fall. And most of the funding is much shorter term than those new investments we've put on 5 years duration and most of the deposits. Even if they're fixed, they're less than a year. And in some of the fee income sources, mortgage tends to do better, as Mike mentioned. Our hedge incomes tend to perform a little better as customers try to lock in longer-term fixed rate funding at a low rate. And we always have a little bit of bond sale activity available to us. And Mike also mentioned service charges on deposit, it's just performing better because the earnings credit rates are less. So I think those are some of the categories that we think I was being countercyclical on. And obviously, our credit quality continues to hold up great.

Brian Joseph Martin - *Janney Montgomery Scott LLC, Research Division - Director of Banks and Thrifts*

Yes. Okay. I appreciate the color. And I guess your comment earlier, Mark, about the second rate cut, if there is one. You kind of -- you would go back to kind of thinking more along the lines of what it was in the layout, the 5 basis points versus this quarter while they still got the deposit costs impact?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

Yes. That is how we think about it. Obviously, the timing of how fast the next one comes matters. But we'd like to see one cut, a little bit of stabilization before the next one.

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

Yes, it's Mike, Brian. And I would agree with what Mark said. We clearly have some proactivity around managing our deposit rates independent of the market. And so we're making some steps there that we know have a tangible benefit should rates go down more than once.

Brian Joseph Martin - *Janney Montgomery Scott LLC, Research Division - Director of Banks and Thrifts*

Yes. And did you guys quantify the amount of deposits that are kind of indexed on variable rate or -- I guess, you do to your point, Mike, have some flexibility on versus what the -- what loans are variable rate?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

The only thing that's really fixed are CD portfolio, and those all have kind of a roll down, and then a handful of institutional accounts. But it's not a real meaningful dollar amount, of the $8.3 billion in deposits that we have.

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

Brian, before you go, I just noticed that when I was offering you some of those figures from the pipeline that I referenced last quarter's $358 million and current quarter's $100 million higher than that as total bank, those are commercial only.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Michael Rechin for any closing remarks.

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

Thanks, Gary. This will be brief. It's one of appreciation for the questions and for any other listeners on the call. We look forward to talking to you following our third quarter results. Thank you.

Operator

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.
