

MANAGEMENT DISCUSSION SECTION

Operator: Greetings ladies and gentlemen and welcome to the First Merchants Corporation Fourth Quarter Earnings Release Conference Call. At this time all participants are in a listen only mode. A brief question and answer session will follow the formal representation. [Operator Instructions]. As a reminder this conference is being recorded. During the call we may make forward-looking statements about the relative business outlook. These forward-looking statements and all other statements made during the call that do not concern historical facts are subject to risks and uncertainties that may materially affect actual results. Specific Forward Looking statements include but are not limited to any indications regarding the Financial Services industry, the economy and future growth of the balance sheet or income statement. It is now my pleasure to introduce your host this afternoon Mr. Michael Cox, Chief Executive Officer of First Merchants Corporation. Thank you Mr. Cox, you may begin.

Michael Cox, President, Chief Executive Officer, Director

Thank you, Hardy [ph]. Good afternoon everyone. Thank you for dialing into our fourth quarter and year end conference call. We appreciate your just patience. With me are Michael Rechin and Mark Hardwick. Mike is joining our conference call for the first time. Mike is our new Chief Operating Officer. He has been on board now for 8 weeks doing a terrific job. Mike comes to us with 25 plus years of banking experience primarily in the commercial field and making contributions already. Mike will have a meaningful part of our presentation today and Mark Hardwick I think most of you Mark is Chief Financial Officer of the Corporation. Just a word about structure if I might, with Mike joining us as Chief Operating Officer he now has reporting to him all of our banking units, our 8 chartered banks and now we report directly to Mike. Our 2 insurance subsidiaries are reporting to Mark and our trust company and our and our staff, internal staff divisions report to me. So, if that's helpful in directing you towards the Q&A session, I wanted to add that.

Mike will talk to us in a few minutes about credit quality, our platform standardization initiatives over the last 2 quarters and say worried about our, our growth initiatives and some market commentary. As it has been our practice Mark will, will add a discussion regarding margin, margin developments and the financial specifics of our balance sheet and income statement over the last quarter and year. I am told I can also announce at this call that as of this morning we received sign off from our auditors BKD on our year end financial reports with an unqualified opinion and also an unqualified opinion with regard to section 404 financial control testing and those of you in the industry know that that's a pretty deal and we are pleased to be able to announce that here this afternoon.

I trust all of you have seen our news release that went out this morning and I would like to hit a couple of high points on that and then we will elaborate further and going to a Q&A at the end. Our fourth quarter earnings per share came in at \$0.41 per share versus \$0.40, 2.5% increase over a year-ago and that's somewhat below our prior quarter run rate and we are going to discuss and some non-recurring issues that occurred, that did happen in the fourth quarter. And hopefully give you a feel for that, for that run rate. Year-to-date '05 over '04 came in at \$1.63 versus a \$1.58, with total of net income at \$30,200,000. I would like to add that this is the 29th year out of the last 30 that we've shown in earnings improvement year-over-year, which is some thing we are frankly pre-products.

Our allowance for loan losses as a result of being somewhat aggressive with our provision during the last 2 quarters specifically is now up to a 1.02% of total loans and we increased the provision by \$2.6 million during the course of the year.

Operating expenses net of the pension curtailment charge that we top in the first quarter of 2005 and announced to all of you, but net of that charge, our operating expenses were only up 7/10 of a percent, which I hope speaks to our initiatives to control overall expenses.

During the fourth quarter, we merged, First United Bank with First Merchants Bank and completed that effective January 1 of this year. So we now are talking about 8 individually chartered banks and the First United Bank numbers will be incorporated in First Merchants Bank going forward. We did that for 2 reasons, primarily to resolve overlapping market issues, those 2 banks are only 12 miles apart. And, we also wanted to resolve some cost redundancies in operating separate banks that closely related.

Also in the fourth quarter, we relocated our data center including operations, technology and call center activities into a new facility in Daleville, Indiana. Again to achieve some cost reduction and centralization efficiency, our old data center, which frankly we had outgrown will be kept in the corporation and used as a disaster recovery backup site allowing us to eliminate an offsite disaster recovery contract that was a bit pricey and will add to our cost savings in making that move in that reduction.

I might say a word about the economy in our served markets, as you know in past quarters I have been a little reserved about this and I still I am, but I think its improving slowly. We are very pleased that our predominant markets are characterized by education, healthcare services and other service industries that are proving to be not only stable, but very contracyclical as we go forward and that would, that would characterize our markets in Columbus, Muncie, Indianapolis, and Lafayette certainly. So we are pleased with that and those businesses are pretty strong. The reliance on the auto industry is one that we all continue to think a good deal about because it's in the press everyday, as near as we can determine at this point there are no major issues to drop in our served markets. But again time will tell and we are watching that as all of you are. With that as preliminary comments I would like to ask Mark to give you some detail regarding the financial statements attached to our new release. Mark would you do that?

Mark Hardwick, Chief Financial Officer and Senior Vice President

Yeah thank you Mike. Another year is in the record books and we do appreciate your interest in First Merchants Corporation. If you look the balance sheet, for just a moment I have a couple of comments regarding the balance sheet and earning assets. In investment securities year-over-year by 12.7 million and commercial real estate loans which is actually in the back page of the release increased by 26 million, while real estate, construction loans improved by 10 million and fee and other loans increased by 10 million. You will note on the back page with the loan detail summary that the residential real estate portfolio did decline by 10 million and the other kind of miscellaneous categories decreased by 7 million, mitigating the total improvement and outstandings to 29 million year-over-year. Total deposits decreased by 25 million as very disciplined deposit pricing and available liquidity aided in the expansion of our net interest margin during the year. On a fully taxable equivalent basis margin increased by 9 basis points to 397 up from 388 in 2004, for the second consecutive quarter margins stuck to a 4% mark, given this difficult operating environment of a flat to inverted yield curve this improvement demonstrates our commitment to predict, protecting our balance sheet against raising interest rate compression. The corporations yield on earning assets increased by 54 basis points during the year, while the cost of supporting liabilities increased by 45 basis points. As with all the banks in the country, we continue to keep a very close eye on deposit pricing, and our core deposit balances and feel very confident that we are managing that portfolio in a prudent manner. With 2 percentage point increase in the Fed funds and prime rate during 2005 and a little over a 650 million in variable rate prime based loans in the portfolio margin have proven to be manageable to-date. The lag in treasury rates is proving to be a challenge, the 3-year treasury increased a 118 basis points, the 5-year treasury increased by 79, and the 30-year old treasury essentially remained flat during the same time period producing that

flat to inverted curve. The increased earning assets and improved net interest margin during the year of 2005 did improve by \$5.7 million.

Moving onto the provision and the allowance, as Mike has already commented the allowance did increase by, the provision did increase by 2.6 million or 46% during the year, and all of that additional provisioning was realized in the allowance for loan loss as we improved the percentage as a percent of total loans from 93 basis points a year ago to a 102 basis points today.

In a moment Mike Rechin will discuss the continued decline in our non-performing asset trends or non-performing loan trends. Non-interest income for the year, the core non-interest income increased by 1.3 million or 4.1%, after discounting the non-recurring bond gains that were taken in 2004. The increase in total and total non-interest income, including the bond gains from the year ago, improved by \$165,000. On the expense side, total non-interest expenses increased 2.3 million or 2.5%, which is I think demonstrates good expense management, especially when you consider the \$1.6 million charge for the pension curtailment.

Overall, earnings per share improved to, from 158 in 2004 to 163 in 2005, a 3.2 improvement. And, I think it's important to note from a run rate perspective that the fourth quarter total of \$0.41 to last year quarter at \$0.44 did include a number of non recurring items as we continue to clean up the loan portfolio which is at a very respectable level. We have, we did expensed \$225,000 overall we have during the quarter and we did increase the provision by a 150,000 relative to our run rate. We additionally have 200, 000 in contingent losses and marketing expenses for the quarter were higher than normal by about a 100,000 as we has invested some money in the branding of the corporation. Those combined expenses totaled about 2.5 percent. Now Mike will discuss the credit quality and growth initiatives.

Michael Rechin, Chief Operating Officer, Executive Vice President Director

Thanks Mark. We're very pleased with the improvement in our credit quality and as Mark referenced that 10 basis point or 12% decline in our non-performing assets as a percent of total loans. The improvement, we've seen is really driven by thoughtful execution workout strategy shared by our bankers and our clients as supposed to charge-offs which were down nearly \$3 million. Amongst the non-performing assets that remained we have no meaningful concentrations by industry and our largest 10 non-performers totaled \$4.8 million. Against those largest 10, we have \$1 million of specific reserves and not only one of the 10 is an excess of \$1 million. To be clear to that handle let me questions around credit quality towards the end of our remarks. I thought I would share few thoughts on our growth in 2005 and our plans for 2006.

Our results for the year show modest increases in loans and deposits but we are pleased with the continued strength in client acquisition we realize in Columbus Ohio, greater Indianapolis markets as well as our banks that straddle the Indiana Ohio line. We see these markets to, and also to include Melfiat [ph] where we have relatively no share, low share as the important opportunity that we continue to add talent selectively on the ground. The end of 2005 as reference earlier by Mike and Mark has showed nearly the completion of our consolidation of our back office operations in one location in Daleville, the result of these investments is directed to offer consistent quality service to all of our clients, retail and commercial. As importantly the projects completions scheduled for early second quarter of this year for our entire sales force and our entire company to be externally focused.

Our effort in 2006 is going to focus on taking share in all our markets for primarily in our newer markets such as Indianapolis, mafia [ph] and Columbus Ohio, our Columbus bank continues its push into the Cincinnati market through the efforts of a long production office that moves into its second year.

Our systems work also enhanced to yield more customer information providing our bankers better solutions to our client's needs that is in our plan and momentum itself in a growing non-interest income line. In our performing share markets, our strategy focus is around retention through superior service and our increased technology investment should allow us to earn more share wallet with declines that have come to expect the best in gross margins.

We'd happy to take questions Mark and Mike continues to join me here on any of the material we share.

Michael Cox, President, Chief Executive Officer, Director

Thank you Mike, I appreciate it and Mark good overview. That pretty much concludes our prepared remarks and we are hopeful that there will be some questions that we can respond to.

QUESTION AND ANSWER SECTION

Operator: Thank you sir. [Operator Instructions]. Our first question comes from the line of Kenneth James of FTN Midwest Securities. Mr James, please state your question.

<Q – Kenneth James>: Thank you. Good afternoon gentlemen.

<A>: Hi Ken, how are you?

<Q – Kenneth James>: I'm doing well. I was wondering if you could touch mainly on fee income this quarter. It was quite a bit lower than the run rate we've seen for most of the year, seemed its going to be evenly spread against by almost a number of categories and I was just kind of wondering if you could allude to, to that a little bit and also talk about was that going to snap back, is that a one time low rate, probably looking a little lower run rate heading into '06?

<A>: Mark, you wanted to deal them?

<A – Mark Hardwick>: Sure. Kenneth, I think there are couple of specific items. One is the commission income and if you look at our historical run rate in the fourth quarter and commission income is typically low. I think the number was 671 a year ago and you can see that the dramatic increase in the first quarter in 2005, and that normally in the first quarter we always receive the contingent income from our, at our insurance agency and the fourth quarter is like I said traditionally a low quarter for us. The earnings on cash or in the value we did have a couple of small policies that we are evaluating and we believe that at end of 2005 we've had an over accrual in those couple of policies we made an adjustment and that really is an adjustment that going forward would be spread out over the 4 quarters and we are evaluating whether we move out of those policies into another high yielding investment through the program. The last item I guess I would mention in total other income is the gain on the sale of loans and we are optimistic about this line item. For next year we have invested some money this year in a new platform that will allow for the entry points to sell loans to these spread out through a larger number of our employees even though we do recognize that the market has headed the opposite direction and we feel out penetration should increase. And traditionally the fourth quarter in that market is a slow quarter as well.

<Q – Kenneth James>: Okay thanks and then Tom if we could just down to the expenses it sounds like – given that you have some maybe onetime elevated expenses this quarter and also some of things you are doing to kind of improve efficiency, would it be a safe assumption to say that we should see for the total year in '06 hopefully expenses to be flattish should vary down slightly relative to the quarter for us?

<A>: Well there is..

<A>: Yeah go ahead.

<A>: That is our intention is to manage that that number, the low single digit number

<Q – Kenneth James>: Okay.

<A>: Into the future.

<Q – Kenneth James>: Okay thank you.

<A>: So as I mentioned earlier total operating expenses were up 7/10 of a percent net of the pension costs from last year and I think that exhibits pretty good expense control. It is our goal going forward to manage that aggressively and hopefully manage it down.

<Q – Kenneth James>: Okay thank you.

Operator: Thank you sir. [Operator Instructions]. Our next question comes from the line Kenneth James of FTN Midwest Securities. Mr. James, please state your question.

<Q – Kenneth James>: Okay I want to, if we can talk about the margin for just a second and its been, I think quite impressive this year the expansion you've been able to manage in given the environment and you attribute a lot of that to the ability to control deposit cost and I am just wondering once the fed [ph] stops tightening and could get a little bit a the asset yield benefit deposit cost are going to continue to catch and we could see some modest, modest compression maybe over, the second half of '06 as those rates continue to come up.

<A>: Kenneth that's a good observation and I can tell you've been paying attention in the call because we do have about 650 million that continue to say, where we continue to yield a benefit from the rising fed movements. The deposit costs are trailing behind and if the fed [ph] does stop we would expect to see some compression or some increase deposit cost and marginal compressions. What we are watching very closely is the other side of the balance sheet with the large number of loans that we do have tied to the tertiary market. We have not been experiencing any significant increase in yield on those variable rate loans prior to the tertiary market. So, I think you have a number of factors 1, when the fed [ph] does stop moving the compression that could occur by increasing deposit rates and then continuing to monitor where we would possibly pick up some left by increased tertiary rates.

<Q – Kenneth James>: Okay and then...

<A>: Ken could I add to that?

<Q – Kenneth James>: Sure.

<A>: I don't disagree with any of it but I do think it's important to note that the improvement in overall yield that we saw in earning assets for the year is partial year, that's \$625 million to \$650 million of market priced assets. We priced upward 6 times during '05, and as we begin to experience a full year of that upward pricing, I think its going to move and offset the increased pressure we will see on the deposit side. So, I am not sure, I don't mean that we are in disagreement here but I am not sure we are going to see compression as the fed [ph] stops moving because there is a definite carry over there that ought to offer to our benefit.

<Q – Kenneth James>: Okay, what about volume side, of kind of the net interest income equation? When you have pretty good loan growth across, across the line of categories per share holding down or shrinking the mortgage part which you kind of, is done at the overall growth of the portfolio. Is that get into your size or it maybe that will stop decreasing our reacher base and these other categories that have been growing better or which have a better rate of loan growth in overall earnings asset growth maybe next year?

<A – Mike Rechin>: Hi Kenneth, its Mike Rechin. We are looking to increase the rate of our loan growth and feels like our strategy relative to mortgages is not going to change. So outside of that, the growth we would expect would come from more traditional consumer and commercial lending outside the product category. I am encouraged by the healthy nature of our balance sheet as we approach 2006. And as referenced a couple of times, we have had rightfully showed significant focus on our technology project not disrupting our client experience. As such I do expect to have more phase time with commercial and consumer client alike in 2006. The information and the product that we have to operate I think continues to be very attractive in the market and coupled with the marketing programs that Mark referenced earlier. It really puts us in a position to distance ourselves in some of the markets that were known to us and make some headway with that isn't the case yet.

<Q – Kenneth James>: Okay.

<A>: Let me add to that Mike if I could. Ken, the issue for us is not so much of booking new business. Our new business bookings are pretty robust. As a matter of fact, our largest bank had its largest booking in the fourth quarter that we've ever had. That's something on the order of \$48 million. The imponderable here is, are pay downs, early pay downs and refinancings in the commercial real estate sector. But I think our new business generation is showing pretty robust activity, but we are pleased with that.

<Q – Kenneth James>: Okay, thank you. And maybe its one last question if I could, what are you kind of seeing in the M&A environment in the Ohio and do you think its been a while since you guys have done a bank transaction, bit of pretty active required historically and do you, is there any attrition out there on the horizons possibly, or is there anything you maybe looking at, anytime over the next in 6, 12, 18 months?

<A>: As you know Ken, we consciously took a breather from M&A activity, given that fact that we closed 2 good size transactions in a very short period of time and we wanted to step back and make sure we got those assimilated well into our systems and our operation. That as you pointed out that is now been well over a year, year and half. So I think we are well enough for long in that process that we could be open to opportunities that present themselves. Are we currently working on anything, I could tell you honestly, now we are not. But the investment bankers know that we are interested in looking at those opportunities that will be accretive to our demographic and perhaps something we will develop during the course of the year.

<Q – Kenneth James>: Okay, thank you for the call.

Operator: Thank you sir. Our next question comes from the line of Steve Covington of Stephen Capital Advisors. Please state your question sir.

<Q – Steve Covington>: Good afternoon guys. Actually all of my questions have been answered. Thank you very much.

<A>: Okay thank you Steve.

<A>: Okay Steve you can't get off that easily now we haven't talked to you for a while.

<A>: Gone.

<A>: Are you gone?

<Q – Steve Covington>: I am still here Mike.

<A>: Okay, nice talking to Steve.

<Q – Steve Covington>: I will talk to you a little bit.

<A>: Thanks for coming in.

Operator: [Operator Instructions].

Sir, so somewhat [ph] it appears we have no further questions at this time. So I'll turn the conference back over to you.

Company Representative

Yeah Hardy [ph] thank you very much engine the call. I think it's, if that concludes Q&A period we pretty much concluded our remarks. Once again we appreciate everybody dialing in and appreciate your interest in our company. And we hope our future performance will continue to satisfy your investment expectations. Thanks very much to everybody.

Operator: Ladies and gentlemen this concludes today's teleconference. Thank you for your participation. And you may disconnect your lines at this time.

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