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THE POWER *of* POSITIVE BANKING

the best of both worlds

First Merchants Corporation

ANNUAL REPORT 1998

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THE POWER *of* POSITIVE BANKING

At First Merchants Corporation, our philosophy of community banking

gives customers the power and convenience of today's technology,

combined with personal service and individual attention...

the best of both worlds

OUR MISSION

It is the mission of First Merchants Corporation to be the financial services provider of choice in east central Indiana by consistently:

- producing customer satisfaction through delivering quality products and superior quality service;
- providing employees with growth opportunities for personal achievement, career satisfaction and teamwork;
- achieving a superior return on our stockholders' investment.

We will take the extra step to recognize customer needs, to exercise initiative in developing sales and service opportunities, and to serve customer needs in a personal, reliable and professional manner.

OUR OPERATING PHILOSOPHY

To achieve our mission, we seek to implement four objectives which define the way we conduct our business.

We strive to be . . .

Customer Focused

placing our customers' needs and superior customer service as our highest priority;

Value Driven

providing products and services of high value at competitively fair prices;

Plan Disciplined

achieving market initiative and superior financial results through planning;

Managed for Achievers

creating a personal growth environment which encourages and allows all of our employees to reach their highest level of achievement.

In our 23rd year of consecutive profit growth, our efforts focused on managing change positively for our communities and for our customers.

Financial HIGHLIGHTS

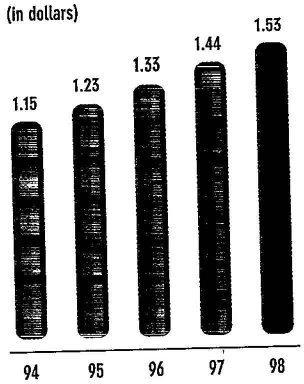
(Table Dollar Amounts in Thousands, Except Per Share Data)

	1998	1997
At Year End		
Total Assets	$1,177,172	$1,020,136
Stockholders' Equity	131,497	121,969
Total Loans	743,748	703,784
Securities	329,361	247,372
Total Deposits	926,844	843,812
Trust Accounts at Market Value *(not included in banking assets)*	1,301,000	1,235,000
For the Year		
Interest Income	$ 79,728	$ 75,475
Interest Expense	38,050	35,725
Net Interest Income	41,678	39,750
Total Other Income	11,725	9,229
Total Other Expenses	27,895	25,748
Net Income	15,399	14,373
Per Share [1]		
Basic Net Income	$ 1.53	$ 1.44
Diluted Net Income	1.51	1.43
Cash Earnings [2]	1.53	1.44
Cash Dividends	.77	.69
Book Value	13.04	12.20
Market Value *(Dec. 31 Bid Price)*	26.00	24.33
Averages During the Year		
Total Assets	$1,064,714	$ 993,338
Total Loans	721,931	675,892
Securities	275,206	260,834
Total Deposits	856,725	800,118

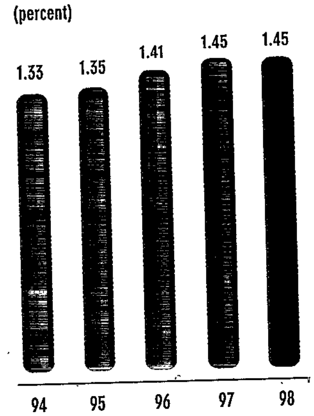
[1] Restated for 3-for-2 stock split distributed October, 1998.

[2] Diluted Net Income plus amortization of purchase, accounting adjustments and goodwill.

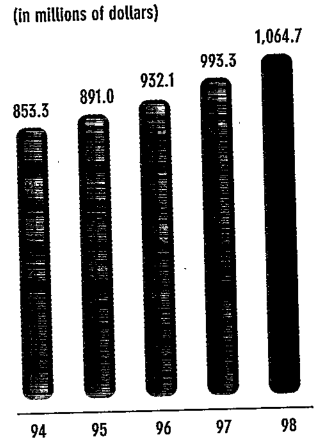
Basic Net Income Per Share [1]
(in dollars)



Return on Average Assets
(percent)



Average Assets
(in millions of dollars)



To Our Stockholders

While financial strength and stability are essential, the true measure of our success as a community bank still begins and ends with customer satisfaction.

The Power of Positive Banking...an apt theme for reporting to you our 23rd consecutive year of profit growth. In 1998, our efforts focused on managing change positively for our communities and for our customers. The phrase, *The Power of Positive Banking,* in an era of customer disruption resulting from the large mega-mergers, represented for us both a challenge and a battle cry!

Our 1998 plan sought to improve the growth rate of non-interest revenues while maintaining our operating efficiency ratio in the top quartile of U. S. banking companies. Both of these objectives were achieved. Earnings of First Merchants Corporation exceeded $15 million for the first time in our history. Diluted per-share earnings were $1.51, an increase of 5.6% over the prior year. Dividends increased for the sixteenth consecutive year, amounting to $ .77 per share, up 11.6% from 1997.

First Merchants Corporation earnings exceeded $15 million for the first time in our history.

Record mortgage activity and record growth in non-interest revenues contributed positively to these results. Non-interest revenues were up 27%. Trust and investment management fees increased 23% from last year, a result achieved in part by trust marketing through affiliate banks. Our investment in non-branded ATMs also produced significant new revenues in 1998.

Our presence was enlarged in faster growing areas with the opening of four new banking centers – three in new markets for us.

Growth rates for loans and deposits met plan objectives. Core deposit growth resulted primarily from the popularity of *First Flex,* an account competitive with money market mutual funds. Loan growth was achieved while maintaining superior credit quality. Actual loan losses and sub-standard assets in 1998 were well below the average levels in our industry...a condition we expect to prevail at First Merchants Corporation.

Operating costs last year included start-up expenses connected with new initiatives designed to improve revenues and efficiency in future years. To implement our strategic design for enlarging our presence in faster growing areas, for example, four new banking centers were opened in 1998. Three of these were in new markets for us. At the same time, we incurred increased expenses to enlarge and upgrade electronic services... e.g. computerized home banking, computer networks and phone systems. We also incurred additional expenses related to installing a new state-of-the-art teller system to improve service and assure Year 2000 functionality. All of these decisions were correct for our future but negatively impacted 1998 earnings.

A significant investment in enlarging and upgrading our electronic services, as well as the installation of a new state-of-the-art teller system, were steps taken to improve service and assure Year 2000 functionality.

For First Merchants Corporation today, *The Power of Positive Banking* describes four dimensions of our business. Each is discussed below.

First Merchants Corporation stock retained its Standard & Poor's A+ rating, and Veribanc named all of our affiliates Blue Ribbon Banks... *the highest rating possible.*

The power of positive banking... for sustained superior performance

In June of 1998, *U. S. Banker* magazine ranked First Merchants 22nd out of 200 mid-sized public banking companies in the United States, near the top 10% based on financial performance. The Corporation's common stock also maintained its A+ Standard & Poor's rating. Veribanc, an independent bank rating service, named all of our affiliates as Blue Ribbon Banks, the highest rating possible. All of these recognitions – none new – reflect the detailed attention we devote to achieving sustainable and consistent financial results.

Positive growth initiatives included:

- **Prospective new affiliates...**
  The First National Bank of Portland and The Anderson Community Bank in Madison County
- **First Merchants Insurance Services**
- **Our new "non-chartered community bank"**
  First Merchants Bank-Hamilton County

The power of positive banking... for growth

The year 1998 saw more positive growth initiatives than any year in the past decade. Two key strategic imperatives, described in last year's Annual Report, were implemented when agreements were executed to acquire two excellent community banks and a multi-line insurance agency.

The First National Bank of Portland, one of our prospective new affiliates, was founded in 1904 and, with assets of $115,000,000, has achieved a record of consistent profit improvement and exceptional community leadership.

First Merchants Corporation's Trust Division experienced the most notable growth with increased assets, trust accounts and a record year for new business.

Community banking *is* our business. Amidst the transient fads of our industry... ***we don't forget who we are.***

Managing for positive change through active local boards and local managements has been the critical key to success at First Merchants Corporation.

The other, The Anderson Community Bank in Madison County, has grown to $78,000,000 in assets since its formation by community leaders only 4 1/2 years ago. This year it will join with our present affiliate in that county, the Pendleton Banking Company, to form the Madison Community Bank, a new $183,000,000 institution. First Merchants Insurance Services joined our family in April following the cash acquisition of the Muncie office of Insurance & Risk Management, Inc. Offering a full line of insurance products while specializing in commercial lines, this agency brings significant potential for growth in the years ahead.

In the last half of 1998, our new "non-chartered community bank," First Merchants Bank-Hamilton County, opened for business with headquarters in Noblesville, Indiana, and its first banking office in nearby Carmel. Hamilton County is the fastest growing county in Indiana. Although legally a part of First Merchants Bank, the Hamilton County entity has its own president and a local advisory board of directors. Active involvement by these directors has been the key to excellent initial new business results in this very competitive banking market near Indianapolis.

First Merchants' ATM network expanded in 1998 to 85 locations. Our non-branded ATMs are now located in stores and other public facilities in 19 counties of Indiana and Ohio.

However, it was in our long-established trust business that *The Power of Positive Banking* most notably meant "growth." Trust assets at market reached $1,301,000,000 at year-end. The number of trust accounts grew 11%, a record year for new business. New services offered by our Employee Benefit Division helped that division produce a 29% increase in its revenues from the administration of pension, 401(k) and other corporate benefit plans.

The power of positive banking... for communities

Managing for positive change through active local boards and local managements has been the critical key to success at First Merchants Corporation. Community banking is our business. Amidst the transient fads of our industry, we don't forget who we are.

The Power of Positive Banking in communities is based on community partnership and local decision-making, supported by good products and operational systems. Leveraging local loyalty and initiative is most possible in efficient operational environments. When joined by the two prospective affiliates just mentioned, First Merchants Corporation will offer services in 20 communities through six affiliate banks, operating 31 banking offices in Indiana and Ohio. Affiliate officers and directors in 1998 were leaders in their communities in local United Way campaigns, community foundations and economic development programs...bringing *The Power of Positive Banking* to their communities.

First Merchants Corporation's commitment to unsurpassed customer service was evidenced in:

- ***New product development***
- ***New training initiatives***
- ***Expansion of our Extra Step customer satisfaction program***

*The power of positive banking...*for customer service

First Merchants' approach to positive banking in 1998 was manifested in new product development, new training initiatives and in the expansion of our *Extra Step* customer satisfaction program. All affiliates now participate in *Extra Step,* our keystone training and employee recognition program aimed at providing service levels which exceed the customer's expectations.

To further support *Extra Step,* "First Merchants University" was launched in late 1998 to provide standardized employee sales and service training throughout our company. In addition, at First Merchants Bank, all managers and service representatives participated in a new personal financial planning curriculum. To maximize the customer service impact of these training endeavors, we installed updated customer relationship management software in December. The new software should provide enlarged capacity for servicing and expanding multi-account customer relationships.

New mortgage options, specifically designed to meet the needs of young adults, were well received and helped make this a record year in home financing.

Planning at First Merchants Corporation in recent years has emphasized

- *developing products which meet the needs of younger families; and*
- *utilizing electronic and Internet technologies to make the delivery of our services more convenient and more cost-efficient.*

In 1998, a new CD product called *Smart Saver* and our *First-Time Home Buyer's* Mortgage Plan were tailored to the needs of younger customers. Both products were well received by this group, who helped make our record year in home financing.

Usage of our *EZ Online Banking* service grew modestly last year. A companion service, the *EZ Tellerline Bill Payment Service,* was introduced to customers in May. This phone banking service allows customers the convenience of paying bills 24 hours-a-day from any touch-tone phone. Trust customers were introduced to a new service called *PAL,* or *Portfolio Account Link,* which provides for them secure 24-hour Internet access to information on their accounts. Electronic services will be further expanded this year.

*The power of positive banking...*for the future

Discussion today about "the future" seems always to begin at the Year 2000 and the new millennium. At First Merchants, for the last two years we have been preparing our computers, systems and software for that big date change. All our core software for processing loans, deposits and trust assets were Year 2000 compliant at the end of 1998. Rigorous testing of all electronic components, systems and hardware is nearing completion now, well in advance of year-end. We will be operationally ready for the new millennium.

Y2k = OK

All our core software for processing loans, deposits and trust assets were Year 2000 compliant at the end of 1998...
First Merchants will be operationally ready for the new millennium.

We have been preparing for the future in other ways as well. Anticipating Steve Anderson's retirement as CEO at age 65 in April of this year, management succession planning commenced four years ago to ensure an effective and smooth transfer of CEO responsibilities to Mike Cox this year. This transfer of responsibilities has been effective and orderly, enabling us to look ahead with solidly based confidence.

We will strive for increased operating efficiencies and profitability in all our banking and insurance endeavors. These improvements will come in the form of managerial processes, systematic product commonality and technology investments. There is little doubt that new technology will cost more than that being replaced. Our challenge is to manage this unending cost while assuring the attainment of intended benefits. The momentum of change will not abate.

We will also continue to develop or acquire businesses which contribute non-interest revenues. As our industry consolidates, innovates and matures, the dependence on net-interest income must be mitigated. The banking industry is steadily expanding the array of products and services it can offer to a large and hard-won customer base.

The 1999 business plan for First Merchants Corporation commits us to achieving several key strategic priorities in the current year. All of these objectives, listed on the right, are receiving the energetic attention of our staff.

When the year 1999 ends, it is likely that our economy will be completing the most prolonged period of expansion in our nation's history. It will also mark another year of accelerating change in the way all enterprises do business. In this environment, the past successes of our Corporation will not always provide clear road maps for our future successes. However, the values which underpinned our past success record are likely to remain as relevant in the next decade as they were in the last. These values have little to do with computers and everything to do with people.

Our people – our customers and our fellow employees and directors – are special assets which distinguish community banking at First Merchants from the evolving impersonality of nationwide behemoths. Our people deserve our thanks and engender our confidence for the future.

Sincerely,

Stefan S. Anderson
Chairman and Chief Executive Officer

Michael L. Cox
President and Chief Operating Officer

KEY STRATEGIC PRIORITIES for 1999

1. **Achieving improved returns through implementing capital management plans**
2. **Expanding market penetration in growth areas**
3. **Adding community bank affiliates**
4. **Marketing insurance products more aggressively to our account base**
5. **Improving the cost efficiency of our affiliate network structure**
6. **Increasing the utilization of electronic banking services from homes and offices**

The POWER of POSITIVE BANKING...

Our world today is one of ever-changing technology that affects nearly every facet of our daily lives. Managing that change positively, especially today, is both fundamental and critical to the success of a company.

Many companies, in the current financial climate, focus primarily on globalization, centralized services and vast networking, all by-products of one merger after another. Unfortunately, many of these same companies have lost sight of a critical ingredient in the corporate recipe for success... customer satisfaction.

At First Merchants Corporation, our philosophy of community banking gives customers the power and convenience of today's technology combined with personal service and individual attention...*the best of both worlds.* By serving the financial and emotional needs of our customers, we can develop a relationship, not just a transaction. That's what community banking is all about. It isn't a new idea or a corporate revelation, but a reaffirmation by every person at First Merchants Corporation to be *everything you'd expect...and more.*

The Power of Positive Banking embodies our confidence in offering *the best of both worlds* to our customers when it comes to technology and service. First Merchants' commitment to customer satisfaction provides an excellent foundation to incorporate future enhancements in the coming millennium.

Making a positive impact in our communities

Making a positive impact in our communities is one very important way *The Power of Positive Banking* works. At First Merchants Corporation, we choose to be a participant, rather than a spectator, in the livelihood and future of our communities. Our local involvement is a primary part of what defines us as a community bank. But being in touch with customers and employees goes beyond just bank-related activities. It's about supporting the causes that make a difference in our communities and being a proactive local partner. This is a cornerstone of community banking that can't be duplicated from a regional or world headquarters.

the best of both worlds

In 1998, First Merchants Corporation employees were found making a positive impact in our communities in a variety of ways.

- In celebration of the Pendleton Banking Company's 125th anniversary, the Fall Creek Overlook was built through the funds and direction of the Bank. This outstanding addition to the Fall Creek Park in Pendleton will be a welcome asset that current and future residents can enjoy for years to come.
- Hundreds of young people across central Indiana have new opportunities in creative arts thanks to an innovative program called 401(k)ids. The non-profit group, founded by Ball State University professor Beth Turcotte, provides scholarships to underprivileged youth for art, music, dance and theater instruction as well as refurbished musical instruments. First Merchants Bank provides office space for the program and sponsored a special picnic for scholarship recipients and their parents at this year's Symphony on the Green on the Ball State campus.
- The Muncie Boys & Girls Club also has new opportunities available for children who utilize their facility. Several computer systems were donated to the organization by First Merchants Corporation to give inner-city youth a chance to learn valuable computer skills and improve language and math performance.
- The young and the young-at-heart are equally important to staff members of First Merchants Bank. Residents of Westminster Village Retirement Community in Delaware County were treated to an old-fashioned ice cream social this summer, just for fun! Bank employees served as hosts for the event, with entertainment provided by a roving magician and a musical performance by First Merchants employees Dana Connell and Michelle Warren.

FROM OUR COMMUNITY SCRAPBOOK
Below from left to right:

❶ **Henry County youngsters display their handiwork in last year's *Bud Cook Memorial Pumpkin Contest* held at First United Bank. The annual event honors the late Mr. Cook who, for many years, donated pumpkins to area youth.**

❷ **The Fall Creek Overlook is a welcome new addition to the community of Pendleton, thanks to the funds and direction of the Pendleton Banking Company. This new improvement will be an asset that local residents can enjoy for years to come in scenic Fall Creek Park.**

❸ **Ball State University coaches rewarded more than 300 student athletes for their academic achievements by cooking and serving at a special event hosted by First Merchants.**

- Ball State athletes were honored for something other than their on-the-field exploits at a special cookout sponsored by First Merchants Corporation. More than 300 male and female athletes attended this unique and fun event that recognized academic achievement in the classroom. Ball State coaches from several teams did the cooking and serving as a reward to their players for scholastic excellence.
- More than 500 children and their parents enjoyed a free "Day at the Movies" last year, courtesy of First Merchants Bank. Three screens were rented at a local theatre with Moola Moola, mascot for the Bank's youth savings account, hosting the event. First Merchants employees staffed the theatre, taking tickets and serving the appreciative group of young savers. Everyone in attendance received free admission, concessions and a beanbag stuffed toy.

"Extra Step" customer service...positively the best

Taking service to a new level doesn't necessarily mean reinventing the wheel. In many instances, it's simply going beyond the expected to make sure every customer's experience with the bank is exceptional. That is the foundation of the *Extra Step* program at First Merchants Corporation...going the extra step to assure the needs of the customer are met and exceeded.

While numerous organizations may claim to emphasize customer service, First Merchants Corporation formally incorporated this into our organization with the introduction of the *Extra Step* program in 1992. All First Merchants Corporation employees are eligible for nomination by a co-worker. Criteria for nomination include taking action to help retain a customer relationship and extraordinary efforts to exceed the needs of a customer. This innovative combination of training and recognition is specifically designed to be employee motivated and customer oriented.

A perfect example of *Extra Step* service this past year was demonstrated by First Merchants Bank assistant vice president and Northwest banking center manager, Joan Wools. A customer, who is legally blind, applied for and received a loan at Joan's branch. At the customer's request, Joan mailed checks to several creditors and then proceeded to drive the customer home along with her guide dog. But Joan didn't just drop them off at the door. She helped the customer inside and made sure she was settled in before leaving. That's *Extra Step* service!

Sometimes, *Extra Step* service doesn't even occur at the Bank. A classic instance involved a late night visit to Gail Rhodes of our Albany banking center. A frantic customer trying to balance an overdrawn account, that should have had a significant balance, awoke Gail in the early hours of the morning. The customer was near hysterics because her wedding was just days away. Gail invited her in *(to her home, not the bank!)* and proceeded to find the problem and alleviate the customer's anxiety. The customer went home at 2:30 a.m. with peace of mind and a new appreciation for what true *Extra Step* service is all about.

In 1998, *Extra Step* training has become an important part of new employee orientation. Many veteran employees are also regular attendees of ongoing sessions to learn new skills and brush up on *Extra Step* fundamentals. *Extra Step* service is a company-wide commitment that continues to grow successfully, a rewarding affirmation that our employees help shape the direction and growth of First Merchants Corporation. We will continue to refine and improve this program to meet the changing needs of our customers and the service-related challenges of the future.

FROM OUR COMMUNITY SCRAPBOOK

Below from left to right:

1 Computer systems, donated to the Muncie Boys & Girls Club by First Merchants, will expand learning opportunities and help develop computer skills for area youth.

2 Residents of Westminster Village Retirement Community were entertained, as special guests of First Merchants, at an old-fashioned ice cream social hosted by the Bank.

3 First Merchants Bank is a primary sponsor of 401(k)ids, an innovative scholarship program for creative arts, which benefits hundreds of central Indiana youth each year.

FROM OUR
COMMUNITY SCRAPBOOK

Above from left to right:

1. Daleville resident and First Merchants retiree, Floyd McWilliams (47 years!) cuts the ribbon on the new Daleville Banking Center, opened on State Road 67 this past July.

2. UCNB president, Ted Montgomery, played an instrumental role in securing a $1 million economic development grant to fund a new regional industrial park in the Whitewater Valley area.

3. First Merchants employees go the *Extra Step*, serving customers at our year-end "Day at the Movies" party. The free event was attended by more than 500 young Moola Moola account holders and their parents.

Powerful new products for our customers

Offering the *best of both worlds* to our customers, is obviously a two-step process. The value of First Merchants' *Extra Step* service becomes even greater when coupled with powerful new products to help customers manage and grow their finances.

Saving money has become almost a pipe dream for many young families trying to make ends meet, even with two incomes. *Smart Saver,* a new CD product introduced in 1998, lets customers earn a one-year fixed rate while making periodic deposits to the account of as little as $25 on a schedule they choose. The account can also be started with as little as $25...a great incentive to save for the future.

With *EZ Tellerline Bill Payment Service*, customers can now pay their bills anywhere at any time using a touch-tone phone. This service saves time and money through decreased postage costs and less frequent trips to the post office. Combined with *EZ Online Banking,* our PC home banking product, customers can conduct a wider range of financial services than ever before, without leaving their home or office.

First Merchants Trust customers also have easier access to their accounts thanks to a new service called *PAL*, an acronym for *Portfolio Account Link. PAL* gives these customers secure 24-hour Internet access to specific, up-to-date information on their accounts via the First Merchants Corporation Web site.

FROM OUR
COMMUNITY SCRAPBOOK

Above from left to right:

1. The rapidly growing Hamilton County market now includes the first ever "non-chartered community bank" in First Merchants Corporation history, guided by an outstanding board of local community leaders.

2. The new headquarters for First Merchants Bank-Hamilton County opened in September. This impressive new faciity, in Noblesville, is well designed to serve our growing customer base in the Indianapolis Metro North area.

3. Moola Moola, mascot of First Merchants' children's account, welcomed all the "little savers"as our first Hamilton County banking center opened in Carmel, inside the latest Marsh signature store.

The power of enhanced technology and delivery systems

At First Merchants Corporation, we won't outgrow or replace face-to-face, one-on-one contact with our customers. It's that very contact that helps us stay in touch with the needs of our customers and the community. We also realize when customers look for a bank, now more than ever, they need the power of today's latest technology with a variety of options to access and manage their finances. *EZ Online Banking* and *EZ Tellerline Bill Payment Service* are both state-of-the-art products that give First Merchants customers convenience and flexibility when accessing their accounts. In addition, our award-winning Web site, *First Page,* is a great resource for both existing and potential customers to learn more about products, rates, stock prices and affiliate news.

Plans are currently underway to improve and expand First Merchants' *Tellerline* and *Loanline* services. When complete, accessing account information, transferring funds and even applying for a loan over the phone will be simpler, faster and more customer friendly than ever.

While ATMs are certainly not new, the technology for this delivery channel is changing rapidly. Our newest machines can now dispense coupons from local merchants as well as postage stamps. The expansion of First Merchants' ATM network is moving positively forward with 85 machines now in place, offering customers more convenience all across the state.

Operationally, a new CD ROM data storage and retrieval system was put in place last year offering faster response to our customers when referencing account information, while eliminating reams of paper. This is a good example of back-room technology improving customer satisfaction and operating efficiency. A new state-of-the-art teller system is another technology upgrade designed to improve service response time to our customers and help assure Year 2000 compatibility.

In a move to diversify the financial products available for customers, First Merchants Corporation acquired the Muncie office of Insurance & Risk Management. This respected agency, renamed First Merchants Insurance Services, brings more than 100 years of combined expertise in offering multi-line insurance products to our customer base.

Expanding our horizons through positive growth

The growth of First Merchants Corporation in 1998 truly expanded our horizons. Early in the second quarter of the year, in a move to diversify the financial products available for customers, First Merchants Corporation acquired the Muncie office of Insurance & Risk Management. This respected agency, a long-time tenant of our downtown Muncie headquarters, officially became First Merchants Insurance Services on April 3rd and brings more than 100 years of combined expertise in offering multi-line insurance products to our customer base.

The rapidly growing Hamilton County market is now home of the first ever "non-chartered community bank" in the history of First Merchants Corporation. The first branch of First Merchants Bank-Hamilton County opened to excellent response inside a new Marsh Supermarket signature store in Carmel, Indiana this past June. Three months later, the headquarters for the Hamilton County operation opened in Noblesville, Indiana. This impressive new facility, located at State Roads 32 & 37, is well designed to serve our growing customer base in the Indianapolis Metro North region. Future plans call for additional expansion in Hamilton County.

In addition to the two Hamilton County openings, January saw First Merchants Corporation affiliate Union County National Bank cut the ribbon on their newest location in Oxford, Ohio – the first ever opened outside the state of Indiana. The branch represents a growth in customer base from the main office in Liberty, Indiana. The town of Daleville also has a new facility located on State Road 67 just south of Interstate 69. The Daleville community had been served by a small branch the past several years prior to the new facility which features three drive-up windows, a drive-up ATM and expanded parking and lobby space for our customers.

New affiliations with like-minded and successful community banks is another positive growth initiative at First Merchants Corporation. In late 1998, two outstanding banks signed definitive agreements to join First Merchants Corporation to continue *The Power of Positive Banking.* The First National Bank of Portland, with assets totaling more than $115 million and The Anderson Community Bank in nearby Madison County with assets in excess of $78 million will both become affiliates early in 1999.

By achieving these positive objectives, we believe 1998 saw the furthering of our common goals as the millennium approaches. Customers, stockholders and employees alike can share credit for the success and direction of First Merchants during the past year. The cooperative efforts of these outstanding people have added to an already solid foundation of financial and community success. As we look towards the future, we are confident that *the best of both worlds* is possible when you use *The Power of Positive Banking* at First Merchants Corporation.

Financial REVIEW

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INDEPENDENT AUDITOR'S REPORT

To the Stockholders and Board of Directors
First Merchants Corporation
Muncie, Indiana

We have audited the consolidated balance sheet of First Merchants Corporation and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1998 (pages 28-47). These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements described above present fairly, in all material respects, the consolidated financial position of First Merchants Corporation and subsidiaries as of December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

OLIVE llp

Indianapolis, Indiana
January 15, 1999

FIVE-YEAR SUMMARY of SELECTED FINANCIAL DATA

(In Thousands, Except Share Data)

	1998	1997	1996	1995	1994
OPERATIONS					
Net Interest Income					
Fully Taxable Equivalent Basis	$ 44,253	$ 42,139	$ 39,258	$ 37,049	$ 35,909
Less Tax Equivalent Adjustment	2,575	2,389	2,111	1,952	1,971
Net Interest Income	41,678	39,750	37,147	35,097	33,938
Provision for Loan Losses	1,984	1,297	1,253	1,388	1,202
Net Interest Income					
After Provision for Loan Losses	39,694	38,453	35,894	33,709	32,736
Total Other Income	11,725	9,229	8,342	7,592	6,919
Total Other Expenses	27,895	25,748	24,135	22,992	22,632
Income Before Income Tax Expense	23,524	21,934	20,101	18,309	17,023
Income Tax Expense	8,125	7,561	6,959	6,261	5,660
Net Income	$ 15,399	$ 14,373	$ 13,142	$ 12,048	$ 11,363
PER SHARE DATA [1]					
Basic Net Income	$ 1.53	$ 1.44	$ 1.33	$ 1.23	$ 1.15
Diluted Net Income	1.51	1.43	1.32	1.21	1.15
Cash Dividends Paid [2]	.77	.69	.59	.51	.47
December 31 Book Value	13.04	12.20	11.38	10.66	9.39
December 31 Market Value (Bid Price)	26.00	24.33	16.83	17.17	13.89
AVERAGE BALANCES					
Total Assets	$1,064,714	$ 993,338	$932,144	$890,995	$853,257
Total Loans	721,931	675,892	585,905	544,457	513,784
Total Deposits	856,725	800,118	753,661	728,826	698,644
Securities Sold Under Repurchase Agreements					
(long-term portion)	16,182				
Total Federal Home Loan Bank Advances	26,942	15,455	9,192	9,000	7,692
Total Stockholders' Equity	126,712	117,014	108,094	99,033	91,466
YEAR-END BALANCES					
Total Assets	$1,177,172	$1,020,136	$967,993	$942,156	$868,153
Total Loans	743,748	703,784	631,700	553,074	528,641
Total Deposits	926,844	843,812	794,451	783,936	720,009
Securities Sold Under Repurchase Agreements					
(long-term portion)	28,000				
Total Federal Home Loan Bank Advances	43,268	20,700	9,150	9,000	8,000
Total Stockholders' Equity	131,497	121,969	112,687	104,967	92,754
FINANCIAL RATIOS					
Return on Average Assets	1.45%	1.45%	1.41%	1.35%	1.33%
Return on Average Stockholders' Equity	12.15	12.28	12.16	12.17	12.42
Average Earning Assets to Total Assets	95.13	94.77	94.48	94.86	94.46
Allowance for Loan Losses as % of Total Loans	.99	.96	1.05	1.21	1.25
Dividend Payout Ratio	50.47	47.93	40.85	39.49	39.44
Average Stockholders' Equity to Average Assets	11.90	11.78	11.60	11.11	10.72
Tax Equivalent Yield on Earning Assets [3]	8.13	8.27	8.13	8.09	7.41
Cost of Supporting Liabilities	3.76	3.79	3.67	3.71	2.95
Net Interest Margin on Earning Assets	4.37	4.48	4.46	4.38	4.46

[1] Restated for 3-for-2 stock splits distributed October, 1995 and October, 1998.

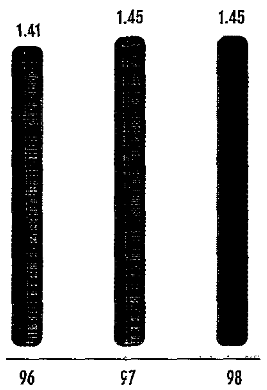
[2] Dividends per share is for First Merchants Corporation only, not restated for pooling transactions.

[3] Average earning assets include the average balance of securities classified as available for sale, computed based on the average of the historical amortized cost balances without the effects of the fair value adjustment.

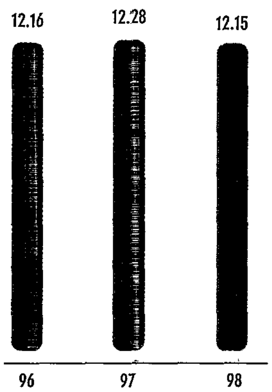
Management's Discussion & ANALYSIS

The Corporation's financial data for periods prior to mergers, which were accounted for as pooling of interests, has been restated.

Return on Average Assets
(percent)



Return on Average Equity
(percent)



RESULTS of OPERATIONS

Net income amounted to $15,399,000 or $1.53 per share, a 6.2 percent increase over 1997 at $1.44 per share. Diluted net income per share amounted to $1.51, a 5.6 percent increase over the 1997 figure of $1.43.

Return on assets was 1.45 percent in 1998 and 1997, up from 1.41 percent in 1996.

Return on equity was 12.15 percent in 1998, 12.28 percent in 1997 and 12.16 percent in 1996.

In 1998, First Merchants Corporation ("Corporation") recorded the twenty-third consecutive year of improvement in net income on both an aggregate and per share basis.

CAPITAL

The Corporation's capital strength continues to exceed regulatory minimums and peer group averages. Management believes that strong capital is a distinct advantage in the competitive environment in which the Corporation operates and will provide a solid foundation for continued growth.

The Corporation's Tier I capital to average assets ratio was 11.9 percent at year-end 1998, equaling 11.9 percent at December 31, 1997. At December 31, 1998, the Corporation had a Tier I risk-based capital ratio of 16.0 percent, total risk-based capital ratio of 16.9 percent, and a leverage ratio of 11.9 percent. Regulatory capital guidelines require a Tier I risk-based capital ratio of 4.0 percent and a total risk-based capital ratio of 8.0 percent.

The Corporation has an employee stock purchase plan and an employee stock option plan. Activity under these plans is described in Note 15 to the Consolidated Financial Statements. The transactions under these plans have not had a material effect on the Corporation's capital position.

ASSET QUALITY/PROVISION for LOAN LOSSES

The Corporation's asset quality and loan loss experience have consistently been superior to that of its peer group, as summarized on the following page. Asset quality has been a major factor in the Corporation's ability to generate consistent profit improvement.

The allowance for loan losses is maintained through the provision for loan losses, which is a charge against earnings.

The amount provided for loan losses and the determination of the adequacy of the allowance are based on a continuous review of the loan portfolio, including an internally administered loan "watch" list and an independent loan review provided by an outside accounting firm. The evaluation takes into consideration identified credit problems, as well as the possibility of losses inherent in the loan portfolio that cannot be specifically identified.

continued

The following table summarizes the risk elements for the Corporation.

	December 31, 1998	December 31, 1997
	(Dollars in Thousands)	
Non-accrual loans	$ 735	$1,410
Loans contractually past due 90 days or more other than non-accruing	2,275	1,972
Restructured loans	926	282
Total	$3,936	$3,664

ASSET QUALITY/PROVISION for LOAN LOSSES continued

At December 31, 1998, non-performing loans totaled $3,936,000, an increase of $272,000, and one non-accrual loan totaling $367,000 was restructured. At December 31, 1998, impaired loans totaled $8,828,000, an increase of $6,277,000, due to the addition of two loans totaling $5,402,000. As of December 31, 1998, the two businesses were experiencing negative cash flows. However, both loans are current, and the Corporation believes the underlying collateral does not warrant a specific reserve.

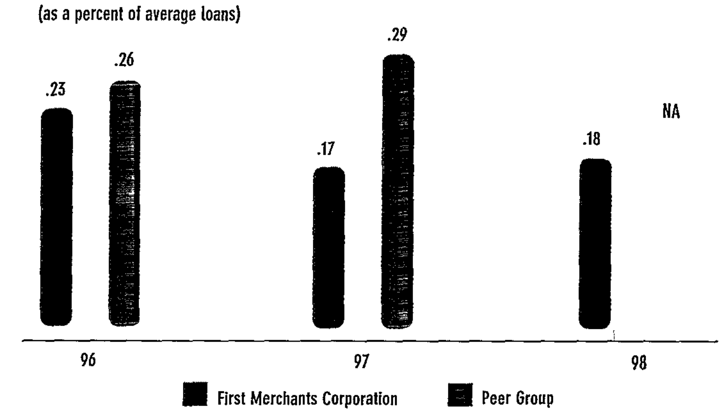
The Corporation adopted Statement of Financial Accounting Standards ("SFAS") No. 114 and No. 118, *Accounting by Creditors for Impairment of a Loan and Accounting by Creditors for Impairment of a Loan – Income Recognition and Disclosures,* on January 1, 1995. Impaired loans included in the table at left totaled $2,222,000 at December 31, 1998. An allowance for losses at December 31, 1998, was not deemed necessary for impaired loans totaling $6,882,000, but an allowance of $712,000 was recorded for the remaining balance of impaired loans of $1,946,000. The average balance of impaired loans for 1998 was $8,318,000.

At December 31, 1998, the allowance for loan losses was $7,412,000, up $634,000 from year end 1997. As a percent of loans, the allowance was .99 percent, up from .96 percent at year-end 1997.

The provision for loan losses in 1998 was $1,984,000 compared to $1,297,000 in 1997.

The Corporation's asset quality and loan loss experience have consistently been superior to that of its peer group. Asset quality has been a major factor in the Corporation's ability to generate consistent profit improvement.

Net Loan Losses
(as a percent of average loans)



The table below presents loan loss experience for the years indicated and compares the Corporation's loss experience to that of its peer group.

	1998	1997	1996
		(Dollars in Thousands)	
Allowance for loan losses:			
Balance at January 1	$6,778	$6,622	$6,696
Chargeoffs	1,881	1,609	1,636
Recoveries	531	468	309
Net chargeoffs	1,350	1,141	1,327
Provision for loan losses	1,984	1,297	1,253
Balance at December 31	$7,412	$6,778	$6,622
Ratio of net chargeoffs during the period to average loans outstanding during the period	.18%	.17%	.23%
Peer Group	NA	.29%	.26%

LIQUIDITY, INTEREST SENSITIVITY and DISCLOSURES ABOUT MARKET RISK

Asset/Liability Management has been an important factor in the Corporation's ability to record consistent earnings growth through periods of interest rate volatility and product deregulation. Management and the Board of Directors monitor the Corporation's liquidity and interest sensitivity positions at regular meetings to ensure that changes in interest rates will not adversely affect earnings. Decisions regarding investment and the pricing of loan and deposit products are made after analysis of reports designed to measure liquidity, rate sensitivity, the Corporation's exposure to changes in net interest income given various rate scenarios and the economic and competitive environments.

It is the objective of the Corporation to monitor and manage risk exposure to net interest income caused by changes in interest rates. It is the goal of the Corporation's Asset/Liability function to provide optimum and stable net interest income. To accomplish this, management uses two asset liability tools. GAP/Interest Rate Sensitivity Reports and Net Interest Income Simulation Modeling are both constructed, presented and monitored quarterly.

The Corporation's liquidity and interest sensitivity position at December 31, 1998, remained adequate to meet the Corporation's primary goal of achieving optimum interest margins while avoiding undue interest rate risk. The table below presents the Corporation's interest rate sensitivity analysis as of December 31, 1998.

Asset/Liability Management has been an important factor in the Corporation's ability to record consistent earnings growth through periods of interest rate volatility.

INTEREST RATE SENSITIVITY ANALYSIS

(Dollars in Thousands)

	At December 31, 1998				
	1-180 DAYS	181-365 DAYS	1-5 YEARS	BEYOND 5 YEARS	TOTAL
Rate-Sensitive Assets:					
Federal funds sold and interest-bearing deposits	$ 38,170				$ 38,170
Investment securities	67,950	$ 44,812	$154,855	$ 61,744	329,361
Loans	319,806	75,404	249,283	99,255	743,748
Federal Reserve and Federal Home Loan Bank stock	3,723				3,723
Total rate-sensitive assets	429,649	120,216	404,138	160,999	$1,115,002
Rate-Sensitive Liabilities:					
Interest-bearing deposits	363,969	179,739	258,564	1,275	803,547
Securities sold under repurchase agreements	10,936	9,900	28,000		48,836
Other short-term borrowings	19,296				19,296
Federal Home Loan Bank advances	1,387	17,763	12,000	12,118	43,268
Total rate-sensitive liabilities	395,588	207,402	298,564	13,393	914,947
Interest rate sensitivity gap by period	$ 34,061	$(87,186)	$105,574	$147,606	
Cumulative rate sensitivity gap	34,061	(53,125)	52,449	200,055	
Cumulative rate sensitivity gap ratio at December 31, 1998	108.6 %	91.2%	105.8%	121.9%	

The Corporation had a cumulative negative gap of $53,125,000 in the one-year horizon at December 31, 1998, just over 4.5 percent of total assets. Net interest income at financial institutions with negative gaps tends to increase when rates decrease and decrease as interest rates increase.

LIQUIDITY, INTEREST SENSITIVITY and DISCLOSURES ABOUT MARKET RISK continued

Net interest income (FTE) increased by $2.1 million during 1998, despite falling interest rates.

The Corporation places its greatest credence in net interest income simulation modeling. The GAP/Interest Rate Sensitivity Report is known to have two major shortfalls. The GAP/Interest Rate Sensitivity Report fails to precisely gauge how often an interest rate sensitive product reprices nor is it able to measure the magnitude of potential future rate movements.

The Corporation's asset liability process monitors simulated net interest income under three separate interest rate scenarios; rising (rate shock), falling (rate shock) and flat. Net interest income is simulated over an 18-month horizon. By policy, the difference between the best performing and the worst performing rate scenarios are not allowed to show a variance greater than 5 percent.

Assumed interest rate changes are simulated to move incrementally over 18 months. The total rate movement (beginning point minus ending point) to noteworthy interest rate indexes are as follows:

Earning assets increased $151.2 million during 1998, reflecting the Corporation's strategy to leverage its strong capital position.

	RISING	FALLING
Prime	300 Basis Points	(300) Basis Points
Federal Funds	300	(300)
90-Day T-Bill	310	(275)
One-Year T-Bill	290	(270)
Three-Year T-Bill	290	(265)
Five-Year T-Note	290	(255)
Ten-Year T-Note	290	(245)
Interest Checking	100	(67)
MMIA Savings	150	(100)
Money Market Index	292	(243)
Regular Savings	100	(67)

Results for the flat, rising (rate shock), and falling (rate shock) interest rate scenarios are listed below. The net interest income shown represents cumulative net interest income over an 18-month time horizon. Balance sheet assumptions are the same under both scenarios:

	FLAT/BASE	RISING	FALLING
Net Interest Income *(Dollars in Thousands)*	$ 64,520	$ 63,838	$ 62,713
Change vs. Flat/Base Scenario		$(682)	$(1,807)
Percent Change		(1.06%)	(2.80%)

EARNING ASSETS

Earning assets increased $151.2 million during 1998.

The table at right reflects the earning asset mix for the years 1998 and 1997 (at December 31).

Loans grew by $39.7 million while investment securities increased by $81.8 million, reflecting the Corporation's strategy to leverage its strong capital position.

Earning Assets
(Dollars in Millions)

	December 31, 1998	December 31, 1997
Federal funds sold and interest-bearing time deposits	$ 38.2	$ 9.4
Securities available for sale	308.5	212.0
Securities held to maturity	20.9	35.3
Mortgage loans held for sale	0.8	0.5
Loans	743.0	703.3
Federal Reserve and Federal Home Loan Bank stock	3.7	3.4
Total	$1,115.1	$963.9

DEPOSITS, SECURITIES SOLD UNDER REPURCHASE AGREEMENTS, OTHER SHORT-TERM BORROWINGS and FEDERAL HOME LOAN BANK ADVANCES

The table at right reflects the level of deposits and borrowed funds (Federal funds purchased, repurchase agreements, U.S. Treasury demand notes and Federal Home Loan Bank advances) based on year-end levels at December 31, 1998 and 1997.

As of December 31 (Dollars in Millions)

	DEPOSITS	SECURITIES SOLD UNDER REPURCHASE AGREEMENTS	OTHER SHORT-TERM BORROWINGS	FEDERAL HOME LOAN BANK ADVANCES
1998	$926.8	$48.8	$19.3	$43.3
1997	$843.8	$15.4	$11.4	$20.7

NET INTEREST INCOME

Net interest income is the primary source of the Corporation's earnings. It is a function of net interest margin and the level of average earning assets.

The table below reflects the Corporation's asset yields, interest expense, and net interest income as a percent of average earning assets for the three-year period ending in 1998.

Asset yields declined .14 percent (FTE) in 1998, due primarily to a decline in interest rates. Interest costs declined by .03 percent resulting in a .11 percent decrease in net interest income (FTE) as a percent of average earning assets. Despite this "spread" decrease, net interest income increased by $2.1 million, due to the growth in average earning assets of $71.6 million.

(Dollars in Thousands)

	INTEREST INCOME (FTE) as a Percent of Average Earning Assets	INTEREST EXPENSE as a Percent of Average Earning Assets	NET INTEREST INCOME (FTE) as a Percent of Average Earning Assets	AVERAGE EARNING ASSETS	NET INTEREST INCOME on a Fully Taxable Equivalent Basis
1998	8.13%	3.76%	4.37%	$1,012,907	$44,253
1997	8.27	3.79	4.48	941,351	42,139
1996	8.13	3.67	4.46	880,729	39,258

Average earning assets include the average balance of securities classified as available for sale, computed based on the average of the historical amortized cost balances without the effects of the fair value adjustment.

OTHER INCOME

The Corporation has placed emphasis on the growth of non-interest income in recent years by offering a wide range of fee-based services. Fee schedules are regularly reviewed by a pricing committee to ensure that the products and services offered by the Corporation are priced to be competitive and profitable.

Other income in 1998 amounted to $11,725,000, or 27 percent higher than in 1997. The increase of $2,496,000 is primarily attributable to the following factors:

Revenues from fiduciary activities grew by $778,000, or 23.2 percent, due to strong new business activity and markets.

1. Revenues from fiduciary activity grew $778,000, or 23.2 percent, due to strong new business activity and markets.
2. Commission income increased $711,000, or 230.1 percent, due to the acquisition of the Muncie office of Insurance & Risk Management, Inc., renamed First Merchants Insurance Services, on April 1, 1998.
3. Other customer fees increased $453,000, or 23.7 percent, due to increased electronic delivery methods and some minor price adjustments.
4. Other income increased $483,000, or 159.9 percent, due primarily to a $442,000 gain on sale of a Bank building.

Other income in 1997 amounted to $9,229,000, or 10.6 percent higher than in 1996. The increase of $887,000 is primarily attributable to the following factors:

1. Revenues from fiduciary activity grew $388,000, or 13.1 percent, due to strong new business activity and markets.
2. Service charges on deposit accounts increased $341,000, or 11.3 percent, due to account growth and some minor price adjustments.
3. Purchase money order agent fees increased $71,000, or 14.6 percent, due to increased sales volume.

OTHER EXPENSES

Commission income increased by $711,000, due primarily to the acquistion of the Muncie office of Insurance & Risk Management, Inc., which was renamed, on April 1, 1998, First Merchants Insurance Services.

Total "other expenses" represent non-interest operating expenses of the Corporation. Those expenses amounted to $27,895,000 in 1998, an increase of 8.3 percent from the prior year, or $2,147,000.

Four major areas account for most of the increase:

1. Salary and benefit expenses, which account for over one-half of the Corporation's non-interest operating expenses, grew by $1,319,000, or 9.2 percent, due to normal salary increases and staff additions.
2. Equipment expenses increased $375,000, or 16.0 percent, reflecting the Corporation's efforts to improve efficiency and provide electronic service delivery to its customers.
3. Net occupancy expense increased $212,000, or 13.1 percent, due primarily to increased branch expansion into new markets.

OTHER EXPENSES continued

Expenses for 1997 amounted to $25,748,000, an increase of 6.7 percent from the prior year, or $1,613,000.

Four major areas account for most of the increase:

1. Salary and benefit expenses, which account for over one-half of the Corporation's non-interest operating expenses, grew by $889,000, or 6.6 percent, due to normal salary increases and staff additions.
2. Equipment expenses increased $193,000, or 9.0 percent, reflecting the Corporation's efforts to improve efficiency and provide electronic service delivery to its customers.
3. Marketing expenses rose $145,000, or 20.5 percent, due to more aggressive product promotion.
4. Outside data processing fees grew by $176,000, or 19.5 percent, due to increased debit card, credit card and trust activity.

Operating costs in 1998 included start-up expenses for three banking centers opened in new markets. These banking centers helped implement our strategy of enlarging our presence in rapidly growing areas and should have a positive effect on earnings in 1999 and succeeding years.

INCOME TAXES

The increase in 1998 tax expense of $564,000 is attributable primarily to a $1,590,000 increase in net pre-tax income, mitigated somewhat by a $347,000 increase in tax-exempt income. Likewise, the $602,000 increase in 1997 resulted primarily from a $1,833,000 increase in pre-tax net income, mitigated somewhat by a $514,000 increase in tax-exempt income.

ACCOUNTING MATTERS

Accounting for Derivative Instruments and Hedging Activities

During 1998, the Financial Accounting Standards Board (FASB) issued Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities.* This Statement requires companies to record derivatives on the balance sheet at their fair value. Statement No. 133 also acknowledges that the method of recording a gain or loss depends on the use of the derivative.

The new Statement applies to all entities. If hedge accounting is elected by the entity, the method of assessing the effectiveness of the hedging derivative and the measurement approach of determining the hedge's ineffectiveness must be established at the inception of the hedge.

Statement No. 133 amends Statement No. 52 and supersedes Statements No. 80, 105 and 119. Statement No. 107 is amended to include the disclosure provisions about the concentrations of credit risk from Statement No. 105. Several Emerging Issues Task Force consensuses are also changed or nullified by the provisions of Statement No. 133.

Statement No. 133 will be effective for all fiscal years beginning after June 15, 1999. The Statement may not be applied retroactively to financial statements of prior periods. The adoption of this Statement will have no material impact on the Corporation's financial condition or result of operations.

On August 11, 1998, the Board of Directors of the Corporation declared a three-for-two stock split on its common shares. The new shares were distributed on October 23, 1998, to holders of record on October 16, 1998.

ACCOUNTING MATTERS continued

Accounting for Mortgage-Backed Securities Retained After the Securitization of Mortgage Loans Held for Sale by a Mortgage Banking Enterprise

Also in 1998, the FASB issued Statement No. 134, *Accounting for Mortgage-Backed Securities Retained After the Securitization of Mortgage Loans Held for Sale by a Mortgage Banking Enterprise.* It establishes accounting standards for certain activities of mortgage banking enterprises and for other enterprises with similar mortgage operations. This Statement amends Statement No. 65.

Statement No. 134, as previously amended by Statements No. 115 and 125, required a mortgage banking enterprise to classify a mortgage-backed security as a trading security following the securitization of the mortgage loan held for sale. This Statement further amends Statement No. 65 to require that after the securitization of mortgage loans held for sale, an entity engaged in mortgage banking activities must classify the resulting mortgage-backed security or other retained interests based on the entity's ability and intent to sell or hold those investments.

The determination of the appropriate classification for securities retained after the securitization of mortgage loans by a mortgage banking enterprise now conforms to Statement No. 115. The only new requirement is that if an entity has a sales commitment in place, the security must be classified into trading.

This Statement is effective for the first fiscal quarter beginning after December 15, 1998. On the date this Statement is initially applied, an entity may reclassify mortgage-backed securities and other beneficial interests retained after the securitization of mortgage loans held for sale from the trading category, except for those with sales commitments in place. Those securities and other interests shall be classified based on the entity's present ability and intent to hold the investments. The adoption of this Statement will have no material impact on the Corporation's financial condition and result of operations.

In 1998, the Corporation experienced its 23rd consecutive year of improved net income on both an aggregate and per share basis. The past year also reflects the Corporation's 16th consecutive year of divided increases.

Reporting on the Costs of Start-Up Activities

During 1998, the Accounting Standards Executive Committee (AcSEC) issued Statement of Position 98-5, *Reporting on the Costs of Start-Up Activities.* Statement of Position 98-5 will affect all non-governmental entities, including not-for-profits, reporting start-up costs in their financial statements.

Some existing industry practices result in the capitalization and amortization of start-up costs. This Statement of Position requires that start-up costs be expensed when incurred. The Statement of Position applies to start-up activities and organizational costs associated with both development stage and established operating entities.

According to Statement of Position 98-5, start-up activities are "those one-time activities related to opening a new facility, introducing a new product or service, conducting business in a new territory, conducting business with a new class of customer or beneficiary, initiating a new process in an existing facility, or commencing some new operation. Start-up activities include activities related to organizing a new entity (commonly referred to as organizational costs)."

Statement of Position 98-5 is effective for fiscal years beginning on or after December 15, 1998. Earlier application is encouraged in fiscal years during which annual financial statements have not yet been issued. The adoption of this Statement will not have a material impact on the Corporation's financial condition or result of operations.

First Merchants common stock continues to receive an "A+" rating from Standard and Poor's Corporation.

INFLATION

Changing prices of goods, services and capital affect the financial position of every business enterprise. The level of market interest rates and the price of funds loaned or borrowed fluctuate due to changes in the rate of inflation and various other factors, including government monetary policy.

Fluctuating interest rates affect the Corporation's net interest income, loan volume and other operating expenses, such as employee salaries and benefits, reflecting the effects of escalating prices, as well as increased levels of operations and other factors. As the inflation rate increases, the purchasing power of the dollar decreases. Those holding fixed-rate monetary assets incur a loss, while those holding fixed-rate monetary liabilities enjoy a gain. The nature of a bank holding company's operations is such that there will be an excess of monetary assets over monetary liabilities, and, thus, a bank holding company will tend to suffer from an increase in the rate of inflation and benefit from a decrease.

The Corporation is utilizing both internal and external resources to identify, correct and test their systems for Year 2000 compliance. Core application testing should be completed by March 31, 1999.

YEAR 2000

The Corporation has conducted a comprehensive review of its computer systems to identify the systems that could be affected by the Year 2000 Issue and has developed an implementation plan to resolve the issue. The Year 2000 Issue is the result of computer programs being written using two digits rather than four to define the applicable year. Any of the Corporation's programs that have time-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in a system failure or miscalculations. The Corporation is utilizing both internal and external resources to identify, correct and test the systems for the Year 2000 compliance. The Corporation began the testing phase during the third quarter of 1998. Core application testing should be completed by March 31, 1999.

The Corporation has contacted the companies that supply or service its material operations to certify that their respective computer systems are Year 2000 compliant. In addition to possible expenses related to the Corporation's systems and those of the Corporation's service providers, the Corporation could incur losses if Year 2000 problems affect any of its depositors or borrowers. Such problems could include delayed loan payments, due to Year 2000 problems affecting any of its significant borrowers or impairing the payroll systems of large employers in its market area. Because the Corporation's loan portfolio to corporate and individual borrowers is diversified and its market area does not depend significantly upon one employer or industry, the Corporation does not expect any such Year 2000 related difficulties that may affect its depositors and borrowers to significantly affect its net earnings or cash flows.

The Securities and Exchange Commission maintains a Web site that contains reports, proxy and information statements and other information regarding registrants with the commission, including the Corporation; http://www.sec.gov is that address.

The Board of Directors reviews, on a quarterly basis, the progress in addressing Year 2000 issues. The Corporation believes that its costs related to upgrading systems and software for Year 2000 compliance will not exceed $900,000. As of December 31, 1998, the Corporation has spent approximately $625,000 in connection with Year 2000 compliance. Of the $625,000, approximately $550,000 has been capitalized as the Corporation replaced and upgraded non-compliant systems. Although the Corporation believes it is taking the necessary steps to address the Year 2000 compliance issue, no assurances can be given that some problems will not occur or that the Corporation will not incur significant additional expenses in future periods.

CONSOLIDATED BALANCE SHEET
(In Thousands, Except Share Data)

	December 31, 1998	December 31, 1997
Assets		
Cash and due from banks	$ 33,908	$ 33,127
Federal funds sold	37,315	9,050
Cash and cash equivalents	71,223	42,177
Interest-bearing time deposits	855	385
Investment securities		
Available for sale	308,507	212,040
Held to maturity (fair value of $21,184 and $35,429)	20,854	35,332
Total investment securities	329,361	247,372
Mortgage loans held for sale	776	471
Loans	742,972	703,313
Less: Allowance for loan losses	(7,412)	(6,778)
Net loans	735,560	696,535
Premises and equipment	16,954	15,382
Federal Reserve and Federal Home Loan Bank stock	3,723	3,373
Interest receivable	9,173	8,968
Core deposit intangibles and goodwill	3,117	1,625
Other assets	6,430	3,848
Total assets	$ 1,177,172	$ 1,020,136
Liabilities		
Deposits		
Noninterest-bearing	$ 123,297	$ 115,613
Interest-bearing	803,547	728,199
Total deposits	926,844	843,812
Borrowings	111,400	47,529
Interest payable	3,614	3,615
Other liabilities	3,817	3,211
Total liabilities	1,045,675	898,167
Commitments and Contingent Liabilities		
Stockholders' Equity		
Preferred stock, no-par value		
Authorized and unissued – 500,000 shares		
Common stock, $.125 stated value		
Authorized - 20,000,000 shares		
Issued and outstanding – 10,086,083 and 6,664,439 shares	1,261	833
Additional paid-in capital	24,969	24,140
Retained earnings	103,076	95,449
Accumulated other comprehensive income	2,191	1,547
Total stockholders' equity	131,497	121,969
Total liabilities and stockholders' equity	$ 1,177,172	$ 1,020,136

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENT of INCOME

(In Thousands, Except Share Data)

	Year Ended December 31, 1998	1997	1996
Interest Income			
Loans receivable			
Taxable	$ 63,062	$ 59,773	$ 52,096
Tax exempt	201	116	90
Investment securities			
Taxable	10,858	10,818	12,832
Tax exempt	4,582	4,320	3,832
Federal funds sold	720	172	498
Deposits with financial institutions	27	34	16
Federal Reserve and Federal Home Loan Bank stock	278	242	132
Total interest income	79,728	75,475	69,496
Interest Expense			
Deposits	33,752	31,920	29,139
Securities sold under repurchase agreements	2,015	1,563	2,137
Federal Home Loan Bank advances	1,645	949	523
Other borrowings	638	1,293	550
Total interest expense	38,050	35,725	32,349
Net Interest Income	41,678	39,750	37,147
Provision for loan losses	1,984	1,297	1,253
Net Interest Income After Provision for Loan Losses	39,694	38,453	35,894
Other Income			
Fiduciary activities	4,133	3,355	2,967
Service charges on deposit accounts	3,303	3,365	3,024
Other customer fees	2,365	1,912	1,659
Net realized gains (losses) on sales of available-for-sale securities	119	(14)	148
Commission income	1,020	309	344
Other income	785	302	200
Total other income	11,725	9,229	8,342
Other Expenses			
Salaries and employee benefits	15,641	14,322	13,433
Net occupancy expenses	1,832	1,620	1,537
Equipment expenses	2,720	2,345	2,152
Marketing expense	817	851	706
Deposit insurance expense	100	97	12
Outside data processing fees	1,061	1,077	901
Printing and office supplies	893	1,021	923
Other expenses	4,831	4,415	4,471
Total other expenses	27,895	25,748	24,135
Income Before Income Tax	23,524	21,934	20,101
Income tax expense	8,125	7,561	6,959
Net Income	$ 15,399	$ 14,373	$ 13,142
Net Income Per Share:			
Basic	$ 1.53	$ 1.44	$ 1.33
Diluted	1.51	1.43	1.32

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENT of COMPREHENSIVE INCOME
(Dollar Amounts In Thousands)

	Year Ended December 31, 1998	1997	1996
Net income	$ 15,399	$ 14,373	$ 13,142
Other comprehensive income, net of tax:			
Unrealized gains (losses) on securities available for sale:			
Unrealized holding gains (losses) arising during the period, net of income tax of $(487), $(424) and $601	715	623	(882)
Less: Reclassification adjustment for (gains) losses included in net income, net of income tax of $48, ($6) and $60	(71)	8	(88)
	644	631	(970)
Comprehensive income	$ 16,043	$ 15,004	$ 12,172

CONSOLIDATED STATEMENT of STOCKHOLDERS' EQUITY
(In Thousands, Except Share Data)

	COMMON STOCK SHARES	COMMON STOCK AMOUNT	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE INCOME	TOTAL
Balances, January 1, 1996	6,562,290	$ 820	$ 22,055	$ 80,205	$ 1,886	$ 104,966
Net income for 1996				13,142		13,142
Cash dividends ($.59 per share)				(5,369)		(5,369)
Other comprehensive income, net of tax					(970)	(970)
Stock issued under employee benefit plans	15,175	2	296			298
Stock issued under dividend reinvestment and stock purchase plan	21,712	3	555			558
Stock options exercised	4,237		64			64
Cash paid in lieu of issuing fractional shares	(95)		(2)			(2)
Balances, December 31, 1996	6,603,319	825	22,968	87,978	916	112,687
Net income for 1997				14,373		14,373
Cash dividends ($ .69 per share)				(6,902)		(6,902)
Other comprehensive income, net of tax					631	631
Stock issued under employee benefit plans	13,690	2	289			291
Stock issued under dividend reinvestment and stock purchase plan	23,276	3	723			726
Stock options exercised	24,154	3	160			163
Balances, December 31, 1997	6,664,439	833	24,140	95,449	1,547	121,969
Net income for 1998				15,399		15,399
Cash dividends ($ .77 per share)				(7,772)		(7,772)
Other comprehensive income, net of tax					644	644
Stock issued under employee benefit plans	14,471	2	383			385
Stock issued under dividend reinvestment and stock purchase plan	19,092	2	677			679
Stock options exercised	31,606	4	267			271
Stock redeemed	(2,000)		(72)			(72)
Three-for-two stock split	3,358,760	420	(420)			
Cash paid in lieu of issuing fractional shares	(285)		(6)			(6)
Balances, December 31, 1998	10,086,083	$1,261	$ 24,969	$ 103,076	$ 2,191	$ 131,497

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENT of CASH FLOWS

(In Thousands, Except Share Data)

	Year Ended December 31, 1998	1997	1996
Operating Activities:			
Net income	$ 15,399	$ 14,373	$ 13,142
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	1,984	1,297	1,253
Depreciation and amortization	1,970	1,810	1,626
Amortization of goodwill and intangibles	184	89	131
Deferred income tax	28	(35)	401
Securities amortization, net	179	236	188
Securities losses (gains), net	(119)	14	(148)
Gain on sale of premises and equipment	(442)		
Mortgage loans originated for sale	(10,251)	(7,139)	(2,501)
Proceeds from sales of mortgage loans	9,946	6,952	2,952
Net change in			
Interest receivable	(205)	(325)	357
Interest payable	(1)	239	(40)
Other adjustments	(2,426)	(1,050)	(593)
Net cash provided by operating activities	16,246	16,461	16,768
Investing Activities:			
Net change in interest-bearing deposits	(470)	(95)	(31)
Purchases of			
Securities available for sale	(184,585)	(68,524)	(113,473)
Securities held to maturity	(90)	(2,652)	(22,450)
Proceeds from maturities of			
Securities available for sale	83,556	73,786	96,441
Securities held to maturity	14,250	15,878	35,715
Proceeds from sales of			
Securities available for sale	5,886	10,552	13,120
Net change in loans	(41,009)	(73,038)	(80,404)
Acquisition of insurance subsidiary	(1,254)		
Purchase of Federal Home Loan Bank stock	(350)	(283)	(389)
Purchases of premises and equipment	(4,447)	(2,157)	(2,083)
Proceeds from sale of fixed assets	1,029		
Other investing activities	(104)	236	71
Net cash used by investing activities	(127,588)	(46,297)	(73,483)
Financing Activities:			
Net change in			
Demand and savings deposits	77,474	16,242	(19,168)
Certificates of deposit and other time deposits	5,558	33,119	29,683
Repurchase agreements and other borrowings	41,303	(18,208)	7,659
Federal Home Loan Bank advances	27,657	11,550	7,150
Repayment of Federal Home Loan Bank advances	(5,089)		(7,000)
Cash dividends	(7,772)	(6,902)	(5,369)
Stock issued under employee benefit plans	385	291	298
Stock issued under dividend reinvestment and stock purchase plan	679	726	558
Stock options exercised	271	163	64
Stock redeemed	(72)		
Cash paid in lieu of issuing fractional shares	(6)		(2)
Net cash provided by financing activities	140,388	36,981	13,873
Net Change in Cash and Cash Equivalents	29,046	7,145	(42,842)
Cash and Cash Equivalents, Beginning of Year	42,177	35,032	77,874
Cash and Cash Equivalents, End of Year	$ 71,223	$ 42,177	$ 35,032
Additional Cash Flows Information:			
Interest paid	$ 38,051	$ 35,486	$ 32,388
Income tax paid	8,252	7,602	6,203

See Notes to Consolidated Financial Statements.

NOTE 1

Nature of Operations and Summary of Significant Accounting Policies

The accounting and reporting policies of First Merchants Corporation ("Corporation"), and its wholly owned subsidiaries, First Merchants Bank, N.A. ("First Merchants"), Pendleton Banking Company ("Pendleton"), and its subsidiary First Merchants Insurance Services, Inc., First United Bank ("First United"), The Randolph County Bank ("Randolph County"), and Union County National Bank ("Union County"), (collectively "the Banks"), conform to generally accepted accounting principles and reporting practices followed by the banking industry. The more significant of the policies are described below.

The preparation of financial statements, in conformity with generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The Corporation is a bank holding company whose principal activity is the ownership and management of the Banks. First Merchants and Union County operate under national bank charters and provide full banking services, including trust services. As national banks, First Merchants and Union County are subject to the regulation of the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation ("FDIC"). Pendleton, First United and Randolph County operate under state bank charters and provide full banking services, including trust services. As state banks, Pendleton, First United and Randolph County are subject to the regulation of the Department of Financial Institutions, State of Indiana, and the FDIC.

The Banks generate commercial, mortgage, and consumer loans and receive deposits from customers located primarily in central and east central Indiana and Butler County, Ohio. The Banks' loans are generally secured by specific items of collateral, including real property, consumer assets, and business assets. Although the Banks have a diversified loan portfolio, a substantial portion of their debtors' ability to honor their contracts is dependent upon economic conditions in the automotive and agricultural industries.

Consolidation

The consolidated financial statements include the accounts of the Corporation and the Banks, after elimination of all material intercompany transactions.

Investment Securities

Debt securities are classified as held to maturity when the Corporation has the positive intent and ability to hold the securities to maturity. Securities held to maturity are carried at amortized cost.

Debt securities not classified as held to maturity are classified as available for sale. Securities available for sale are carried at fair value with unrealized gains and losses reported as accumulated other comprehensive income in stockholders' equity, net of tax.

Amortization of premiums and accretion of discounts are recorded as interest income from securities. Realized gains and losses are recorded as net security gains (losses). Gains and losses on sales of securities are determined on the specific-identification method.

Loans Held for Sale are carried at the lower of aggregate cost or market. Market is determined using the aggregate method. Net unrealized losses are recognized through a valuation allowance by charges to income.

Loans are carried at the principal amount outstanding. Certain nonaccrual and substantially delinquent loans may be considered to be impaired. A loan is impaired when, based on current information or events, it is probable that the Banks will be unable to collect all amounts due (principal and interest) according to the contractual terms of the loan agreement. In applying the provisions of Statement of Financial Accounting Standards ("SFAS") No. 114, the Corporation considers its investment in one-to-four family residential loans and consumer installment loans to be homogeneous and therefore excluded from separate identification for evaluation of impairment. Interest income is accrued on the principal balances of loans, except for installment loans with add-on interest, for which a method that approximates the level yield method is used. The accrual of interest on impaired loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed when considered uncollectible. Interest income is subsequently recognized only to the extent cash payments are received.

Certain loan fees and direct costs are being deferred and amortized as an adjustment of yield on the loans.

Allowance for Loan Losses is maintained to absorb potential loan losses based on management's continuing review and evaluation of the loan portfolio and its judgment as to the impact of economic conditions on the portfolio. The evaluation by management includes consideration of past loan loss experience, changes in the composition of the loan portfolio, the current condition and amount of loans outstanding, and the probability of collecting all amounts due. Impaired loans are measured by the present value of expected future cash flows, or the fair value of the collateral of the loans, if collateral dependent.

The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. Management believes that, as of December 31, 1998, the allowance for loan losses is adequate based on information currently available. A worsening or protracted economic decline in the area within which the Corporation operates would increase the likelihood of additional losses due to credit and market risks and could create the need for additional loss reserves.

continued

NOTE 1

Nature of Operations and Summary of Significant Accounting Policies continued

Premises and Equipment are carried at cost net of accumulated depreciation. Depreciation is computed using the straight-line and declining balance methods based on the estimated useful lives of the assets. Maintenance and repairs are expensed as incurred, while major additions and improvements are capitalized. Gains and losses on dispositions are included in current operations.

Federal Reserve and Federal Home Loan Bank Stock are required investments for institutions that are members of the Federal Reserve Bank ("FRB") and Federal Home Loan Bank ("FHLB") systems. The required investment in the common stock is based on a predetermined formula.

Intangible Assets are being amortized on the straight-line basis over periods ranging from 7 to 25 years. Such assets are periodically evaluated as to the recoverability of their carrying value.

Income Tax in the consolidated statement of income includes deferred income tax provisions or benefits for all significant temporary differences in recognizing income and expenses for financial reporting and income tax purposes. The Corporation files consolidated income tax returns with its subsidiaries.

Stock Options are granted for a fixed number of shares to employees with an exercise price equal to the fair value of the shares at the date of grant.

The Corporation accounts for and will continue to account for stock option grants in accordance with APB Opinion No. 25, *Accounting for Stock Issued to Employees,* and accordingly, recognizes no compensation expense for the stock option grants.

Earnings Per Share have been computed based upon the weighted average common and common equivalent shares outstanding during each year and have been restated to give effect to a three-for-two stock split distributed to stockholders on October 23, 1998.

Reclassifications of certain amounts in the prior years consolidated financial statements have been made to conform to the 1998 presentation.

NOTE 2

Business Combinations

On August 20, 1998, the Corporation signed a definitive agreement to acquire all of the outstanding shares of Jay Financial Corporation, Portland, Indiana. Under terms of the agreement, the Corporation will issue approximately 1,099,000 shares of its common stock. The transaction will be accounted for under the pooling-of-interests method of accounting and is subject to approval by appropriate regulatory agencies. Although the Corporation anticipates that the merger will be consummated during the second quarter of 1999, there can be no assurance that the acquisition will be completed. At December 31, 1997, Jay Financial Corporation, had total assets and stockholders' equity of $104,977,000 and $13,627,000, respectively.

On October 27, 1998, the Corporation signed a definitive agreement to acquire all of the outstanding shares of Anderson Community Bank, Anderson, Indiana. Under terms of the agreement, the Corporation will issue approximately 811,000 shares of its common stock. The transaction will be accounted for under the pooling-of-interests method of accounting and is subject to approval by appropriate regulatory agencies. Although the Corporation anticipates that the merger will be consummated during the second quarter of 1999, there can be no assurance that the acquisition will be completed. At December 31, 1997, Anderson Community Bank had total assets and stockholders' equity of $62,836,000 and $6,448,000, respectively. The Anderson Community Bank will merge with Pendleton to form the Madison Community Bank.

On August 1, 1996, the Corporation issued 1,414,028 shares of its common stock in exchange for all of the outstanding shares of Union National Bancorp, Liberty, Indiana. On October 2, 1996, the Corporation issued 848,558 shares of its common stock in exchange for all of the outstanding shares of Randolph County Bancorp, Winchester, Indiana. These transactions were accounted for under the pooling-of-interests method of accounting. The financial information contained herein reflects the mergers and reports the financial condition and results of operations as though the Corporation had been combined as of January 1, 1996. Separate operating results of Union National Bancorp and Randolph County Bancorp for the periods prior to the merger were as follows on page 34:

(Table Dollar Amounts in Thousands, Except Share Data)

NOTE 2

Business Combinations continued

	1996
Net interest income:	
First Merchants Corporation	$33,060
Union National Bancorp	2,961
Randolph County Bancorp	1,126
Combined	$37,147
Net income:	
First Merchants Corporation	$11,556
Union National Bancorp	974
Randolph County Bancorp	612
Combined	$13,142
Net income per share:	
Basic:	
First Merchants Corporation	$ 1.17
Union National Bancorp	.10
Randolph County Bancorp	.06
Combined	$ 1.33
Diluted:	
First Merchants Corporation	$ 1.16
Union National Bancorp	.10
Randolph County Bancorp	.06
Combined	$ 1.32

NOTE 3

Restriction on Cash and Due from Banks

The Banks are required to maintain reserve funds in cash and/or on deposit with the Federal Reserve Bank. The reserve required at December 31, 1998, was $12,229,000.

(Table Dollar Amounts in Thousands, Except Share Data)

NOTE 4

Investment Securities

	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE
Available for sale at December 31, 1998				
U.S. Treasury	$ 20,269	$ 95		$ 20,364
Federal agencies	52,598	577	$ 19	53,156
State and municipal	86,537	2,620	4	89,153
Mortgage-backed securities	126,329	424	183	126,570
Other asset-backed securities	265	1	11	255
Corporate obligations	18,624	143	8	18,759
Marketable equity securities	250			250
Total available for sale	304,872	3,860	225	308,507
Held to maturity at December 31, 1998				
U.S. Treasury	249	4		253
Federal agencies	500	1		501
State and municipal	17,480	348	1	17,827
Mortgage-backed securities	864	3		867
Other asset-backed securities	1,761	2	27	1,736
Total held to maturity	20,854	358	28	21,184
Total investment securities	$325,726	$4,218	$253	$329,691
Available for sale at December 31, 1997				
U.S. Treasury	$ 19,207	$ 104	$ 11	$ 19,300
Federal agencies	66,783	405	48	67,140
State and municipal	67,842	1,815	28	69,629
Mortgage-backed securities	36,682	362	86	36,958
Other asset-backed securities	487	2	54	435
Corporate obligations	18,219	139	30	18,328
Marketable equity securities	250			250
Total available for sale	209,470	2,827	257	212,040
Held to maturity at December 31, 1997				
U.S. Treasury	249		2	247
Federal agencies	3,412	6	1	3,417
State and municipal	26,206	252	2	26,456
Mortgage-backed securities	1,255	4	1	1,258
Other asset-backed securities	4,210	7	166	4,051
Total held to maturity	35,332	269	172	35,429
Total investment securities	$244,802	$3,096	$429	$247,469

The amortized cost and fair value of securities held to maturity and available for sale at December 31, 1998, by contractual maturity, are shown on the following page. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

continued

(Table Dollar Amounts in Thousands, Except Share Data)

NOTE 4

Investment Securities continued

	AVAILABLE FOR SALE		HELD TO MATURITY	
	AMORTIZED COST	FAIR VALUE	AMORTIZED COST	FAIR VALUE
Maturity distribution at December 31, 1998:				
Due in one year or less	$ 52,579	$ 52,837	$ 5,370	$ 5,397
Due after one through five years	93,213	94,927	10,741	11,003
Due after five through ten years	26,830	28,047	1,638	1,701
Due after ten years	5,406	5,621	480	480
	178,028	181,432	18,229	18,581
Mortgage-backed securities	126,329	126,570	864	867
Other asset-backed securities	265	255	1,761	1,736
Marketable equity securities	250	250		
Totals	$304,872	$308,507	$20,854	$21,184

Securities with a carrying value of approximately $144,863,000 and $92,991,000 were pledged at December 31, 1998 and 1997, to secure certain deposits and securities sold under repurchase agreements, and for other purposes as permitted or required by law.

In addition, all otherwise unpledged securities are pledged as collateral for Federal Home Loan Bank advances with qualified first mortgage loans.

Proceeds from sales of securities available for sale during 1998, 1997 and 1996 were $5,886,000, $10,552,000 and $13,120,000. Gross gains of $119,000 and $148,000 in 1998 and 1996 and gross losses of $14,000 in 1997 were realized on those sales.

NOTE 5

Loans and Allowance

	1998	1997
Loans at December 31:		
Commercial and industrial loans	$ 169,685	$ 148,281
Bankers' acceptances and loans to financial institutions	900	705
Agricultural production financing and other loans to farmers	16,661	16,764
Real estate loans:		
Construction	26,426	21,389
Commercial and farmland	95,172	97,503
Residential	302,680	287,072
Individuals' loans for household and other personal expenditures	128,253	125,706
Tax-exempt loans	2,115	2,598
Other loans	1,217	3,782
	743,109	703,800
Unearned interest on loans	(137)	(487)
Total loans	$ 742,972	$ 703,313

	1998	1997	1996
Allowance for loan losses:			
Balance, January 1	$ 6,778	$ 6,622	$ 6,696
Provision for losses	1,984	1,297	1,253
Recoveries on loans	531	468	309
Loans charged off	(1,881)	(1,609)	(1,636)
Balance, December 31	$ 7,412	$ 6,778	$ 6,622

continued

(Table Dollar Amounts in Thousands, Except Share Data)

NOTE 5

Loans and Allowance continued

Information on impaired loans is summarized below:

	1998	1997	1996
As of, and for, the year ending December 31:			
Impaired loans with an allowance	$1,946	$1,476	$3,124
Impaired loans for which the discounted cash flows or collateral value exceeds the carrying value of the loan	6,882	1,075	868
Total impaired loans	$8,828	$2,551	$3,992
Allowance for impaired loans (included in the Corporation's allowance for loan losses)	$ 712	$ 407	$1,092
Average balance of impaired loans	8,318	3,414	5,213
Interest income recognized on impaired loans	873	180	311
Cash basis interest included above	745	162	291

The Banks have entered into transactions with certain directors, executive officers, significant stockholders, and their affiliates or associates ("related parties"). Such transactions were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other customers, and did not, in the opinion of management, involve more than normal credit risk or present other unfavorable features.

The aggregate amount of loans, as defined, to such related parties is as shown on the right:

Balances, January 1, 1998	$ 12,433
New loans, including renewals	5,440
Payments, etc., including renewals	(5,432)
Balances, December 31, 1998	$ 12,441

NOTE 6

Premises and Equipment

	1998	1997
Cost at December 31:		
Land	$ 2,991	$ 2,826
Buildings and leasehold improvements	15,660	13,723
Equipment	16,385	15,320
Total cost	35,036	31,869
Accumulated depreciation	(18,082)	(16,487)
Net	$ 16,954	$ 15,382

The Corporation is committed under various noncancelable lease contracts for certain subsidiary office facilities. Total lease expense for 1998, 1997 and 1996 was $204,000, $141,000, and $134,000, respectively. The future minimum rental commitments required under the operating leases in effect at December 31, 1998, expiring at various dates through the year 2016, follow on the

1999	$180
2000	159
2001	116
2002	99
2003	48
After 2003	177

(Table Dollar Amounts in Thousands, Except Share Data)

NOTE 7

Deposits

	1998	1997
Deposits at December 31:		
Demand deposits	$261,708	$234,905
Savings deposits	227,624	176,953
Certificates and other time deposits of $100,000 or more	91,579	104,100
Other certificates and time deposits	345,933	327,854
Total deposits	$926,844	$843,812

Certificates and other time deposits maturing in years ending December 31:

1999	$302,973
2000	87,437
2001	26,694
2002	13,270
2003	5,863
After 2003	1,275
	$437,512

NOTE 8

Borrowings

	1998	1997
Borrowings at December 31:		
Securities sold under repurchase agreements	$ 48,836	$15,398
Federal funds purchased	17,070	4,070
U. S. Treasury demand notes	2,226	7,361
Federal Home Loan Bank advances	43,268	20,700
Total borrowings	$111,400	$47,529

Securities sold under repurchase agreements consist of obligations of the Banks to other parties. The obligations are secured by U.S. Treasury, Federal agency obligations and corporate asset-backed securities. The maximum amount of outstanding agreements at any month-end during 1998 and 1997 totaled $78,302,000 and $33,802,000, and the average of such agreements totaled $36,506,000 and $31,327,000.

Maturities of Federal Home Loan Bank advances and securities sold under repurchase agreements as of December 31, 1998 are as follows:

	Federal Home Loan Bank Advances		Securities Sold Under Repurchase Agreements	
	AMOUNT	WEIGHTED-AVERAGE INTEREST RATE	AMOUNT	WEIGHTED-AVERAGE INTEREST RATE
Maturities in years ending December 31:				
1999	$19,150	5.45%	$20,836	5.07%
2000	2,850	5.84	11,700	5.69
2001	6,000	5.44	2,500	5.73
2002	150	7.07		
2003	3,000	5.26	13,800	5.80
After 2003	12,118	6.26		
Total	$43,268	5.69	$48,836	5.46

The terms of a security agreement with the FHLB require the Corporation to pledge, as collateral for advances, qualifying first mortgage loans and all otherwise unpledged investment securities in an amount equal to at least 160 percent of these advances. Advances are subject to restrictions or penalties in the event of prepayment.

(Table Dollar Amounts in Thousands, Except Share Data)

NOTE 9

Loan Servicing

Mortgage loans serviced for others are not included in the accompanying consolidated balance sheet. The loans are serviced primarily for the Federal Home Loan Mortgage Corporation and the unpaid balances totaled $15,541,000 and $11,877,000 at December 31, 1998 and 1997.

The Corporation has adopted SFAS No. 122, *Accounting for Mortgage Servicing Rights.* The adoption of this statement has had no material impact on the Corporation's financial condition and results of operations for all years presented.

NOTE 10

Income Tax

	1998	1997	1996
Income tax expense, for the year ended December 31:			
Currently payable:			
Federal	$ 6,090	$ 5,702	$ 4,903
State	2,007	1,894	1,655
Deferred:			
Federal	38	(21)	336
State	(10)	(14)	65
Total income tax expense	$ 8,125	$ 7,561	$ 6,959
Reconciliation of federal statutory to actual tax expense:			
Federal statutory income tax at 34%	$ 7,998	$ 7,458	$ 6,834
Tax-exempt interest	(1,311)	(1,257)	(1,140)
Graduated tax rates	173		
Effect of state income taxes	1,318	1,241	1,135
Other	(53)	119	130
Actual tax expense	$ 8,125	$ 7,561	$ 6,959

Tax expense (benefit) applicable to security gains and losses for the years ended December 31, 1998, 1997 and 1996, was $47,600, $(5,700) and $60,000, respectively.

A cumulative net deferred tax asset is included in other assets. The components of the asset are as follows:

	1998	1997
Deferred tax asset at December 31:		
Assets:		
Differences in accounting for loan losses	$3,042	$2,692
Deferred compensation	344	313
Differences in accounting for pensions and other employee benefits	84	183
Total assets	3,470	3,188
Liabilities:		
Differences in depreciation methods	968	1,012
Differences in accounting for loans and securities	206	125
Differences in accounting for loan fees	228	28
Net unrealized gain on securities available for sale	1,444	1,023
State income tax	141	146
Other	91	69
Total liabilities	3,078	2,403
Net deferred tax asset	$ 392	$ 785

(Table Dollar Amounts in Thousands, Except Share Data)

NOTE 11

Commitments and Contingent Liabilities

In the normal course of business, there are outstanding commitments and contingent liabilities, such as commitments to extend credit and standby letters of credit, which are not included in the accompanying financial statements. The Banks' exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual or notional amount of those instruments. The Banks use the same credit policies in making such commitments as they do for instruments that are included in the consolidated balance sheet.

Financial instruments whose contract amount represents credit risk as of December 31, were as follows:

	1998	1997
Commitments to extend credit	$185,879	$138,828
Standby letters of credit	4,310	4,649

Commitments to extend credit are agreements to lend to a customer, as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Banks evaluate each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Banks upon extension of credit, is based on management's credit evaluation. Collateral held varies, but may include accounts receivable, inventory, property and equipment, and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Banks to guarantee the performance of a customer to a third party.

The Corporation and subsidiaries are also subject to claims and lawsuits which arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the consolidated financial position of the Corporation.

NOTE 12

Year 2000

Like all entities, the Corporation and subsidiaries are exposed to risks associated with the Year 2000 Issue, which affects computer software and hardware; transactions with customers, vendors and entities; and equipment dependent upon microchips. The Company has begun, but not yet completed, the process of remediating potential Year 2000 problems. It is not possible for any entity to guarantee the results of its own remediation efforts or to accurately predict the impact of the Year 2000 Issue on third parties with which the Company and subsidiaries do business. If remediation efforts of the Company or third parties with which the Company and subsidiaries do business are not successful, the Year 2000 Issue could have negative effects on the Company's financial condition and results of operations in the near term.

NOTE 13

Stockholders' Equity

National and state banking laws restrict the maximum amount of dividends that a bank may pay in any calendar year. National and state banks are limited to the bank's retained net income (as defined) for the current year plus those for the previous two years. The amount at December 31, 1998, available for 1999 dividends to the Corporation is $23,878,000. The subsidiaries restrict dividends to a lesser amount because of the need to maintain an adequate capital structure.

Total stockholders' equity for all subsidiaries at December 31, 1998, was $129,067,000, of which $105,189,000 was restricted from dividend distribution to the Corporation.

The Corporation has a Dividend Reinvestment and Stock Purchase Plan, enabling stockholders to elect to have their cash dividends on all shares held, automatically reinvested in additional shares of the Corporation's common stock. In addition, stockholders may elect to make optional cash payments up to an aggregate of $2,500 per quarter for the purchase of additional shares of common stock. The stock is credited to participant accounts at fair market value. Dividends are reinvested on a quarterly basis. At December 31, 1998, there were 543,913 shares of common stock reserved for purchase under the plan.

On August 11, 1998, the Board of Directors of the Corporation declared a three-for-two stock split on its common shares. The new shares were distributed on October 23, 1998, to holders of record on October 16, 1998.

(Table Dollar Amounts In Thousands, Except Share Data)

NOTE 14

Regulatory Capital

The Corporation and Banks are subject to various regulatory capital requirements administered by the federal banking agencies and are assigned to a capital category. The assigned capital category is largely determined by three ratios that are calculated according to the regulations: total risk adjusted capital, Tier 1 capital, and Tier 1 leverage ratios. The ratios are intended to measure capital relative to assets and credit risk associated with those assets and off-balance sheet exposures of the entity. The capital category assigned to an entity can also be affected by qualitative judgments made by regulatory agencies about the risk inherent in the entity's activities that are not part of the calculated ratios.

There are five capital categories defined in the regulations, ranging from well capitalized to critically undercapitalized. Classification of a bank in any of the undercapitalized categories can result in actions by regulators that could have a material effect on a bank's operations.

At December 31, 1998, the management of the Corporation believes that it meets all capital adequacy requirements to which it is subject. The most recent notifications from the regulatory agencies categorized the Corporation and Banks as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Corporation and Banks must maintain a minimum total capital to risk-weighted assets, Tier I capital to risk-weighted assets and Tier I capital to average assets of 10 percent, 6 percent and 5 percent, respectively. There have been no conditions or events since that notification that management believes have changed this categorization.

Actual and required capital amounts and ratios are as follows:

	1998				1997			
	ACTUAL		REQUIRED FOR ADEQUATE CAPITAL [1]		ACTUAL		REQUIRED FOR ADEQUATE CAPITAL [1]	
	AMOUNT	RATIO	AMOUNT	RATIO	AMOUNT	RATIO	AMOUNT	RATIO
December 31								
Total Capital [1] *(to risk-weighted assets)*								
Consolidated	$133,762	16.9%	$63,206	8.0%	$125,762	17.9%	$56,166	8.0%
First Merchants	79,685	15.7	40,678	8.0	75,539	17.4	34,756	8.0
Pendleton	13,486	18.5	5,844	8.0	12,256	17.4	5,628	8.0
First United	8,069	18.5	3,484	8.0	7,570	18.2	3,332	8.0
Randolph County	10,574	18.2	4,640	8.0	10,278	15.1	5,448	8.0
Union County	19,375	16.4	9,451	8.0	18,075	17.0	8,498	8.0
Tier I Capital [1] *(to risk-weighted assets)*								
Consolidated	$126,350	16.0%	$31,603	4.0%	$118,984	16.9%	$28,083	4.0%
First Merchants	75,752	14.9	20,338	4.0	71,900	16.6	17,378	4.0
Pendleton	12,701	17.4	2,922	4.0	11,506	16.4	2,814	4.0
First United	7,599	17.5	1,742	4.0	7,133	17.1	1,666	4.0
Randolph County	9,848	17.0	2,320	4.0	9,548	14.0	2,724	4.0
Union County	17,966	15.2	4,726	4.0	16,852	15.9	4,249	4.0
Tier I Capital [1] *(to average assets)*								
Consolidated	$126,350	11.9%	$42,464	4.0%	$118,984	11.9%	$40,010	4.0%
First Merchants	75,752	10.8	27,981	4.0	71,900	11.7	24,548	4.0
Pendleton	12,701	12.4	4,092	4.0	11,506	11.8	3,897	4.0
First United	7,599	11.5	2,646	4.0	7,133	11.5	2,481	4.0
Randolph County	9,848	13.0	3,042	4.0	9,548	14.0	2,733	4.0
Union County	17,966	8.6	8,362	4.0	16,852	9.1	7,438	4.0

[1] As defined by regulatory agencies

continued

(Table Dollar Amounts in Thousands, Except Share Data)

NOTE 15

Employee Benefit Plans

The Corporation's defined-benefit pension plans cover substantially all of the Banks' employees. The benefits are based primarily on years of service and employees' pay near retirement. Contributions are intended to provide not only for benefits attributed to service-to-date, but also for those expected to be earned in the future.

The table below sets forth the plans' funded status and amounts recognized in the consolidated balance sheet at December 31:

	December 31 1998	1997
Change in benefit obligation		
Benefit obligation at beginning of year	$ 14,454	$ 13,060
Service cost	688	624
Interest cost	1,044	956
Actuarial gain	793	388
Benefits paid	(660)	(574)
Benefit obligation at end of year	16,319	14,454
Change in plan assets		
Fair value of plan assets at beginning of year	18,865	15,188
Actual return of plan assets	1,038	4,251
Benefits paid	(660)	(574)
Fair value of plan assets at end of year	19,243	18,865
Funded status	2,924	4,411
Unrecognized net actuarial gain	(2,579)	(4,169)
Unrecognized prior service cost	(144)	(156)
Unrecognized transition asset	(480)	(617)
Accrued benefit cost	$(279)	$(531)

	1998	1997	1996
Pension expense (benefit) includes the following components:			
Service cost-benefits earned during the year	$ 688	$ 624	$ 537
Interest cost on projected benefit obligation	1,044	956	921
Actual return on plan assets	(1,038)	(4,251)	(1,966)
Net amortization and deferral	(946)	2,810	699
Total pension expense (benefit)	$(252)	$ 139	$ 191

	1998	1997	1996
Assumptions used in the accounting as of December 31 were:			
Discount rate	6.77%	7.40%	7.50%
Rate of increase in compensation	4.00%	4.50%	4.50%
Expected long-term rate of return on assets	9.00%	9.00%	8.75%

Randolph County employees participated in a defined-benefit pension plan, which is included in the above disclosures. This plan was merged with the Corporation's plan as of December 31, 1996. Randolph County's plan assumptions used in the accounting were different than the Corporation's plan assumptions. However, the differences do not have a material impact on the disclosures presented.

In 1989, stockholders approved the 1989 Stock Option Plan, reserving 253,125 shares of Corporation common stock for the granting of options to certain employees. The exercise price of the shares may not be less than the fair market value of the shares upon grant of the option. Options become 100 percent vested when granted and are fully exercisable generally six months after the date of grant, for a period of ten years. There were no shares available for grant at December 31, 1998.

continued

(Table Dollar Amounts in Thousands, Except Share Data)

NOTE 15

Employee Benefit Plans continued

On March 31, 1994, stockholders approved the 1994 Stock Option Plan, reserving 472,500 shares of Corporation common stock for the granting of options to certain employees and non-employee directors. The exercise price of the shares may not be less than the fair market value of the shares upon the grant of the option. Options become 100 percent vested when granted and are fully exercisable generally six months after the date of the grant, for a period of ten years. There were 34,829 shares available for grant at December 31, 1998.

The table below is a summary of the status of the Corporation's stock option plans and changes in those plans as of and for the years ended December 31, 1998, 1997 and 1996. The number of shares and prices have been restated to give effect to the Corporation's 1998 stock split.

	Year Ended December 31,					
	1998		1997		1996	
OPTIONS	SHARES	WEIGHTED-AVERAGE EXERCISE PRICE	SHARES	WEIGHTED-AVERAGE EXERCISE PRICE	SHARES	WEIGHTED-AVERAGE EXERCISE PRICE
Outstanding, beginning of year	447,577	$14.98	408,127	$12.89	334,532	$12.05
Granted	97,645	28.64	96,375	20.91	79,950	16.18
Exercised	(67,628)	12.99	(56,925)	9.99	(6,355)	10.11
Cancelled	(862)	28.71				
Outstanding, end of year	476,732	$18.04	447,577	$14.98	408,127	$12.89
Options exercisable at year end	376,949		348,652		324,925	
Weighted-average fair value of options granted during the year		$ 5.95		$ 4.21		$ 3.39

As of December 31, 1998, other information by exercise price range for options outstanding and exercisable is as follows:

	OUTSTANDING			EXERCISABLE	
EXERCISE PRICE RANGE	NUMBER OF SHARES	WEIGHTED-AVERAGE EXERCISE PRICE	WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE	NUMBER OF SHARES	WEIGHTED-AVERAGE EXERCISE PRICE
$ 6.07 - $14.39	166,589	$11.72	4.4 years	166,589	$11.72
15.39 - 20.92	213,360	18.16	7.7 years	207,360	18.17
24.67 - 30.44	96,783	28.63	9.6 years	3,000	26.13
	476,732	$18.04	6.9 years	376,949	$15.38

The Corporation's stock option plans are accounted for in accordance with Accounting Principles Board Opinion ("APB") No. 25, *Accounting for Stock Issued to Employees,* and related interpretations. The exercise price of each option was equal to the market price of the Corporation's stock on the date of grant; therefore, no compensation expense was recognized.

Although the Corporation has elected to follow APB No. 25, SFAS No. 123 requires pro forma disclosures of net income and earnings per share as if the Corporation had accounted for its employee stock options under that Statement. The fair value of each option grant was estimated on the grant date using an option-pricing model with the following assumptions:

	1998	1997	1996
Risk-free interest rates	5.45%	6.54%	6.66%
Dividend yields	3.25%	3.37%	3.41%
Volatility factors of expected market price common stock	17.19%	11.20%	12.00%
Weighted-average expected life of the options	8.50 years	8.50 years	8.50 years

continued

(Table Dollar Amounts in Thousands, Except Share Data)

NOTE 15

Employee Benefit Plans continued

Under SFAS No. 123, compensation cost is recognized in the amount of the estimated fair value of the options and amortized to expense over the options' vesting period. The pro forma effect on net income and earnings per share of this statement are shown on the right:

	1998	1997	1996
Net Income			
As reported	$15,399	$14,373	$13,142
Pro Forma	14,650	13,948	12,852
Earnings per share			
Basic:			
As reported	$ 1.53	$ 1.44	$ 1.33
Pro forma	1.46	1.40	1.30
Diluted:			
As reported	$ 1.51	$ 1.43	$ 1.32
Pro forma	1.44	1.38	1.29

In 1994, the stockholders approved the 1994 Employee Stock Purchase Plan, enabling eligible employees to purchase the Corporation's common stock. A total of 253,125 shares of the Corporation's common stock are reserved for issuance persuant to the plan. The price of the stock to be paid by the employees is determined by the Corporation's compensation committee, but may not be less than 85 percent of the lesser of the fair market value of the Corporation's common stock at the beginning or at the end of the offering period. Common stock purchases are made annually and are paid through advance payroll deductions of up to 20 percent of eligible compensation. Participants under the plan purchased 21,706 shares in 1998 at $17.71 per share. The fair market value per share on the purchase date was $30.44.

At December 31, 1998, there were 162,977 shares of Corporation common stock reserved for purchase under the plan, and $444,000 has been withheld from compensation, plus interest, toward the purchase of shares after June 30, 1999, the end of the annual offering period.

The Corporation's Employee Stock Purchase Plan is accounted for in accordance with APB No. 25. Although the Corporation has elected to follow APB No. 25, SFAS No. 123 requires pro forma disclosures of net income and earnings per share as if the Corporation had accounted for the purchased shares under that statement. The pro forma disclosures are included in the table above and were estimated using an option pricing model with the following assumptions for 1998, 1997 and 1996, respectively: dividend yield of 3.25, 3.37 and 3.41 percent; an expected life of one year for all years; expected volatility of 17.19, 11.20 and 12.00 percent; and risk-free interest rates of 5.41, 6.54 and 6.66 percent. The fair value of those purchase rights granted in 1998, 1997 and 1996 was $12.69, $5.03 and $4.68, respectively.

The Banks have retirement savings 401(k) plans in which substantially all employees may participate. The Banks match employees' contributions at the rate of 25-50 percent for the first 5-6 percent of base salary contributed by participants. The Banks' expense for the plans was $108,000 for 1998, $110,000 for 1997, and $92,000 for 1996.

NOTE 16

Net Income Per Share

Year Ended December 31,

	1998			1997			1996		
	INCOME	WEIGHTED-AVERAGE SHARES	PER SHARE AMOUNT	INCOME	WEIGHTED-AVERAGE SHARES	PER SHARE AMOUNT	INCOME	WEIGHTED-AVERAGE SHARES	PER SHARE AMOUNT
Basic net income per share:									
Net income available to common stockholders	$15,399	10,045,502	$1.53	$14,373	9,950,303	$1.44	$13,142	9,871,751	$1.33
Effect of dilutive stock options		155,568			135,157			99,556	
Diluted net income per share:									
Net income available to common stockholders and assumed conversions	$15,399	10,201,070	$1.51	$14,373	10,085,460	$1.43	$13,142	9,971,307	$1.32

(Table Dollar Amounts in Thousands, Except Share Data)

NOTE 17

Fair Values of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Cash and Cash Equivalents

The fair value of cash and cash equivalents approximates carrying value.

Interest-Bearing Time Deposits

The fair value of interest-bearing time deposits approximates carrying value.

Investment Securities

Fair values are based on quoted market prices.

Mortgage Loans Held for Sale

The fair value of mortgages held for sale approximates carrying values.

Loans

For both short-term loans and variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair value for other loans is estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

Interest Receivable/Payable

The fair values of interest receivable/payable approximate carrying values.

Federal Reserve and Federal Home Loan Bank Stock

The fair value of FRB and FHLB stock is based on the price at which it may be resold to the FRB and FHLB.

Deposits

The fair values of noninterest-bearing demand accounts, interest-bearing demand accounts and savings deposits are equal to the amount payable on demand at the balance sheet date. The carrying amounts for variable rate, fixed-term certificates of deposit approximate their fair values at the balance sheet date. Fair values for fixed-rate certificates of deposit and other time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on such time deposits.

Federal Funds Purchased and U.S. Treasury Demand Notes

These financial instruments are short-term borrowing arrangements. The rates at December 31, 1998 and 1997, approximate market rates, thus the fair value approximates carrying value.

Securities Sold Under Repurchase Agreements and Federal Home Loan Bank Advances

The fair value of the these borrowings is estimated, using a discounted cash flow calculation, based on current rates for similar debt.

Off-Balance Sheet Commitments

Loan commitments and letters-of-credit generally have short-term, variable-rate features and contain clauses which limit the Banks' exposure to changes in customer credit quality. Accordingly, their carrying values, which are immaterial at the respective balance sheet dates, are reasonable estimates of fair value.

The estimated fair values of the Corporation's financial instruments are as follows:

	1998		1997	
	CARRYING AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE
Assets at December 31:				
Cash and cash equivalents	$ 71,223	$ 71,223	$ 42,177	$ 42,177
Interest-bearing time deposits	855	855	385	385
Investment securities available for sale	308,507	308,507	212,040	212,040
Investment securities held to maturity	20,854	21,184	35,332	35,429
Mortgage loans held for sale	776	776	471	471
Loans	742,972	751,589	703,313	704,335
FRB and FHLB stock	3,723	3,723	3,373	3,373
Interest receivable	9,173	9,173	8,968	8,968
Liabilities at December 31:				
Deposits	926,844	928,712	843,812	845,277
Borrowings:				
Securities sold under repurchase agreements	48,836	43,903	15,398	15,398
Federal funds purchased	17,070	17,070	4,070	4,070
U.S. Treasury demand notes	2,226	2,226	7,361	7,361
FHLB advances	43,268	43,425	20,700	21,114
Interest payable	3,614	3,614	3,615	3,615

(Table Dollar Amounts in Thousands, Except Share Data)

NOTE 18

Condensed Financial Information (Parent Company Only)

Presented below is condensed financial information as to financial position, results of operations, and cash flows of the Corporation:

CONDENSED BALANCE SHEET

	December 31, 1998	1997
Assets		
Cash	$ 84	$ 318
Loans to affiliates	1,500	
Security purchased with agreement to resell to an affiliate		2,000
Investment securities available for sale	250	250
Investment in subsidiaries	129,067	118,732
Goodwill	535	553
Other assets	329	230
Total assets	$131,765	$122,083
Liabilities	$ 268	$ 114
Stockholders' Equity	131,497	121,969
Total liabilities and stockholders' equity	$131,765	$122,083

CONDENSED STATEMENT of INCOME

	Year Ended December 31, 1998	1997	1996
Income			
Dividends from subsidiaries	$ 7,772	$ 6,903	$ 5,420
Other income	105	101	25
Total income	7,877	7,004	5,445
Expenses			
Amortization of core deposit intangibles, goodwill, and fair value adjustments	45	45	43
Business combination expenses	36		258
Other expenses	500	591	269
Total expenses	581	636	570
Income Before Income Tax Benefit and Equity in Undistributed Income of Subsidiaries	7,296	6,368	4,875
Income tax benefit	(201)	(193)	(100)
Income Before Equity in Undistributed Income of Subsidiaries	7,497	6,561	4,975
Equity in undistributed income of subsidiaries	7,902	7,812	8,167
Net Income	$ 15,399	$ 14,373	$ 13,142

continued

(Table Dollar Amounts in Thousands, Except Share Data)

NOTE 18

Condensed Financial Information (Parent Company Only) continued

CONDENSED STATEMENT of CASH FLOWS

	Year Ended December 31, 1998	1997	1996
Operating Activities:			
Net income	$ 15,399	$ 14,373	$ 13,142
Adjustments to reconcile net income to net cash provided by operating activities:			
Amortization	18	17	20
Equity in undistributed income of subsidiaries	(7,902)	(7,812)	(8,167)
Security gains			(19)
Net change in:			
Other assets	(131)	25	567
Other liabilities	126	16	(337)
Net cash provided by operating activities	7,510	6,619	5,206
Investing Activities:			
Security purchased with an agreement to resell to an affiliate	2,000	(1,000)	(1,000)
Net change in loans	(1,500)		
Proceeds from sales of securities available for sale		8	103
Investment in subsidiary	(1,729)		
Other investing activities			(78)
Net cash used by investing activities	(1,229)	(992)	(975)
Financing Activities:			
Cash dividends	(7,772)	(6,902)	(5,369)
Stock issued under employee benefit plans	385	291	298
Stock issued under dividend reinvestment and stock purchase plan	679	726	558
Stock options exercised	271	163	64
Stock redeemed	(72)		
Cash paid in lieu of issuing fractional shares	(6)		(2)
Net cash used by financing activities	(6,515)	(5,722)	(4,451)
Net change in cash	(234)	(95)	(220)
Cash, beginning of year	318	413	633
Cash, end of year	$ 84	$ 318	$ 413

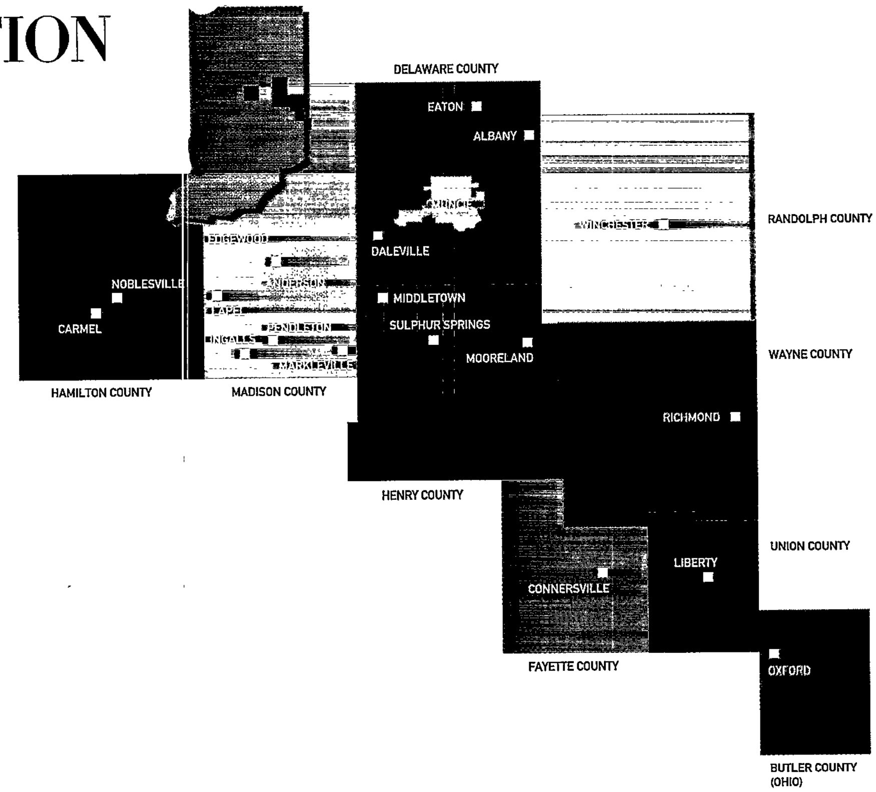
NOTE 19

Quarterly Results of Operations (Unaudited)

The following table sets forth certain quarterly results for the years ended December 31, 1998 and 1997:

QUARTER ENDED	INTEREST INCOME	INTEREST EXPENSE	NET INTEREST INCOME	PROVISION FOR LOAN LOSSES	NET INCOME	AVERAGE SHARES OUTSTANDING BASIC	DILUTED	NET INCOME PER SHARE BASIC	DILUTED
1998:									
March	$19,122	$ 8,970	$10,152	$ 411	$ 3,824	10,005,041	10,186,400	$ .38	$ .38
June	19,736	9,431	10,305	411	3,798	10,024,931	10,210,374	.38	.37
Sept.	20,145	9,687	10,458	446	3,891	10,071,921	10,222,876	.39	.38
Dec.	20,725	9,962	10,763	716	3,886	10,080,117	10,217,407	.38	.38
	$79,728	$38,050	$41,678	$1,984	$15,399	10,045,502	10,201,070	$1.53	$1.51
1997:									
March	$17,884	$ 8,343	$ 9,541	$ 287	$ 3,429	9,907,518	10,039,461	$ .35	$ .34
June	18,980	8,901	10,079	290	3,707	9,928,085	10,054,069	.37	.37
Sept.	19,042	9,132	9,910	375	3,536	9,974,990	10,101,611	.35	.35
Dec.	19,569	9,349	10,220	345	3,701	9,990,621	10,146,708	.37	.37
	$75,475	$35,725	$39,750	$1,297	$14,373	9,950,303	10,085,460	$1.44	$1.43

Stockholder INFORMATION



First Merchants Corporation currently provides services through offices located in Delaware, Fayette, Hamilton, Henry, Madison, Wayne, Randolph and Union counties in Indiana and Butler county in Ohio.

First Merchants Corporation

CORPORATE OFFICE

200 East Jackson Street
Muncie, Indiana 47305-2814

765-747-1500

http://firstmerchants.com

First Merchants Corporation of Muncie, Indiana, was organized in September, 1982, as the bank holding company for The Merchants National Bank, now First Merchants Bank, N.A., an institution which has served Muncie and the surrounding communities since 1893.

In November 1988, First Merchants acquired Pendleton Banking Company of Pendleton, Indiana, a commercial bank which was organized in 1872.

In July 1991, the Corporation acquired First United Bank of Middletown, Indiana, which was established in 1882.

In August 1996, First Merchants Corporation acquired Union County National Bank, established in 1872 and based in Liberty, Indiana.

In October 1996, the Corporation acquired The Randolph County Bank of Winchester, Indiana, which was founded in 1865.

In April 1998, the Corporation acquired the Muncie office of Insurance & Risk Management, Inc., renamed First Merchants Insurance Services, Inc.

Subsidiaries of First Merchants Corporation conduct a full range of banking operations, including commercial, industrial, consumer and real estate lending, deposit and investment services, and other banking services. First Merchants Bank, with more than one billion dollars in fiduciary assets at market value, operates one of the ten largest trust departments in Indiana.

First Merchants Corporation is committed to the sound management of its subsidiaries and to leading its east central Indiana marketplace in meeting customer banking needs and expectations.

Annual MEETING

The Annual Meeting of Stockholders of First Merchants Corporation will be held...

Wednesday, April 14, 1999 • 3:30 p.m.

Horizon Convention Center
401 South High Street
Muncie, Indiana 47305

Stock PRICE & Dividend INFORMATION

PRICE PER SHARE

QUARTER	HIGH		LOW		DIVIDENDS DECLARED	
	1998	1997	1998	1997	1998	1997
First Quarter	$27.67	$20.00	$24.50	$16.83	$ .187	$ .160
Second Quarter	31.83	20.50	25.67	18.50	.187	.160
Third Quarter	30.83	21.58	24.00	20.00	.200	.187
Fourth Quarter	28.75	25.33	21.50	21.42	.200	.187

The table above lists per share prices and dividend payments during 1998 and 1997.
Prices are as reported by the National Association of Securities Dealers.
Automated Quotation – National Market System.
Numbers rounded to nearest cent when applicable.
Restated for 3-for-2 stock split distributed October, 1998.

STOCK INFORMATION

Common Stock Listing

First Merchants Corporation common stock is traded over-the-counter on the NASDAQ National Market System. Quotations are carried in many daily papers. The NASDAQ symbol is FRME (Cusip #320817-10-9). At the close of business on December 31, 1998, the number of shares outstanding was 10,086,083. There were 1,555 stockholders of record on that date.

General Stockholder Inquiries

Stockholders and interested investors may obtain information about the Corporation upon written request or by calling:

Mr. Douglas B. Harris
Vice President
Investor Services & Bank Investments

First Merchants Corporation
P. O. Box 792
Muncie, Indiana 47308-0792

765-741-7278
1-800-262-4261 Ext. 7278

Stock Transfer Agent and Registrar

First Merchants Bank, N.A.
Corporate Trust Department
P. O. Box 792
Muncie, Indiana 47308-0792

MARKET MAKERS

The following firms make a market in First Merchants Corporation stock:

Robert W. Baird & Co., Inc.

Keefe, Bruyette & Woods, Inc.

Knight Securities, L.P.

Herzog, Heine, Geduld, Inc.

Howe, Barnes & Johnson, Inc.

McDonald Investments Inc.

NatCity Investments, Inc.

Troster Securities, L.P.

Form 10-k and Financial Information

First Merchants Corporation, upon request and without charge, will furnish stockholders, security analysts and investors a copy of Form 10-k filed with the Securities and Exchange Commission.

Please contact:

Mr. James L. Thrash
Senior Vice President
and Chief Financial Officer

First Merchants Corporation
P. O. Box 792
Muncie, Indiana 47308-0792

765-747-1390
1-800-262-4261 Ext. 1390

First Merchants Corporation

Stefan S. Anderson
Chairman of the Board
First Merchants Corporation
Chief Executive Officer

Robert M. Smitson
Vice Chairman of the Board
Maxon Corporation
Chairman of the Board

Frank A. Bracken, Esq.
Of Counsel
Bingham, Summers,
Welsh & Spilman

Thomas B. Clark
Alltrista Corporation
President
Chief Executive Officer

Michael L. Cox
First Merchants Corporation
President
Chief Operating Officer

David A. Galliher
Boyce Forms • Systems
Chairman of the Board

Norman M. Johnson
Stein Roe & Farnham
Executive Vice President
Retired

Ted J. Montgomery
Union County
National Bank
Chairman of the Board
President
Chief Executive Officer

George A. Sissel
Ball Corporation
Chairman of the Board
President
Chief Executive Officer

Michael D. Wickersham
Wick's Pies, Inc.
President

Dr. John E. Worthen
Ball State University
President

SECRETARY to the BOARD

Larry R. Helms
Senior Vice President

ASSISTANT SECRETARY to the BOARD

C. Ronald Hall
Vice President

First Merchants Bank, N.A.

Stefan S. Anderson
Chairman of the Board
First Merchants Bank
Chief Executive Officer

Robert M. Smitson
Vice Chairman of the Board
Maxon Corporation
Chairman of the Board

Michael L. Cox
First Merchants Bank
President
Chief Operating Officer

Thomas K. Gardiner, M.D., FACP
Cardinal Health System, Inc.
Executive Vice President
Chief Operating Officer

Roger W. Gilcrest
First Merchants Bank
Executive Vice President

Suzanne Gresham, Ph.D.
Comprehensive Mental
Health Services, Inc.
President
Chief Executive Officer

John W. Hartmeyer
Al Pete Meats, Inc.
President

Nelson W. Heinrichs
Centennial Packaging, Inc.
Chairman of the Board

Jon H. Moll
DeFur, Voran, Hanley,
Radcliff & Reed
Partner

Joseph E. Wilson
Muncie Power Products, Inc.
President
Chief Operating Officer

SECRETARY to the BOARD

Cynthia G. Holaday
Executive Administrative Officer

CHAIRMAN EMERITUS

William P. Givens

DIRECTORS EMERITI

Edmund F. Ball
Clell W. Douglass
Hurley C. Goodall
Betty J. Kendall
Hamer D. Shafer

First United Bank

William D. Cronk
Chairman of the Board
Farmer

Ted S. Doles, M.D.
Physician

Daniel Eichhorn, D.V.M.
Veterinarian

John M. Finnerty
First United Bank
President

Larry R. Helms
First Merchants Corporation
Senior Vice President

Mary Wisehart Phillips
Wisehart & Wisehart
Partner

Pendleton Banking Company

George R. Likens
Chairman of the Board
Farmer

Larry R. Helms
First Merchants Corporation
Senior Vice President

John S. Keeler
Baker & Daniels
Partner

Joe Kilmer
Attorney at Law

Norman Locke
Pendleton Banking Company
President

G. Douglass Owens
Attorney at Law
Madison County Abstract
and Title Corporation
President

Curtis L. Stephenson
Pendleton Insurance Co., Inc.
Owner

The Randolph County Bank

Michael D. Wickersham
Chairman of the Board
Wick's Pies, Inc.
President

Charles B. Ball
First Merchants Bank
First Vice President

Thomas E. Chalfant
Farmer

W. Scott Hawkins
Registered Representative
Lincoln Financial Advisors

Joseph G. Pierce
The Randolph County Bank
President

William H. Ward
Matchett and Ward Insurance

Union County National Bank

Ted J. Montgomery
Chairman of the Board
President
Chief Executive Officer

Larry R. Helms
First Merchants Corporation
Senior Vice President

Norman M. Johnson
Stein Roe & Farnham
Executive Vice President
Retired

Pastor Ron L. Norris
Bethel A.M.E. Church

Gerald S. Paul
Medreco, Inc.
Chief Executive Officer
Owner

Elizabeth M. Swailes
Swailes Enterprises
Owner

Jan S. Williams
Certified Public Accountant

special thanks to...

Rodney A. Medler, First Vice President of First Merchants Bank, who served as Secretary to the Board of Directors of First Merchants Bank for 18 years and through 34 years of service contributed importantly to both the personality and the achievements of the Bank.

Two valued Directors, who both made important contributions to the Union County National Bank, reached mandatory retirement age in 1998. *Dale S. Stevens*...served the Bank for 14 years and *Harold J. Reihman*...served as a Director for 7 years.

First Merchants Corporation Executive Officers

Stefan S. Anderson
Chairman of the Board
Chief Executive Officer

Michael L. Cox
President
Chief Operating Officer

Larry R. Helms
Senior Vice President
Corporate Counsel

James L. Thrash
Senior Vice President
Chief Financial Officer

Ted J. Montgomery
Senior Vice President

First Merchants Bank Senior Officers

Stefan S. Anderson
Chairman of the Board
Chief Executive Officer

Michael L. Cox
President
Chief Operating Officer

Roger V. Gilcrest
Executive Vice President

Thomas E. Buczek
Senior Vice President

Jack L. Demaree
Senior Vice President

Larry R. Helms
Senior Vice President

Charles R. Phillips
Senior Vice President

James L. Thrash
Senior Vice President

Charles B. Ball
First Vice President

Michael G. Richardson
First Vice President

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T. Ben Bales
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Patricia Hudson
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L. Kristina Laughlin
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Gary D. Marshall
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Jeffrey M. Parsons
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Linda I. Villegas
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James R. Witte
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Vice President

Ralph N. Flowers
Auditor

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Marjorie Phillips
Senior Vice President

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Senior Vice President

Joyce Dick
Senior Vice President

Sue E. Goodman
Vice President

Rebecca I. Black
Vice President

Chris Allen
Vice President

Pendleton Banking Company Senior Officers

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President
Chief Executive Officer

Edward L. Armantrout
Vice President

Elke Baltimore
Vice President

Mary Gardner
Vice President

Sherry Hazelbaker
Vice President

Brenda Nivens
Vice President

Gretchen Patterson
Vice President

The Randolph County Bank Senior Officers

Joseph G. Pierce
President
Chief Executive Officer

Brian A. Edwards
Executive Vice President
& Cashier

Rick D. Tudor
Vice President

Alvin P. Peters
Vice President

Union County National Bank Senior Officers

Ted J. Montgomery
President
Chief Executive Officer

Dale A. Cummins
Executive Vice President

Diane M. Bolser
Senior Vice President

Carl M. Knupp
Senior Vice President

Kurt A. Kinzler
Senior Vice President

Lee M. Elzemeyer
Vice President

Marilyn K. Williams
Vice President

The greater part of progress is the desire to progress.

—SENECA

First Merchants Corporation