



## COMPANY UPDATE/ ESTIMATES CHANGE/ PRICE TARGET CHANGE/ RATING CHANGE

### Banks

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J.J.B. Hilliard, W.L. Lyons, LLC  
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### Key Metrics

GABC - NASDAQ (as of 04/25/17)	\$34.85
Price Target	\$33.00
52-Week Range	\$20.23-\$36.31
Shares Outstanding (mm)	22.9
Market Cap. (\$mm)	\$799
3-Mo. Average Daily Volume (000)	48.7
Institutional Ownership	22.4%
Tangible Equity / Tangible Assets	9.5%
ROE	10.9%
Tangible Book Value Per Share	\$12.40
Price/Tangible Book Value	281.0%
Dividend Yield	1.5%
Price/LTM Earnings	21.9x

### Operating EPS CY 12/31

	2016A	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	\$0.37	\$0.40	\$0.42A	\$0.48	\$0.48
2Q	\$0.60	\$0.41	\$0.42	\$0.47	\$0.48
3Q	\$0.43	\$0.43	\$0.44	\$0.50	\$0.51
4Q	\$0.42	\$0.45	\$0.45	\$0.52	\$0.52
Year	\$1.82	\$1.70	\$1.73	\$1.97	\$1.99
P/E	19.1x		20.2x		17.5x

### Common Dividends

	2016A	Curr. 2017E	Prior %chg.	Curr. 2018E
1Q	\$0.18	\$0.19A	5.6	\$0.20
2Q	\$0.18	\$0.19	5.6	\$0.20
3Q	\$0.18	\$0.19	5.6	\$0.20
4Q	\$0.18	\$0.19	5.6	\$0.20
Year	\$0.72	\$0.76	5.6	\$0.80

**Company Description** - German American Bancorp, Inc. (GABC) is a commercial banking organization based in Jasper, Indiana. GABC operates 37 retail and commercial banking offices in 13 southern Indiana counties. The company also owns a trust, brokerage, and financial planning subsidiary (German American Financial Advisors & Trust Company) and a full line property and casualty insurance agency (German American Insurance, Inc.).

## German American Bancorp, Inc.

GABC – NASDAQ – Underperform – 3

### Loan Growth Disappoints, but NIM Surprises to the Upside; Downgrading to Underperform

- **Earnings Update:** GABC reported GAAP and operating EPS of \$0.42, which was \$0.01 ahead of our estimate and the Street consensus.
- **Positive Highlights:** Operating noninterest income increased 4.9% sequentially to \$8.2 million primarily due to a 51.0% increase in insurance revenues stemming from seasonal contingent income. We had projected noninterest income of \$8.3 million.

Operating noninterest expense fell 1.6% linked-quarter (LQ) to \$19.0 million. The decrease was primarily attributable to declines in salaries & benefits (1.4%) and “other” expense (6.1%). Results were modestly below our estimate for noninterest expense of \$19.3 million.

- **Negative Highlights:** Net interest income declined 0.7% LQ to \$24.7 million as nine bps of net interest margin (NIM) expansion to 3.86% was more than offset by a 1.6% fall in average earning assets and two fewer days in the quarter. We had modeled net interest income of \$25.5 million and a NIM of 3.74%. With the NIM benefitting from 17 bps of purchase accounting accretion versus 13 bps in 4Q16, the core NIM rose five bps to 3.69%.

The provision for loan losses rose to \$0.5 million following two consecutive quarters of recording no provision. We had projected a provision of \$0.3 million.

End-of-period loans declined 0.3% LQ, while average loans were down 1.5%. We had modeled 0.8% end-of-period loan growth.

- **Estimates & Valuation:** We are raising our 2017 and 2018 operating EPS estimates to \$1.73 and \$1.99 from \$1.70 and \$1.97, respectively. We are raising our 12-month price target by \$1.67 to \$33.00. Our price target suggests potential depreciation of 5.3%. In accordance with our rating system, we are reducing our rating to Underperform from Neutral.

**Note Important Disclosures on pages 4 and 5**  
**Note Analyst Certification on page 4**

**OTHER TAKEAWAYS & VALUATION**

- Our downgrade is based solely on valuation as we believe GABC is a best in class bank.
- Our earnings estimates and price target reflect the 3-for-2 stock split effective on April 24.
- Credit quality metrics remained pristine. Excluding performing restructured loans, Nonperforming Assets/ Assets rose six bps to 0.20%, while the net charge-off ratio decreased four bps to 0.03%.
- The sequential advance in the core NIM was primarily attributable to higher securities yields resulting largely from a shift in composition of the portfolio to municipal bonds from lower yielding securities, along with lower premium amortization on mortgage-backed securities. Additionally, the cost of interest bearing liabilities rose only four bps LQ despite the recent Fed rate hikes. GABC is liability sensitive and we believe future Fed rate hikes will place increasing pressure on the NIM as it becomes increasingly difficult to lag deposit pricing.
- The increase in the loan loss provision was primarily driven by the downgrade of a single CRE relationship to nonaccrual status and two agricultural relationships to special mention. However, management noted that they are not seeing widespread credit deterioration.
- Loan growth was negatively impacted by seasonal declines in agricultural loan balances and subdued demand for commercial loans. Management noted that the loan pipeline is solid. We are modeling loan growth of 6.0% in 2017.
- Our price target is derived through our discounted dividend model and the application of historical forward multiple of approximately 15X to our 2Q18-1Q19 EPS estimates. The 15X multiple that we employ is appropriate relative to GABC's long-term growth prospects, in our opinion.
- Major model assumptions include one additional Fed rate hike this year and two more next year, continued flattening of the yield curve, slower loan growth in 2017 and a 28% corporate tax rate in 2018.

**SUITABILITY**

Our suitability rating on GABC is 3 on our scale of 1 to 4 (1 = most conservative, 4 = most aggressive). Factors contributing to our suitability rating include the company's market capitalization, liquidity and trading volume, diversity of revenues and the geographic diversification of its footprint.

**RISK FACTORS**

- **Economy** – If the economy softens, loan demand could wane and credit quality could deteriorate.
- **Geography** – The company's operations are clustered in one state. Accordingly, its earnings are more vulnerable to any regional shock and/or slowdown.
- **Real Estate** – A significant percentage of the company's loans are real estate oriented. Any deterioration in real estate values would impair the value of the underlying real estate collateral.
- **Competition** – The industry is highly competitive and many of the company's competitors have greater resources.
- **Sector Rotation** – The share price of the company's common stock may be vulnerable to any sector rotation that might occur.
- **Regulatory Environment** – Banks operate in a highly regulated environment. Consequently, the company is vulnerable to regulatory uncertainties that could negatively impact shareholders.
- **Other** – Please see the company's financial statements for a further discussion of risks and considerations.

	GERMAN AMERICAN BANCORP, INC.										GABC: UNDERPERFORM				
	1Q016 A	2Q016 A	3Q016 A	4Q016 A	1Q017 A	2Q017 A	3Q017 A	4Q017 A	FY 2015 A	FY 2016 A	FY 2017 E	FY 2018 E	FY 2016 A	FY 2017 E	FY 2018 E
<b>Balance Sheet Data:</b>															
Assets	2,866.7	2,915.8	2,979.5	2,956.0	2,933.1	2,979.3	3,041.9	3,105.8	2,373.7	2,956.0	3,105.8	3,317.0	24.5%	5.1%	6.8%
Gross Loans	1,923.6	1,965.7	2,015.3	2,005.2	1,990.4	2,026.3	2,074.9	2,124.7	1,575.1	2,005.2	2,124.7	2,289.4	27.3%	6.0%	7.8%
Average Earning Assets	2,411.2	2,684.4	2,739.9	2,762.3	2,719.3	2,747.3	2,797.8	2,856.6	2,136.7	2,648.4	2,780.2	2,965.6	23.9%	5.0%	6.7%
Deposits	2,240.6	2,277.4	2,329.7	2,349.6	2,326.5	2,359.4	2,404.0	2,449.5	1,826.4	2,349.6	2,449.5	2,599.1	28.6%	4.3%	6.1%
Equity	321.6	332.4	341.0	330.3	341.2	346.4	352.2	358.2	252.3	330.3	358.2	385.6	30.9%	8.4%	7.6%
<b>State of Operations:</b>															
FTE Net Interest Income	21.8	25.8	25.8	26.1	26.0	26.1	26.9	27.4	79.1	99.5	106.4	111.7	25.8%	7.0%	5.0%
Net Interest Income	20.8	24.7	24.6	24.9	24.7	24.9	25.6	26.1	75.6	94.9	101.2	106.3	25.6%	6.7%	5.0%
Provision for Loan Losses	0.9	0.4	0.0	0.0	0.5	0.5	0.6	0.6	0.0	1.2	2.3	3.4	NA	87.6%	52.0%
<b>Non-Interest Income:</b>															
Trust and Investment Product Fees	1.0	1.2	1.2	1.2	1.2	1.3	1.3	1.3	4.0	4.6	5.1	5.4	17.4%	9.1%	6.7%
Service Charges on Deposit Accounts	1.2	1.5	1.6	1.6	1.5	1.6	1.7	1.7	4.8	6.0	6.4	6.5	23.8%	7.3%	0.7%
Insurance Revenues	2.7	1.6	1.7	1.7	2.6	1.7	1.7	1.8	7.5	7.7	7.8	8.2	3.4%	1.0%	4.5%
Company Owned Life Insurance	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.8	1.0	1.0	1.0	16.7%	2.9%	0.0%
Net Gains on Sales of Loans	0.7	0.9	1.0	0.8	0.7	0.9	0.8	0.7	3.0	3.4	3.1	3.0	13.5%	-9.1%	-0.1%
Other Operating Income	1.3	1.6	2.2	2.2	1.9	2.0	2.0	2.0	6.6	7.3	7.8	8.3	9.8%	7.6%	6.0%
Securities Gains	0.0	1.0	0.5	0.6	0.0	0.0	0.0	0.0	0.7	2.0	0.0	0.0	173.0%	-100.0%	NA
Total Non-Interest Income	7.2	8.0	8.4	8.4	8.2	7.6	7.7	7.7	27.4	32.0	31.2	32.4	16.5%	-2.4%	3.9%
Non-Core Adjustment	0.0	-1.0	-0.5	-0.6	0.0	0.0	0.0	0.0	(2.1)	(2.0)	0.0	0.0	-6.9%	-100.0%	NA
Adjusted Non-Interest Income	7.2	7.0	7.9	7.8	8.2	7.6	7.7	7.7	25.3	30.0	31.2	32.4	18.5%	4.1%	3.9%
<b>Non-Interest Expense:</b>															
Salaries and Employee Benefits	11.6	10.2	10.6	11.6	11.4	10.9	11.0	11.0	35.0	44.0	44.4	45.7	25.5%	0.9%	3.1%
Occupancy & Equipment	1.9	2.2	2.2	2.2	2.2	2.2	2.2	2.2	6.8	8.6	8.8	9.0	25.6%	2.8%	2.0%
FDIC Premiums	0.3	0.3	0.4	0.1	0.2	0.2	0.2	0.3	1.1	1.2	1.0	1.0	0.6%	-14.9%	6.0%
Data Processing Fees	2.2	1.2	1.3	1.1	1.0	1.1	1.1	1.1	3.5	5.7	4.4	4.6	60.6%	-22.9%	3.9%
Professional Fees	1.3	0.8	0.8	0.8	0.8	0.8	0.8	0.8	2.7	3.7	3.2	3.3	38.0%	-11.9%	2.0%
Advertising and Promotion	0.5	0.6	0.7	0.8	0.8	0.7	0.7	0.7	3.7	2.7	3.0	3.0	-27.6%	11.6%	0.1%
Other Operating Expenses	2.2	2.5	2.5	2.5	2.3	2.3	2.3	2.3	7.7	9.7	9.3	9.4	26.3%	-3.6%	1.0%
Total Non-Interest Expense	20.2	18.2	18.7	19.4	19.0	18.6	18.6	18.7	61.3	76.4	74.9	76.5	24.6%	-2.0%	2.2%
Non-Core Adjustment	-3.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(1.8)	(3.9)	0.0	0.0	121.9%	-100.0%	NA
Adjusted Non-Interest Expense	16.4	18.2	18.7	19.4	19.0	18.6	18.7	18.7	59.6	72.5	74.9	76.6	21.8%	3.3%	2.2%
Pretax Income	10.8	13.2	13.8	13.3	13.4	13.3	14.1	14.5	41.3	51.2	55.3	58.7	23.9%	8.1%	6.3%
Income Taxes	3.1	3.9	3.9	3.6	3.8	3.8	4.0	4.1	11.7	14.6	15.7	13.0	24.9%	7.5%	-17.2%
Operating Net Income	7.7	9.3	9.9	9.7	9.6	9.6	10.1	10.4	29.6	36.5	39.6	45.7	23.5%	8.3%	15.6%
<b>Share &amp; Per Share Data:</b>															
Diluted EPS	0.25	0.43	0.45	0.44	0.42	0.42	0.44	0.45	1.51	1.56	1.73	1.99	3.2%	10.7%	15.6%
Operating EPS	0.37	0.60	0.43	0.42	0.42	0.42	0.44	0.45	1.49	1.82	1.73	1.99	22.6%	-5.3%	15.6%
Dividends Per Share	0.18	0.18	0.18	0.18	0.19	0.19	0.19	0.19	0.68	0.72	0.76	0.80	5.9%	5.6%	5.3%
Tangible Book Value	11.54	12.03	12.42	11.94	12.40	12.64	12.90	13.17	11.57	11.94	13.17	14.39	3.1%	10.3%	9.3%
Common Shares Outstanding	22,896	22,887	22,887	22,904	22,929	22,929	22,929	22,929	19,918	22,904	22,929	22,929	15.0%	0.1%	0.0%
Average Diluted Shares	20,893	22,886	22,887	22,888	22,909	22,929	22,929	22,929	19,897	22,383	22,924	22,929	12.5%	2.4%	0.0%
<b>Key Financial Statistics:</b>															
Return on Assets	0.81%	1.36%	1.38%	1.36%	1.31%	1.30%	1.33%	1.34%	1.33%	1.22%	1.32%	1.43%	(10)	9	12
Return on Equity	7.39%	12.02%	12.07%	11.90%	11.39%	11.17%	11.45%	11.57%	12.48%	10.83%	11.40%	12.31%	(165)	56	91
Net Interest Margin	3.63%	3.86%	3.75%	3.77%	3.86%	3.81%	3.81%	3.81%	3.70%	3.75%	3.83%	3.77%	5	8	(6)
Operating Non-Int. Inc./Operating Rev.	25.77%	22.22%	24.40%	23.87%	24.88%	23.18%	23.18%	23.77%	25.10%	24.01%	23.57%	23.38%	(109)	(45)	(19)
Efficiency Ratio	69.75%	54.17%	54.64%	56.15%	55.69%	54.43%	53.24%	52.63%	57.51%	58.73%	54.00%	52.73%	122	(473)	(127)
Tangible Common Ratio	9.41%	9.63%	9.72%	9.43%	9.89%	9.92%	9.91%	9.90%	9.80%	9.43%	9.90%	10.11%	(37)	47	21
Reserves/Loans	0.79%	0.78%	0.75%	0.74%	0.76%	0.76%	0.76%	0.75%	0.92%	0.76%	0.75%	0.75%	(18)	1	0
NCOs/Average Loans	0.03%	0.04%	0.03%	0.07%	0.03%	0.05%	0.07%	0.09%	0.03%	0.04%	0.06%	0.10%	1	2	4

Source: Company reports and Hilliard Lyons estimates.

*Additional information is available upon request.*

### **Analyst Certification**

I, Andrew W. Stapp, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

### **Important Disclosures**

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

German American Bancorp is/was a client of Hilliard Lyons within the past 12 months, received non-investment banking securities-related services, and Hilliard Lyons received compensation for those services.

Hilliard Lyons customers own at least 5% of the outstanding common stock of German American Bancorp.

### **Definitions of Ratings:**

**Buy** - We believe the stock has significant total return potential in the coming 12 months.

**Long-term Buy** - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.

**Neutral** - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.

**Underperform** - We believe the stock is vulnerable to a price decline in the next 12 months.

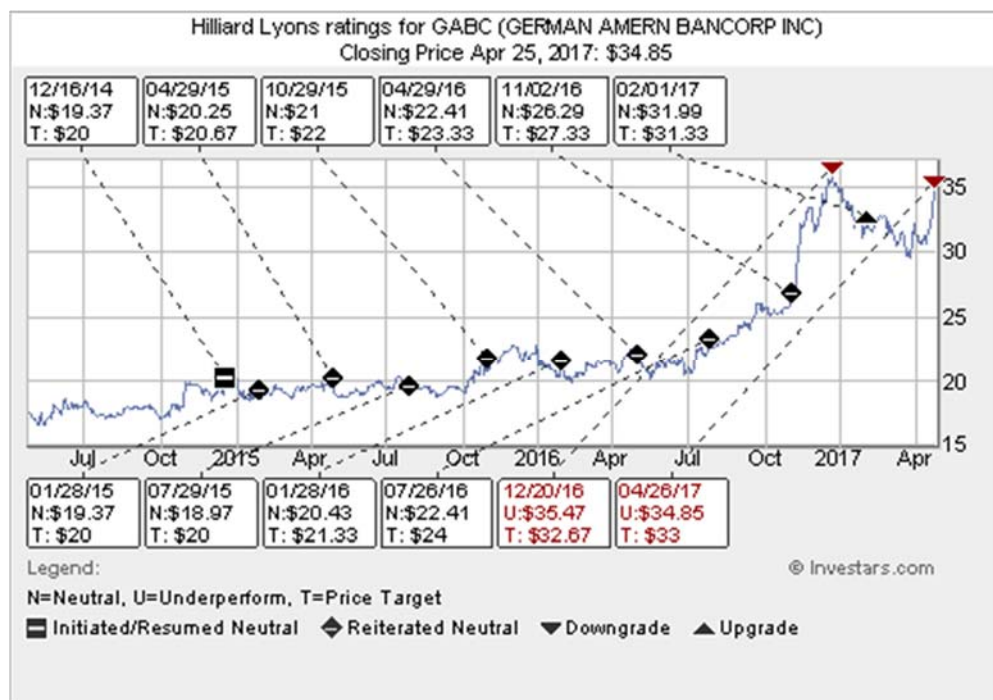
### **Definitions of Suitabilities:**

1. A large cap, core holding with a solid history.

2. A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks.

3. An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage.

4. Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base



Hilliard Lyons Recommended Issues			Investment Banking Provided in Past 12 Mo.	
Rating	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	36	30%	14%	86%
Hold/Neutral	71	58%	6%	94%
Sell	15	12%	7%	93%

As of 5 April 2017

**Other Disclosures**

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