

1ST SOURCE CORP
Form 10-Q
July 31, 2009
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2009

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 0-6233

(Exact name of registrant as specified in its charter)

INDIANA

35-1068133

(State or other jurisdiction

of
incorporation or
organization)
No.)

(I.R.S. Employer

Identification

100 North Michigan Street

Indiana

46601

South Bend,

(Address of principal executive

offices)

(Zip Code)

(574) 235-2000

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report.)

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

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). o Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes No

Number of shares of common stock outstanding as of July 24, 2009 – 24,180,849 shares

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1st SOURCE CORPORATION
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Unaudited - Dollars in thousands, except share amounts)

| | June 30, 2009 | December 31, 2008 |
|---|------------------|-------------------------|
| ASSETS | | |
| Cash and due from banks | \$ 70,798 | \$ 119,771 |
| Federal funds sold and interest bearing deposits with other banks | 29,545 | 6,951 |
| Investment securities available-for-sale (amortized cost of \$874,562 and \$715,380 at June 30, 2009 and December 31, 2008, respectively) | 883,047 | 724,754 |
| Other investments | 18,612 | 18,612 |
| Trading account securities | 104 | 100 |
| Mortgages held for sale | 136,505 | 46,686 |
| Loans and leases - net of unearned discount | | |
| Commercial and agricultural loans | 593,914 | 643,440 |
| Auto, light truck and environmental equipment | 338,774 | 353,838 |
| Medium and heavy duty truck | 225,345 | 243,375 |
| Aircraft financing | 619,797 | 632,121 |
| Construction equipment financing | 345,928 | 375,983 |
| Loans secured by real estate | 910,728 | 918,749 |
| Consumer loans | 119,930 | 130,706 |
| Total loans and leases | 3,154,416 | 3,298,212 |
| Reserve for loan and lease losses | (83,124) | (79,776) |
| Net loans and leases | 3,071,292 | 3,218,436 |
| Equipment owned under operating leases, net | 87,094 | 83,062 |
| Net premises and equipment | 38,837 | 40,491 |
| Goodwill and intangible assets | 91,009 | 91,691 |
| Accrued income and other assets | 117,526 | 113,620 |
| Total assets | \$ 4,544,369 | \$ 4,464,174 |
| LIABILITIES | | |
| Deposits: | | |
| Noninterest bearing | \$ 434,729 | \$ 416,960 |
| Interest bearing | 3,180,314 | 3,097,582 |
| Total deposits | 3,615,043 | 3,514,542 |
| Federal funds purchased and securities sold under agreements to repurchase | 146,529 | 272,529 |
| Other short-term borrowings | 27,464 | 23,646 |
| Long-term debt and mandatorily redeemable securities | 19,947 | 29,832 |
| Subordinated notes | 89,692 | 89,692 |
| Accrued expenses and other liabilities | 76,804 | 80,269 |
| Total liabilities | 3,975,479 | 4,010,510 |
| SHAREHOLDERS' EQUITY | | |
| Preferred stock; no par value | | |
| Authorized 10,000,000 shares; issued 111,000 at June 30, 2009 | | |

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| | | |
|--|--------------|--------------|
| and none at December 31, 2008 | 104,298 | - |
| Common stock; no par value | | |
| Authorized 40,000,000 shares; issued 25,886,413 at June 30, 2009 and 25,895,505 at December 31, 2008, less unearned shares (242,907 at June 30, 2009 and 251,999 at December 31, 2008) | 350,263 | 342,982 |
| Retained earnings | 140,355 | 136,877 |
| Cost of common stock in treasury (1,462,857 shares at June 30, 2009, and 1,532,576 shares at December 31, 2008) | (31,314) | (32,019) |
| Accumulated other comprehensive income | 5,288 | 5,824 |
| Total shareholders' equity | 568,890 | 453,664 |
| Total liabilities and shareholders' equity | \$ 4,544,369 | \$ 4,464,174 |

The accompanying notes are a part of the consolidated financial statements.

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CONSOLIDATED STATEMENTS OF
INCOME(Unaudited - Dollars in thousands, except
per share amounts)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|-----------|------------------------------|------------|
| | 2009 | 2008 | 2009 | 2008 |
| Interest income: | | | | |
| Loans and leases | \$ 44,474 | \$ 50,348 | \$ 89,071 | \$ 103,611 |
| Investment securities, taxable | 4,207 | 5,945 | 8,243 | 12,392 |
| Investment securities, tax-exempt | 1,685 | 1,926 | 3,395 | 4,031 |
| Other | 264 | 360 | 597 | 669 |
| Total interest income | 50,630 | 58,579 | 101,306 | 120,703 |
| Interest expense: | | | | |
| Deposits | 16,596 | 21,649 | 34,202 | 46,769 |
| Short-term borrowings | 295 | 1,798 | 644 | 4,179 |
| Subordinated notes | 1,647 | 1,647 | 3,294 | 3,419 |
| Long-term debt and mandatorily redeemable securities | 179 | 361 | 531 | 915 |
| Total interest expense | 18,717 | 25,455 | 38,671 | 55,282 |
| Net interest income | 31,913 | 33,124 | 62,635 | 65,421 |
| Provision for loan and lease losses | 8,487 | 4,493 | 16,272 | 6,032 |
| Net interest income after provision for loan and lease losses | 23,426 | 28,631 | 46,363 | 59,389 |
| Noninterest income: | | | | |
| Trust fees | 3,887 | 4,954 | 7,691 | 9,216 |
| Service charges on deposit accounts | 5,219 | 5,764 | 9,965 | 10,872 |
| Mortgage banking income | 3,339 | 1,417 | 5,909 | 2,534 |
| Insurance commissions | 1,076 | 1,092 | 2,592 | 3,038 |
| Equipment rental income | 6,402 | 5,760 | 12,549 | 11,509 |
| Other income | 2,356 | 2,446 | 4,591 | 4,668 |
| Investment securities and other investment gains (losses) | 426 | (1,066) | (43) | (443) |
| Total noninterest income | 22,705 | 20,367 | 43,254 | 41,394 |
| Noninterest expense: | | | | |
| Salaries and employee benefits | 16,829 | 19,065 | 36,915 | 39,699 |
| Net occupancy expense | 2,273 | 2,481 | 4,874 | 4,957 |
| Furniture and equipment expense | 3,765 | 3,883 | 7,246 | 7,861 |
| Depreciation - leased equipment | 5,088 | 4,609 | 10,044 | 9,225 |
| Professional fees | 815 | 2,522 | 1,877 | 3,680 |
| Supplies and communication | 1,428 | 1,682 | 2,995 | 3,351 |
| FDIC and other insurance | 3,719 | 334 | 5,269 | 683 |
| Other expense | 3,432 | 3,819 | 6,769 | 6,840 |
| Total noninterest expense | 37,349 | 38,395 | 75,989 | 76,296 |
| Income before income taxes | 8,782 | 10,603 | 13,628 | 24,487 |
| Income tax expense | 2,499 | 3,358 | 1,094 | 7,888 |
| Net income | 6,283 | 7,245 | 12,534 | 16,599 |
| | (1,696) | - | (3,009) | - |

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Preferred stock dividends and discount
accretion

| | | | | | | | | |
|--|----|-------|----|-------|----|-------|----|--------|
| Net income available to common shareholders | \$ | 4,587 | \$ | 7,245 | \$ | 9,525 | \$ | 16,599 |
|--|----|-------|----|-------|----|-------|----|--------|

Per common share

| | | | | | | | | |
|---|----|------------|----|------------|----|------------|----|------------|
| Basic net income per common share | \$ | 0.19 | \$ | 0.30 | \$ | 0.39 | \$ | 0.69 |
| Diluted net income per common share | \$ | 0.19 | \$ | 0.30 | \$ | 0.39 | \$ | 0.68 |
| Dividends | \$ | 0.14 | \$ | 0.14 | \$ | 0.28 | \$ | 0.28 |
| Basic weighted average common shares outstanding | | 24,185,415 | | 24,105,746 | | 24,167,905 | | 24,101,010 |
| Diluted weighted average common shares outstanding | | 24,226,542 | | 24,374,273 | | 24,208,966 | | 24,372,225 |

The accompanying notes are a part of the
consolidated financial statements.

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1st SOURCE
CORPORATION
STATEMENT OF CHANGES IN
SHAREHOLDERS' EQUITY
(Unaudited - Dollars in thousands, except
per share amounts)

| | Total | Preferred Stock | Common Stock | Retained Earnings | Cost of Common Stock in Treasury | Net Unrealized Appreciation (Depreciation) of Securities Available- For-Sale |
|--|------------|--------------------|-----------------|----------------------|---|---|
| Balance at January 1, 2008 | \$ 430,504 | \$ - | \$ 342,840 | \$ 117,373 | \$ (32,231) | \$ 2,522 |
| Comprehensive Income, net of tax: | | | | | | |
| Net Income | 16,599 | - | - | 16,599 | - | - |
| Change in unrealized appreciation of available-for-sale securities, net of tax | (1,173) | - | - | - | - | (1,173) |
| Total Comprehensive Income | 15,426 | - | - | - | - | - |
| Issuance of 17,758 common shares under stock based compensation awards, including related tax effects | 319 | - | - | 119 | 200 | - |
| Stock-based compensation | 136 | - | 136 | - | - | - |
| Common stock dividend (\$0.28 per share) | (6,763) | - | - | (6,763) | - | - |
| Balance at June 30, 2008 | \$ 439,622 | \$ - | \$ 342,976 | \$ 127,328 | \$ (32,031) | \$ 1,349 |
| Balance at January 1, 2009 | \$ 453,664 | \$ - | \$ 342,982 | \$ 136,877 | \$ (32,019) | \$ 5,824 |
| Comprehensive Income, net of tax: | | | | | | |
| Net Income | 12,534 | - | - | 12,534 | - | - |
| Change in unrealized appreciation of available-for-sale securities, net of tax | (536) | - | - | - | - | (536) |

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| | | | | | | |
|---|------------|------------|------------|------------|-------------|----------|
| Total Comprehensive Income | 11,998 | - | - | - | - | - |
| Issuance of 83,202 common shares under stock based compensation awards, including related tax effects | 1,659 | - | - | 723 | 936 | - |
| Cost of 13,483 shares of common stock acquired for treasury | (231) | - | - | - | (231) | - |
| Issuance of preferred stock | 103,725 | 103,725 | - | - | - | - |
| Preferred stock discount accretion | - | 573 | - | (573) | - | - |
| Issuance of warrants to purchase common stock | 7,275 | - | 7,275 | - | - | - |
| Preferred stock dividend paid and/or accrued | (2,436) | - | - | (2,436) | - | - |
| Common stock dividend (\$0.28 per share) | (6,770) | - | - | (6,770) | - | - |
| Stock based compensation | 6 | - | 6 | - | - | - |
| Balance at June 30, 2009 | \$ 568,890 | \$ 104,298 | \$ 350,263 | \$ 140,355 | \$ (31,314) | \$ 5,288 |

The accompanying notes are a part of the consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited - Dollars in thousands)

| | Six Months Ended June 30, | |
|--|------------------------------|-----------|
| | 2009 | 2008 |
| Operating activities: | | |
| Net income | \$ 12,534 | \$ 16,599 |
| Adjustments to reconcile net income to net cash provided (used) by operating activities: | | |
| Provision for loan and lease losses | 16,272 | 6,032 |
| Depreciation of premises and equipment | 2,428 | 2,848 |
| Depreciation of equipment owned and leased to others | 10,044 | 9,225 |
| Amortization of investment security premiums and accretion of discounts, net | 3,337 | 654 |
| Amortization of mortgage servicing rights | 1,572 | 1,552 |
| Mortgage servicing asset impairment (recovery) charges | (1,507) | 69 |
| Deferred income taxes | 597 | (5,405) |
| Realized investment securities losses | 43 | 443 |
| Originations/purchases of loans held for sale, net of principal collected | (388,345) | (209,797) |
| Proceeds from the sales of loans held for sale | 300,667 | 200,656 |
| Net gain on sale of loans held for sale | (2,141) | (821) |
| Change in trading account securities | (4) | (150) |
| Change in interest receivable | 911 | 1,528 |
| Change in interest payable | 6,010 | (4,132) |
| Change in other assets | (4,447) | 2,456 |
| Change in other liabilities | (10,184) | (1,733) |
| Other | 566 | 3,105 |
| Net change in operating activities | (51,647) | 23,129 |
| Investing activities: | | |
| Proceeds from sales of investment securities | 103,203 | 5,579 |
| Proceeds from maturities of investment securities | 259,862 | 287,077 |
| Purchases of investment securities | (525,625) | (228,095) |
| Net change in short-term investments | (22,594) | (6,974) |
| Loans sold or participated to others | 8,982 | - |
| Net change in loans and leases | 121,890 | (123,137) |
| Net change in equipment owned under operating leases | (14,077) | (9,782) |
| Purchases of premises and equipment | (953) | (1,073) |
| Net change in investing activities | (69,312) | (76,405) |
| Financing activities: | | |
| Net change in demand deposits, NOW accounts and savings accounts | 144,403 | (73,017) |
| Net change in certificates of deposit | (43,902) | (31,580) |
| Net change in short-term borrowings | (122,182) | 148,162 |
| Proceeds from issuance of long-term debt | 166 | 10,022 |
| Payments on subordinated notes | - | (10,310) |
| Payments on long-term debt | (10,310) | (10,370) |
| Net proceeds from issuance of treasury stock | 1,659 | 319 |

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| | | |
|---|-----------|------------|
| Acquisition of treasury stock | (231) | - |
| Proceeds from issuance of preferred stock & common stock warrants | 111,000 | - |
| Cash dividends | (8,617) | (6,879) |
| Net change in financing activities | 71,986 | 26,347 |
| Net change in cash and cash equivalents | (48,973) | (26,929) |
| Cash and cash equivalents, beginning of year | 119,771 | 153,137 |
| Cash and cash equivalents, end of period | \$ 70,798 | \$ 126,208 |

The accompanying notes are a part of the consolidated financial statements.

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1ST SOURCE CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Basis of Presentation

The accompanying unaudited consolidated financial statements reflect all adjustments (all of which are normal and recurring in nature) which are, in the opinion of management, necessary for a fair presentation of the consolidated financial position, the results of operations, changes in shareholders' equity, and cash flows for the periods presented. These unaudited consolidated financial statements have been prepared according to the rules and regulations of the Securities and Exchange Commission (SEC) and, therefore, certain information and footnote disclosures normally included in financial statements prepared in accordance with U. S. generally accepted accounting principles (GAAP) have been omitted. The Notes to the Consolidated Financial Statements appearing in 1st Source Corporation's Annual Report on Form 10-K (2008 Annual Report), which include descriptions of significant accounting policies, should be read in conjunction with these interim financial statements. The balance sheet at December 31, 2008 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by U. S. generally accepted accounting principles for complete financial statements. Certain amounts in the prior period consolidated financial statements have been reclassified to conform with the current year presentation.

Note 2. Other Activity

On January 23, 2009, we entered into a Letter Agreement with the United States Department of the Treasury ("Treasury"), pursuant to which we issued and sold (i) 111,000 shares of our Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the "Series A Preferred Stock") and (ii) a warrant (the "Warrant") to purchase 837,947 shares of our common stock, without par value (the "Common Stock"), for an aggregate purchase price of \$111,000,000 in cash.

The Series A Preferred Stock qualifies as Tier 1 capital and pays cumulative dividends at a rate of 5% per annum for the first five years, and 9% per annum thereafter. The Series A Preferred Stock is non-voting except with respect to certain matters affecting the rights of the holders thereof, and may be redeemed by us after notice to the Treasury and our primary federal regulator, the Board of Governors of the Federal Reserve System ("Federal Reserve Bank") and subject to consultation between the Treasury and Federal Reserve Bank. At the time of redemption, if we do not choose to exercise our option to repurchase the warrants, the Secretary of Treasury intends to sell the warrants through an auction process.

The Warrant has a 10-year term and is immediately exercisable upon its issuance, with an exercise price, subject to anti-dilution adjustments, equal to \$19.87 per share of the Common Stock.

In addition, we may not increase the quarterly dividend we pay on our common stock above \$0.16 per share during the three-year period ending January 23, 2012, without consent of the Treasury, unless the Treasury no longer holds shares of the Series A Preferred Stock.

On December 12, 2008, 1st Source Corporation Investment Advisors, Inc. ("1st Source Investment Advisors"), a wholly-owned subsidiary of 1st Source Bank and second tier subsidiary of 1st Source Corporation, finalized a Purchase and Sale Agreement with WA Holdings, Inc. ("Buyer") whereby 1st Source Investment Advisors sold certain assets to Buyer and entered into a long-term strategic partnership with Buyer (the "Transaction"). Under terms of the Purchase and Sale Agreement, we received a one time payment of \$11.70 million at closing and will receive performance payments ("earnout fees") over the next ten years based on the

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net growth and investment performance returns of the Funds. Pursuant to the Purchase and Sale Agreement, Buyer and its wholly-owned subsidiary, Wasatch Advisors, Inc., investment advisor of the Wasatch Funds, Inc., acquired assets of 1st Source Investment Advisors related to the management of the 1st Source Monogram Mutual Funds - the Income Equity Fund, the Long/Short Fund and the Income Fund. The 1st Source Monogram Mutual Funds were reorganized into the Wasatch - 1st Source Income Equity Fund, the Wasatch - 1st Source Long/Short Fund, and the Wasatch - 1st Source Income Fund.

Note 3. Recent Accounting Pronouncements

FASB Accounting Standards Codification™(Codification): In June 2009, the Financial Accounting Standards Board (FASB) issued Statement No. 168, “FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles – a replacement of FASB Statement No. 162” (SFAS 168). The Codification will officially become the single source of authoritative nongovernmental U.S. generally accepted accounting principles (GAAP). The Codification does not change current GAAP, but is intended to simplify user access to all authoritative GAAP by providing all the authoritative literature related to a particular topic in one place. All existing accounting standard documents will be superseded and all other accounting literature not included in the Codification will be considered nonauthoritative. The Codification is effective for interim or annual reporting periods ending after September 15, 2009. We will make the appropriate changes to GAAP references in our financial statements effective July 1, 2009.

Amendments to FASB Interpretation No. 46(R): In June 2009, the FASB issued Statement No. 167, “Amendments to FASB Interpretation No. 46(R)” (SFAS 167). SFAS 167 amends the consolidation guidance applicable to variable interest entities. The amendments to the consolidation guidance affect all entities currently within the scope of FIN 46(R), as well as qualifying special-purpose entities (QSPEs) that are currently excluded from the scope of FIN 46(R). SFAS 167 is effective as of the beginning of the first annual reporting period that begins after November 15, 2009. We are assessing the impact of SFAS 167 on our financial condition, results of operations, and disclosures.

Accounting for Transfers of Financial Assets: In June 2009, the FASB issued Statement No. 166, “Accounting for Transfers of Financial Assets, an amendment of FASB Statement No. 140” (SFAS No. 166). SFAS 166 amends the derecognition accounting and disclosure guidance relating to SFAS 140. SFAS 166 eliminates the exemption from consolidation for QSPEs, it also requires a transferor to evaluate all existing QSPEs to determine whether it must be consolidated in accordance with SFAS 167. SFAS 166 is effective as of the beginning of the first annual reporting period that begins after November 15, 2009. We are assessing the impact of SFAS 166 on our financial condition, results of operations, and disclosures.

Subsequent Events: In May 2009, the FASB issued Statement No. 165, “Subsequent Events” (SFAS No. 165). SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. SFAS 165 is effective for interim or annual periods ending after June 15, 2009. We adopted the provisions of SFAS 165 and this change is reflected in Note 10 - Subsequent Events.

FASB Amends Disclosures about Fair Value of Financial Instruments: In April 2009, the FASB issued FASB Staff Position (FSP) 107-1 and APB 28-1, “Interim Disclosures about Fair Value of Financial Instruments.” The FSP requires a public entity to provide disclosures about fair value of financial instruments in interim financial information. FSP 107-1 and APB 28-1 is effective for interim and annual financial periods ending after June 15, 2009. We adopted the provisions of FSP FAS 107-1 and APB 28-1 on April 1, 2009 and the impact on our disclosures is more fully discussed in Note 9 – Fair Value.

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FASB Clarifies Other-Than-Temporary Impairment: In April 2009, the FASB issued FSP FAS 115-2, FAS124-2 and EITF 99-20-2, “Recognition and Presentation of Other-Than-Temporary-Impairment.” The FSP (i) changes existing guidance for determining whether an impairment is other than temporary to debt securities and (ii) replaces the existing requirement that the entity’s management assert it has both the intent and ability to hold an impaired security until recovery with a requirement that management assert: (a) it does not have the intent to sell the security; and (b) it is more likely than not it will not have to sell the security before recovery of its cost basis. Under FSP FAS 115-2, FAS124-2 and EITF 99-20-2, declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses to the extent the impairment is related to credit losses. The amount of impairment related to other factors is recognized in other comprehensive income. FAS 115-2, FAS 124-2 and EITF 99-20-2 is effective for interim and annual periods ending after June 15, 2009. We adopted the provisions of FSP FAS 115-2, FAS 124-2 and EITF 99-20-2-1 on April 1, 2009. Details related to the adoption of FSP FAS 115-2, FAS 124-2 and EITF 99-20-2-1 and the impact on our disclosures are more fully discussed in Note 4 – Investment Securities. The provisions of FSP FAS 115-2, FAS 124-2 and EITF 99-20-2-1 did not have an impact on our financial condition and results of operations.

FASB Clarifies Application of Fair Value Accounting: In April 2009, the FASB issued FSP FAS 157-4, “Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly.” The FSP affirms the objective of fair value when a market is not active, clarifies and includes additional factors for determining whether there has been a significant decrease in market activity, eliminates the presumption that all transactions are distressed unless proven otherwise, and requires an entity to disclose a change in valuation technique. The FSP is effective for interim and annual periods ending after June 15, 2009. We adopted the provisions of FSP FAS 157-4 on April 1, 2009. The provisions of FSP FAS 157-4 did not have a material impact on our financial condition and results of operations.

Earnings Per Share (EPS): In June 2008, the FASB issued FSP EITF 03-6-1, “Determining Whether Instruments Granted in Shared-Based Payment Transaction are Participating Securities.” The FSP clarifies that unvested share-based payment awards with a right to receive nonforfeitable dividends are participating securities. This FSP also provides guidance on how to allocate earnings to participating securities and compute EPS using the two-class method. The FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. All prior-period EPS data presented shall be adjusted retrospectively (including interim financial statements, summaries of earnings, and selected financial data) to conform with the provisions of this FSP. The provisions of FSP EITF 03-6-1 did not have a material impact on our EPS calculation.

Disclosures About Derivative Instruments and Hedging Activities: In March 2008, the FASB issued Statement No. 161, “Disclosures About Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133” (SFAS No. 161). SFAS No. 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. SFAS No. 161 is effective for fiscal years beginning after November 15, 2008. We adopted the provisions of SFAS No. 161 on January 1, 2009. Details related to the adoption of SFAS No. 161 and the impact on our financial statements is more fully discussed in Note 6– Financial Instruments with Off-Balance Sheet Risk and Derivative Transactions.

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Noncontrolling Interests in Consolidated Financial Statements: In December 2007, the FASB issued Statement No. 160, “Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51” (SFAS No. 160). SFAS No. 160 requires that a noncontrolling interest in a subsidiary be reported separately within equity and the amount of consolidated net income specifically attributable to the noncontrolling interest be identified in the consolidated financial statements. It also calls for consistency in the manner of reporting changes in the parent’s ownership interest and requires fair value measurement of any noncontrolling equity investment retained in a deconsolidation. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. We adopted the provisions of SFAS No. 160 on January 1, 2009. The provisions of SFAS No. 160 did not have an impact on our financial condition and results of operations.

Business Combinations: In December 2007, the FASB issued Statement No. 141R, “Business Combinations” (SFAS No. 141R). SFAS No. 141R broadens the guidance of SFAS No. 141, extending its applicability to all transactions and other events in which one entity obtains control over one or more other businesses. It broadens the fair value measurement and recognition of assets acquired, liabilities assumed, and interests transferred as a result of business combinations. SFAS No. 141R expands on required disclosures to improve the statement users’ abilities to evaluate the nature and financial effects of business combinations. SFAS No. 141R is effective for the first annual reporting period beginning on or after December 15, 2008. In April 2009, the FASB issued FSP FAS 141(R)-1, “Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies”. This FSP amends the guidance in FASB Statement No. 141(R) and is effective for the first annual reporting period beginning on or after December 15, 2008. The provisions of SFAS No. 141R and FSP 141(R)-1 will only impact us if we are party to a business combination closing on or after January 1, 2009.

Note 4. Investment Securities

Investment securities available-for-sale were as follows:

| (Dollars in thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|--|-------------------|------------------------------|-------------------------------|------------|
| June 30, 2009 | | | | |
| U.S. Treasury and Federal agencies securities | \$ 396,487 | \$ 1,967 | \$ (375) | \$ 398,079 |
| U.S. State and political subdivisions securities | 204,336 | 3,790 | (2,592) | 205,534 |
| Mortgage-backed securities - Federal agencies | 252,600 | 5,294 | (1,358) | 256,536 |
| Corporate debt securities | 18,977 | 152 | - | 19,129 |
| Foreign government securities | 775 | - | - | 775 |
| Total debt securities | 873,175 | 11,203 | (4,325) | 880,053 |
| Marketable equity securities | 1,387 | 1,634 | (27) | 2,994 |
| Total investment securities available-for-sale | \$ 874,562 | \$ 12,837 | \$ (4,352) | \$ 883,047 |
| December 31, 2008 | | | | |
| U.S. Treasury and Federal agencies securities | \$ 293,461 | \$ 2,892 | \$ (2) | \$ 296,351 |
| U.S. State and political subdivisions securities | 198,640 | 3,995 | (1,686) | 200,949 |
| Mortgage-backed securities - Federal agencies | 207,954 | 3,553 | (1,499) | 210,008 |
| Corporate debt securities | 10,000 | 50 | - | 10,050 |
| Foreign government and other securities | 929 | - | - | 929 |
| Total debt securities | 710,984 | 10,490 | (3,187) | 718,287 |
| Marketable equity securities | 4,396 | 2,092 | (21) | 6,467 |
| Total investment securities available-for-sale | \$ 715,380 | \$ 12,582 | \$ (3,208) | \$ 724,754 |

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The contractual maturities of debt securities available-for-sale at June 30, 2009, are shown below. Expected maturities will differ from contractual maturities, because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollars in thousands)

| | Amortized | |
|--|------------|------------|
| | Cost | Fair Value |
| Due in one year or less | \$ 196,725 | \$ 197,187 |
| Due after one year through five years | 304,672 | 308,376 |
| Due after five years through ten years | 100,530 | 101,308 |
| Due after ten years | 18,648 | 16,646 |
| Mortgage backed securities | 252,600 | 256,536 |
| Total debt securities available-for-sale | \$ 873,175 | \$ 880,053 |

At June 30, 2009, the mortgage-backed securities we held consisted primarily of GNMA, FNMA and FHLMC pass-through certificates which are guaranteed by those respective agencies of the United States government.

The following table shows the gross realized gains and losses on sale of securities from the securities available-for-sale portfolio, including marketable equity securities. The gross losses in the second quarter and year-to-date 2008 reflect other-than-temporary impairment ("OTTI") writedowns of \$0.94 million and \$1.26 million, respectively, on preferred stock issued by FNMA and FHLMC. There have been no OTTI writedowns in 2009. There were net gains of \$4 thousand and \$0 recorded on \$0.10 million in trading securities outstanding at June 30, 2009, and December 31, 2008, respectively.

(Dollars in thousands)

| | Three Months Ended | | Six Months Ended | |
|-----------------------------|--------------------|----------|------------------|----------|
| | June 30, | | June 30, | |
| | 2009 | 2008 | 2009 | 2008 |
| Gross realized gains | \$ 60 | \$ 1 | \$ 654 | \$ 826 |
| Gross realized losses | - | (936) | (707) | (1,457) |
| Net realized gains (losses) | \$ 60 | \$ (935) | \$ (53) | \$ (631) |

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The following tables summarize our gross unrealized losses and fair value by investment category and age:

| (Dollars in thousands) | Less than 12 Months | | 12 months or Longer | | Total | |
|--|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| June 30, 2009 | | | | | | |
| U.S. Treasury and Federal agencies securities | \$ 80,004 | \$ (375) | \$ - | \$ - | \$ 80,004 | \$ (375) |
| U.S. State and political subdivisions securities | 19,101 | (382) | 19,044 | (2,210) | 38,145 | (2,592) |
| Mortgage-backed securities - Federal agencies | 53,083 | (953) | 25,678 | (405) | 78,761 | (1,358) |
| Corporate debt securities | - | - | - | - | - | - |
| Foreign government securities | - | - | - | - | - | - |
| Total debt securities | 152,188 | (1,710) | 44,722 | (2,615) | 196,910 | (4,325) |
| Marketable equity securities | 2 | (1) | 5 | (26) | 7 | (27) |
| Total investment securities available-for-sale | \$ 152,190 | \$ (1,711) | \$ 44,727 | \$ (2,641) | \$ 196,917 | \$ (4,352) |
| December 31, 2008 | | | | | | |
| U.S. Treasury and Federal agencies securities | \$ 19,998 | \$ (2) | \$ - | \$ - | \$ 19,998 | \$ (2) |
| U.S. State and political subdivisions securities | 29,594 | (1,686) | - | - | 29,594 | (1,686) |
| Mortgage-backed securities - Federal agencies | 14,840 | (229) | 34,721 | (1,270) | 49,561 | (1,499) |
| Corporate debt securities | - | - | - | - | - | - |
| Foreign government and other securities | 493 | (1) | - | - | 493 | (1) |
| Total debt securities | 64,925 | (1,918) | 34,721 | (1,270) | 99,646 | (3,188) |
| Marketable equity securities | 11 | (18) | 2 | (2) | 13 | (20) |
| Total investment securities available-for-sale | \$ 64,936 | \$ (1,936) | \$ 34,723 | \$ (1,272) | \$ 99,659 | \$ (3,208) |

The initial indication of OTTI for both debt and equity securities is a decline in fair value below amortized cost. Quarterly, the impaired securities are analyzed on a qualitative and quantitative basis in determining OTTI. Declines in the fair value of available-for-sale debt securities below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses to the extent the impairment is related to credit losses. The amount of impairment related to other factors is recognized in other comprehensive income. In estimating OTTI impairment losses, we consider among other things, (i) the length of time and the extent to which fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) whether it is more likely than not that we will not have to sell any such securities before a recovery of cost.

At June 30, 2009, we do not have the intent to sell any of the available-for-sale securities in the table above and believe that is more likely than not that we will not have to sell any such securities before a recovery of cost. The unrealized losses are due to increases in market interest rates over the yields available at the time the underlying securities were purchased and market illiquidity on adjustable rate coupon securities. The fair value is expected to recover on all debt securities as they approach their maturity date or repricing date or if market yields for such

investments decline. We do not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of June 30, 2009, we believe the impairments detailed in the table above are temporary and no impairment loss has been realized in our consolidated income statement.

Note 5. Reserve for Loan and Lease Losses

The reserve for loan and lease losses is maintained at a level believed to be adequate by management to absorb probable losses inherent in the loan and lease portfolio. The determination of the reserve requires significant judgment reflecting management's best estimate of probable loan and lease losses related to specifically identified loans and leases as well as probable losses in the remainder of the various loan and lease portfolios. The methodology for assessing the appropriateness of the reserve consists of several key elements,

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which include: specific reserves for impaired loans with the impairment reserve determined in accordance with SFAS 114, percentage allocations for special attention loans and leases (classified loans and leases and internal watch list credits) without specific reserves, formula reserves for each business lending division portfolio, and reserves for pooled homogeneous loans and leases. Management's evaluation is based upon a continuing review of these portfolios, estimates of customer performance, collateral values and dispositions, and assessments of economic and geopolitical events, all of which are subject to judgment and will change.

Note 6. Financial Instruments with Off-Balance-Sheet Risk and Derivative Transactions

To meet the financing needs of our customers, 1st Source Corporation and its subsidiaries are parties to financial instruments with off-balance-sheet risk in the normal course of business. These off-balance-sheet financial instruments include commitments to originate, purchase and sell loans and standby letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated statements of financial condition. Our exposure to credit loss in the event of nonperformance by the other party to the financial instruments for loan commitments and standby letters of credit is represented by the dollar amount of those instruments. We use the same credit policies and collateral requirements in making commitments and conditional obligations as we do for on-balance-sheet instruments.

We have certain interest rate derivative positions that relate to transactions in which we enter into an interest rate swap with a client while at the same time entering into an offsetting interest rate swap with another financial institution. In connection with each transaction, we agree to pay interest to the client on a notional amount at a variable interest rate and receive interest from the client on the same notional amount at a fixed interest rate. At the same time, we agree to pay another financial institution the same fixed interest rate on the same notional amount and receive the same variable interest rate on the same notional amount. The transaction allows our client to effectively convert a variable rate loan to a fixed rate. Because the terms of the swaps with our customers and the other financial institution offset each other, with the only difference being counterparty credit risk, changes in the fair value of the underlying derivative contracts are not materially different and do not significantly impact our results of operations. Changes in the fair value are included in other expense. The fair value of interest rate swap positions is determined by a third-party pricing agent using an income approach and utilizing models that use as their basis readily observable market parameters. This valuation process considers various factors including interest rate yield curves, time value and volatility factors.

1st Source Bank (Bank), a subsidiary of 1st Source Corporation, grants mortgage loan commitments to borrowers, subject to normal loan underwriting standards. The interest rate risk associated with these loan commitments is managed by entering into contracts for future deliveries of loans. Loan 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. Commitments to originate or purchase residential mortgage loans held for sale and forward commitments to sell residential mortgage loans are considered derivative instruments and changes in the fair value are recorded to mortgage banking income. Fair value of mortgage loan commitments is determined using a market value approach and utilizing an appropriate current market yield and a loan commitment closing rate based on historical analysis.

Fair values of derivative instruments as of June 30, 2009:

(Dollars in thousands)

| | Asset derivatives | | | Liability derivatives | |
|--|--------------------------------|-------------------------|------------|-------------------------|------------|
| | Notional or contractual amount | Balance sheet location | Fair value | Balance sheet location | Fair value |
| Derivatives not designated as hedging instruments under SFAS 133 | | | | | |
| Interest rate swap contracts | \$ 442,207 | Other assets | \$ 15,022 | Other liabilities | \$ 15,295 |
| Commitments | 93,831 | Mortgages held for sale | 555 | N/A | - |
| Forward contracts | 181,375 | N/A | - | Mortgages held for sale | 414 |
| Total | | | \$ 15,577 | | \$ 15,709 |

We issue letters of credit which are conditional commitments that guarantee the performance of a customer to a third party. The credit risk involved and collateral obtained in issuing letters of credit is essentially the same as that involved in extending loan commitments to customers. Standby letters of credit totaled \$46.34 million and \$82.18 million at June 30, 2009, and December 31, 2008, respectively. Standby letters of credit have terms ranging from six months to one year.

Note 7. Stock-Based Compensation

As of June 30, 2009, we had five stock-based employee compensation plans, which are more fully described in Note L of the Consolidated Financial Statements in 1st Source's Annual Report on Form 10-K for the year ended December 31, 2008. These plans include two stock option plans, the Employee Stock Purchase Plan, the Executive Incentive Plan, and the Restricted Stock Award Plan.

Stock-based compensation expense for all stock-based compensation awards granted is based on the grant-date fair value. For all awards except stock option awards, the grant date fair value is either the fair market value per share or book value per share (corresponding to the type of stock awarded) as of the grant date. For stock option awards, the grant date fair value is estimated using the Black-Scholes option pricing model. For all awards we recognize these compensation costs only for those shares expected to vest on a straight-line basis over the requisite service period of the award, for which we use the related vesting term. We estimate forfeiture rates based on historical employee option exercise and employee termination experience. We have identified separate groups of awardees that exhibit similar option exercise behavior and employee termination experience and have considered them as separate groups in the valuation models and expense estimates.

The stock-based compensation expense recognized in the condensed consolidated statement of operations for the six months ended June 30, 2009 and 2008 was based on awards ultimately expected to vest, and accordingly has been adjusted by the amount of estimated forfeitures. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based partially on historical experience.

The aggregate intrinsic value in the table below represents the total pretax intrinsic value (the difference between 1st Source's closing stock price on the last trading day of the second quarter of 2009 (June 30, 2009) and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on June 30, 2009. This amount changes based on the fair market value of 1st Source's stock. Total fair value of options vested and expensed was \$6 thousand and \$9 thousand, net of tax, for the six months ended June 30, 2009 and 2008, respectively.

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| | June 30, 2009 | | Average | Total |
|--|---------------|----------|-------------|------------|
| | Number of | Weighted | Remaining | Intrinsic |
| | Shares | Average | Contractual | Value |
| | | Exercise | Term | (in 000's) |
| | | Price | (in years) | |
| Options outstanding, beginning of year | 80,948 | \$ 18.51 | | |
| Granted | - | - | | |
| Exercised | - | - | | |
| Forfeited | - | - | | |
| Options outstanding, June 30, 2009 | 80,948 | \$ 18.51 | 2.34 | \$ 115 |
| Vested and expected to vest at June 30, 2009 | 80,948 | \$ 18.51 | 2.34 | \$ 115 |
| Exercisable at June 30, 2009 | 75,448 | \$ 18.99 | 2.23 | \$ 86 |

No options were granted during the six months ended June 30, 2009.

As of June 30, 2009, there was \$2.62 million of total unrecognized compensation cost related to nonvested share-based compensation arrangements. That cost is expected to be recognized over a weighted-average period of 3.61 years.

The following table summarizes information about stock options outstanding at June 30, 2009:

| Range of Exercise Prices | Options Outstanding | | | Options Exercisable | |
|--------------------------|------------------------------|---|---------------------------------|------------------------------|---------------------------------|
| | Number of shares Outstanding | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Number of shares Exercisable | Weighted Average Exercise Price |
| \$12.04 to \$17.99 | 29,508 | 3.24 | \$13.38 | 24,008 | \$13.69 |
| \$18.00 to \$26.99 | 45,885 | 1.76 | 20.55 | 45,885 | 20.55 |
| \$27.00 to \$29.46 | 5,555 | 2.32 | 28.95 | 5,555 | 28.95 |

The fair value of each stock option was estimated on the date of grant using the Black-Scholes option-pricing model.

Note 8. Income Taxes

The total amount of unrecognized tax benefits that would affect the effective tax rate if recognized was \$1.20 million at June 30, 2009 and \$4.19 million at December 31, 2008. Interest and penalties were recognized through the income

tax provision. For the six months ending June 30, 2009 and the twelve months ending December 31, 2008, we recognized approximately (\$0.69) million and \$0.14 million in interest, net of tax effect, and penalties, respectively. Interest and penalties of approximately \$0.58 and \$1.27 million were accrued at June 30, 2009 and December 31, 2008, respectively.

Tax years that remain open and subject to audit include the federal 2005-2008 years and the Indiana 2005-2008 years. Additionally, during the first quarter of 2009 we reached a resolution of audit examinations for the 2002-2007 years and as a result recorded a reduction of unrecognized tax benefits in the amount of \$4.80 million that affected the effective tax rate and increased earnings in the amount of \$2.60 million. We do not anticipate a significant change in the amount of uncertain tax positions within the next 12 months.

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Note 9. Fair Value

As of January 1, 2008, we adopted SFAS No. 157, "Fair Value Measurements" and SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities," including an amendment of SFAS No. 115. SFAS No. 157 does not change existing guidance as to whether or not an asset or liability is carried at fair value. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 159 generally permits the measurement of selected eligible financial instruments at fair value at specified election dates, subject to the conditions set forth in the standard.

We also adopted the provisions of FASB Staff Position (FSP) No. 157-2, which deferred until January 1, 2009 the application of SFAS 157 to nonfinancial assets and nonfinancial liabilities not recognized or disclosed at least annually at fair value. Items affected by this deferral included goodwill, repossessions and other real estate, all for which any necessary impairment analyses are performed using fair value measurements.

We elected to adopt SFAS No. 159 for mortgages held for sale (MHFS) at fair value prospectively for new MHFS originations starting on January 1, 2008. We believe the fair value election for MHFS (which are now hedged with free-standing derivatives (economic hedges)) will reduce certain timing differences and better match changes in the value of these assets with changes in the value of derivatives used as economic hedges for these assets. There was no transition adjustment required upon adoption of SFAS No. 159 for MHFS because we continued to account for MHFS originated prior to January 1, 2008 at the lower of cost or fair value. At June 30, 2009, MHFS carried at fair value totaled \$136.51 million.

In accordance with SFAS No. 157, we group our financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

- § Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reported date.
- § Level 2 – Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities include items for which quoted prices are available but traded less frequently, and items that are fair valued using other financial instruments, the parameters of which can be directly observed.
- § Level 3 – Assets and liabilities that have little to no pricing observability as of the reported date. These items do not have two-way markets and are measured using management's best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

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The table below presents the balance of assets and liabilities at June 30, 2009 measured at fair value on a recurring basis:

| (Dollars in thousands) | Level 1 | Level 2 | Level 3 | Total |
|--|-------------------|-------------------|------------------|---------------------|
| Assets: | | | | |
| Investment securities available for sale | \$ 107,030 | \$ 746,508 | \$ 29,509 | \$ 883,047 |
| Trading account securities | 104 | - | - | 104 |
| Mortgages held for sale | - | 136,505 | - | 136,505 |
| Accrued income and other assets (Interest rate swap agreements) | - | 15,022 | - | 15,022 |
| Total | \$ 107,134 | \$ 898,035 | \$ 29,509 | \$ 1,034,678 |
| Liabilities: | | | | |
| Accrued expenses and other liabilities (Interest rate swap agreements) | \$ - | \$ 15,295 | \$ - | \$ 15,295 |
| Total | \$ - | \$ 15,295 | \$ - | \$ 15,295 |

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows:

| (Dollars in thousands) | Quarter ended June 30, 2009 Investment securities available for sale |
|--|---|
| Beginning balance April 1, 2009 | \$ 30,232 |
| Total gains or losses (realized/unrealized): | |
| Included in earnings | - |
| Included in other comprehensive income | 420 |
| Purchases and issuances | 4,597 |
| Settlements | - |
| Expirations | (5,740) |
| Transfers in and/or out of Level 3 | - |
| Ending balance June 30, 2009 | \$ 29,509 |

There were no gains or losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets and liabilities still held at June 30, 2009.

We may be required, from time to time, to measure certain other financial assets at fair value on a nonrecurring basis in accordance with GAAP. These other financial assets include loans measured for impairment under SFAS 114, venture capital partnership investments, mortgage servicing rights, goodwill, repossessions and other real estate.

Impaired loans and related write-downs are based on the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using customized discounting criteria, appraisals and dealer and trade magazine quotes which are used in a market valuation approach. Repossessions are similarly valued. Venture capital partnership investments and the adjustments to fair value primarily result from application of lower-of-cost-or-fair value accounting. The partnership investments are priced using financial statements provided by

the partnerships.

Mortgage servicing rights (MSRs) and related adjustments to fair value result from application of lower-of-cost-or-fair value accounting. Fair value measurements for mortgage servicing rights are derived based on a variety of inputs including prepayment speeds, discount rates, scheduled servicing cash flows, delinquency rates and other assumptions. MSRs do not trade in an active, open market with readily observable prices and though sales of MSRs do occur, precise terms and conditions typically are not readily available. Goodwill is reviewed

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for impairment at least annually, or on an interim basis if an event occurs or circumstances change that would more likely than not reduce the carrying amount. Goodwill is allocated into two reporting units as defined by SFAS 142. Fair value for each reporting unit is estimated using stock price multiples or revenue multiples. Other real estate (ORE) is based on the fair value of the underlying collateral less expected selling costs. Collateral values are estimated primarily using appraisals and reflect a market value approach.

For assets measured at fair value on a nonrecurring basis the following represents impairment charges (recoveries) recognized on these assets during the quarter ended June 30, 2009: impaired loans - \$10.78 million; venture capital partnership investments - \$(0.37) million; mortgage servicing rights - \$(2.07) million; goodwill - \$0.00 million; repossessions - \$0.05 million, and other real estate - \$0.00 million.

For assets measured at fair value on a nonrecurring basis on hand at June 30, 2009, the following table provides the level of valuation assumptions used to determine each valuation and the carrying value of the related assets:

| (Dollars in thousands) | Level 1 | Level 2 | Level 3 | Total |
|---|---------|-----------|-----------|------------|
| Loans | \$ - | \$ - | \$ 59,073 | \$ 59,073 |
| Accrued income and other assets (venture capital partnership investments) | - | - | 2,430 | 2,430 |
| Accrued income and other assets (mortgage servicing rights) | - | - | 8,769 | 8,769 |
| Goodwill and intangible assets (goodwill) | - | 83,329 | - | 83,329 |
| Accrued income and other assets (repossessions) | - | - | 6,960 | 6,960 |
| Accrued income and other assets (other real estate) | - | - | 4,885 | 4,885 |
| | \$ - | \$ 83,329 | \$ 82,117 | \$ 165,446 |

Fair Value Option

The following table reflects the differences between the fair value carrying amount of mortgages held for sale measured at fair value under SFAS No. 159 and the aggregate unpaid principal amount we are contractually entitled to receive at maturity on June 30, 2009:

| (Dollars in thousands) | Fair value carrying amount | Aggregate unpaid principal | Excess of fair value carrying amount over (under) unpaid principal |
|---|----------------------------|----------------------------|--|
| Mortgages held for sale reported at fair value: | | | |
| Total loans | \$ 136,505 | \$ 136,477 | \$ 28 (1) |
| Nonaccrual loans | - | - | - |
| Loans 90 days or more past due and still accruing | - | - | - |

(1) The excess of fair value carrying amount over unpaid principal includes changes in fair value recorded at and subsequent to funding, gains and losses on the related loan commitment prior to funding, and premiums on acquired loans.

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The fair values of our financial instruments as of June 30, 2009, and December 31, 2008, are summarized in the table below.

| (Dollars in thousands) | June 30, 2009 | | December 31, 2008 | |
|---|----------------------------|--------------|----------------------------|--------------|
| | Carrying or Contract Value | Fair Value | Carrying or Contract Value | Fair Value |
| Assets: | | | | |
| Cash and due from banks | \$ 70,798 | \$ 70,798 | \$ 119,771 | \$ 119,771 |
| Federal funds sold and interest bearing deposits with other banks | 29,545 | 29,545 | 6,951 | 6,951 |
| Investment securities, available-for-sale | 883,047 | 883,047 | 724,754 | 724,754 |
| Other investments and trading account securities | 18,716 | 18,716 | 18,712 | 18,712 |
| Mortgages held for sale | 136,505 | 136,505 | 46,686 | 46,686 |
| Loans and leases, net of reserve for loan and lease losses | 3,071,292 | 3,126,417 | 3,218,436 | 3,239,567 |
| Interest rate swaps | 15,022 | 15,022 | 22,663 | 22,663 |
| Liabilities: | | | | |
| Deposits | \$ 3,615,043 | \$ 3,664,860 | \$ 3,514,542 | \$ 3,486,609 |
| Short-term borrowings | 173,993 | 173,993 | 296,175 | 296,175 |
| Long-term debt and mandatorily redeemable securities | 19,947 | 19,742 | 29,832 | 29,674 |
| Subordinated notes | 89,692 | 65,504 | 89,692 | 73,972 |
| Interest rate swaps | 15,295 | 15,295 | 23,003 | 23,003 |
| Off-balance-sheet instruments * | - | 291 | - | 297 |

* Represents estimated cash outflows required to currently settle the obligations at current market rates.

SFAS 107, "Disclosures about Fair Value of Financial Instruments," as amended, requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring or non-recurring basis. The methodologies for estimating fair value of financial assets and financial liabilities that are measured at fair value on a recurring or non-recurring basis are discussed above. The estimated fair value approximates carrying value for cash and cash equivalents. The methodologies for other financial assets and financial liabilities are discussed below:

Loans and Leases — For variable rate loans and leases that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for certain real estate loans (e.g., one-to-four family residential mortgage loans) are based on quoted market prices of similar loans sold in conjunction with securitization transactions, adjusted for differences in loan characteristics. The fair values of all other loans and leases are estimated using discounted cash flow analyses which use interest rates currently being offered for loans and leases with similar terms to borrowers of similar credit quality.

Deposits — The fair values for all deposits other than time deposits are equal to the amounts payable on demand (the carrying value). Fair values of variable rate time deposits are equal to their carrying values. Fair values for fixed rate time deposits are estimated using discounted cash flow analyses using interest rates currently being offered for deposits with similar remaining maturities.

Short-Term Borrowings — The carrying values of Federal funds purchased, securities sold under repurchase agreements, and other short-term borrowings, including our liability related to mortgage loans available for repurchase under GNMA optional repurchase programs, approximate their fair values.

Long-Term Debt and Mandatorily Redeemable Securities — The fair values of long-term debt are estimated using discounted cash flow analyses, based on our current estimated incremental borrowing rates for similar types of borrowing arrangements. The carrying values of mandatorily redeemable securities are based on approximate fair values.

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Subordinated Notes — Fair values are based on quoted market prices, where available. If quoted market prices are not available, fair values are estimated based on calculated market prices of comparable securities.

Off-Balance-Sheet Instruments — Contract and fair values for certain of our off-balance-sheet financial instruments (guarantees and loan commitments) are estimated based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

Limitations — Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instruments. Because no market exists for a significant portion of our financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other such factors.

These estimates do not reflect any premium or discount that could result from offering for sale at one time our entire holdings of a particular financial instrument. These estimates are subjective in nature and require considerable judgment to interpret market data. Accordingly, the estimates presented herein are not necessarily indicative of the amounts we could realize in a current market exchange, nor are they intended to represent the fair value of 1st Source as a whole. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. The fair value estimates presented herein are based on pertinent information available to management as of the respective balance sheet date. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued since the presentation dates, and therefore, estimates of fair value after the balance sheet date may differ significantly from the amounts presented herein.

Other significant assets, such as premises and equipment, other assets, and liabilities not defined as financial instruments, are not included in the above disclosures. Also, the fair value estimates for deposits do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

Note 10. Subsequent Events

We have evaluated subsequent events through the date our financial statements were issued, or July 30, 2009. We do not believe any subsequent events have occurred that would require further disclosure or adjustment to our financial statements.

ITEM 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Except for historical information contained herein, the matters discussed in this document express "forward-looking statements." Generally, the words "believe," "contemplate," "seek," "plan," "possible," "assume," "expect," "intend," "targeted," "remain," "estimate," "anticipate," "project," "will," "should," "indicate," "would," "may" and similar expressions indicate forward-looking statements. Those statements, including statements, projections, estimates or assumptions concerning future events or performance, and other statements that are other than statements of historical fact, are subject to material risks and uncertainties. We caution readers not to place undue reliance on any forward-looking statements, which speak only as of the date

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made. We may make other written or oral forward-looking statements from time to time. Readers are advised that various important factors could cause our actual results or circumstances for future periods to differ materially from those anticipated or projected in such forward-looking statements. Such factors include, but are not limited to, changes in law, regulations or U. S. generally accepted accounting principles; our competitive position within the markets we serve; increasing consolidation within the banking industry; unforeseen changes in interest rates; unforeseen changes in loan prepayment assumptions; unforeseen downturns in or major events affecting the local, regional or national economies or the industries in which we have credit concentrations; and other matters discussed in our filings with the SEC, including our Annual Report on Form 10-K for 2008, which filings are available from the SEC. We undertake no obligation to publicly update or revise any forward-looking statements.

The following management's discussion and analysis is presented to provide information concerning our financial condition as of June 30, 2009, as compared to December 31, 2008, and the results of operations for the three and six months ended June 30, 2009 and 2008. This discussion and analysis should be read in conjunction with our consolidated financial statements and the financial and statistical data appearing elsewhere in this report and our 2008 Annual Report.

FINANCIAL CONDITION

Our total assets at June 30, 2009, were \$4.54 billion, an increase of \$80.20 million or 1.80% from December 31, 2008. Total loans and leases were \$3.15 billion, a decrease of \$143.80 million or 4.36% from December 31, 2008. Mortgages held for sale were \$136.51 million, an increase of \$89.82 million or 192.39% from December 31, 2008. Total investment securities, available for sale were \$883.05 million which represented an increase of \$158.29 million or 21.84% and total deposits were \$3.62 billion, an increase of \$100.50 million or 2.86% over the comparable figures at the end of 2008.

Nonperforming assets at June 30, 2009, were \$80.72 million, which was an increase of \$36.55 million or 82.75% from the \$44.17 million reported at December 31, 2008. At June 30, 2009, nonperforming assets were 2.48% of net loans and leases compared to 1.30% at December 31, 2008.

Accrued income and other assets were as follows:

(Dollars in Thousands)

| | June 30, 2009 | December 31, 2008 |
|--|------------------|-------------------------|
| Accrued income and other assets: | | |
| Bank owned life insurance cash surrender value | \$ 39,446 | \$ 38,837 |
| Accrued interest receivable | 16,999 | 17,910 |
| Mortgage servicing assets | 8,769 | 4,635 |
| Other real estate | 1,790 | 1,381 |
| Former bank premises held for sale | 3,095 | 3,356 |
| Repossessions | 6,960 | 1,669 |
| All other assets | 40,467 | 45,832 |
| Total accrued income and other assets | \$ 117,526 | \$ 113,620 |

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CAPITAL

As of June 30, 2009, total shareholders' equity was \$568.89 million, up \$115.23 million or 25.40% from the \$453.66 million at December 31, 2008. In addition to net income of \$12.53 million, other significant changes in shareholders' equity during the first six months of 2009 included \$111.00 million from the issuance of preferred stock and common stock warrants to the Treasury as part of the Treasury's Capital Purchase Program and \$9.21 million of dividends paid and/or accrued. The accumulated other comprehensive income/(loss) component of shareholders' equity totaled \$5.29 million at June 30, 2009, compared to \$5.82 million at December 31, 2008. The decline in accumulated other comprehensive income/(loss) during 2009 was primarily a result of changes in unrealized gain/(loss) on securities in the available-for-sale portfolio. Our equity-to-assets ratio was 12.52% as of June 30, 2009, compared to 10.16% at December 31, 2008. Book value per common share rose to \$19.21 at June 30, 2009, up from \$18.82 at December 31, 2008.

We declared and paid dividends per common share of \$0.14 during the second quarter of 2009. The trailing four quarters dividend payout ratio, representing dividends per common share divided by diluted earnings per common share, was 53.70%. The dividend payout is continually reviewed by management and the Board of Directors.

The banking regulators have established guidelines for leverage capital requirements, expressed in terms of Tier 1 or core capital as a percentage of average assets, to measure the soundness of a financial institution. In addition, banking regulators have established risk-based capital guidelines for U.S. banking organizations. The actual capital amounts and ratios of 1st Source Corporation and 1st Source Bank as of June 30, 2009, are presented in the table below:

| (Dollars in thousands) | Actual | | Minimum Capital Adequacy | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|--|------------|--------|--------------------------|-------|--|--------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| Total Capital (To Risk-Weighted Assets): | | | | | | |
| 1st Source Corporation | \$ 605,436 | 16.90% | \$ 286,615 | 8.00% | \$ 358,268 | 10.00% |
| 1st Source Bank | 569,867 | 15.95 | 285,745 | 8.00 | 357,181 | 10.00 |
| Tier 1 Capital (to Risk-Weighted Assets): | | | | | | |
| 1st Source Corporation | 559,456 | 15.62 | 143,307 | 4.00 | 214,961 | 6.00 |
| 1st Source Bank | 524,698 | 14.69 | 142,872 | 4.00 | 214,309 | 6.00 |
| Tier 1 Capital (to Average Assets): | | | | | | |
| 1st Source Corporation | 559,456 | 12.60 | 177,600 | 4.00 | 220,000 | 5.00 |
| 1st Source Bank | 524,698 | 11.88 | 176,678 | 4.00 | 220,848 | 5.00 |

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LIQUIDITY AND INTEREST RATE SENSITIVITY

Effective liquidity management ensures that the cash flow requirements of depositors and borrowers, as well as the operating cash needs of 1st Source Corporation, are met. Funds are available from a number of sources, including the securities portfolio, the core deposit base, Federal Home Loan Bank borrowings, Federal Reserve Bank borrowings, and the capability to package loans for sale. Our loan to asset ratio was 69.41% at June 30, 2009 compared to 73.88% at December 31, 2008 and 74.00% at June 30, 2008. Cash and cash equivalents totaled \$70.80 million at June 30, 2009 compared to \$119.77 million at December 31, 2008 and \$126.21 million at June 30, 2008. At June 30, 2009, the consolidated statement of financial condition was rate sensitive by \$75.39 million more assets than liabilities scheduled to reprice within one year, or approximately 1.03%. Management believes that the present funding sources provide adequate liquidity to meet our cash flow needs.

RESULTS OF OPERATIONS

Net income for the three and six month periods ended June 30, 2009, was \$6.28 million and \$12.53 million respectively, compared to \$7.25 million and \$16.60 million for the same periods in 2008. Diluted net income per common share was \$0.19 and \$0.39 respectively, for the three and six month periods ended June 30, 2009, compared to \$0.30 and \$0.68 for the same periods in 2008. Return on average common shareholders' equity was 4.12% for the six months ended June 30, 2009, compared to 7.54% in 2008. The return on total average assets was 0.56% for the six months ended June 30, 2009, compared to 0.76% in 2008.

The decrease in net income for the six months ended June 30, 2009, over the first six months of 2008, was primarily the result of an increase in provision for loan and leases losses. This negative impact to net income was partially offset by a decrease in income taxes. Details of the changes in the various components of net income are discussed further below.

NET INTEREST INCOME

The taxable equivalent net interest income for the three months ended June 30, 2009, was \$32.84 million, a decrease of 3.51% over the same period in 2008. The net interest margin on a fully taxable equivalent basis was 3.11% for the three months ended June 30, 2009, compared to 3.38% for the three months ended June 30, 2008. The taxable equivalent net interest income for the six months ended June 30, 2009 was \$64.48 million, a decrease of 4.12% over 2008, resulting in a net yield of 3.07%, compared to a net yield of 3.35% for the same period in 2008.

During the three and six month periods ended June 30, 2009, average earning assets increased \$176.36 million or 4.35% and \$197.71 million or 4.90%, respectively, over the comparable periods in 2008. Average interest-bearing liabilities decreased \$24.18 million or 0.69% and increased \$5.01 million or 0.14% respectively, for the three and six month periods ended June 30, 2009, over the comparable periods one year ago. The yield on average earning assets decreased 101 basis points to 4.89% for the second quarter of 2009 from 5.90% for the second quarter of 2008. The yield on average earning assets for the six month period ended June 30, 2009 decreased 119 basis points to 4.92% from 6.11% for the six month period ended June 30, 2008. The rate earned on assets decreased due to the reduction in short-term market interest rates from a year ago. Total cost of average interest-bearing liabilities decreased 77 basis points to 2.17% for the second quarter 2009 from 2.94% for the second quarter 2008. Total cost of average interest-bearing liabilities decreased 95 basis points to 2.24% for the six months ended June 30, 2009, from 3.19% for the six months ended June 30, 2008. The cost of interest-bearing liabilities was also affected by short-term market interest rate decreases. The result to the net interest margin, or the difference between interest income on earning assets and interest expense on

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interest-bearing liabilities, was a decrease of 27 basis points and 28 basis points respectively, for the three and six month periods ended June 30, 2009 from June 30, 2008.

The largest contributor to the decrease in the yield on average earning assets for the three and six months ended June 30, 2009, compared to the three and six months ended June 30, 2008, was a decline in the yield on net loans and leases of 74 basis points and 97 basis points respectively. Total average investment securities increased 16.41% and 9.00% respectively, for the three and six month periods over one year ago. Average mortgages held for sale increased 232.96% and 187.46% for the three and six month periods ended June 30, 2009, over comparable periods a year ago primarily due to an increase in refinance activity. Average other investments, which include federal funds sold, time deposits with other banks, Federal Reserve Bank and Federal Home Loan Bank stock and commercial paper, increased 128.83% for the three month period ended June 30, 2009, from the same period a year ago and 194.14% for the six month period ended June 30, 2009, over one year ago as excess funds were invested.

Average interest-bearing deposits increased \$162.70 million or 5.41% and \$168.06 million or 5.59% respectively, for the second quarter of 2009 and first six months of 2009, over the same periods in 2008. The effective rate paid on average interest-bearing deposits decreased 80 basis points to 2.10% for the second quarter 2009 compared to 2.90% for the second quarter 2008. The effective rate paid on average interest-bearing deposits decreased 96 basis points to 2.17% for the first six months of 2009 compared to 3.13% for the first six months of 2008. The decline in the average cost of interest-bearing deposits during the second quarter and first six months of 2009 as compared to the second quarter and first six months of 2008 was primarily the result of decreases in interest rates offered on deposit products due to decreases in market interest rates.

Average short-term borrowings decreased \$171.90 million or 48.45% and \$146.92 million or 42.32% respectively, for the second quarter of 2009 and the first six months of 2009, compared to the same periods in 2008. The decrease in average short-term borrowings was primarily due to lower repurchase agreements and lower Federal Home Loan Bank borrowings. Interest paid on short-term borrowings decreased 139 basis points for the second quarter of 2009 and 177 basis points for the first six months of 2009 due to the interest rate decrease on adjustable rate borrowings. Average subordinated notes decreased \$2.55 million for the first six months of 2009, compared to the same period in 2008. Average long-term debt decreased \$14.89 million or 42.55% during the second quarter of 2009 as compared to the second quarter of 2008 and decreased \$13.59 million or 39.33% during the first six months of 2009 as compared to the first six months of 2008. The majority of the decrease in long-term debt consisted of Federal Home Loan Bank borrowings.

Average demand deposits increased \$38.64 million and \$37.29 million respectively, during the second quarter and first six months of 2009, compared to the same periods one year ago.

The following table provides an analysis of net interest income and illustrates the interest earned and interest expense charged for each major component of interest-earning assets and interest-bearing liabilities. Yields/rates are computed on a tax-equivalent basis, using a 35% rate. Nonaccrual loans and leases are included in the average loan and lease balance outstanding.

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DISTRIBUTION OF ASSETS, LIABILITIES AND
 SHAREHOLDERS' EQUITY
 INTEREST RATES AND INTEREST DIFFERENTIAL
 (Dollars in thousands)

| | Three months ended June 30, | | | | | | Six months ended June 30, | | | |
|--|-----------------------------|--------------------------------|----------------|---------------------|--------------------------------|----------------|---------------------------|--------------------------------|----------------|---------------------|
| | 2009 | | | 2008 | | | 2009 | | | |
| | Average Balance | Interest Income/ Expense | Yield/ Rate | Average Balance | Interest Income/ Expense | Yield/ Rate | Average Balance | Interest Income/ Expense | Yield/ Rate | Average Balance |
| ASSETS: | | | | | | | | | | |
| Investment securities: | | | | | | | | | | |
| Taxable | \$ 641,698 | \$ 4,207 | 2.63% | \$ 505,109 | \$ 5,945 | 4.73% | \$ 605,601 | \$ 8,243 | 2.74% | \$ 516,000 |
| Tax exempt | 208,408 | 2,441 | 4.70% | 225,172 | 2,688 | 4.80% | 208,846 | 4,902 | 4.73% | 230,000 |
| Mortgages - held for sale | 121,405 | 1,539 | 5.08% | 36,462 | 537 | 5.92% | 98,920 | 2,526 | 5.15% | 34,000 |
| Net loans and leases | 3,179,034 | 43,107 | 5.44% | 3,253,147 | 49,959 | 6.18% | 3,211,858 | 86,886 | 5.46% | 3,215,000 |
| Other investments | 81,179 | 264 | 1.30% | 35,476 | 360 | 4.08% | 105,254 | 597 | 1.14% | 35,000 |
| Total Earning Assets | 4,231,724 | 51,558 | 4.89% | 4,055,366 | 59,489 | 5.90% | 4,230,479 | 103,154 | 4.92% | 4,032,000 |
| Cash and due from banks | 55,921 | | | 88,565 | | | 59,711 | | | 92,000 |
| Reserve for loan and lease losses | (86,529) | | | (68,407) | | | (84,168) | | | (67,000) |
| Other assets | 324,641 | | | 314,399 | | | 324,991 | | | 318,000 |
| Total | \$ 4,525,757 | | | \$ 4,389,923 | | | \$ 4,531,013 | | | \$ 4,375,000 |
| LIABILITIES AND SHAREHOLDERS' EQUITY: | | | | | | | | | | |
| Interest-bearing deposits | | | | | | | | | | |
| | \$ 3,168,917 | \$ 16,596 | 2.10% | \$ 3,006,221 | \$ 21,649 | 2.90% | \$ 3,174,874 | \$ 34,202 | 2.17% | \$ 3,006,000 |
| Short-term borrowings | | | | | | | | | | |
| | 182,982 | 295 | 0.65% | 354,971 | 1,798 | 2.04% | 200,208 | 644 | 0.65% | 347,000 |
| Subordinated notes | | | | | | | | | | |
| | 89,692 | 1,647 | 7.37% | 89,692 | 1,647 | 7.39% | 89,692 | 3,294 | 7.41% | 92,000 |
| Long-term debt and mandatorily redeemable securities | | | | | | | | | | |
| | 20,105 | 179 | 3.57% | 34,993 | 361 | 4.15% | 20,956 | 531 | 5.11% | 34,000 |
| Total Interest-Bearing Liabilities | 3,461,696 | 18,717 | 2.17% | 3,485,877 | 25,455 | 2.94% | 3,485,730 | 38,671 | 2.24% | 3,480,000 |

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| | | | | |
|------------------------------|--------------|--------------|--------------|----------|
| Noninterest-bearing deposits | 422,398 | 383,756 | 414,331 | 377 |
| Other liabilities | 69,833 | 74,781 | 73,205 | 75 |
| Shareholders' equity | 571,830 | 445,509 | 557,747 | 442 |
| Total | \$ 4,525,757 | \$ 4,389,923 | \$ 4,531,013 | \$ 4,375 |

| | | | |
|---------------------|-----------|-----------|-----------|
| Net Interest Income | \$ 32,841 | \$ 34,034 | \$ 64,482 |
|---------------------|-----------|-----------|-----------|

| | | | |
|---|-------|-------|-------|
| Net Yield on Earning Assets on a Taxable Equivalent Basis | 3.11% | 3.38% | 3.07% |
|---|-------|-------|-------|

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PROVISION AND RESERVE FOR LOAN AND LEASE LOSSES

The provision for loan and lease losses for the three and six month periods ended June 30, 2009, was \$8.49 million and \$16.27 million respectively, compared to a provision for loan and lease losses in the three and six month periods ended June 30, 2008, of \$4.49 million and \$6.03 million respectively. Net charge-offs of \$9.72 million were recorded for the second quarter 2009, compared to \$0.22 million for the same quarter a year ago. Year-to-date net charge-offs of \$12.92 million have been recorded in 2009, compared to \$0.94 million through June 2008.

On June 30, 2009, 30 day and over loan and lease delinquencies were 2.20% as compared to 0.37% on June 30, 2008. The change in delinquencies was primarily in aircraft loans, auto and light truck loans, commercial loans and construction equipment financing. The reserve for loan and lease losses as a percentage of loans and leases outstanding at the end of the period was 2.64% as compared to 2.16% one year ago and 2.42% at December 31, 2008. A summary of loan and lease loss experience during the three and six month periods ended June 30, 2009 and 2008 is provided below.

Summary of Reserve for Loan and Lease Losses
(Dollars in Thousands)

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|--------------|------------------|--------------|
| | June 30, 2009 | 2008 | June 30, 2009 | 2008 |
| Reserve for loan and lease losses - beginning balance | \$ 84,357 | \$ 67,428 | \$ 79,776 | \$ 66,602 |
| Charge-offs | (10,778) | (1,333) | (15,455) | (2,915) |
| Recoveries | 1,058 | 1,110 | 2,531 | 1,979 |
| Net (charge-offs)/recoveries | (9,720) | (223) | (12,924) | (936) |
| Provision for loan and lease losses | 8,487 | 4,493 | 16,272 | 6,032 |
| Reserve for loan and lease losses - ending balance | \$ 83,124 | \$ 71,698 | \$ 83,124 | \$ 71,698 |
| Loans and leases outstanding at end of period | \$ 3,154,416 | \$ 3,313,642 | \$ 3,154,416 | \$ 3,313,642 |
| Average loans and leases outstanding during period | 3,179,034 | 3,253,147 | 3,211,858 | 3,215,371 |
| Reserve for loan and lease losses as a percentage of loans and leases outstanding at end of period | 2.64% | 2.16% | 2.64% | 2.16% |
| Ratio of net charge-offs/(recoveries) during period to average loans and leases outstanding | 1.23% | 0.03% | 0.81% | 0.06% |

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NONPERFORMING ASSETS

Nonperforming assets were as follows:

(Dollars in thousands)

| | June 30, 2009 | December 31, 2008 | June 30, 2008 |
|--|------------------|----------------------|------------------|
| Loans and leases past due 90 days or more | \$ 621 | \$ 1,022 | \$ 929 |
| Nonaccrual and restructured loans and leases | 67,983 | 36,555 | 20,807 |
| Other real estate | 1,790 | 1,381 | 1,079 |
| Former bank premises held for sale | 3,095 | 3,356 | 4,181 |
| Repossessions | 6,960 | 1,669 | 1,091 |
| Equipment owned under operating leases | 269 | 185 | 57 |
| Total nonperforming assets | \$ 80,718 | \$ 44,168 | \$ 28,144 |

Nonperforming assets totaled \$80.72 million at June 30, 2009, an increase of 82.75% from the \$44.17 million reported at December 31, 2008, and a 186.80% increase from the \$28.14 million reported at June 30, 2008. The increase during the first six months of 2009 compared to the same period in 2008 and compared to December 31, 2008 was primarily related to nonaccrual and restructured loans and leases and repossessions. The increase in nonaccrual and restructured loans and leases was spread among the various loan portfolios. The increase in repossessions related to aircraft. Nonperforming assets as a percentage of total loans and leases were 2.48% at June 30, 2009, 1.30% at December 31, 2008, and 0.83% at June 30, 2008.

Repossessions consisted mainly of aircraft and construction equipment at June 30, 2009. At the time of repossession, the recorded amount of the loan or lease is written down, if necessary, to the estimated value of the equipment or vehicle by a charge to the reserve for loan and lease losses, unless the equipment is in the process of immediate sale. Any subsequent write-downs are included in noninterest expense.

Supplemental Loan and Lease Information as of June 30, 2009

| (Dollars in thousands) | Loans and leases outstanding | Nonaccrual and restructured loans | Other real estate owned and repossessions | Year-to-date net credit losses/ (recoveries) |
|---|------------------------------|-----------------------------------|---|--|
| Commercial and agricultural loans | \$ 593,914 | \$ 7,583 | \$ 47 | \$ 5,918 |
| Auto, light truck and environmental equipment | 338,774 | 6,502 | 303 | 1,350 |

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| | | | | |
|----------------------------------|---------------------|------------------|-----------------|------------------|
| Medium and heavy duty truck | 225,345 | 12,387 | 2 | 2,219 |
| Aircraft financing | 619,797 | 5,125 | 5,528 | 1,723 |
| Construction equipment financing | 345,928 | 2,895 | 1,066 | 535 |
| Loans secured by real estate | 910,728 | 33,327 | 1,790 | 536 |
| Consumer loans | 119,930 | 164 | 14 | 1,086 |
| Total | \$ 3,154,416 | \$ 67,983 | \$ 8,750 | \$ 13,367 |

For financial statement purposes, nonaccrual loans and leases are included in loan and lease outstandings, whereas repossessions and other real estate are included in other assets. Net credit losses include net charge-offs on loans and leases and valuation adjustments and gains and losses on disposition of repossessions and defaulted operating leases.

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NONINTEREST INCOME

Noninterest income for the three month period ended June 30, 2009 and 2008 was \$22.71 million and \$20.37 million, respectively. Noninterest income for the six month period ended June 30, 2009 and 2008 was \$43.25 million and \$41.39 million, respectively. Details of noninterest income follow:

| (Dollars in thousands) | Three Months Ended | | Six Months Ended | |
|---|--------------------|------------------|------------------|------------------|
| | June 30, | | June 30, | |
| | 2009 | 2008 | 2009 | 2008 |
| Noninterest income: | | | | |
| Trust fees | \$ 3,887 | \$ 4,954 | \$ 7,691 | \$ 9,216 |
| Service charges on deposit accounts | 5,219 | 5,764 | 9,965 | 10,872 |
| Mortgage banking income | 3,339 | 1,417 | 5,909 | 2,534 |
| Insurance commissions | 1,076 | 1,092 | 2,592 | 3,038 |
| Equipment rental income | 6,402 | 5,760 | 12,549 | 11,509 |
| Other income | 2,356 | 2,446 | 4,591 | 4,668 |
| Investment securities and other investment gains (losses) | 426 | (1,066) | (43) | (443) |
| Total noninterest income | \$ 22,705 | \$ 20,367 | \$ 43,254 | \$ 41,394 |

Noninterest income decreased in all categories for the second quarter and year-to-date 2009 as compared to the same periods in 2008 except mortgage banking income, equipment rental income and investment gains (losses). Trust fees decreased \$1.07 million, or 21.54%, during the second quarter of 2009 as compared to the second quarter of 2008, and \$1.53 million or 16.55% for the first six months of 2009 as compared to the first six months of 2008. This decrease was primarily due to a reduction in our investment advisory management fees received from the 1st Source Monogram Funds due to the sale of assets of 1st Source Investment Advisors related to the management of such funds in December 2008. The reduction in investment advisory management fees is partially offset by earnout fees on the sale which are reflected in other income. Service charges on deposit accounts decreased \$0.55 million or 9.46% and \$0.91 million or 8.34% during the first three and six months of 2009, respectively as compared to the same periods in 2008. The decline in service charges on deposit accounts reflects a lower volume of fee income on overdraft and nonsufficient fund transactions.

Mortgage banking income increased \$1.92 million, or 135.64%, in the second quarter of 2009 as compared to the second quarter of 2008. The second quarter increase was due to recoveries of mortgage servicing rights impairment charges and underwriting fees. Mortgage banking income increased \$3.38 million or 133.19% for the six months ended June 30, 2009 over the same period one year ago. This increase was due to recoveries of mortgage servicing rights impairment charges, gains on the sales of mortgage loans, and underwriting fees. Insurance commissions decreased \$0.45 million, or 14.68% during the first six months of 2009 as compared to the first six months of 2008, mainly due to lower premiums as a result of market conditions and a reduction in customer accounts. Equipment rental income generated from operating leases increased during the first three and six months of 2009 as compared to the first three and six months of 2008 due to an increase in the operating lease portfolio from one year ago.

Other income decreased slightly for the three and six month periods ended June 30, 2009 as compared to the same periods in 2008, mainly due to a reduction in fees generated from customer-related interest rate swaps and in credit card merchant fees which were offset by earnout fees on the sale of assets of 1st Source Investment Advisors related to the management of the 1st Source Monogram Funds in December 2008. The increase in investment securities and other investments (losses) gains was due to partnership gains and a reduction in other than temporary impairment of securities in the three and six months ended June 30, 2009 as compared to the same periods one year ago.

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NONINTEREST EXPENSE

Noninterest expense for the three month periods ended June 30, 2009 and 2008 was \$37.35 million and \$38.40 million, respectively. Noninterest expense for the six month periods ended June 30, 2009 and 2008 was \$75.99 million and \$76.30 million, respectively. Details of noninterest expense follow:

| (Dollars in thousands) | Three Months Ended | | Six Months Ended | |
|--|--------------------|------------------|------------------|------------------|
| | June 30, | | June 30, | |
| | 2009 | 2008 | 2009 | 2008 |
| Noninterest expense: | | | | |
| Salaries and employee benefits | \$ 16,829 | \$ 19,065 | \$ 36,915 | \$ 39,699 |
| Net occupancy expense | 2,273 | 2,481 | 4,874 | 4,957 |
| Furniture and equipment expense | 3,765 | 3,883 | 7,246 | 7,861 |
| Depreciation - leased equipment | 5,088 | 4,609 | 10,044 | 9,225 |
| Professional fees | 815 | 2,522 | 1,877 | 3,680 |
| Supplies and communication | 1,428 | 1,682 | 2,995 | 3,351 |
| Business development and marketing expense | 794 | 1,000 | 1,279 | 1,643 |
| Intangible asset amortization | 341 | 350 | 682 | 701 |
| Loan and lease collection and repossession expense | 1,070 | 269 | 1,629 | 802 |
| FDIC and other insurance | 3,719 | 334 | 5,269 | 683 |
| Other expense | 1,227 | 2,200 | 3,179 | 3,694 |
| Total noninterest expense | \$ 37,349 | \$ 38,395 | \$ 75,989 | \$ 76,296 |

During the second quarter of 2009, salaries and employee benefits decreased \$2.24 million or 11.73% compared to the second quarter of 2008. For the first six months of 2009, salaries and employee benefits decreased \$2.78 million or 7.01% compared to the first six months of 2008. This decrease was due to a reversal of post retirement benefit obligations and lower executive incentive provisions, offset by lower deferred salary expense. Leased equipment depreciation expense increased in conjunction with the increase in equipment rental income for the three and six months ended June 30, 2009 as compared to the same periods in 2008. Net occupancy, furniture and equipment, supplies and communication, business development and marketing, and intangible asset amortization all decreased slightly in 2009 over the same periods in 2008.

Professional fees decreased \$1.71 million or 67.68% and \$1.80 million or 48.99% for the three and six month periods ended June 30, 2009 as compared to the three and six month periods ended June 30, 2008, respectively. The decrease in professional fees in 2009 is the result of higher fees in 2008 due to a May 2008 systems security breach. Loan and lease collection and repossession expense increased for the second quarter and first six months of 2009 as compared to the same periods in 2008 due to increased collection and repossession activity.

Insurance expense increased \$3.39 million for the second quarter 2009 compared to the same period a year earlier, and \$4.59 million for the first six months of 2009 compared to the same period a year earlier due to higher Federal Deposit Insurance Corporation (FDIC) insurance premiums and a special FDIC insurance assessment of 5 basis points of assets minus tier 1 capital as of June 30, 2009. Other expense decreased \$0.97 million or 44.23% and \$0.52 million or 13.94% for the three and six months ended June 30, 2009 over the same periods one year ago.

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INCOME TAXES

The provision for income taxes for the three and six month periods ended June 30, 2009 was \$2.50 million and \$1.09 million respectively, compared to \$3.36 million and \$7.89 million for the same periods in 2008. The effective tax rates were 28.46% and 31.67% for the second quarters ended June 30, 2009 and 2008, respectively, and 8.02% and 32.21% for the six months ended June 30, 2009 and 2008, respectively. The provision for income taxes for the six months ended June 30, 2009 included a one time benefit of \$2.60 million which resulted in the lower effective tax rate for the six months ended June 30, 2009. This benefit was the result of a reduction in our tax contingency reserve due to the resolution of tax audits.

ITEM 3.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in market risks faced by 1st Source since December 31, 2008. For information regarding our market risk, refer to 1st Source's Annual Report on Form 10-K for the year ended December 31, 2008.

ITEM 4.

CONTROLS AND PROCEDURES

As of the end of the period covered by this report an evaluation was carried out, under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, at June 30, 2009, our disclosure controls and procedures were effective in ensuring that information required to be disclosed by 1st Source in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and are designed to ensure that information required to be disclosed in those reports is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure.

In addition, there were no changes in our internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) during the second fiscal quarter of 2009 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings.

1st Source and its subsidiaries are involved in various legal proceedings incidental to the conduct of our businesses. Management does not expect that the outcome of any such proceedings will have a material adverse effect on our consolidated financial position or results of operations.

ITEM 1A. Risk Factors.

There have been no material changes in risks faced by 1st Source since December 31, 2008. For information regarding our risk factors, refer to 1st Source's Annual Report on Form 10-K for the year ended December 31, 2008.

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ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

ISSUER PURCHASES OF EQUITY SECURITIES

| Period | Total number of shares purchased | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs (1) | Maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or programs |
|------------------------|--|------------------------------------|--|---|
| April 01 - 30, 2009 | - | - | - | 1,447,448 |
| May 01 - 31, 2009 | 13,483 | 17.14 | 13,483 | 1,433,965 |
| June 01 - 30, 2009 | - | - | - | 1,433,965 |

(1) 1st Source maintains a stock repurchase plan that was authorized by the Board of Directors on April 26, 2007. Under the terms of the plan, 1st Source may repurchase up to 2,000,000 shares of its common stock when favorable conditions exist on the open market or through private transactions at various prices from time to time. Since the inception of the plan, 1st Source has repurchased a total of 566,035 shares.

ITEM 3. Defaults Upon Senior Securities.

None

ITEM 4. Submission of Matters to a Vote of Security Holders.

The following actions were taken by the shareholders of 1st Source at the annual shareholders' meeting held April 23, 2009:

1. Election of Directors

The directors named below were elected to the board of directors, as follows:

Term Expiring in April 2011:

| Nominee | Votes For | Votes Withheld |
|-----------------|-----------|----------------|
| Terry L. Gerber | | 21,533,262 |
| | | 259,813 |

Terms Expiring in April 2012:

| Nominee | Votes For | Votes Withheld |
|--------------------|-----------|----------------|
| William P. Johnson | | 21,566,772 |
| Craig A. Kapson | | 21,604,349 |
| John T. Phair | | 21,648,908 |
| Mark D. Schwabero | | 21,437,502 |
| | | 226,303 |
| | | 188,726 |
| | | 144,167 |
| | | 355,573 |

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In addition, the following directors continued in office after the 2009 annual meeting:

Terms Expiring in April 2010:
2011:

Daniel B. Fitzpatrick
Wellington D. Jones III
Dane A. Miller

Timothy K. Ozark

Terms Expiring in April

Lawrence E. Hiler
Rex Martin
Christopher J. Murphy III

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2. Reapproval of 1998 Performance Compensation Plan Material Terms

1st Source has a 1998 Performance Compensation Plan (Plan) previously approved by the shareholders. The purpose of the Plan is to promote the interests of 1st Source and its shareholders through the attraction and retention of executive officers and other key employees (Employees), to motivate the Employees using performance-related incentives linked to performance goals, and to enable the Employees to share in the growth and success of 1st Source. The Plan was resubmitted to shareholders to help ensure deductibility of payments under the Plan for federal income tax purposes.

| Votes For | Votes Against | Votes Abstain | Broker Non-Vote |
|------------|---------------|---------------|-----------------|
| 21,185,366 | 496,990 | 110,713 | 0 |

3. Advisory Vote on Executive Compensation

The American Recovery and Reinvestment Act of 2009 (AARA), which was enacted on February 17, 2009, contains a requirement that financial institutions, like 1st Source, that issued preferred stock and warrants to the U.S. Treasury Department under the TARP Capital Purchase Program permit a separate, non-binding shareholder vote to approve the compensation of the financial institution's executive officers. The SEC has issued guidance that requires participants in the TARP Capital Purchase Program to submit to shareholders annually for their non-binding approval the executive compensation arrangements.

| Votes For | Votes Against | Votes Abstain | Broker Non-Vote |
|------------|---------------|---------------|-----------------|
| 19,182,551 | 529,967 | 83,857 | 1,996,700 |

ITEM 5. Other Information.

None

ITEM 6. Exhibits

The following exhibits are filed with this report:

- 31.1 Certification of Chief Executive Officer required by Rule 13a-14(a).
- 31.2 Certification of Chief Financial Officer required by Rule 13a-14(a).
- 32.1 Certification pursuant to 18 U.S.C. Section 1350 of Chief Executive Officer.
- 32.2 Certification pursuant to 18 U.S.C. Section 1350 of Chief Financial Officer.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

1st Source Corporation

DATE: July 30, 2009

Christopher J. Murphy III
Chairman of the Board, President and CEO

/s/CHRISTOPHER J. MURPHY III

DATE: July 30, 2009

Larry E. Lentych
Treasurer and Chief Financial Officer
Principal Accounting Officer

/s/LARRY E. LENTYCH

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