HORIZON BANCORP /IN/
Form 10-Q
August 08, 2012
Table of Contents

HORIZON BANCORP

FORM 10-Q

United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2012

Commission file number 0-10792

HORIZON BANCORP

(Exact name of registrant as specified in its charter)

Indiana	**35-1562417**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
515 Franklin Square, Michigan City, Indiana	**46360**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (219) 879-0211

Former name, former address and former fiscal year, if changed since last report: N/A

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 x No ¨

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). Yes x 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	x
Non-accelerated Filer	¨ Do not check if 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). Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 5,790,327 shares of Common Stock, no par value, at August 8, 2012.

Table of Contents

HORIZON BANCORP

FORM 10-Q

INDEX

Table of Contents

PART 1 FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

HORIZON BANCORP AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(Dollar Amounts in Thousands)

	June 30 2012 (Unaudited)	December 31 2011
Assets		
Cash and due from banks	**$ 23,743**	$ 20,447
Investment securities, available for sale	**435,615**	431,045
Investment securities, held to maturity	**6,100**	7,100
Loans held for sale	**9,300**	14,090
Loans, net of allowance for loan losses of $18,374 and $18,882	**978,765**	964,311
Premises and equipment	**35,980**	34,665
Federal Reserve and Federal Home Loan Bank stock	**12,390**	12,390
Goodwill	**5,910**	5,910
Other intangible assets	**2,072**	2,292
Interest receivable	**6,685**	6,671
Cash value life insurance	**30,649**	30,190
Other assets	**16,056**	18,051
Total assets	**$ 1,563,265**	$ 1,547,162
Liabilities		
Deposits		
Non-interest bearing	**$ 136,979**	$ 130,673
Interest bearing	**908,810**	879,192
Total deposits	**1,045,789**	1,009,865
Borrowings	**339,880**	370,111
Subordinated debentures	**30,722**	30,676
Interest payable	**911**	596
Other liabilities	**15,351**	14,449
Total liabilities	**1,432,653**	1,425,697
Commitments and contingent liabilities Stockholders Equity		
Preferred stock, $.01 par value, $1,000 liquidation value Authorized, 1,000,000 Series B shares Issued 12,500 and 12,500 shares	**12,500**	12,500
Common stock, $.3333 stated value Authorized, 22,500,000 shares Issued, 5,002,517 and 4,967,196 shares Outstanding, 4,957,347 and 4,947,696 shares	**1,135**	1,126
Additional paid-in capital	**10,853**	10,610
Retained earnings	**97,349**	89,387
Accumulated other comprehensive income	**8,775**	7,842
Total stockholders equity	**130,612**	121,465

Total liabilities and stockholders equity	**$ 1,563,265**	$ 1,547,162

See notes to condensed consolidated financial statements

3

Table of Contents

HORIZON BANCORP AND SUBSIDIARIES

Condensed Consolidated Statements of Income

(Dollar Amounts in Thousands, Except Per Share Data)

	Three Months Ended June 30 2012 (Unaudited)	Three Months Ended June 30 2011 (Unaudited)	Six Months Ended June 30 2012 (Unaudited)	Six Months Ended June 30 2011 (Unaudited)
Interest Income				
Loans receivable	**$ 13,327**	$ 11,891	**$ 26,859**	$ 23,779
Investment securities				
Taxable	**2,246**	2,786	**4,560**	5,286
Tax exempt	**950**	1,035	**1,930**	2,078
Total interest income	**16,523**	15,712	**33,349**	31,143
Interest Expense				
Deposits	**1,526**	2,195	**3,165**	4,532
Borrowed funds	**1,519**	1,600	**3,038**	3,177
Subordinated debentures	**472**	454	**942**	904
Total interest expense	**3,517**	4,249	**7,145**	8,613
Net Interest Income	**13,006**	11,463	**26,204**	22,530
Provision for loan losses	**209**	1,332	**768**	2,880
Net Interest Income after Provision for Loan Losses	**12,797**	10,131	**25,436**	19,650
Other Income				
Service charges on deposit accounts	**763**	825	**1,475**	1,620
Wire transfer fees	**213**	137	**395**	245
Interchange fees	**714**	639	**1,342**	1,184
Fiduciary activities	**982**	932	**1,957**	1,895
Gain on sale of securities		365		639
Gain on sale of mortgage loans	**3,411**	1,308	**5,685**	1,841
Mortgage servicing income net of impairment	**170**	99	**260**	863
Increase in cash value of bank owned life insurance	**235**	211	**460**	416
Other income	**67**	(68)	**123**	59
Total other income	**6,555**	4,448	**11,697**	8,762
Other Expenses				
Salaries and employee benefits	**6,539**	5,470	**12,502**	10,831
Net occupancy expenses	**976**	1,039	**2,030**	2,120
Data processing	**603**	494	**1,129**	901
Professional fees	**583**	331	**1,117**	680
Outside services and consultants	**526**	386	**997**	767
Loan expense	**866**	694	**1,568**	1,456
FDIC insurance expense	**250**	303	**507**	690
Other losses	**162**	246	**192**	277
Other expenses	**1,675**	1,524	**3,298**	3,023

Total other expenses	**12,180**	10,487	**23,340**	20,745
Income Before Income Tax	**7,172**	4,092	**13,793**	7,667
Income tax expense	**2,262**	999	**4,270**	1,809
Net Income	**4,910**	3,093	**9,523**	5,858
Preferred stock dividend and discount accretion	**(106)**	(277)	**(263)**	(553)
Net Income Available to Common Shareholders	**$ 4,804**	$ 2,816	**$ 9,260**	$ 5,305
Basic Earnings Per Share	**$ 0.97**	$ 0.57	**$ 1.87**	$ 1.08
Diluted Earnings Per Share	**0.93**	0.56	**1.81**	1.05

See notes to condensed consolidated financial statements

Table of Contents

HORIZON BANCORP AND SUBSIDIARIES

Condensed Consolidated Statements of Comprehensive Income

(Dollar Amounts in Thousands)

	Three Months Ended June 30		Six Months Ended June 30	
	2012 (Unaudited)	2011 (Unaudited)	2012 (Unaudited)	2011 (Unaudited)
Net Income	**$ 4,910**	$ 3,093	**$ 9,523**	$ 5,858
Other Comprehensive Income				
Change in fair value of derivative instruments, net of taxes of $(423) and $(226) for three and six months ended 2012 and $2,006 and $2,772, for three and six months ended 2011, respectively	**(785)**	3,725	**(419)**	5,148
Unrealized appreciation (depreciation) on available-for-sale securities, net of taxes of $424 and $728, for three and six months ended 2012 and $(201) and $53 for the three and six months ended 2011, respectively	**787**	(373)	**1,352**	98
Less: reclassification adjustment for realized gains included in net income, net of taxes of $0 for three and six months ended 2012, and $128 and $224, for three and six months ended 2011, respectively		237		415
	2	3,115	**933**	4,831
Comprehensive Income	**$ 4,912**	$ 6,208	**$ 10,456**	$ 10,689

See notes to condensed consolidated financial statements

5

Table of Contents

HORIZON BANCORP AND SUBSIDIARIES

Condensed Consolidated Statement of Stockholders Equity

(Unaudited)

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

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balances, January 1, 2012	**$ 12,500**	**$ 1,126**	**$ 10,610**	**$ 89,387**	**$ 7,842**	**$ 121,465**
Net income				9,523		9,523
Other comprehensive income, net of tax					933	933
Amortization of unearned compensation			69			69
Issuance of restricted shares		8	108			116
Exercise of stock options		1	49			50
Stock option expense			17			17
Cash dividends on preferred stock				(263)		(263)
Cash dividends on common stock ($.26 per share)				(1,298)		(1,298)
Balances, June 30, 2012	**$ 12,500**	**$ 1,135**	**$ 10,853**	**$ 97,349**	**$ 8,775**	**$ 130,612**

See notes to condensed consolidated financial statements

6

Table of Contents

HORIZON BANCORP AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(Dollar Amounts in Thousands)

	Six Months Ended June 30 2012 (Unaudited)	2011 (Unaudited)
Operating Activities		
Net income	**$ 9,523**	$ 5,858
Items not requiring (providing) cash		
Provision for loan losses	**768**	2,880
Depreciation and amortization	**1,298**	1,227
Share based compensation	**17**	20
Mortgage servicing rights impairment (recovery)	**(64)**	(728)
Premium amortization on securities available for sale, net	**1,410**	1,026
Gain on sale of investment securities		(639)
Gain on sale of mortgage loans	**(5,685)**	(1,841)
Proceeds from sales of loans	**184,317**	109,902
Loans originated for sale	**(178,632)**	(108,061)
Change in cash value of life insurance	**(459)**	(416)
(Gain) loss on sale of other real estate owned	**26**	86
Net change in		
Interest receivable	**(14)**	(259)
Interest payable	**315**	(76)
Other assets	**(464)**	1,977
Other liabilities	**260**	(812)
Net cash provided by operating activities	**12,616**	10,144
Investing Activities		
Purchases of securities available for sale	**(54,618)**	(108,989)
Proceeds from sales, maturities, calls, and principal repayments of securities available for sale	**50,718**	49,049
Purchase of securities held to maturity		(2,437)
Proceeds from maturities of securities held to maturity	**1,000**	1,400
Net change in loans	**(11,431)**	50,962
Proceeds on the sale of OREO and repossessed assets	**2,991**	1,069
Purchases of premises and equipment	**(2,324)**	(13)
Net cash used in by investing activities	**(13,664)**	(7,685)
Financing Activities		
Net change in		
Deposits	**35,924**	34,778
Borrowings	**(30,185)**	(30,554)
Proceeds from issuance of stock	**166**	55
Tax benefit from issuance of stock		8
Dividends paid on common shares	**(1,298)**	(1,128)
Dividends paid on preferred shares	**(263)**	(469)
Net cash provided by financing activities	**4,344**	2,690
Net Change in Cash and Cash Equivalent	**3,296**	5,149

Cash and Cash Equivalents, Beginning of Period	**20,447**	15,683
Cash and Cash Equivalents, End of Period	**$ 23,743**	$ 20,832
Additional Cash Flows Information		
Interest paid	**$ 6,829**	$ 8,689
Income taxes paid	**3,925**	100
Transfer of loans to other real estate owned	**1,224**	3,717

See notes to condensed consolidated financial statements

7

Table of Contents

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Note 1 Accounting Policies

The accompanying condensed consolidated financial statements include the accounts of Horizon Bancorp (Horizon or the Company) and its wholly-owned subsidiaries, including Horizon Bank, N.A. (Bank). All inter-company balances and transactions have been eliminated. The results of operations for the periods ended June 30, 2012 and June 30, 2011 are not necessarily indicative of the operating results for the full year of 2012 or 2011. The accompanying unaudited condensed consolidated financial statements reflect all adjustments that are, in the opinion of Horizon's management, necessary to fairly present the financial position, results of operations and cash flows of Horizon for the periods presented. Those adjustments consist only of normal recurring adjustments.

Certain information and note disclosures normally included in Horizon's annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in Horizon's Annual Report on Form 10-K for 2011 filed with the Securities and Exchange Commission on March 12, 2012. The consolidated condensed balance sheet of Horizon as of December 31, 2011 has been derived from the audited balance sheet of Horizon as of that date.

Basic earnings per share is computed by dividing net income available to common shareholders (net income less dividend requirements for preferred stock and accretion of preferred stock discount) by the weighted-average number of common shares outstanding. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. The following table shows computation of basic and diluted earnings per share.

	Three months ended December 31 June 30		Six months ended June 30	
	2012 (Unaudited)	**2011 (Unaudited)**	**2012 (Unaudited)**	**2011 (Unaudited)**
Basic earnings per share				
Net income	**$ 4,910**	$ 3,093	**$ 9,523**	$ 5,858
Less: Preferred stock dividends and accretion of discount	**106**	277	**263**	553
Net income available to common shareholders	**$ 4,804**	$ 2,816	**$ 9,260**	$ 5,305
Weighted average common shares outstanding[(1)]	**4,956,358**	4,937,750	**4,952,466**	4,930,887
Basic earnings per share	**$ 0.97**	$ 0.57	**$ 1.87**	$ 1.08
Diluted earnings per share				
Net income available to common shareholders	**$ 4,804**	$ 2,816	**$ 9,260**	$ 5,305
Weighted average common shares outstanding[(1)]	**4,956,358**	4,937,750	**4,952,466**	4,930,887
Effect of dilutive securities:				
Warrants	**159,008**	110,509	**136,513**	113,219
Restricted stock	**17,582**	7,139	**12,374**	14,709
Stock options	**19,398**	10,056	**14,829**	10,373
Weighted average shares outstanding	**5,152,346**	5,065,454	**5,116,182**	5,069,188
Diluted earnings per share	**$ 0.93**	$ 0.56	**$ 1.81**	$ 1.05

(1) Adjusted for 3:2 stock split on December 9, 2011

Table of Contents

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

At June 30, 2012 and 2011, there were 8,500 shares and 51,176 shares, respectively that were not included in the computation of diluted earnings per share because they were non-dilutive.

Horizon has share-based employee compensation plans, which are described in the notes to the financial statements included in the December 31, 2011 Annual Report on Form 10-K.

Reclassifications

Certain reclassifications have been made to the 2011 consolidated financial statements to be comparable to 2012. These reclassifications had no effect on net income.

Note 2 Securities

The fair value of securities is as follows:

June 30, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
U.S. Treasury and federal agencies	$ 16,889	$ 327	$	$ 17,216
State and municipal	131,305	9,990	(70)	141,225
Federal agency collateralized mortgage obligations	92,554	1,886	(82)	94,358
Federal agency mortgage-backed pools	172,991	6,913	(20)	179,884
Private labeled mortgage-backed pools	2,786	106		2,892
Corporate notes	32	8		40
Total available for sale investment securities	$ 416,557	$ 19,230	$ (172)	$ 435,615
Held to maturity, State and Municipal	$ 6,100	$	$	$ 6,100

December 31, 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
U.S. Treasury and federal agencies	$ 12,693	$ 329	$	$ 13,022
State and municipal	135,011	8,950	(71)	143,890
Federal agency collateralized mortgage obligations	89,016	2,106		91,122
Federal agency mortgage-backed pools	173,797	5,669	(115)	179,351
Private labeled mortgage-backed pools	3,518	118		3,636
Corporate notes	32		(8)	24

Total available for sale investment securities	$ 414,067	$ 17,172	$ (194)	$ 431,045
Held to maturity, State and Municipal	$ 7,100	$ 34	$	$ 7,134

Based on evaluation of available evidence, including recent changes in market interest rates, credit rating information, and information obtained from regulatory filings, management believes the declines in fair value for these securities are temporary. While these securities are held in the available for sale portfolio, Horizon intends, and has the ability, to hold them until the earlier of a recovery in fair value or maturity.

Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other-than-temporary impairment is identified. At June 30, 2012, no individual investment security had an unrealized loss that was determined to be other-than-temporary.

The unrealized losses on the Company s investments in securities of state and municipal governmental agencies, and federal agency mortgage-backed pools were caused by interest rate volatility and not a decline in credit quality. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. The Company expects to recover the amortized

Table of Contents

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

cost basis over the term of the securities. Because the Company does not intend to sell the investments and it is not likely that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be at maturity, the Company did not consider those investments to be other-than-temporarily impaired at June 30, 2012.

The amortized cost and fair value of securities available for sale and held to maturity at June 30, 2012 and December 31, 2011, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	June 30, 2012		December 31, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for sale				
Within one year	$ 1,141	$ 1,147	$ 931	$ 940
One to five years	28,475	29,658	30,796	31,910
Five to ten years	60,633	65,160	51,476	55,053
After ten years	57,977	62,516	64,533	69,033
	148,226	158,481	147,736	156,936
Federal agency collateralized mortgage obligations	92,554	94,358	89,016	91,122
Federal agency mortgage-backed pools	172,991	179,884	173,797	179,351
Private labeled mortgage-backed pools	2,786	2,892	3,518	3,636
Total available for sale investment securities	$ 416,557	$ 435,615	$ 414,067	$ 431,045
Held to maturity				
Within one year	$ 6,100	$ 6,100	$ 7,100	$ 7,134
One to five years				
Total held to maturity investment securities	$ 6,100	$ 6,100	$ 7,100	$ 7,134

The following table shows the gross unrealized losses and the fair value of the Company s investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position.

	Less than 12 Months		12 Months or More		Total	
June 30, 2012	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
State and municipal	$ 3,393	$ (70)	$	$	$ 3,393	$ (70)
Federal agency collateralized mortgage obligations	13,674	(82)			13,674	(82)
Federal agency mortgage-backed pools	3,176	(20)			3,176	(20)

Total temporarily impaired securities	$ 20,243	$ (172)	$	$	$ 20,243	$ (172)

	Less than 12 Months		12 Months or More		Total	
December 31, 2011	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
State and municipal	$ 1,550	$ (44)	$ 1,948	$ (27)	$ 3,498	$ (71)
Federal agency mortgage-backed pools	23,442	(115)	23		23,465	(115)
Corporate notes	24	(8)			24	(8)
Total temporarily impaired securities	$ 25,016	$ (167)	$ 1,971	$ (27)	$ 26,987	$ (194)

Table of Contents

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

	Three months ended June 30		Six months ended June 30	
	2012	2011	2012	2011
Sales of securities available for sale (Unaudited)				
Proceeds	$	$ 8,116	$	$ 17,390
Gross gains		365		639
Gross losses				

Note 3 Loans

	June 30 2012	December 31 2011
Commercial		
Working capital and equipment	**$ 166,300**	$ 170,325
Real estate, including agriculture	**180,371**	172,910
Tax exempt	**3,587**	3,818
Other	**6,291**	5,323
Total	**356,549**	352,376
Real estate		
1 4 family	**152,953**	153,039
Other	**3,722**	4,102
Total	**156,675**	157,141
Consumer		
Auto	**138,006**	134,686
Recreation	**4,766**	4,737
Real estate/home improvement	**28,580**	27,729
Home equity	**91,128**	92,249
Unsecured	**3,209**	3,183
Other	**2,748**	2,793
Total	**268,437**	265,377
Mortgage warehouse	**215,478**	208,299
Total	**215,478**	208,299
Total loans	**997,139**	983,193
Allowance for loan losses	**(18,374)**	(18,882)
Loans, net	**$ 978,765**	$ 964,311

Commercial

Commercial loans are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial real estate loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company s commercial real estate portfolio are diverse in terms of property type, which are monitored for concentrations of credit. Management monitors and evaluates commercial real estate loans based on collateral, cash flow and risk grade criteria. As a general rule, the Company avoids financing single purpose projects unless other underwriting factors are present to help mitigate risk. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans.

Real Estate and Consumer

With respect to residential loans that are secured by 1-4 family residences and are generally owner occupied, the Company generally establishes a maximum loan-to-value ratio and requires private mortgage insurance if that ratio is exceeded. Home equity loans are typically secured by a subordinate interest in 1-4 family residences, and consumer loans are secured by consumer assets such as automobiles or recreational vehicles. Some consumer loans are unsecured such as small installment loans and certain lines of credit. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Repayment can also be impacted by changes in property values on residential properties. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

Mortgage Warehousing

Horizon s mortgage warehouse lending has specific mortgage companies as customers of Horizon Bank. Individual mortgage loans originated by these mortgage companies are funded as a secured borrowing with pledge of collateral under Horizon s agreement with the mortgage company. Each individual mortgage is assigned to Horizon until the loan is sold to the secondary market by the mortgage company. In addition, Horizon takes possession of each original note and forwards such note to the end investor once the mortgage company has sold the loan. At the time a loan is transferred to the secondary market, the mortgage company repurchases the loan under its option within the agreement. Due to the repurchase feature contained in the agreement, the transaction does not qualify as a sale and therefore is accounted for as a secured borrowing with pledge of collateral pursuant to the agreement with the mortgage company. When the individual loan is sold to the end investor by the mortgage company, the proceeds from the sale of the loan are received by Horizon and used to pay off the loan balance with Horizon along with any accrued interest and any related fees. The remaining balance from the sale is forwarded to the mortgage company. These individual loans typically are sold by the mortgage company within 30 days and are seldom held more than 90 days. Interest income is accrued during this period and collected at the time each loan is sold. Fee income for each loan sold is collected when the loan is sold and no costs are deferred due to the term between each loan funding and related payoff, which is typically less than 30 days.

Based on the agreements with each mortgage company, at any time a mortgage company can repurchase from Horizon their outstanding loan balance on an individual mortgage and regain possession of the original note. Horizon also has the option to request that the mortgage company repurchase an individual mortgage. Should this occur, Horizon would return the original note and reassign the assignment of the mortgage to the mortgage company. Also, in the event that the end investor would not be able to honor the purchase commitment and the mortgage company would not be able to repurchase its loan on an individual mortgage, Horizon would be able to exercise its rights under the agreement.

Table of Contents

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

The following table shows the recorded investment of individual loan categories.

June 30, 2012	Loan Balance	Interest Due	Deferred Fees / (Costs)	Recorded Investment
Owner occupied real estate	$ 133,700	$ 412	$ 22	$ 134,134
Non owner occupied real estate	152,707	399	95	153,201
Residential spec homes	4,038	5		4,043
Development & spec land loans	7,064	20		7,084
Commercial and industrial	58,920	185	3	59,108
Total commercial	356,429	1,021	120	357,570
Residential mortgage	147,916	529	84	148,529
Residential construction	8,675	13		8,688
Mortgage warehouse	215,478	427		215,905
Total real estate	372,069	969	84	373,122
Direct installment	25,526	82	(368)	25,240
Direct installment purchased	587			587
Indirect installment	130,928	381	(201)	131,108
Home equity	112,726	541	(761)	112,506
Total consumer	269,767	1,004	(1,330)	269,441
Total loans	998,265	2,994	(1,126)	1,000,133
Allowance for loan losses	(18,374)			(18,374)
Net loans	$ 979,891	$ 2,994	$ (1,126)	$ 981,759

December 31, 2011	Loan Balance	Interest Due	Deferred Fees / (Costs)	Recorded Investment
Owner occupied real estate	$ 131,893	$ 383	$ 30	$ 132,306
Non owner occupied real estate	142,269	360	94	142,723
Residential spec homes	3,574	6		3,580
Development & spec land loans	8,739	16		8,755
Commercial and industrial	65,774	169	3	65,946
Total commercial	352,249	934	127	353,310
Residential mortgage	150,893	513	68	151,474
Residential construction	6,181	8		6,189
Mortgage warehouse	208,299	427		208,726
Total real estate	365,373	948	68	366,389

Direct installment	24,252	94	(360)	23,986
Direct installment purchased	981			981
Indirect installment	127,751	420	(56)	128,115
Home equity	113,561	559	(752)	113,368
Total consumer	266,545	1,073	(1,168)	266,450
Total loans	984,167	2,955	(973)	986,149
Allowance for loan losses	(18,882)			(18,882)
Net loans	$ 965,285	$ 2,955	$ (973)	$ 967,267

Table of Contents

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Note 4 Allowance for Loan Losses

The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company over the prior one to five years. Management believes the two-year historical loss experience methodology is appropriate in the current economic environment, as it captures loss rates that are comparable to the current period being analyzed. The actual allowance for loan loss activity is provided below.

	Three Months Ended		Six Months Ended	
	June 30 2012 (Unaudited)	June 30 2011 (Unaudited)	June 30 2012 (Unaudited)	June 30 2011 (Unaudited)
Balance at beginning of the period	$ 19,412	$ 19,090	$ 18,882	$ 19,064
Loans charged-off:				
Commercial				
Owner occupied real estate	3	113	3	124
Non owner occupied real estate	28	114	28	114
Residential development				
Development & Spec Land Loans				
Commercial and industrial	327	160	327	210
Total commercial	358	387	358	448
Real estate				
Residential mortgage	115	669	204	751
Residential construction				
Mortgage warehouse				
Total real estate	115	669	204	751
Consumer				
Direct Installment	58	217	171	402
Direct Installment Purchased				
Indirect Installment	271	331	609	786
Home Equity	754	552	887	1,529
Total consumer	1,083	1,100	1,667	2,717
Total loans charged-off	1,556	2,156	2,229	3,916
Recoveries of loans previously charged-off:				
Commercial				
Owner occupied real estate	52	18	352	18
Non owner occupied real estate			7	
Residential development				
Development & Spec Land Loans				
Commercial and industrial	28	3	53	5

Total commercial	80	21	412	23
Real estate				
Residential mortgage	2	10	32	10
Residential construction				
Mortgage warehouse				
Total real estate	2	10	32	10
Consumer				
Direct Installment	20	19	35	67
Direct Installment Purchased				
Indirect Installment	189	220	390	389
Home Equity	18	50	84	69
Total consumer	227	289	509	525
Total loan recoveries	309	320	953	558
Net loans charged-off	1,247	1,836	1,276	3,358
Provision charged to operating expense				
Commercial	(391)	(1,165)	(305)	(51)
Real estate	35	106	646	153
Consumer	565	2,391	427	2,778
Total provision charged to operating expense	209	1,332	768	2,880
Balance at the end of the period	$ 18,374	$ 18,586	$ 18,374	$ 18,586

Table of Contents

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Certain loans are individually evaluated for impairment, and the Company s general practice is to proactively charge down impaired loans to the fair value of the underlying collateral.

Consistent with regulatory guidance, charge-offs on all loan segments are taken when specific loans, or portions thereof, are considered uncollectible. The Company s policy is to promptly charge these loans off in the period the uncollectible loss is reasonably determined.

For all loan portfolio segments except 1-4 family residential properties and consumer, the Company promptly charges-off loans, or portions thereof, when available information confirms that specific loans are uncollectible based on information that includes, but is not limited to, (1) the deteriorating financial condition of the borrower, (2) declining collateral values, and/or (3) legal action, including bankruptcy, that impairs the borrower s ability to adequately meet its obligations. For impaired loans that are considered to be solely collateral dependent, a partial charge-off is recorded when a loss has been confirmed by an updated appraisal or other appropriate valuation of the collateral.

The Company charges-off 1-4 family residential and consumer loans, or portions thereof, when the Company reasonably determines the amount of the loss. The Company adheres to timeframes established by applicable regulatory guidance which provides for the charge-down or specific allocation of 1-4 family first and junior lien mortgages to the net realizable value less costs to sell when the value is known but no later than when a loan is 180 days past due. Pursuant to such guidelines, the Company also charges-off unsecured open-end loans when the loan is 90 days past due, and charges down to the net realizable value other secured loans when they are 90 days past due. Loans at these respective delinquency thresholds for which the Company can clearly document that the loan is both well-secured and in the process of collection, such that collection will occur regardless of delinquency status are not charged off.

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment analysis:

June 30, 2012	Commercial	Real Estate	Mortgage Warehousing	Consumer	Total
Allowance For Loan Losses					
Ending allowance balance attributable to loans:					
Individually evaluated for impairment	$ 2,463	$	$	$	$ 2,463
Collectively evaluated for impairment	5,303	2,946	1,695	5,967	15,911
Total ending allowance balance	$ 7,766	$ 2,946	$ 1,695	$ 5,967	$ 18,374
Loans:					
Individually evaluated for impairment	$ 8,796	$	$	$	$ 8,796
Collectively evaluated for impairment	348,774	157,217	215,905	269,441	991,337
Total ending loans balance	$ 357,570	$ 157,217	$ 215,905	$ 269,441	$ 1,000,133

December 31, 2011	Commercial	Real Estate	Mortgage Warehousing	Consumer	Total
Allowance For Loan Losses					
Ending allowance balance attributable to loans:					

Individually evaluated for impairment	$ 2,136	$	$	$	$ 2,136
Collectively evaluated for impairment	5,881	2,472	1,695	6,698	16,746
Total ending allowance balance	$ 8,017	$ 2,472	$ 1,695	$ 6,698	$ 18,882
Loans:					
Individually evaluated for impairment	$ 7,960	$	$	$	$ 7,960
Collectively evaluated for impairment	345,350	157,663	208,726	266,450	978,189
Total ending loans balance	$ 353,310	$ 157,663	$ 208,726	$ 266,450	$ 986,149

15

Table of Contents

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Note 5 Non-performing Loans and Impaired Loans

The following table presents the nonaccrual, loans past due over 90 days still on accrual, and troubled debt restructured (TDR s) by class of loans:

June 30, 2012	Nonaccrual	Loans Past Due Over 90 Days Still Accruing	Non Performing TDR s	Performing TDR s	Total Non-Performing Loans
Commercial					
Owner occupied real estate	$ 2,956	$	$	$	$ 2,956
Non owner occupied real estate	3,982		123		4,105
Residential development					
Development & Spec Land Loans	675				675
Commercial and industrial	194		867		1,061
Total commercial	7,807		990		8,797
Real estate					
Residential mortgage	4,624.00		1,720	1,958	8,302
Residential construction				292	292
Mortgage warehouse					
Total real estate	4,624		1,720	2,250	8,594
Consumer					
Direct Installment	103	7	24		134
Direct Installment Purchased					
Indirect Installment	772	6			778
Home Equity	1,619		52	842	2,513
Total Consumer	2,494	13	76	842	3,425
Total	$ 14,925	$ 13	$ 2,786	$ 3,092	$ 20,816

December 31, 2011	Nonaccrual	Loans Past Due Over 90 Days Still Accruing	Non Performing TDR s	Performing TDR s	Total Non-Performing Loans
Commercial					
Owner occupied real estate	$ 2,515	$	$	$	$ 2,515
Non owner occupied real estate	3,970		152		4,122
Residential development					

Development & Spec Land Loans	90				90
Commercial and industrial	330		901		1,231
Total commercial	6,905		1,053		7,958
Real estate					
Residential mortgage	4,550		1,120	2,389	8,059
Residential construction	144			293	437
Mortgage warehouse					
Total real estate	4,694		1,120	2,682	8,496
Consumer					
Direct Installment	256	1			257
Direct Installment Purchased		4			4
Indirect Installment	926	29			955
Home Equity	1,587	3	25	858	2,473
Total Consumer	2,769	37	25	858	3,689
Total	$ 14,368	$ 37	$ 2,198	$ 3,540	$ 20,143

From time to time, the Bank obtains information that may lead management to believe that the collection of payments may be doubtful on a particular loan. In recognition of this, it is management s policy to convert

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

the loan from an earning asset to a non-accruing loan. The entire balance of a loan is considered delinquent if the minimum payment contractually required to be made is not received by the specified due date. Further, it is management s policy to place a loan on a non-accrual status when the amount delinquent in excess of 90 days or the loan has had the accrual of interest discontinued by management. The officer responsible for the loan and the Chief Operating Officer or the senior collection officer must review all loans placed on non-accrual status. Subsequent payments on non-accrual loans are recorded as a reduction of principal, and interest income is recorded only after principal recovery is reasonably assured. Nonaccrual loans are returned to accrual status when, in the opinion of management, the financial position of the borrower indicates there is no longer any reasonable doubt as to the timely collection of interest or principal in accordance with the loan terms. The Company requires a period of satisfactory performance of not less than six months before returning a nonaccrual loan to accrual status.

A loan becomes impaired when, based on current information, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. When a loan is classified as impaired, the degree of impairment must be recognized by estimating future cash flows from the debtor. The present value of these cash flows is computed at a discount rate based on the interest rate contained in the loan agreement. However, if a particular loan has a determinable market value for its collateral, the creditor may use that value. Also, if the loan is secured and considered collateral dependent, the creditor may use the fair value of the collateral. Interest income on loans individually classified as impaired is recognized on a cash basis after all past due and current principal payments have been made.

Smaller-balance, homogeneous loans are evaluated for impairment in total. Such loans include residential first mortgage loans secured by 1 4 family residences, residential construction loans, automobile, home equity, second mortgage loans and mortgage warehouse loans. Commercial loans and mortgage loans secured by other properties are evaluated individually for impairment. When analysis of borrower operating results and financial condition indicate that underlying cash flows of a borrower s business are not adequate to meet its debt service requirements, the loan is evaluated for impairment. Often this is associated with a delay or shortfall in payments of 30 days or more. Loans are generally moved to non-accrual status when they are 90 days or more past due. These loans are often considered impaired. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

Loans for which it is probable that the Company will not collect all principal and interest due according to contractual terms, including TDR s, are measured for impairment. Allowable methods for determining the amount of impairment include estimating fair value using the fair value of the collateral for collateral-dependent loans.

The Company s TDR s are considered impaired loans and included in the allowance methodology using the guidance for impaired loans. At June 30, 2012, the type of concessions the Company has made on restructured loans has been temporary rate reductions and/or reductions in monthly payments. Any modification to a loan that is a concession and is not in the normal course of lending is considered a restructured loan. A restructured loan is returned to accruing status after six consecutive payments but is still reported as TDR unless the loan bears interest at a market rate. As of June 30, 2012, the Company had $5.9 million in TDR s and $3.1 million were performing according to the restructured terms. The financial statement impact of non-performing TDR s was not material for the three and six months ending June 30, 2012. There was $273,000 of specific reserves allocated to TDR s at June 30, 2012 based on the collateral deficiencies.

Table of Contents

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Loans classified as troubled debt restructuring during the six months ended June 30, 2012 and 2011, segregated by class, are shown in the table below.

	June 30, 2012		June 30, 2011	
	Number of Defaults	Unpaid Principal Balance	Number of Defaults	Unpaid Principal Balance
Commercial				
Owner occupied real estate		$		$
Non owner occupied real estate				
Residential development				
Development & Spec Land Loans				
Commercial and industrial				
Total commercial				
Real estate				
Residential mortgage	**1**	**332**	2	342
Residential construction				
Mortgage warehouse				
Total real estate	**1**	**332**	2	342
Consumer				
Direct Installment				
Direct Installment Purchased				
Indirect Installment				
Home Equity			1	9
Total Consumer			1	9
Total	**1**	**$ 332**	3	$ 351

Troubled debt restructured loans which had payment defaults during the six months ended June 30, 2012 and 2011, segregated by class, are shown in the table below. Default occurs when a loan is 90 days or more past due or has been transferred to nonaccrual.

	June 30, 2012		June 30, 2011	
	Number of Defaults	Unpaid Principal Balance	Number of Defaults	Unpaid Principal Balance
Commercial				
Owner occupied real estate		$		$
Non owner occupied real estate				

Residential development						
Development & Spec Land Loans						
Commercial and industrial						
Total commercial						
Real estate						
Residential mortgage	**2**		**410**	1		459
Residential construction				1		293
Mortgage warehouse						
Total real estate	**2**		**410**	2		752
Consumer						
Direct Installment						
Direct Installment Purchased						
Indirect Installment						
Home Equity						
Total Consumer						
Total	**2**	**$**	**410**	2	$	752

Table of Contents

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

The following table presents commercial loans individually evaluated for impairment by class of loan:

				Three Months Ending		Six Months Ending	
June 30, 2012	**Unpaid Principal Balance**	**Recorded Investment**	**Allowance For Loan Loss Allocated**	**Average Balance in Impaired Loans**	**Cash/Accrual Interest Income Recognized**	**Average Balance in Impaired Loans**	**Cash/Accrual Interest Income Recognized**
With no recorded allowance							
Commercial							
Owner occupied real estate	$ 1,350	$ 1,350	$	$ 1,403	$	$ 1,343	$ 2
Non owner occupied real estate	422	422		389	3	392	3
Residential development							
Development & Spec Land Loans	14	14		5	1	2	1
Commercial and industrial	257	257		365		312	5
Total commercial	2,043	2,043		2,162	3	2,049	11
With an allowance recorded							
Commercial							
Owner occupied real estate	1,606	1,606	475	1,161	17	1,127	18
Non owner occupied real estate	3,682	3,684	1,100	3,685		3,524	
Residential development							
Development & Spec Land Loans	661	661	615	676		455	6
Commercial and industrial	804	804	273	806		811	
Total commercial	6,753	6,755	2,463	6,328	17	5,917	24
Total	$ 8,796	$ 8,798	$ 2,463	$ 8,490	$ 20	$ 7,966	$ 35

				Three Months Ending		Six Months Ending	
June 30, 2011	**Unpaid Principal Balance**	**Recorded Investment**	**Allowance For Loan Loss Allocated**	**Average Balance in Impaired Loans**	**Cash/Accrual Interest Income Recognized**	**Average Balance in Impaired Loans**	**Cash/Accrual Interest Income Recognized**
With no recorded allowance							
Commercial							
Owner occupied real estate	$ 1,003	$ 1,006	$	$ 818	$ 1	$ 1,403	$ 1
Non owner occupied real estate	1,254	1,254		1,037	4	389	4
Residential development	16	16		16			
Development & Spec Land Loans	124	124		83		5	
Commercial and industrial	191	191		154		7,878	
Total commercial	2,588	2,591		2,107	5	9,675	5
With an allowance recorded							

Commercial							
Owner occupied real estate	1,538	1,537	585	1,141		1,161	18
Non owner occupied real estate	4,849	4,888	665	4,884		3,685	
Residential development							
Development & Spec Land Loans	250	250	125	250		676	6
Commercial and industrial	251	251	115	251	1	806	
Total commercial	6,888	6,926	1,490	6,526	1	6,328	24
Total	$ 9,476	$ 9,517	$ 1,490	$ 8,633	$ 6	$ 16,003	$ 29

Table of Contents

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

The following table presents the payment status by class of loan:

June 30, 2012	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial						
Owner occupied real estate	$ 72	$	$	$ 72	$ 133,628	$ 133,700
Non owner occupied real estate	34			34	152,673	152,707
Residential development					4,038	4,038
Development & Spec Land Loans					7,064	7,064
Commercial and industrial	294			294	58,626	58,920
Total commercial	400			400	356,029	356,429
Real estate						
Residential mortgage	1,092			1,092	146,824	147,916
Residential construction	292			292	8,383	8,675
Mortgage warehouse					215,478	215,478
Total real estate	1,384			1,384	370,685	372,069
Consumer						
Direct Installment	131	44	7	182	25,344	25,526
Direct Installment Purchased	8	2		10	577	587
Indirect Installment	1,113	90	6	1,209	129,719	130,928
Home Equity	576	25		601	112,125	112,726
Total consumer	1,828	161	13	2,002	267,765	269,767
Total	$ 3,612	$ 161	$ 13	$ 3,786	$ 994,479	$ 998,265

December 31, 2011	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial						
Owner occupied real estate	$ 89	$ 168	$	$ 257	$ 131,636	$ 131,893
Non owner occupied real estate	228			228	142,041	142,269
Residential development					3,574	3,574
Development & Spec Land Loans					8,739	8,739
Commercial and industrial	34	22		56	65,718	65,774
Total commercial	351	190		541	351,708	352,249
Real estate						
Residential mortgage	411			411	150,482	150,893

Residential construction					6,181	6,181
Mortgage warehouse					208,299	208,299
Total real estate	411			411	364,962	365,373
Consumer						
Direct Installment	164	22	1	187	24,065	24,252
Direct Installment Purchased	7	14	4	25	956	981
Indirect Installment	1,333	335	29	1,697	126,054	127,751
Home Equity	363	92	3	458	113,103	113,561
Total consumer	1,867	463	37	2,367	264,178	266,545
Total	$ 2,629	$ 653	$ 37	$ 3,319	$ 980,848	$ 984,167

The entire balance of a loan is considered delinquent if the minimum payment contractually required to be made is not received by the specified due date.

Horizon Bank s processes for determining credit quality differ slightly depending on whether a new loan or a renewed loan is being underwritten, or whether an existing loan is being re-evaluated for credit quality. The latter usually occurs upon receipt of current financial information or other pertinent data that would trigger a change in the loan grade.

For new and renewed commercial loans, the Bank s Credit Department, which acts independently of the loan officer, assigns the credit quality grade to the loan. Loan grades for loans with an aggregate credit exposure of $500,000 or greater are validated by the Loan Committee, which is chaired by the Chief Operating Officer (COO).

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Commercial loan officers are responsible for reviewing their loan portfolios and report any adverse material change to the COO or Loan Committee. When circumstances warrant a change in the credit quality grade, loan officers are required to notify the COO; and the Credit Department of the change in the loan grade. Downgrades are accepted immediately by the COO however, lenders must present their factual information to either the Loan Committee or the COO when recommending an upgrade.

The COO meets weekly with loan officers to discuss the status of past-due loans and classified loans. These meetings are also designed to give the loan officers an opportunity to identify an existing loan that should be downgraded to a classified grade.

Monthly, senior management meets with the Watch Committee, which reviews all of the past due, classified, and impaired loans and the relative trends of these assets. This committee also reviews the actions taken by management regarding foreclosure mitigation, loan extensions, troubled debt restructures, and collateral repossessions. The information reviewed in this meeting acts as a precursor for developing management s analysis of the adequacy of the Allowance for Loan and Lease Losses.

For real estate and consumer loans, Horizon uses a grading system based on delinquency. Loans that are 90 days or more past due, on non-accrual, or are classified as a troubled debt restructure are graded Substandard. After being 90 days delinquent a loan is charged off unless it is well secured and in the process of collection. If the latter case exists, the loan is placed on non-accrual. Occasionally a mortgage loan may be graded as Special Mention. When this situation arises, it is because the characteristics of the loan and the borrower fit the definition of a Risk Grade 5 described below, which is normally used for grading commercial loans. Loans not graded Substandard are considered Pass.

Horizon Bank employs an eight-grade rating system to determine the credit quality of commercial loans. The first four grades represent acceptable quality, and the last four grades mirror the criticized and classified grades used by the bank regulatory agencies (special mention, substandard, doubtful, and loss). The loan grade definitions are detailed below.

Risk Grade 1: Excellent (Pass)

Loans secured by liquid collateral, such as certificates of deposit, reputable bank letters of credit, or other cash equivalents; loans that are guaranteed or otherwise backed by the full faith and credit of the United States government or an agency thereof, such as the Small Business Administration; or loans to any publicly held company with a current long-term debt rating of A or better.

Risk Grade 2: Good (Pass)

Loans to businesses that have strong financial statements containing an unqualified opinion from a CPA firm and at least three consecutive years of profits; loans supported by unaudited financial statements containing strong balance sheets, five consecutive years of profits, a five-year satisfactory relationship with the Bank, and key balance sheet and income statement trends that are either stable or positive; loans secured by publicly traded marketable securities where there is no impediment to liquidation; loans to individuals backed by liquid personal assets and unblemished credit history; or loans to publicly held companies with current long-term debt ratings of Baa or better.

Table of Contents

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Risk Grade 3: Satisfactory (Pass)

Loans supported by financial statements (audited or unaudited) that indicate average or slightly below average risk and having some deficiency or vulnerability to changing economic conditions; loans with some weakness but offsetting features of other support are readily available; loans that are meeting the terms of repayment, but which may be susceptible to deterioration if adverse factors are encountered. Loans may be graded Satisfactory when there is no recent information on which to base a current risk evaluation and the following conditions apply:

At inception, the loan was properly underwritten, did not possess an unwarranted level of credit risk, and the loan met the above criteria for a risk grade of Excellent, Good, or Satisfactory;

At inception, the loan was secured with collateral possessing a loan value adequate to protect the Bank from loss.

The loan has exhibited two or more years of satisfactory repayment with a reasonable reduction of the principal balance.

During the period that the loan has been outstanding, there has been no evidence of any credit weakness. Some examples of weakness include slow payment, lack of cooperation by the borrower, breach of loan covenants, or the borrower is in an industry known to be experiencing problems. If any of these credit weaknesses is observed, a lower risk grade may be warranted.

Risk Grade 4: Satisfactory/Monitored (Pass)

Loans in this category are considered to be of acceptable credit quality, but contain greater credit risk than Satisfactory loans due to weak balance sheets, marginal earnings or cash flow, lack of financial information, weakening markets, insufficient or questionable collateral coverage or other uncertainties. These loans warrant a higher than average level of monitoring to ensure that weaknesses do not advance. The level of risk in a Satisfactory/Monitored loan is within acceptable underwriting guidelines so long as the loan is given the proper level of management supervision. Loans that normally fall into this grade include construction of commercial real estate buildings, land development and subdivisions, and rental properties that have not attained stabilization.

Risk Grade 5: Special Mention

Loans which possess some credit deficiency or potential weakness which deserves close attention. Such loans pose an unwarranted financial risk that, if not corrected, could weaken the loan by adversely impacting the future repayment ability of the borrower. The key distinctions of a Special Mention classification are that (1) it is indicative of an unwarranted level of risk and (2) weaknesses are considered potential, not defined, impairments to the primary source of repayment. These loans may be to borrowers with adverse trends in financial performance, collateral value and/or marketability, or balance sheet strength.

Risk Grade 6: Substandard

One or more of the following characteristics may be exhibited in loans classified Substandard:

Loans which possess a defined credit weakness. The likelihood that a loan will be paid from the primary source of repayment is uncertain. Financial deterioration is under way and very close attention is warranted to ensure that the loan is collected without loss.

Loans are inadequately protected by the current net worth and paying capacity of the obligor.

The primary source of repayment is gone, and the Bank is forced to rely on a secondary source of repayment, such as collateral liquidation or guarantees.

Loans have a distinct possibility that the Bank will sustain some loss if deficiencies are not corrected.

Unusual courses of action are needed to maintain a high probability of repayment.

The borrower is not generating enough cash flow to repay loan principal; however, it continues to make interest payments.

The lender is forced into a subordinated or unsecured position due to flaws in documentation.

Loans have been restructured so that payment schedules, terms, and collateral represent concessions to the borrower when compared to the normal loan terms.

Table of Contents

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

- The lender is seriously contemplating foreclosure or legal action due to the apparent deterioration in the loan.
- There is a significant deterioration in market conditions to which the borrower is highly vulnerable.

Risk Grade 7: Doubtful

One or more of the following characteristics may be present in loans classified Doubtful:

- Loans have all of the weaknesses of those classified as Substandard. However, based on existing conditions, these weaknesses make full collection of principal highly improbable.
- The primary source of repayment is gone, and there is considerable doubt as to the quality of the secondary source of repayment.
- The possibility of loss is high but because of certain important pending factors which may strengthen the loan, loss classification is deferred until the exact status of repayment is known.

Risk Grade 8: Loss

Loans are considered uncollectible and of such little value that continuing to carry them as assets is not feasible. Loans will be classified Loss when it is neither practical nor desirable to defer writing off or reserving all or a portion of a basically worthless asset, even though partial recovery may be possible at some time in the future.

Table of Contents

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

June 30, 2012	Pass	Special Mention	Substandard	Doubtful	Total
Commercial					
Owner occupied real estate	$ 118,396	$ 4,633	$ 10,671	$	$ 133,700
Non owner occupied real estate	130,034	15,443	7,230		152,707
Residential development	2,364	341	1,333		4,038
Development & Spec Land Loans	4,096	415	2,553		7,064
Commercial and industrial	55,924	1,166	1,830		58,920
Total commercial	310,814	21,998	23,617		356,429
Real estate					
Residential mortgage	139,614		8,302		147,916
Residential construction	8,383		292		8,675
Mortgage warehouse	215,478				215,478
Total real estate	363,475		8,594		372,069
Consumer					
Direct Installment	25,392		134		25,526
Direct Installment Purchased	587				587
Indirect Installment	130,150		778		130,928
Home Equity	110,213		2,513		112,726
Total Consumer	266,342		3,425		269,767
Total	$ 940,630	$ 21,998	$ 35,636	$	$ 998,265

December 31, 2011	Pass	Special Mention	Substandard	Doubtful	Total
Commercial					
Owner occupied real estate	$ 107,155	$ 4,101	$ 20,637	$	$ 131,893
Non owner occupied real estate	118,446	11,423	12,400		142,269
Residential development	1,677	529	1,368		3,574
Development & Spec Land Loans	3,778	860	4,101		8,739
Commercial and industrial	55,964	3,012	6,798		65,774
Total commercial	287,020	19,925	45,304		352,249
Real estate					
Residential mortgage	142,834		8,059		150,893
Residential construction	5,744		437		6,181
Mortgage warehouse	208,299				208,299
Total real estate	356,877		8,496		365,373
Consumer					
Direct Installment	23,995		257		24,252
Direct Installment Purchased	977		4		981

Indirect Installment	126,796		955		127,751
Home Equity	111,088		2,473		113,561
Total Consumer	262,856		3,689		266,545
Total	$ 906,753	$ 19,925	$ 57,489	$	$ 984,167

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Note 6 Derivative financial instruments

Cash Flow Hedges

As a strategy to maintain acceptable levels of exposure to the risk of changes in future cash flow due to interest rate fluctuations, the Company entered into interest rate swap agreements for a portion of its floating rate debt. The agreements provide for the Company to receive interest from the counterparty at three month LIBOR and to pay interest to the counterparty at a weighted average fixed rate of 5.63% on a notional amount of $30.5 million at June 30, 2012. Under these agreements, the Company pays or receives the net interest amount monthly, with the monthly settlements included in interest expense.

Management has designated the interest rate swap agreement as a cash flow hedging instrument. For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of the other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings. At June 30, 2012, the Company s cash flow hedge was effective and is not expected to have a significant impact the Company s net income over the next 12 months.

Fair Value Hedges

Fair value hedges are intended to reduce the interest rate risk associated with the underlying hedged item. The Company enters into fixed rate loan agreements as part of its lending activities. To mitigate the risk of changes in fair value based on fluctuations in interest rates, the Company has entered into interest rate swap agreements on individual loans, converting the fixed rate loans to a variable rate. For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative as well as the offsetting gain or loss on the hedged item attributable to the hedged risk are recognized in current earnings. At June 30, 2012, the Company s fair value hedges were effective and are not expected to have a significant impact on the Company s net income over the next 12 months.

The change in fair value of both the hedge instruments and the underlying loan agreements are recorded as gains or losses in interest income. The fair value hedges are considered to be highly effective, and any hedge ineffectiveness was deemed not material. The notional amounts of the loan agreements being hedged were $63.5 million at June 30, 2012.

Other Derivative Instruments

The Company enters into non-hedging derivatives in the form of mortgage loan forward sale commitments with investors and commitments to originate mortgage loans as part of its mortgage banking business. At June 30, 2012, the Company s fair value of these derivatives was recorded and over the next 12 months, this activity is not expected to have a significant impact on the Company s net income.

The change in fair value of both the forward sale commitments and commitments to originate mortgage loans were recorded and the net gains or losses included in the Company s gain on sale of loans.

Table of Contents

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

The following tables summarize the fair value of derivative financial instruments utilized by Horizon Bancorp:

	Asset Derivative June 30, 2012		Liability Derivatives June 30, 2012	
Derivatives designated as hedging instruments (Unaudited)	**Balance Sheet Location**	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Interest rate contracts	Loans	$ 594	Other liabilities	$ 2,411
Interest rate contracts	Other Assets	1,817	Other liabilities	5,559
Total derivatives designated as hedging instruments		2,411		7,970
Derivatives not designated as hedging instruments				
Mortgage loan contracts	Other assets	942	Other liabilities	
Total derivatives not designated as hedging instruments		942		
Total derivatives		$ 3,353		$ 7,970

	Asset Derivative December 31, 2011		Liability Derivatives December 31, 2011	
Derivatives designated as hedging instruments (Unaudited)	**Balance Sheet Location**	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Interest rate contracts	Loans	$ 754	Other liabilities	$ 2,187
Interest rate contracts	Other Assets	1,433	Other liabilities	4,914
Total derivatives designated as hedging instruments		2,187		7,101
Derivatives not designated as hedging instruments				
Mortgage loan contracts	Other assets	662	Other liabilities	
Total derivatives not designated as hedging instruments		662		
Total derivatives		$ 2,849		$ 7,101

The effect of the derivative instruments on the consolidated statement of income for the three and six-month periods ending is as follows:

	Amount of Loss Recognized in Other Comprehensive Income on Derivative (Effective Portion)		Amount of Loss Recognized in Other Comprehensive Income on Derivative (Effective Portion)	
	Three Months Ended June 30		Six Months Ended June 30	
Derivative in cash flow hedging relationship	2012 (Unaudited)	2011 (Unaudited)	2012 (Unaudited)	2011 (Unaudited)
Interest rate contracts	$ (785)	$ (611)	$ (418)	$ (318)

FASB Accounting Standards Codification (ASC) Topic 820-10-20 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. Topic 820-10-55 establishes a fair value hierarchy that emphasizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value.

Table of Contents

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Derivative in fair value hedging relationship	Location of gain (loss) recognized on derivative	Amount of Gain (Loss) Recognized on Derivative Three Months Ended June 30 2012 (Unaudited)	2011 (Unaudited)	Amount of Gain (Loss) Recognized on Derivative Six Months Ended June 30 2012 (Unaudited)	2011 (Unaudited)
Interest rate contracts	Interest income -loans	$ 298	$ 351	$ 224	$ (59)
Interest rate contracts	Interest income -loans	(298)	(351)	(224)	59
Total		$	$	$	$

Derivative not designated as hedging relationship	Location of gain (loss) recognized on derivative	Amount of Gain (Loss) Recognized on Derivative Three Months Ended June 30 2012 (Unaudited)	2011 (Unaudited)	Amount of Gain (Loss) Recognized on Derivative Six Months Ended June 30 2012 (Unaudited)	2011 (Unaudited)
Mortgage contracts	Other income -gain on sale of loans	$ 503	$ 165	$ 280	$ 799

Note 7 Disclosures about fair value of assets and liabilities

The Fair Value Measurements topic of the FASB ASC defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. There are three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying financial statements, as well as the general classification of such instruments pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the period ended June 30, 2012. For assets classified within Level 3 of the fair value hierarchy, the process used to develop the reported fair value is described below.

Available for sale securities

When quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities include U.S. Treasury and federal agency securities, state and municipal securities, federal agency mortgage obligations and mortgage-backed pools, private-label mortgage-backed pools and corporate notes. Level 2 securities are valued by a third party pricing service commonly used in the banking industry utilizing observable inputs. Observable inputs include dealer quotes, market spreads, cash flow analysis, the U.S. Treasury yield curve, trade execution data, market consensus prepayment spreads and available credit information and the bond s terms and conditions. The pricing provider utilizes evaluated pricing models that vary based on asset class. These models incorporate available market information including quoted prices of securities with similar characteristics and, because many fixed-income securities do not trade on a daily basis, apply available information through processes such as benchmark curves, benchmarking of like securities, sector grouping, and matrix pricing. In addition, model processes, such as an option adjusted spread model is used to develop prepayment and interest rate scenarios for securities with prepayment features.

Table of Contents

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Hedged loans

Certain fixed rate loans have been converted to variable rate loans by entering into interest rate swap agreements. The fair value of those fixed rate loans is based on discounting the estimated cash flows using interest rates determined by the respective interest rate swap agreement. Loans are classified within Level 2 of the valuation hierarchy based on the unobservable inputs used.

Interest rate swap agreements

The fair value of the Company s interest rate swap agreements is estimated by a third party using inputs that are primarily unobservable including a yield curve, adjusted for liquidity and credit risk, contracted terms and discounted cash flow analysis, therefore, are classified within Level 2 of the valuation hierarchy.

The following table presents the fair value measurements of assets and liabilities recognized in the accompanying financial statements measured at fair value on a recurring basis and the level within the FASB ASC fair value hierarchy in which the fair value measurements fall at the following:

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2012				
Available-for-sale securities				
U.S. Treasury and federal agencies	$ 17,216	$	$ 17,216	$
State and municipal	141,225		141,225	
Federal agency collateralized mortgage obligations	94,358		94,358	
Federal agency mortgage-backed pools	179,884		179,884	
Private labeled mortgage-backed pools	2,892		2,892	
Corporate notes	40		40	
Total available-for-sale securities	435,615		435,615	
Hedged loans	65,921		65,921	
Forward sale commitments	942		942	
Interest rate swap agreements	(7,969)		(7,969)	
Commitments to originate loans				
December 31, 2011				
Available-for-sale securities				
U.S. Treasury and federal agencies	$ 13,022	$	$ 13,022	$
State and municipal	143,890		143,890	
Federal agency collateralized mortgage obligations	91,122		91,122	
Federal agency mortgage-backed pools	179,351		179,351	
Private labeled mortgage-backed pools	3,636			