First Internet Bancorp
Form 10-Q
August 12, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period June 30, 2014
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 001-35750

First Internet Bancorp
(Exact Name of Registrant as Specified in Its Charter)

Indiana (State or Other Jurisdiction of Incorporation or Organization)	20-3489991 (I.R.S. Employer Identification No.)
8888 Keystone Crossing, Suite 1700 Indianapolis, Indiana (Address of Principal Executive Offices)	46240 (Zip Code)

(317) 532-7900
(Registrant's Telephone Number, Including Area Code)

(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 þ 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 such shorter period that the registrant was required to submit and post such files). Yes þ 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 (as defined in Rule 12b-2 of the Exchange Act).

Large Accelerated Filer ¨ Accelerated Filer ¨

Non-accelerated Filer ¨ (Do not check if a smaller reporting company)	Smaller Reporting Company þ

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

As of August 8, 2014, the registrant had 4,449,619 shares of common stock issued and outstanding.

Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains certain “forward-looking statements” within the meaning of the federal securities laws. These statements are not historical facts, rather statements based on First Internet Bancorp’s (“we,” “our,” “us” or the “Company”) current expectations regarding its business strategies, intended results and future performance. Forward-looking statements are generally preceded by terms such as “expects,” “believes,” “anticipates,” “intends” and similar expressions. Such statements are subject to certain risks and uncertainties including: failures or interruptions in our information systems; growth in our commercial lending activities; declines in market values of our investments; technological obsolescence; our possible need for additional capital resources in the future; competition; loss of key members of management; fluctuations in interest rates; inadequate allowance for loan losses; risks relating to consumer lending; our dependence on capital distributions from the First Internet Bank of Indiana (the "Bank"); our ability to maintain growth in our mortgage lending business; a decline in the mortgage loan markets or real estate markets; risks associated with the regulation of financial institutions; and changes in regulatory capital requirements. Additional factors that may affect our results include those discussed in our most recent Annual Report on Form 10-K under the heading “Risk Factors” and in other reports filed with the Securities and Exchange Commission (the "SEC"). The Company cautions readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. The factors listed above could affect the Company’s financial performance and could cause the Company’s actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements.

Except as required by law, the Company does not undertake, and specifically disclaims any obligation, to publicly release the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

(i)

PART I

ITEM 1. FINANCIAL STATEMENTS

First Internet Bancorp
Condensed Consolidated Balance Sheets
(Amounts in thousands except share data)

	June 30, 2014 (Unaudited)	December 31, 2013
Assets		
Cash and due from banks	$1,926	$2,578
Interest-bearing demand deposits	18,718	51,112
Total cash and cash equivalents	20,644	53,690
Interest-bearing time deposits	2,000	2,500
Securities available-for-sale - at fair value (amortized cost of $159,393 and $185,091, respectively)	159,528	181,409
Loans held-for-sale (includes $19,130 and $24,254 at fair value, respectively)	21,466	28,610
Loans receivable	631,678	501,153
Allowance for loan losses	(5,140)	(5,426)
Net loans receivable	626,538	495,727
Accrued interest receivable	2,694	2,904
Federal Home Loan Bank of Indianapolis stock	2,943	2,943
Cash surrender value of bank-owned life insurance	12,128	11,935
Premises and equipment, net	7,133	7,134
Goodwill	4,687	4,687
Other real estate owned	4,664	4,381
Accrued income and other assets	3,682	6,422
Total assets	$868,107	$802,342
Liabilities and Shareholders’ Equity		
Liabilities		
Non-interest bearing deposits	$19,065	$19,386
Interest-bearing deposits	725,108	653,709
Total deposits	744,173	673,095
Advances from Federal Home Loan Bank	21,845	31,793
Subordinated debt	2,831	2,789
Accrued interest payable	96	102
Accrued expenses and other liabilities	4,628	3,655
Total liabilities	773,573	711,434
Commitments and Contingencies		
Shareholders’ Equity		
Preferred stock, no par value; 4,913,779 shares authorized; issued and outstanding - none	—	—
Voting common stock, no par value; 45,000,000 shares authorized; 4,449,619 and 4,448,326 shares issued and outstanding, respectively	71,509	71,378
Nonvoting common stock, no par value; 86,221 shares authorized; issued and outstanding - none	—	—
Retained earnings	22,938	21,902
Accumulated other comprehensive income (loss)	87	(2,372)

Total shareholders’ equity	94,534	90,908
Total liabilities and shareholders’ equity	$868,107	$802,342

See Notes to Condensed Consolidated Financial Statements

1

First Internet Bancorp
Condensed Consolidated Statements of Income – Unaudited
(Amounts in thousands except share and per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Interest Income				
Loans	$6,571	$4,861	$12,700	$9,903
Securities – taxable	1,041	902	1,887	1,386
Securities – non-taxable	—	396	58	699
Total interest income	7,612	6,159	14,645	11,988
Interest Expense				
Deposits	1,922	1,656	3,782	3,284
Other borrowed funds	317	267	624	575
Total interest expense	2,239	1,923	4,406	3,859
Net Interest Income	5,373	4,236	10,239	8,129
Provision (Credit) for Loan Losses	(73)	24	74	158
Net Interest Income After Provision (Credit) for Loan Losses	5,446	4,212	10,165	7,971
Noninterest Income				
Service charges and fees	187	179	354	338
Mortgage banking activities	1,229	3,457	2,129	6,468
Other-than-temporary impairment				
Total loss related to other-than-temporarily impaired securities	—	(15)	—	(994)
Portion of loss recognized in other comprehensive income (loss)	—	—	—	945
Other-than-temporary impairment loss recognized in net income	—	(15)	—	(49)
Gain (loss) on sale of securities	125	19	484	(166)
Loss on asset disposals	(18)	(8)	(31)	(87)
Other	99	87	197	202
Total noninterest income	1,622	3,719	3,133	6,706
Noninterest Expense				
Salaries and employee benefits	3,021	2,846	6,076	5,225
Marketing, advertising, and promotion	394	455	776	827
Consulting and professional services	494	561	952	1,214
Data processing	239	232	476	446
Loan expenses	136	285	250	365
Premises and equipment	666	616	1,268	934
Deposit insurance premium	138	115	282	227
Other	472	415	918	850
Total noninterest expense	5,560	5,525	10,998	10,088
Income Before Income Taxes	1,508	2,406	2,300	4,589
Income Tax Provision	531	694	723	1,389
Net Income	$977	$1,712	$1,577	$3,200
Income Per Share of Common Stock				
Basic	$0.22	$0.59	$0.35	$1.11
Diluted	$0.22	$0.59	$0.35	$1.11
Weighted-Average Number of Common Shares Outstanding				
Basic	4,496,219	2,888,260	4,495,449	2,887,207
Diluted	4,504,302	2,888,260	4,503,010	2,887,207
Dividends Declared Per Share	$0.06	$0.06	$0.12	$0.10

See Notes to Condensed Consolidated Financial Statements

First Internet Bancorp
Condensed Consolidated Statements of Comprehensive Income – Unaudited
(Dollar amounts in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income	$977	$1,712	$1,577	$3,200
Other comprehensive income (loss)				
Net unrealized holding gains (losses) on securities available-for-sale	2,625	(5,048)	3,550	(4,459)
Reclassification adjustment for (gains) losses realized	(125)	(19)	(484)	166
Net unrealized holding gains (losses) on securities available-for-sale for which an other-than-temporary impairment has been recognized in income	688	(15)	751	(994)
Reclassification adjustment for other-than-temporary impairment loss recognized in income	—	15	—	49
Other comprehensive income (loss) before tax	3,188	(5,067)	3,817	(5,238)
Income tax provision (benefit)	1,134	(1,774)	1,358	(1,834)
Other comprehensive income (loss) - net of tax	2,054	(3,293)	2,459	(3,404)
Comprehensive income (loss)	$3,031	$(1,581)	$4,036	$(204)

See Notes to Condensed Consolidated Financial Statements

First Internet Bancorp
Condensed Consolidated Statements of Shareholders' Equity - Unaudited
Six Months Ended June 30, 2014
(Dollar amounts in thousands except per share data)

	Voting and Nonvoting Common Stock	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Shareholders' Equity
Balance, January 1, 2014	$71,378	$(2,372)	$21,902	$90,908
Net income	—	—	1,577	1,577
Other comprehensive income	—	2,459	—	2,459
Dividends declared ($0.12 per share)	—	—	(541)	(541)
Recognition of the fair value of share-based compensation	252	—	—	252
Common stock redeemed for the net settlement of share-based awards	(71)	—	—	(71)
Other	(50)	—	—	(50)
Balance, June 30, 2014	$71,509	$87	$22,938	$94,534

See Notes to Condensed Consolidated Financial Statements

First Internet Bancorp
Condensed Consolidated Statements of Cash Flows – Unaudited
(Dollar amounts in thousands)

	Six Months Ended June 30, 2014	2013
Operating Activities		
Net income	$1,577	$3,200
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation & amortization	1,004	1,265
Increase in cash surrender value of bank-owned life insurance	(193)	(196)
Provision for loan losses	74	158
Share-based compensation expense	252	60
Loss on other-than-temporary impairment of securities	—	49
Loss (gain) from sale of available-for-sale securities	(484)	166
Loans originated for sale	(161,992)	(512,531)
Proceeds from sale of loans	171,434	537,627
Gain on loans sold	(1,908)	(6,465)
Unrealized loss (gain) on loans held-for-sale	(390)	1,127
Loss (gain) on derivatives	169	(1,130)
Net change in:		
Accrued interest receivable	210	(75)
Accrued income and other assets	1,267	1,758
Accrued expenses and other liabilities	658	950
Net cash provided by operating activities	11,678	25,963
Investing Activities		
Net change in loans	(73,596)	(9,137)
Net change in interest bearing deposits	500	(2,500)
Maturities of securities available for sale	8,946	22,064
Proceeds from sale of securities available for sale	113,587	41,040
Purchase of securities available for sale	(96,803)	(103,526)
Purchase of premises and equipment	(557)	(7,326)
Loans purchased	(57,217)	—
Net cash used in investing activities	(105,140)	(59,385)
Financing Activities		
Net increase in deposits	71,078	30,471
Cash dividends paid	(529)	(114)
Proceeds from issuance of subordinated debt and related warrants	—	3,000
Proceeds from FHLB advances	30,000	—
Repayment of FHLB advances	(40,000)	(17,000)
Other, net	(133)	—
Net cash provided by financing activities	60,416	16,357
Net Decrease in Cash and Cash Equivalents	(33,046)	(17,065)
Cash and Cash Equivalents, Beginning of Period	53,690	32,513
Cash and Cash Equivalents, End of Period	$20,644	$15,448
Supplemental Disclosures of Cash Flows Information		
Cash paid during the period for interest	$4,412	$3,879
Cash paid during the period for taxes	—	723
Loans transferred to real estate owned	—	507

Cash dividends declared, not paid	265	169

See Notes to Condensed Consolidated Financial Statements

First Internet Bancorp
Notes to Condensed Consolidated Financial Statements – Unaudited
(Dollar amounts in thousands except per share data)

Note 1: Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles ("GAAP") for interim financial information and pursuant to the rules and regulations of the SEC. Accordingly, they do not include all of the information or footnotes necessary for a complete presentation of financial condition, results of operations, or cash flows in accordance with U.S. GAAP. In our opinion, all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation have been included. The results of operations for the three and six months ended June 30, 2014 are not necessarily indicative of the results expected for the year ending December 31, 2014 or any other period. The June 30, 2014 condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the First Internet Bancorp Annual Report on Form 10-K for the year ended December 31, 2013.

The preparation of the condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates, judgments, or assumptions that could have a material effect on the carrying value of certain assets and liabilities. These estimates, judgments, and assumptions affect the amounts reported in the condensed consolidated financial statements and the disclosures provided. The determination of the allowance for loan losses, valuations and impairments of investment securities, and the accounting for income tax expense are highly dependent upon management's estimates, judgments, and assumptions where changes in any of these could have a significant impact on the financial statements.

The condensed consolidated financial statements include the accounts of First Internet Bancorp ("Company"), its wholly-owned subsidiary, First Internet Bank of Indiana ("Bank"), and the Bank's wholly-owned subsidiary, JKH Realty Services, LLC. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Company is subject to claims and lawsuits that arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the consolidated financial position, results of operations, and cash flows of the Company.

Certain reclassifications have been made to the 2013 financial statements to conform to the 2014 financial statement presentation. These reclassifications had no effect on net income.

On June 21, 2013, the Company completed a three-for-two (3:2) split of its common stock by the payment of a stock dividend of one-half of one share on each outstanding share of common stock. Except as otherwise indicated, all of the share and per-share information referenced throughout this report has been adjusted to reflect this stock split.

Note 2: Earnings Per Share

Earnings per share of common stock are based on the weighted-average number of basic shares and dilutive shares outstanding during the period.

The following is a reconciliation of the weighted-average common shares for the basic and diluted earnings per share computations for the three and six months ended June 30, 2014 and 2013:

	Three Months Ended June 30,	
	2014	2013
Basic earnings per share		
Net income available to common shareholders	$977	$1,712
Weighted-average common shares	4,496,219	2,888,260
Basic earnings per common share	$0.22	$0.59
Diluted earnings per share		
Net income applicable to diluted earnings per share	$977	$1,712
Weighted-average common shares	4,496,219	2,888,260
Dilutive effect of warrants	4,835	—
Dilutive effect of equity compensation	3,248	—
Weighted-average common and incremental shares	4,504,302	2,888,260
Diluted earnings per common share	$0.22	$0.59
Number of warrants excluded from the calculation of diluted earnings per share as the exercise prices were greater than the average market price of the Company's common stock during the period	—	48,750

	Six Months Ended June 30,	
	2014	2013
Basic earnings per share		
Net income available to common shareholders	$1,577	$3,200
Weighted-average common shares	4,495,449	2,887,207
Basic earnings per common share	$0.35	$1.11
Diluted earnings per share		
Net income applicable to diluted earnings per share	$1,577	$3,200
Weighted-average common shares	4,495,449	2,887,207
Dilutive effect of warrants	5,838	—
Dilutive effect of equity compensation	1,723	—
Weighted-average common and incremental shares	4,503,010	2,887,207
Diluted earnings per common share	$0.35	$1.11
Number of warrants excluded from the calculation of diluted earnings per share as the exercise prices were greater than the average market price of the Company's common stock during the period	—	48,750

Note 3: Securities

Securities at June 30, 2014 and December 31, 2013 are as follows:

	June 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available-for-sale				
U.S. Government-sponsored enterprises	$20,204	$174	$(450)	$19,928
Mortgage-backed and asset-backed securities – government-sponsored enterprises	137,189	1,272	(856)	137,605
Other securities	2,000	—	(5)	1,995
Total available-for-sale	$159,393	$1,446	$(1,311)	$159,528

	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available-for-sale				
U.S. Government-sponsored enterprises	$57,569	$470	$(1,762)	$56,277
Municipals	46,126	1,080	(883)	46,323
Mortgage-backed and asset-backed securities – government-sponsored enterprises	75,058	696	(1,813)	73,941
Mortgage-backed and asset-backed securities – private labeled	1,313	9	(90)	1,232
Other securities	5,025	—	(1,389)	3,636
Total available-for-sale	$185,091	$2,255	$(5,937)	$181,409

The carrying value of securities at June 30, 2014 is shown below by their contractual maturity date. Actual maturities will differ because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-Sale	
	Amortized Cost	Fair Value
Within one year	$2,009	$2,004
One to five years	3,697	3,689
Five to ten years	949	952
After ten years	15,549	15,278
	22,204	21,923
Mortgage-backed and asset-backed securities – government-sponsored enterprises	137,189	137,605
Totals	$159,393	$159,528

In the three months ended June 30, 2014, the Company continued the restructuring and repositioning of its securities portfolio that began in early 2014 by selling a portion of the portfolio, including the ALESCO IV and I-PreTSL I collateralized debt obligations. During the three months ended March 31, 2014, the Company sold all of the municipal securities that were held in the securities portfolio at December 31, 2013. The actions taken in 2014 are intended to further mitigate interest rate risk and credit risk, while also reducing the overall size of the securities portfolio.

Gross gains of $898 and $24, and gross losses of $773 and $5 resulting from sales of available for sale securities were realized for the three months ended June 30, 2014 and 2013, respectively. In the six months ended June 30, 2014 and 2013, gross gains of $2,299 and $126 and gross losses of $1,815 and $292 were recognized, respectively.

8

Certain investments in debt securities are reported in the condensed consolidated financial statements at an amount less than their historical cost. Total fair value of these investments at June 30, 2014 and December 31, 2013 was $43,923 and $109,946, which is approximately 28% and 61%, respectively, of the Company's available-for-sale investment portfolio. These declines primarily resulted from fluctuations in market interest rates after purchase.

Except as discussed below, management believes the declines in fair value for these securities are temporary.

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 in which the other-than-temporary impairment ("OTTI") is identified.

The following tables show the Company's investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2014 and December 31, 2013:

	June 30, 2014					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available for sale:						
U.S. Government-sponsored enterprises	$537	$(2)	$10,886	$(448)	$11,423	$(450)
Mortgage-backed and asset-backed securities - government-sponsored enterprises	—	—	30,505	(856)	30,505	(856)
Other securities	—	—	1,995	(5)	1,995	(5)
	$537	$(2)	$43,386	$(1,309)	$43,923	$(1,311)

	December 31, 2013					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available for sale:						
U.S. Government-sponsored enterprises	$43,085	$(1,761)	$14	$(1)	$43,099	$(1,762)
Municipals	14,105	(882)	351	(1)	14,456	(883)
Mortgage-backed and asset-backed securities - government-sponsored enterprises	47,875	(1,813)	—	—	47,875	(1,813)
Mortgage-backed and asset-backed securities – private labeled	43	(1)	838	(89)	881	(90)
Other securities	1,962	(38)	1,673	(1,351)	3,635	(1,389)
	$107,070	$(4,495)	$2,876	$(1,442)	$109,946	$(5,937)

U.S. Government Sponsored Enterprise and Municipal Securities

The unrealized losses on the Company's investments in securities issued by U.S. Government sponsored enterprises and municipal securities were caused by interest rate changes. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Company does not intend to sell the investments at a loss and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other than temporarily impaired at June 30, 2014.

Mortgage-Backed Securities

The unrealized losses on the Company's investment in mortgage-backed securities were caused by interest rate changes. The Company expects to recover the amortized cost basis over the term of the securities. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments at a loss and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other than temporarily impaired at June 30, 2014.

For identified mortgage-backed securities in the investment portfolio, an extensive, quarterly review is conducted to determine if an other-than-temporary impairment has occurred. Various inputs to the economic models are used to determine if an unrealized loss is other than temporary. The most significant inputs are voluntary prepay rates, default rates, liquidation rates, and loss severity.

To determine if the unrealized loss for mortgage-backed securities is other than temporary, the Company projects total estimated defaults of the underlying assets (mortgages) and multiplies that calculated amount by an estimate of realizable value upon sale in the marketplace (severity) in order to determine the projected collateral loss. The Company also evaluates the current credit enhancement underlying the bond to determine the impact on cash flows. If the Company determines that a given mortgage-backed security position will be subject to a write-down or loss, the Company records the expected credit loss as a charge to earnings.

Other Securities

The Company's unrealized loss on investments in other securities at December 31, 2013 primarily consists of two investments, both of which were sold in the second quarter of 2014.

The first investment is a $2,000 par investment in I-PreTSL I B-2 pooled trust security. The unrealized loss was primarily caused by a sector downgrade by several industry analysts. The determination of no credit loss was calculated by comparing expected discounted cash flows based on performance indicators of the underlying assets in the security to the carrying value of the investment.

The second investment is a $2,000 par investment in ALESCO IV Series B2 pooled trust security on which the Company recognized an other-than-temporary impairment loss. The unrealized loss was primarily caused by (a) a decrease in performance and (b) a sector downgrade by several industry analysts. The credit loss was calculated by comparing expected discounted cash flows based on performance indicators of the underlying assets in the security to the carrying value of the investment.

The credit losses recognized in earnings during the three and six months ended June 30, 2014 and 2013 were as follows:

	Three Months Ended June 30,	
	2014	2013
Mortgage-backed and asset-backed securities – private labeled	—	15
Total credit losses recognized in earnings	$—	$15

	Six Months Ended June 30,	
	2014	2013
Mortgage-backed and asset-backed securities – private labeled	—	49
Total credit losses recognized in earnings	$—	$49

Credit Losses Recognized on Investments

Certain debt securities have experienced fair value deterioration due to credit losses, as well as due to other market factors, but are not otherwise other than temporarily impaired.

The following tables provide information about debt securities for which only a credit loss was recognized in income and other losses are recorded in accumulated other comprehensive income (loss).

	Accumulated Credit Losses
Credit losses on debt securities held	
April 1, 2014	$1,150
Realized losses related to OTTI	(1,106)
Recoveries related to OTTI	(44)
Additions related to OTTI losses not previously recognized	—
Additions related to increases in previously recognized OTTI losses	—
June 30, 2014	$—

	Accumulated Credit Losses
Credit losses on debt securities held	
April 1, 2013	$1,505
Realized losses related to OTTI	(178)
Recoveries related to OTTI	—
Additions related to OTTI losses not previously recognized	—
Additions related to increases in previously recognized OTTI losses	15
June 30, 2013	$1,342

	Accumulated Credit Losses
Credit losses on debt securities held	
January 1, 2014	$1,183
Realized losses related to OTTI	(1,139)
Recoveries related to OTTI	(44)
Additions related to OTTI losses not previously recognized	—
Additions related to increases in previously recognized OTTI losses	—
June 30, 2014	$—

	Accumulated Credit Losses
Credit losses on debt securities held	
January 1, 2013	$1,737
Realized losses related to OTTI	(444)
Recoveries related to OTTI	—
Additions related to OTTI losses not previously recognized	31
Additions related to increases in previously recognized OTTI losses	18
June 30, 2013	$1,342

Amounts reclassified from accumulated other comprehensive income (loss) and the affected line items in the condensed consolidated statements of income during the three and six months ended June 30, 2014 and 2013, were as follows:

	Amounts Reclassified from Accumulated Other Comprehensive Income (Loss) for the Three Months Ended June 30,		Affected Line Item in the Statements of Income
	2014	2013	
Securities available for sale			
Gain realized in earnings	$125	$19	Gain (loss) on sale of securities
OTTI losses recognized in earnings	—	(15)	Other-than-temporary impairment loss recognized in net income
Total reclassified amount before tax	125	4	Income Before Income Taxes
Tax expense	39	1	Income Tax Provision
Total reclassifications out of accumulated other comprehensive income (loss)	$86	$3	Net Income

	Amounts Reclassified from Accumulated Other Comprehensive Income (Loss) for the Six Months Ended June 30,		Affected Line Item in the Statements of Income
	2014	2013	
Securities available for sale			
Gain (loss) realized in earnings	$484	$(166)	Gain (loss) on sale of securities
OTTI losses recognized in earnings	—	(49)	Other-than-temporary impairment loss recognized in net income
Total reclassified amount before tax	484	(215)	Income Before Income Taxes
Tax expense (benefit)	165	(75)	Income Tax Provision
Total reclassifications out of accumulated other comprehensive income (loss)	$319	$(140)	Net Income

Note 4: Loans Receivable

Loans that management intends to hold until maturity or pay off and for which the Company has the ability to hold for the foreseeable future are reported at their outstanding principal balance adjusted for unearned income, charge-offs, the allowance for loan losses, any unamortized deferred fees or costs on originated loans, and unamortized premiums or discounts on purchased loans.

For loans recorded at cost, interest income is accrued based on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, as well as premiums and discounts, are deferred and amortized as a level yield adjustment over the respective term of the loan.

Categories of loans include:

	June 30, 2014	December 31, 2013
Real estate loans		
Residential	$250,262	$191,007
Commercial	201,591	142,429
Total real estate loans	451,853	333,436
Commercial loans	71,997	55,168
Consumer loans	102,843	107,562
Total loans	626,693	496,166
Deferred loan origination costs and premiums and discounts on purchased loans	4,985	4,987
Allowance for loan losses	(5,140)	(5,426)
Loans receivable - net of allowance for loan losses	$626,538	$495,727

The risk characteristics of each loan portfolio segment are as follows:

Commercial Real Estate: These 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 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 and geographic location. Management monitors and evaluates commercial real estate loans based on property financial performance, collateral value, and other risk grade criteria. As a general rule, the Company avoids financing special use projects or properties outside of its designated market areas unless other underwriting factors are present to help mitigate risk. In addition, management tracks the level of owner-occupied commercial real estate loans versus nonowner-occupied loans.

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. Loans are made for working capital, equipment purchases, or other purposes. Most commercial loans are secured by the assets being financed and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis.

Residential 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. Repayment on residential loans can be impacted by changes in property values on residential properties. Consumer loans are secured by consumer assets such as automobiles, horse trailers, or recreational vehicles. Some consumer loans are unsecured, such as small installment loans and certain lines of credit. Repayment of consumer loans is primarily dependent upon the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

Allowance for Loan Losses Methodology

Company policy is designed to ensure that an adequate allowance for loan losses ("ALLL") is maintained. The portfolio is segmented by loan type. The required ALLL for types of performing homogeneous loans which do not have a specific reserve is determined by applying a factor based on historical losses averaged over the past twelve months. Management believes the 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. Management adds qualitative factors for observable trends, changes in internal practices, changes in delinquencies and impairments, and external factors. Observable factors include changes in the composition and size of portfolios, as well as loan terms or concentration levels. The Company evaluates the impact of internal changes such as management and staff experience levels or modification to loan review processes. Delinquency trends are scrutinized for both volume and severity of past due, nonaccrual, classified or graded loans as well as any changes in the value of underlying collateral. Finally, the Company considers the effect of other external factors such as national, regional and local economic and business conditions, as well as competitive, legal and regulatory requirements. All criticized, classified, and impaired loans are evaluated for impairment by applying at least one of three methodologies: present value of future cash flows; fair value of collateral less cost to sell; or the loan's observable market price. All troubled debt restructurings ("TDR") are considered impaired loans. Loans evaluated for impairment are removed from other pools to prevent double-counting.

Provision (Credit) for Loan Losses

A provision for estimated losses on loans is charged to operations based upon management's evaluation of the potential losses. Such an evaluation, which includes a review of all loans for which full collectability may not be reasonably assured considers, among other matters, the estimated net realizable value of the underlying collateral, as applicable, economic conditions, loan loss experience, and other factors that are particularly susceptible to changes that could result in a material adjustment in the near term. While management endeavors to use the best information available in making its evaluations, future allowance adjustments may be necessary if economic conditions change substantially from the assumptions used in making the evaluations.

Accounting Standards Codification ("ASC") Topic 310, Receivables, requires that impaired loans be measured based on the present value of expected future cash flows discounted at the loans' effective interest rates or the fair value of the underlying collateral and allows existing methods for recognizing interest income.

Policy for Charging Off Loans

The Company's policy is to charge off a loan at any point in time when it no longer can be considered a bankable asset, meaning collectible within the parameters of policy. A secured loan is generally charged off to the estimated fair value of the collateral, less costs to sell, no later than when it is 120 days past due as to principal or interest. An unsecured loan generally is charged off no later than when it is 180 days past due as to principal or interest. All charge-offs are approved by the Chief Credit Officer.

The following tables present changes in the balance of the ALLL during the three and six month periods ended June 30, 2014 and 2013:

	Three Months Ended June 30, 2014				
	Residential Real Estate	Commercial Real Estate	Commercial	Consumer	Total
Allowance for loan losses:					
Balance, beginning of period	$1,044	$2,696	$871	$777	$5,388
Provision (credit) charged to expense	239	(302)	(136)	126	(73)
Losses charged off	(89)	—	—	(166)	(255)

Recoveries	9	1	—	70	80
Balance, end of period	$1,203	$2,395	$735	$807	$5,140

	Six Months Ended June 30, 2014				
	Residential Real Estate	Commercial Real Estate	Commercial	Consumer	Total
Allowance for loan losses:					
Balance, beginning of period	$1,219	$2,517	$819	$871	$5,426
Provision (credit) charged to expense	173	(123)	(84)	108	74
Losses charged off	(211)	—	—	(335)	(546)
Recoveries	22	1	—	163	186
Balance, end of period	$1,203	$2,395	$735	$807	$5,140

	Three Months Ended June 30, 2013				
	Residential Real Estate	Commercial Real Estate	Commercial	Consumer	Total
Allowance for loan losses:					
Balance, beginning of period	$1,022	$3,082	$466	$1,178	$5,748
Provision (credit) charged to expense	(49)	74	11	(12)	24
Losses charged off	—	(238)	—	(162)	(400)
Recoveries	11	—	70	74	155
Balance, end of period	$984	$2,918	$547	$1,078	$5,527

	Six Months Ended June 30, 2013				
	Residential Real Estate	Commercial Real Estate	Commercial	Consumer	Total
Allowance for loan losses:					
Balance, beginning of period	$1,149	$3,107	$371	$1,206	$5,833
Provision (credit) charged to expense	(130)	49	106	133	158
Losses charged off	(54)	(238)	—	(398)	(690)
Recoveries	19	—	70	137	226
Balance, end of period	$984	$2,918	$547	$1,078	$5,527

The following tables present the recorded investment in loans based on portfolio segment and impairment method as of June 30, 2014, and December 31, 2013:

	June 30, 2014				
	Residential Real Estate	Commercial Real Estate	Commercial	Consumer	Total
Loans:					
Ending balance	$250,262	$201,591	$71,997	$102,843	$626,693
Ending balance: individually evaluated for impairment	1,059	1,048	—	241	2,348
Ending balance: collectively evaluated for impairment	$249,203	$200,543	$71,997	$102,602	$624,345
Allowance for loan losses:					
Ending Balance	$1,203	$2,395	$735	$807	$5,140
Ending balance: individually evaluated for impairment	—	—	—	23	23
Ending balance: collectively evaluated for impairment	$1,203	$2,395	$735	$784	$5,117

15

	December 31, 2013				
	Residential Real Estate	Commercial Real Estate	Commercial	Consumer	Total
Loans:					
Ending balance	$191,007	$142,429	$55,168	$107,562	$496,166
Ending balance: individually evaluated for impairment	1,684	1,054	—	339	3,077
Ending balance: collectively evaluated for impairment	$189,323	$141,375	$55,168	$107,223	$493,089
Allowance for loan losses:					
Ending Balance	$1,219	$2,517	$819	$871	$5,426
Ending balance: individually evaluated for impairment	116	98	—	28	242
Ending balance: collectively evaluated for impairment	$1,103	$2,419	$819	$843	$5,184

The Company utilizes a risk grading matrix to assign a risk grade to each of its commercial loans. Loans are graded on a scale of 1 to 8. A description of the general characteristics of the eight risk grades is as follows:

- Grades 1 & 2 - These grades are assigned to loans with very high credit quality borrowers of investment or near investment grade or where the loan is primarily secured by cash or conservatively margined high quality marketable securities. These borrowers are generally publicly traded, have significant capital strength, possess investment grade public debt ratings, demonstrate low leverage, exhibit stable earnings and growth and have ready access to various financing alternatives.

- Grades 3 & 4 - Loans assigned these grades include loans to borrowers possessing solid credit quality with acceptable risk. Borrowers in these grades are differentiated from higher grades on the basis of size (capital and/or revenue), leverage, asset quality, stability of the industry or specific market area and quality/coverage of collateral. These borrowers generally have a history of consistent earnings and reasonable leverage.

- Grade 5 - This grade includes "Pass Grade" loans to borrowers which require special monitoring because of deteriorating financial results, declining credit ratings, decreasing cash flow, increasing leverage, marginal collateral coverage or industry stress that has resulted or may result in a changing overall risk profile.

- Grade 6 - This grade is for "Special Mention" loans in accordance with regulatory guidelines. This grade is intended to include loans to borrowers whose credit quality has clearly deteriorated and where risk of further decline is possible unless active measures are taken to correct the situation. Weaknesses are considered potential at this state and are not yet fully defined.

- Grade 7 - This grade includes "Substandard" loans in accordance with regulatory guidelines. Loans categorized in this grade possess a well-defined credit weakness, and the likelihood of repayment from the primary source is uncertain. Significant financial deterioration has occurred, and very close attention is warranted to ensure the full repayment without loss. Collateral coverage may be marginal, and the accrual of interest has been suspended.

- Grade 8 - This grade includes "Doubtful" loans in accordance with regulatory guidelines. Such loans have been placed on nonaccrual status and may be heavily dependent upon collateral possessing a value that is difficult to determine or based upon some near-term event which lacks clear certainty. These loans have all of the weaknesses of those classified as Substandard; however, based on existing conditions, these weaknesses make full collection of the principal balance highly improbable.

Nonaccrual Loans

Any loan which becomes 90 days delinquent or has the full collection of principal and interest in doubt will be considered for nonaccrual status. At the time a loan is placed on nonaccrual, all accrued but unpaid interest will be reversed from interest income. Placing the loan on nonaccrual does not relieve the borrower of the obligation to repay interest. A loan placed on nonaccrual may be restored to accrual status when all delinquent principal and interest has been brought current, and the Company expects full payment of the remaining contractual principal and interest.

The following tables present the credit risk profile of the Company's loan portfolio based on rating category and payment activity as of June 30, 2014 and December 31, 2013:

	June 30, 2014	
	Commercial Real Estate	Commercial
Rating:		
1-5 Pass	$198,260	$69,481
6 Special Mention	2,283	2,516
7 Substandard	1,048	—
8 Doubtful	—	—
Total	$201,591	$71,997

	June 30, 2014	
	Residential Real Estate	Consumer
Performing	$250,236	$102,757
Nonaccrual	26	86
Total	$250,262	$102,843

	December 31, 2013	
	Commercial Real Estate	Commercial
Rating:		
1-5 Pass	$139,052	$54,035
6 Special Mention	2,323	1,133
7 Substandard	1,054	—
8 Doubtful	—	—
Total	$142,429	$55,168

	December 31, 2013	
	Residential Real Estate	Consumer
Performing	$190,377	$107,412
Nonaccrual	630	150
Total	$191,007	$107,562

The following tables present the Company's loan portfolio aging analysis as of June 30, 2014 and December 31, 2013:

	June 30, 2014							
	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans Receivable	Non-accrual Loans	Total Loans 90 Days or More Past Due and Accruing
Residential real estate	$201	$—	$—	$201	$250,061	$250,262	$26	$—
	—	—	955	955	200,636	201,591	1,048	—

Commercial real estate								
Commercial	—	—	—	—	71,997	71,997	—	—
Consumer	121	16	66	203	102,640	102,843	86	17
Total	$322	$16	$1,021	$1,359	$625,334	$626,693	$1,160	$17

17

	December 31, 2013							
	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans Receivable	Non-accrual Loans	Total Loans 90 Days or More Past Due and Accruing
Residential real estate	$122	$—	$603	$725	$190,282	$191,007	$630	$—
Commercial real estate	—	—	955	955	141,474	142,429	1,054	—
Commercial	—	—	—	—	55,168	55,168	—	—
Consumer	484	45	84	613	106,949	107,562	150	18
Total	$606	$45	$1,642	$2,293	$493,873	$496,166	$1,834	$18

Impaired Loans

A loan is designated as impaired, in accordance with the impairment accounting guidance (ASC 310-10-35-16) when, based on current information or events, it is probable that the Company will be unable to collect all amounts due (principal and interest) according to the contractual terms of the loan agreement. Payments with insignificant delays not exceeding 90 days outstanding are not considered impaired. Certain nonaccrual and substantially all delinquent loans may be considered to be impaired. Generally, loans are placed on nonaccrual status at 90 days past due and accrued interest is reversed against earnings, unless the loan is well-secured and in the process of collection. The accrual of interest on impaired and nonaccrual loans is discontinued when, in management’s opinion, the borrower may be unable to meet payments as they become due.

Impaired loans include nonperforming commercial loans but also include loans modified in TDRs where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection.

The following table presents the Company’s impaired loans as of June 30, 2014 and December 31, 2013:

	June 30, 2014			December 31, 2013		
	Recorded Balance	Unpaid Principal Balance	Specific Allowance	Recorded Balance	Unpaid Principal Balance	Specific Allowance
Loans without a specific valuation allowance						
Residential real estate loans	$1,059	$1,066	$—	$1,551	$1,842	$—
Commercial real estate loans	1,048	1,506	—	956	2,310	—
Commercial loans	—	—	—	—	—	—
Consumer loans	190	200	—	271	326	—
Total	2,297	2,772	—	2,778	4,478	—
Loans with a specific valuation allowance						
Residential real estate loans	—	—	—	133	141	116
Commercial real estate loans	—	—	—	98	98	98
Commercial loans	—	—	—	—	—	—
Consumer loans	51	67	23	68	80	28
Total	51	67	23	299	319	242
Total impaired loans						

Residential real estate loans	1,059	1,066	—	1,684	1,983	116
Commercial real estate loans	1,048	1,506	—	1,054	2,408	98
Commercial loans	—	—	—	—	—	—
Consumer loans	241	267	23	339	406	28
Total	$2,348	$2,839	$23	$3,077	$4,797	$242

The table below presents average balances and interest income recognized for impaired loans during both the three and six month periods ended June 30, 2014 and June 30, 2013:

	June 30, 2014				June 30, 2013			
	Three Months Ended		Six Months Ended		Three Months Ended		Six Months Ended	
	Average Balance	Interest Income	Average Balance	Interest Income	Average Balance	Interest Income	Average Balance	Interest Income
Loans without a specific valuation allowance								
Residential real estate loans	$1,107	$5	$1,290	$11	$2,122	$7	$2,097	$14
Commercial real estate loans	1,049	3	1,050	3	—	—	—	—
Commercial loans	—	—	—	—	—	—	—	—
Consumer loans	234	12	265	17	345	9	357	21
Total	2,390	20	2,605	31	2,467	16	2,454	35
Loans with a specific valuation allowance								
Residential real estate loans	13	—	18	—	40	1	171	1
Commercial real estate loans	—	—	—	—	2,210	2	2,295	3
Commercial loans	—	—	—	—	—	—	—	—
Consumer loans	54	1	66	1	95	2	95	4
Total	67	1	84	1	2,345	5	2,561	8
Total impaired loans								
Residential real estate loans	1,120	5	1,308	11	2,162	8	2,268	15
Commercial real estate loans	1,049	3	1,050	3	2,210	2	2,295	3
Commercial loans	—	—	—	—	—	—	—	—
Consumer loans	288	13	331	18	440	11	452	25
Total	$2,457	$21	$2,689	$32	$4,812	$21	$5,015	$43

Troubled Debt Restructurings ("TDRs")

The loan portfolio includes TDRs which are loans that have been modified to grant economic concessions to borrowers who have experienced financial difficulties. These concessions typically result from loss mitigation efforts and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. Certain TDRs are classified as nonperforming at the time of restructuring and typically are returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally not less than six consecutive months.

When loans are modified in a TDR, any possible impairment similar to other impaired loans is evaluated based on the present value of expected future cash flows, discounted at the contractual interest rate of the original loan agreement, or using the current fair value of the collateral, less selling costs for collateral dependent loans. If it is determined that the value of the modified loan is less than the recorded balance of the loan, impairment is recognized through a specific allowance or charge-off to the allowance. In periods subsequent to modification, all TDRs, including those that have payment defaults, are evaluated for possible impairment, and impairment is recognized through the allowance.

In the course of working with troubled borrowers, the Company may choose to restructure the contractual terms of certain loans in an effort to work out an alternative payment schedule with the borrower in order to optimize the collectability of the loan. Any loan modified is reviewed by the Company to identify if a TDR has occurred (when the Company grants a concession to the borrower that it would not otherwise consider based on economic or legal reasons related to a borrower's financial difficulties). Terms may be modified to fit the ability of the borrower to repay in line with its current financial status or the loan may be restructured to secure additional collateral and/or guarantees to support the debt, or a combination of the two.

Loans classified as TDRs during the three and six months ended June 30, 2014 and 2013 are shown in the tables below. The 2014 and 2013 modifications consisted solely of maturity date concessions.

	New TDRs During the Three Months Ended					
	June 30, 2014			June 30, 2013		
	Number of Contracts	Recorded Balance Before	Recorded Balance After	Number of Contracts	Recorded Balance Before	Recorded Balance After
Real estate loans:						
Residential	—	$—	$—	—	$—	$—
Commercial	—	—	—	—	—	—
Total real estate loans	—	—	—	—	—	—
Commercial loans	—	—	—	—	—	—
Consumer loans	—	—	—	1	15	15
Total loans	—	$—	$—	1	$15	$15

	New TDRs During the Six Months Ended					
	June 30, 2014			June 30, 2013		
	Number of Contracts	Recorded Balance Before	Recorded Balance After	Number of Contracts	Recorded Balance Before	Recorded Balance After
Real estate loans:						
Residential	—	$—	$—	—	$—	$—
Commercial	—	—	—	—	—	—
Total real estate loans	—	—	—	—	—	—
Commercial loans	—	—	—	—	—	—
Consumer loans	1	21	21	3	17	17
Total loans	1	$21	$21	3	$17	$17

There were no TDR loans which had payment defaults during the three and six months ended June 30, 2014 and 2013. Default occurs when a loan is 90 days or more past due or transferred to nonaccrual within twelve months of restructuring.

Note 5: Premises and Equipment

Premises and equipment at June 30, 2014 and December 31, 2013 consisted of the following:

	June 30, 2014	December 31, 2013
Land	$2,500	$2,500
Building and improvements	2,910	2,858
Furniture and equipment	5,051	4,883
Less: accumulated depreciation	(3,328)	(3,107)
	$7,133	$7,134

In 2013, the Company acquired an office building with approximately 52,000 square feet of office space and related real estate located in Fishers, Indiana. The Company acquired the property for the current and future operations of the Bank for $4,083. The cost basis of the building is being depreciated on a straight-line basis over 39 years.

20

Note 6: Goodwill

The change in the carrying amount of goodwill for the periods ended June 30, 2014 and December 31, 2013 were:

Balance as of January 1, 2013	$4,687
Changes in goodwill during the year	—
Balance as of December 31, 2013	4,687
Changes in goodwill during the period	—
Balance as of June 30, 2014	$4,687

Goodwill is tested for impairment on an annual basis as of August 31, or whenever events or changes in circumstances indicate the carrying amount of goodwill exceeds its implied fair value. No events or changes in circumstances have occurred since the August 31, 2013 annual impairment test that would suggest it was more likely than not goodwill impairment existed.

Note 7: Benefit Plans

Employment Agreements

The Company has entered into employment or change in control agreements with certain officers that provide for the continuation of salary and certain benefits for a specified period of time under certain conditions. Under the terms of the agreements, these payments could occur in the event of a change in control of the Company, as defined, along with othe