HORIZON BANCORP /IN/
Form 10-Q
November 07, 2014
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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 September 30, 2014

Commission file number 0-10792

HORIZON BANCORP

(Exact name of registrant as specified in its charter)

Indiana	**35-1562417**
(State or other jurisdiction of	**(I.R.S. Employer**

incorporation or organization)	**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: 9,210,786 shares of Common Stock, no par value, at November 7, 2014.

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PART 1 FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

HORIZON BANCORP AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(Dollar Amounts in Thousands)

	September 30 2014 (Unaudited)	December 31 2013
Assets		
Cash and due from banks	**$ 37,318**	$ 31,721
Investment securities, available for sale	**323,492**	508,591
Investment securities, held to maturity (fair value of $175,838 and $9,910)	**172,449**	9,910
Loans held for sale	**4,167**	3,281
Loans, net of allowance for loan losses of $16,160 and $15,992	**1,326,861**	1,052,836
Premises and equipment, net	**50,945**	46,194
Federal Reserve and Federal Home Loan Bank stock	**16,912**	14,184
Goodwill	**28,034**	19,748
Other intangible assets	**4,193**	3,288
Interest receivable	**8,411**	7,501
Cash value life insurance	**39,120**	36,190
Other assets	**25,143**	24,832
Total assets	**$ 2,037,045**	$ 1,758,276
Liabilities		
Deposits		
Non-interest bearing	**$ 278,527**	$ 231,096
Interest bearing	**1,171,136**	1,060,424
Total deposits	**1,449,663**	1,291,520
Borrowings	**350,113**	256,296
Subordinated debentures	**32,603**	32,486
Interest payable	**477**	506
Other liabilities	**14,409**	12,948
Total liabilities	**1,847,265**	1,593,756
Commitments and contingent liabilities		
Stockholders Equity		
Preferred stock, Authorized, 1,000,000 shares Series B shares $.01 par value, $1,000 liquidation value Issued 12,500 shares	**12,500**	12,500

Common stock, no par value Authorized, 22,500,000 shares Issued, 9,280,041 and 8,706,971 shares Outstanding, 9,210,786 and 8,630,966 shares		
Additional paid-in capital	**45,729**	32,496
Retained earnings	**130,864**	121,253
Accumulated other comprehensive income (loss)	**687**	(1,729)
Total stockholders equity	**189,780**	164,520
Total liabilities and stockholders equity	**$ 2,037,045**	$ 1,758,276

See notes to condensed consolidated financial statements

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HORIZON BANCORP AND SUBSIDIARIES

Condensed Consolidated Statements of Income

(Dollar Amounts in Thousands, Except Per Share Data)

	Three Months Ended September 30		Nine Months Ended September 30	
	2014 (Unaudited)	**2013 (Unaudited)**	**2014 (Unaudited)**	**2013 (Unaudited)**
Interest Income				
Loans receivable	**$ 16,403**	$ 14,843	**$ 45,988**	$ 48,189
Investment securities				
Taxable	**2,339**	2,084	**7,124**	6,153
Tax exempt	**1,109**	1,114	**3,328**	3,105
Total interest income	**19,851**	18,041	**56,440**	57,447
Interest Expense				
Deposits	**1,352**	1,395	**3,984**	4,320
Borrowed funds	**1,593**	1,465	**4,493**	4,369
Subordinated debentures	**506**	512	**1,503**	1,504
Total interest expense	**3,451**	3,372	**9,980**	10,193
Net Interest Income	**16,400**	14,669	**46,460**	47,254
Provision for loan losses	**1,741**	104	**2,080**	2,917
Net Interest Income after Provision for Loan Losses	**14,659**	14,565	**44,380**	44,337
Non-interest Income				
Service charges on deposit accounts	**1,076**	1,083	**3,037**	2,984
Wire transfer fees	**151**	169	**408**	562
Interchange fees	**1,223**	1,123	**3,436**	3,049
Fiduciary activities	**1,131**	953	**3,378**	3,140
Gain on sale of investment securities (includes $988 for the three and nine months ended September 30, 2014 and $6 for the three months ended and $374 for the nine months ended September 30, 2013, related to accumulated other comprehensive earnings reclassifications)	**988**	6	**988**	374
Gain on sale of mortgage loans	**2,153**	1,667	**6,101**	7,580
Mortgage servicing income net of impairment	**116**	348	**556**	813
Increase in cash value of bank owned life insurance	**296**	278	**781**	787
Other income	**256**	283	**854**	930
Total non-interest income	**7,390**	5,910	**19,539**	20,219

Non-interest Expense				
Salaries and employee benefits	**8,215**	7,694	**23,991**	22,919
Net occupancy expenses	**1,404**	1,172	**4,188**	3,778
Data processing	**907**	766	**2,714**	2,184
Professional fees	**358**	357	**1,385**	1,310
Outside services and consultants	**595**	436	**2,554**	1,634
Loan expense	**1,202**	1,040	**3,489**	3,556
FDIC insurance expense	**313**	270	**854**	821
Other losses	**(35)**	55	**98**	146
Other expense	**2,394**	2,271	**7,002**	6,487
Total non-interest expense	**15,353**	14,061	**46,275**	42,835
Income Before Income Tax	**6,696**	6,414	**17,644**	21,721
Income tax expense (includes $346 for the three and nine months ended September 30, 2014 and $2 for the three months ended and $131 for the nine months ended September 30, 2013 related to income tax expense from reclassification items)	**1,738**	1,629	**4,491**	5,960
Net Income	**4,958**	4,785	**13,153**	15,761
Preferred stock dividend and discount accretion	**(40)**	(66)	**(102)**	(308)
Net Income Available to Common Shareholders	**$ 4,918**	$ 4,719	**$ 13,051**	$ 15,453
Basic Earnings Per Share	**$ 0.53**	$ 0.55	**$ 1.45**	$ 1.79
Diluted Earnings Per Share	**0.51**	0.52	**1.39**	1.72

See notes to condensed consolidated financial statements

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HORIZON BANCORP AND SUBSIDIARIES

Condensed Consolidated Statements of Comprehensive Income

(Dollar Amounts in Thousands)

	Three Months Ended September 30		Nine Months Ended September 30	
	2014 (Unaudited)	2013 (Unaudited)	2014 (Unaudited)	2013 (Unaudited)
Net Income	**$ 4,958**	$ 4,785	**$ 13,153**	$ 15,761
Other Comprehensive Income				
Change in fair value of derivative instruments:				
Change in fair value of derivative instruments for the period	**373**	38	**(169)**	2,058
Income tax effect	**(131)**	(13)	**59**	(720)
Changes from derivative instruments	**242**	25	**(110)**	1,338
Change in securities available-for-sale:				
Unrealized appreciation (depreciation) for the period on available-for-sale securities	**(6,039)**	(959)	**723**	(15,566)
Unrealized appreciation for the period on held-to-maturity (1)	**2,283**		**2,175**	
Reclassification adjustment for securities gains realized in income	**988**	6	**988**	374
Income tax effect	**969**	334	**(1,360)**	5,318
Unrealized gains (losses) on available-for-sale securities	**(1,799)**	(619)	**2,526**	(9,874)
Other Comprehensive Income (Loss), Net of Tax	**(1,557)**	(594)	**2,416**	(8,536)
Comprehensive Income	**$ 3,401**	**$ 4,191**	**$ 15,569**	$ 7,225

(1) - The amortization of the unrealized holding gains in accumulated other comprehensive income at the date of the transfer partially offsets the accretion of the difference between the par value and the fair value of the investment securities at the date of the transfer.

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HORIZON BANCORP AND SUBSIDIARIES

Condensed Consolidated Statement of Stockholders   Equity

(Unaudited)

(Dollar Amounts in Thousands, Except Per Share Data)

	Preferred Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balances, January 1, 2014	**$ 12,500**	**$ 32,496**	**$ 121,253**	**$ (1,729)**	**$ 164,520**
Net income			13,153		13,153
Other comprehensive income, net of tax				2,416	2,416
Amortization of unearned compensation		271			271
Exercise of stock options		128			128
Stock option expense		145			145
Stock issued from acquisition		12,689			12,689
Cash dividends on preferred stock (1.00%)			(102)		(102)
Cash dividends on common stock ($.37 per share)			(3,440)		(3,440)
Balances, September 30, 2014	**$ 12,500**	**$ 45,729**	**$ 130,864**	**$ 687**	**$ 189,780**

See notes to condensed consolidated financial statements

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HORIZON BANCORP AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(Dollar Amounts in Thousands)

	Nine Months Ended September 30	
	2014	**2013**
	(Unaudited)	**(Unaudited)**
Operating Activities		
Net income	**$ 13,153**	$ 15,761
Items not requiring (providing) cash		
Provision for loan losses	**2,080**	2,917
Depreciation and amortization	**2,806**	2,522
Share based compensation	**145**	31
Mortgage servicing rights recovery	**(28)**	(208)
Premium amortization on securities available for sale, net	**1,733**	2,221
Gain on sale of investment securities	**(988)**	(374)
Gain on sale of mortgage loans	**(6,101)**	(7,580)
Proceeds from sales of loans	**169,858**	306,505
Loans originated for sale	**(164,643)**	(289,775)
Change in cash value of life insurance	**(745)**	(753)
Gain on sale of other real estate owned	**(176)**	(270)
Net change in		
Interest receivable	**(563)**	210
Interest payable	**(50)**	(72)
Other assets	**2,251**	8,493
Other liabilities	**327**	326
Net cash provided by operating activities	**19,059**	39,954
Investing Activities		
Purchases of securities available for sale	**(77,164)**	(152,275)
Proceeds from sales, maturities, calls, and principal repayments of securities available for sale	**99,805**	103,893
Purchase of securities held to maturity	**(4,839)**	(9,910)
Proceeds from maturities of securities held to maturity	**7,900**	
Purchase of Federal Reserve Bank stock	**(592)**	(851)
Net change in loans	**(154,677)**	101,796
Proceeds on the sale of OREO and repossessed assets	**2,378**	2,138
Purchases of premises and equipment	**(4,086)**	(3,033)
Acquisition of SCB	**7,894**	
Purchase of Mortgage Company	**(735)**	
Net cash provided by (used in) by investing activities	**(124,116)**	41,758

Financing Activities		
Net change in		
Deposits	**37,124**	34,167
Borrowings	**76,944**	(103,142)
Proceeds from issuance of stock	**128**	34
Dividends paid on common shares	**(3,440)**	(2,698)
Dividends paid on preferred shares	**(102)**	(308)
Net cash provided by (used in) financing activities	**110,654**	(71,947)
Net Change in Cash and Cash Equivalents	**5,597**	9,765
Cash and Cash Equivalents, Beginning of Period	**31,721**	30,735
Cash and Cash Equivalents, End of Period	**$ 37,318**	$ 40,500
Additional Supplemental Information		
Interest paid	**$ 10,009**	$ 10,265
Income taxes paid	**1,600**	3,100
Transfer of loans to other real estate owned	**3,078**	2,528
Transfer of available-for-sale securities to held-to-maturity	**167,047**	
The Company purchased all of the capital stock of Summit for $18,896. In conjunction with the acquisition, liabilities were assumed as follows:		
Fair value of assets acquired	**158,585**	
Cash paid to retire Summit debt	**6,207**	
Cash paid for the capital stock	**1,029**	
Liabilities assumed	**138,660**	

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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 unaudited 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 September 30, 2014 are not necessarily indicative of the operating results for the full year of 2014. 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 2013 filed with the Securities and Exchange Commission on February 28, 2014. The condensed consolidated balance sheet of Horizon as of December 31, 2013 has been derived from the audited balance sheet 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 September 30		Nine Months Ended September 30	
	2014 (Unaudited)	**2013 (Unaudited)**	**2014 (Unaudited)**	**2013 (Unaudited)**
Basic earnings per share				
Net income	**$ 4,958**	$ 4,785	**$ 13,153**	$ 15,761
Less: Preferred stock dividends and accretion of discount	**40**	66	**102**	308
Net income available to common shareholders	**$ 4,918**	$ 4,719	**$ 13,051**	$ 15,453
Weighted average common shares outstanding	**9,208,707**	8,618,969	**9,009,663**	8,617,972
Basic earnings per share	**$ 0.53**	$ 0.55	**$ 1.45**	$ 1.79

Diluted earnings per share				
Net income available to common shareholders	**$ 4,918**	$ 4,719	**$ 13,051**	$ 15,453
Weighted average common shares outstanding	**9,208,707**	8,618,969	**9,009,663**	8,617,972
Effect of dilutive securities:				
Warrants	**309,790**	314,353	**308,647**	299,704
Restricted stock	**36,387**	40,833	**37,127**	39,883
Stock options	**33,448**	45,056	**33,922**	41,069
Weighted average shares outstanding	**9,588,332**	9,019,211	**9,389,359**	8,998,628
Diluted earnings per share	**$ 0.51**	$ 0.52	**$ 1.39**	$ 1.72

At September 30, 2014 and 2013, there were 46,766 and no shares, respectively, which were not included in the computation of diluted earnings per share because they were non-dilutive.

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Horizon has share-based employee compensation plans, which are described in the notes to the financial statements included in the December 31, 2013 Annual Report on Form 10-K.

Reclassifications

Certain reclassifications have been made to the 2013 condensed consolidated financial statements to be comparable to 2014. These reclassifications had no effect on net income.

Note 2 Acquisition

On April 3, 2014 Horizon closed its acquisition of SCB Bancorp, Inc. (Summit) and Horizon Bank N.A. s acquisition of Summit Community Bank, through mergers effective as of that date. Under the final terms of the acquisition, the exchange ratio was 0.4904 shares of Horizon s common stock and $5.15 in cash for each share of Summit common stock outstanding. Summit shares outstanding at the closing were 1,164,442, and the shares of Horizon common stock issued to Summit shareholders totaled 570,820. Horizon s stock price was $22.23 per share at the close of business on April 3, 2014. Based upon these numbers, the total value of the consideration for the acquisition was $18.9 million (not including the retirement of Summit debt). For the nine months ended September 30, 2014, the Company had approximately $1.3 million in costs related to the acquisition. These expenses are classified in the other expense section of the income statement and primarily located in the salaries and employee benefits, professional services and other expense line items. As a result of the acquisition, the Company will have an opportunity to increase its deposit base and reduce transaction costs. The Company also expects to reduce cost through economies of scale.

Under the purchase method of accounting, the total estimated purchase price is allocated to Summit s net tangible and intangible assets based on their current estimated fair values on the date of the acquisition. Based on management s preliminary valuation of the fair value of tangible and intangible assets acquired and liabilities assumed, which are based on estimates and assumptions that are subject to change, the preliminary purchase price for the Summit acquisition is allocated as follows:

ASSETS	
Cash and due from banks	$ 15,161
Commercial	70,441
Residential mortgage	43,448
Consumer	10,192
Total loans	124,081
Premises and equipment, net	2,548
FRB and FHLB stock	2,136

Goodwill	8,286
Core deposit intangible	822
Interest receivable	347
Cash value life insurance	2,185
Other assets	3,019
Total assets purchased	$ 158,585
Common shares issued	$ 12,689
Cash paid	6,207
Retirement of Holding Company Debt	1,029
Total estimated purchase price	$ 19,925
LIABILITIES	
Deposits	
Non-interest bearing	$ 27,274
NOW accounts	16,332
Savings and money market	35,045
Certificates of deposits	42,368
Total deposits	121,019
Borrowings	16,990
Interest payable	52
Other liabilities	599
Total liabilities assumed	$ 138,660

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HORIZON BANCORP AND SUBSIDIARIES

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Of the total estimated purchase price of $19.9 million, $822,000 has been allocated to core deposit intangible. Additionally, $8.3 million has been allocated to goodwill and $4.4 million of the purchase price is deductible and was assigned to the business assets. The core deposit intangible will be amortized over seven years on a straight line basis.

The Company acquired loans in the acquisition and the transferred loans had evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected.

Loans purchased with evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected are considered to be credit impaired. Evidence of credit quality deterioration as of the purchase date may include information such as past-due and non-accrual status, borrower credit scores and recent loan-to-value percentages. Purchased credit-impaired loans are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality (ASC 310-30) and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loan. Accordingly, an allowance for credit losses related to these loans is not carried over and recorded at the acquisition date. Management estimated the cash flows expected to be collected at acquisition using our internal risk models, which incorporate the estimate of current key assumptions, such as default rates, severity and prepayment speeds.

The Company acquired the $130.5 million loan portfolio at a fair value discount of $6.4 million. The performing portion of the portfolio, $106.2 million, had an estimated fair value of $104.6 million. The excess of expected cash flows above the fair value of the performing portion of loans will be accreted to interest income over the remaining lives of the loans in accordance with ASC 310-20.

Final estimates of certain loans, those for which specific credit-related deterioration, since origination, are recorded at fair value, reflecting the present value of the amounts expected to be collected. Income recognition of these loans is based on reasonable expectation about the timing and amount of cash flows to be collected.

The following table details the acquired loans that are accounted for in accordance with ASC 310-30 as of April 3, 2014.

Contractually required principal and interest at acquisition	$ 14,460
Contractual cash flows not expected to be collected (nonaccretable differences)	3,146
Expected cash flows at acquisition	11,314
Interest component of expected cash flows (accretable discount)	1,688
Fair value of acquired loans accounted for under ASC 310-30	$ 9,626

Pro-forma statements were not presented due to the materiality of the transaction.

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HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Note 3 Securities

The fair value of securities is as follows:

September 30, 2014	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
U.S. Treasury and federal agencies	$ 27,093	$ 67	$ (335)	$ 26,825
State and municipal	47,006	1,641	(52)	48,595
Federal agency collateralized mortgage obligations	123,916	970	(1,758)	123,128
Federal agency mortgage-backed pools	122,393	2,678	(962)	124,109
Private labeled mortgage-backed pools	763	23		786
Corporate notes	32	17		49
Total available for sale investment securities	$ 321,203	$ 5,396	$ (3,107)	$ 323,492
Held to maturity				
U.S. Treasury and federal agencies	$ 9,783	$ 49	$ (4)	$ 9,828
State and municipal	135,839	2,958	(22)	138,775
Federal agency collateralized mortgage obligations	4,193	9		4,202
Federal agency mortgage-backed pools	22,634	399		23,033
Total held to maturity investment securities	$ 172,449	$ 3,415	$ (26)	$ 175,838

December 31, 2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
U.S. Treasury and federal agencies	$ 43,808	$ 133	$ (807)	$ 43,134
State and municipal	176,670	4,405	(3,177)	177,898
Federal agency collateralized mortgage obligations	116,047	1,242	(2,583)	114,706

Federal agency mortgage-backed pools	170,006	3,172	(2,284)	170,894
Private labeled mortgage-backed pools	1,188	38		1,226
Corporate notes	708	25		733
Total available for sale investment securities	$ 508,427	$ 9,015	$ (8,851)	$ 508,591
Held to maturity, State and Municipal	$ 9,910	$	$	$ 9,910

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 and held-to-maturity, 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 September 30, 2014, 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, U.S. Treasury and federal agencies, federal agency collateralized mortgage obligations, 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 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 September 30, 2014.

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HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

The Company elected to transfer 319 available-for-sale (AFS) securities with an aggregate fair value of $167.1 million to a classification of held-to-maturity (HTM) on April 1, 2014. In accordance with FASB ASC 320-10-55-24, the transfer from AFS to HTM must be recorded at the fair value of the AFS securities at the time of transfer. The net unrealized holding gain of $1.3 million, net of tax, at the date of transfer was retained in accumulated other comprehensive income (loss), with the associated pre-tax amount retained in the carrying value of the HTM securities. Such amounts will be amortized to comprehensive income over the remaining life of the securities. The fair value of the transferred AFS securities became the book value of the HTM securities at April 1, 2014, with no unrealized gain or loss at this date. Future reporting periods, with potential changes in market value for these securities, would likely record an unrealized gain or loss for disclosure purposes.

The amortized cost and fair value of securities available for sale and held to maturity at September 30, 2014 and December 31, 2013, 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.

	September 30, 2014		December 31, 2013	
	Amortized Cost	**Fair Value**	**Amortized Cost**	**Fair Value**
Available for sale				
Within one year	$ 4,623	$ 4,670	$ 3,643	$ 3,663
One to five years	45,741	46,156	49,198	49,627
Five to ten years	17,166	17,888	106,225	107,424
After ten years	6,601	6,755	62,120	61,051
	74,131	75,469	221,186	221,765
Federal agency collateralized mortgage obligations	123,916	123,128	116,047	114,706
Federal agency mortgage-backed pools	122,393	124,109	170,006	170,894
Private labeled mortgage-backed pools	763	786	1,188	1,226
Total available for sale investment securities	$ 321,203	$ 323,492	$ 508,427	$ 508,591
Held to maturity				
Within one year	$ 5,951	$ 6,136	$ 9,910	$ 9,910
One to five years	381	382		
Five to ten years	93,628	95,216		
After ten years	45,662	46,869		

	145,622	148,603	9,910	9,910
Federal agency collateralized mortgage obligations	4,193	4,202		
Federal agency mortgage-backed pools	22,634	23,033		
Total held to maturity investment securities	$ 172,449	$ 175,838	$ 9,910	$ 9,910

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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	
September 30, 2014	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U.S. Treasury and federal agencies	$ 3,956	$ (4)	$ 23,648	$ (335)	$ 27,604	$ (339)
State and municipal	6,200	(35)	2,674	(39)	8,874	(74)
Federal agency collateralized mortgage obligations	37,987	(318)	40,882	(1,440)	78,869	(1,758)
Federal agency mortgage-backed pools	7,945	(26)	33,870	(936)	41,815	(962)
Total temporarily impaired securities	$ 56,088	$ (383)	$ 101,074	$ (2,750)	$ 157,162	$ (3,133)

	Less than 12 Months		12 Months or More		Total	
December 31, 2013	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U.S. Treasury and federal agencies	$ 32,099	$ (807)	$	$	$ 32,099	$ (807)
State and municipal	57,078	(2,993)	3,206	(184)	60,284	(3,177)
Federal agency collateralized mortgage obligations	64,445	(2,121)	8,601	(462)	73,046	(2,583)
Federal agency mortgage-backed pools	87,919	(2,284)			87,919	(2,284)
Total temporarily impaired securities	$ 241,541	$ (8,205)	$ 11,807	$ (646)	$ 253,348	$ (8,851)

	Three Months Ended September 30		Nine Months Ended September 30	
	2014	**2013**	**2014**	**2013**
Sales of securities available for sale (Unaudited)				
Proceeds	**$ 45,228**	$ 648	**$ 45,228**	$ 23,853
Gross gains	**1,001**	6	**1,001**	382
Gross losses	**(13)**		**(13)**	(8)

Note 4 Loans

	September 30 2014	December 31 2013
Commercial		
Working capital and equipment	**$ 292,265**	$ 241,569
Real estate, including agriculture	**354,132**	245,313
Tax exempt	**8,899**	2,898
Other	**22,053**	15,409
Total	**677,349**	505,189
Real estate		
1 4 family	**247,196**	181,393
Other	**4,543**	4,565
Total	**251,739**	185,958
Consumer		
Auto	**150,795**	139,915
Recreation	**5,676**	4,839
Real estate/home improvement	**35,240**	30,729
Home equity	**108,608**	96,924
Unsecured	**3,910**	3,825
Other	**4,571**	3,293
Total	**308,800**	279,525
Mortgage warehouse	**105,133**	98,156
Total loans	**1,343,021**	1,068,828
Allowance for loan losses	**(16,160)**	(15,992)
Loans, net	**$ 1,326,861**	$ 1,052,836

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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 larger 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 are monitored for concentrations of credit. The Company 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 a 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 a 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.

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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.

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

September 30, 2014	**Loan Balance**	**Interest Due**	**Deferred Fees / (Costs)**	**Recorded Investment**
Owner occupied real estate	$ 233,069	$ 390	$ 678	$ 234,137
Non owner occupied real estate	298,408	352	545	299,305
Residential spec homes	1,289	2		1,291
Development & spec land loans	12,574	20	37	12,631
Commercial and industrial	130,682	842	67	131,591
Total commercial	676,022	1,606	1,327	678,955
Residential mortgage	239,989	1,048	628	241,665
Residential construction	11,122	20		11,142
Mortgage warehouse	105,133	480		105,613
Total real estate	356,244	1,548	628	358,420
Direct installment	36,720	111	(380)	36,451
Direct installment purchased	236			236
Indirect installment	139,138	298		139,436
Home equity	133,190	565	(104)	133,651
Total consumer	309,284	974	(484)	309,774
Total loans	1,341,550	4,128	1,471	1,347,149
Allowance for loan losses	(16,160)			(16,160)
Net loans	$ 1,325,390	$ 4,128	$ 1,471	$ 1,330,989

December 31, 2013	**Loan Balance**	**Interest Due**	**Deferred Fees / (Costs)**	**Recorded Investment**

Owner occupied real estate	$ 156,262	$ 257	$ 207	$ 156,726
Non owner occupied real estate	224,713	105	299	225,117
Residential spec homes	400			400
Development & spec land loans	21,289	62	42	21,393
Commercial and industrial	101,920	737	57	102,714
Total commercial	504,584	1,161	605	506,350
Residential mortgage	176,068	578	382	177,028
Residential construction	9,508	14		9,522
Mortgage warehouse	98,156	480		98,636
Total real estate	283,732	1,072	382	285,186
Direct installment	29,983	104	(281)	29,806
Direct installment purchased	294			294
Indirect installment	131,384	320		131,704
Home equity	117,958	529	187	118,674
Total consumer	279,619	953	(94)	280,478
Total loans	1,067,935	3,186	893	1,072,014
Allowance for loan losses	(15,992)			(15,992)
Net loans	$ 1,051,943	$ 3,186	$ 893	$ 1,056,022

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HORIZON BANCORP AND SUBSIDIARIES

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Note 5 Accounting for Certain Loans Acquired in a Transfer

The Company acquired loans in acquisitions and the transferred loans had evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected.

Loans purchased with evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected are considered to be credit impaired. Evidence of credit quality deterioration as of the purchase date may include information such as past-due and non-accrual status, borrower credit scores and recent loan-to-value percentages. Purchased credit-impaired loans are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality (ASC 310-30) and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loan. Accordingly, an allowance for credit losses related to these loans is not carried over and recorded at the acquisition date. Management estimated the cash flows expected to be collected at acquisition using our internal risk models, which incorporate the estimate of current key assumptions, such as default rates, severity and prepayment speeds.

The carrying amounts of those loans included in the balance sheet amounts of loans receivable are as follows:

	September 30 2014 Heartland	September 30 2014 Summit	September 30 2014 Total
Commercial	18,527	67,646	$ 86,173
Real estate	10,055	24,747	34,802
Consumer	8,287	9,106	17,393
Outstanding balance	$ 36,869	$ 101,499	$ 138,368
Carrying amount, net of allowance of $205			$ 138,163

	December 31 2013 Heartland	December 31 2013 Summit	December 31 2013 Total
Commercial	$ 37,048	$	$ 37,048
Real estate	11,761		11,761
Consumer	11,485		11,485

Outstanding balance	$	60,294	$		$	60,294
Carrying amount, net of allowance of $389					$	59,905

Accretable yield, or income expected to be collected for the nine months ended September 30, is as follows:

	Nine Months Ended September 30, 2014		
	Heartland	Summit	Total
Balance at January 1	$ 3,185	$	$ 3,185
Additions		1,688	1,688
Accretion	(425)	(222)	(647)
Reclassification from nonaccreatable difference			
Disposals	(210)	(46)	(256)
Balance at September 30	$ 2,550	$ 1,420	$ 3,970

	Nine Months Ended September 30, 2013		
	Heartland	Summit	Total
Balance at January 1	$ 6,111	$	$ 6,111
Additions			
Accretion	(1,016)		(1,016)
Reclassification from nonaccreatable difference			
Disposals	(1,629)		(1,629)
Balance at September 30	$ 3,466	$	$ 3,466

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During the three and nine months ended September 30, 2014, the Company increased the allowance for loan losses by a charge to the income statement of $0 and $253,000, respectively, and for the three and nine months ended September 30, 2013, $100,000 and $1.5 million, respectively. $134,000 of allowances for loan losses were reversed for the three and nine months ended September 30, 2014 and $0 of allowance for loan losses were reversed for the three and nine months ended September 30, 2013.

Note 6 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 five-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 September 30		Nine Months Ended September 30	
	2014 (Unaudited)	2013 (Unaudited)	2014 (Unaudited)	2013 (Unaudited)
Balance at beginning of the period	$ 15,660	$ 19,565	$ 15,992	$ 18,270
Loans charged-off:				
Commercial				
Owner occupied real estate		6		138
Non owner occupied real estate		45	22	191
Residential development				
Development & Spec Land Loans			173	
Commercial and industrial	1,093	774	1,220	913
Total commercial	1,093	825	1,415	1,242
Real estate				
Residential mortgage	31	416	225	559
Residential construction				
Mortgage warehouse				
Total real estate	31	416	225	559
Consumer				
Direct Installment	74	88	151	195
Direct Installment Purchased				
Indirect Installment	306	271	874	624
Home Equity	37	201	468	639

Total consumer	417	560	1,493	1,458
Total loans charged-off	1,541	1,801	3,133	3,259
Recoveries of loans previously charged-off:				
Commercial				
Owner occupied real estate	4	14	10	46
Non owner occupied real estate	10	1	85	3
Residential development				
Development & Spec Land Loans	55		55	
Commercial and industrial	18	111	435	147
Total commercial	87	126	585	196
Real estate				
Residential mortgage	12	5	19	8
Residential construction				
Mortgage warehouse				
Total real estate	12	5	19	8
Consumer				
Direct Installment	10	54	49	448
Direct Installment Purchased				
Indirect Installment	165	202	431	372
Home Equity	26		137	32
Total consumer	201	256	617	852
Total loan recoveries	300	387	1,221	1,056
Net loans charged-off (recovered)	1,241	1,414	1,912	2,203
Provision charged to operating expense				
Commercial	1,563	(940)	1,682	802
Real estate	697	675	(290)	986
Consumer	(519)	994	688	1,025
Total provision charged to operating expense	1,741	729	2,080	2,813
Balance at the end of the period	$ 16,160	$ 18,880	$ 16,160	$ 18,880

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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 in full 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:

September 30, 2014	Commercial	Real Estate	Mortgage Warehousing	Consumer	Total
Allowance For Loan Losses					
Ending allowance balance attributable to loans:					
Individually evaluated for impairment	$ 1,175	$	$	$	$ 1,175
Collectively evaluated for impairment	5,846	3,304	1,300	4,041	14,491
Loans acquired with deteriorated credit quality	494				494

Total ending allowance balance	$ 7,515	$ 3,304	$ 1,300	$ 4,041	$ 16,160
Loans:					
Individually evaluated for impairment	$ 8,497	$	$	$	$ 8,497
Collectively evaluated for impairment	669,867	252,807	105,613	309,774	1,338,061
Loans acquired with deteriorated credit quality	591				591
Total ending loans balance	$ 678,955	$ 252,807	$ 105,613	$ 309,774	$ 1,347,149

December 31, 2013	**Commercial**	**Real Estate**	**Mortgage Warehousing**	**Consumer**	**Total**
Allowance For Loan Losses					
Ending allowance balance attributable to loans:					
Individually evaluated for impairment	$ 1,312	$	$	$	$ 1,312
Collectively evaluated for impairment	4,963	3,462	&nbs		