

HORIZON BANCORP /IN/
Form 10-Q
November 14, 2011
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United States
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

**QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF
THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2011

Commission file number 0-10792

HORIZON BANCORP

(Exact name of registrant as specified in its charter)

Indiana
(State or other jurisdiction of

35-1562417
(I.R.S. Employer

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incorporation or organization)

Identification No.)

515 Franklin Square,

Michigan City, Indiana
(Address of principal executive offices)

46360
(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 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 No

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

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer Do not check if a smaller reporting company

Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 3,309,512 shares of Common Stock, no par value, at November 14, 2011.

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HORIZON BANCORP

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Table of Contents**PART 1 FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****HORIZON BANCORP AND SUBSIDIARIES****Condensed Consolidated Balance Sheets**

(Dollar Amounts in Thousands)

	September 30 2011 (Unaudited)	December 31 2010
Assets		
Cash and due from banks	\$ 18,462	\$ 15,683
Investment securities, available for sale	430,702	382,344
Investment securities, held to maturity	10,632	9,595
Loans held for sale	12,300	18,833
Loans, net of allowance for loan losses of \$19,110 and \$19,064	906,730	863,813
Premises and equipment	34,289	34,194
Federal Reserve and Federal Home Loan Bank stock	12,390	13,664
Goodwill	5,910	5,910
Other intangible assets	2,403	2,741
Interest receivable	6,651	6,519
Cash value life insurance	29,959	27,195
Other assets	20,382	20,428
Total assets	\$ 1,490,810	\$ 1,400,919
Liabilities		
Deposits		
Non-interest bearing	\$ 121,483	\$ 107,606
Interest bearing	868,266	877,892
Total deposits	989,749	985,498
Borrowings	336,095	260,741
Subordinated debentures	30,653	30,584
Interest payable	582	781
Other liabilities	15,051	11,032
Total liabilities	1,372,130	1,288,636
Commitments and contingent liabilities		
Stockholders Equity		
Preferred stock, \$.01 par value, \$1,000 liquidation value Authorized, 1,000,000 Series A shares Issued 0 and 18,750 shares		18,217
Preferred stock, \$.01 par value, \$1,000 liquidation value Authorized, 1,000,000 Series B shares Issued 12,500 and 0 shares	12,500	
Common stock, \$.2222 stated value Authorized, 22,500,000 shares Issued, 3,309,512 and 3,300,659 shares	1,126	1,122
Additional paid-in capital	10,579	10,356
Retained earnings	86,524	80,240
Accumulated other comprehensive income	7,951	2,348
Total stockholders equity	118,680	112,283

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Total liabilities and stockholders' equity	\$ 1,490,810	\$ 1,400,919
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See notes to condensed consolidated financial statements

Table of Contents**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	
	2011	2010	2011	2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Interest Income				
Loans receivable	\$ 12,481	\$ 14,466	\$ 36,260	\$ 40,283
Investment securities				
Taxable	2,542	2,431	7,828	7,394
Tax exempt	988	979	3,066	3,138
Total interest income	16,011	17,876	47,154	50,815
Interest Expense				
Deposits	1,978	2,769	6,510	8,238
Borrowed funds	1,583	2,026	4,760	6,807
Subordinated debentures	459	461	1,363	1,229
Total interest expense	4,020	5,256	12,633	16,274
Net Interest Income	11,991	12,620	34,521	34,541
Provision for loan losses	1,564	2,657	4,444	8,890
Net Interest Income after Provision for Loan Losses	10,427	9,963	30,077	25,651
Other Income				
Service charges on deposit accounts	802	921	2,422	2,750
Wire transfer fees	167	211	412	536
Interchange fees	721	649	1,905	1,663
Fiduciary activities	1,016	934	2,911	2,936
Gain on sale of securities	1,115	336	1,754	467
Gain on sale of mortgage loans	2,145	2,473	3,986	5,529
Mortgage servicing income net of impairment	(172)	(331)	691	(363)
Increase in cash surrender value of bank owned life insurance	245	246	661	599
Death benefit on officer life insurance	453		453	
Other income	46	209	105	828
Total other income	6,538	5,648	15,300	14,945
Other Expenses				
Salaries and employee benefits	6,081	5,985	16,912	15,973
Net occupancy expenses	1,056	1,036	3,176	3,077
Data processing	549	502	1,450	1,474
Professional fees	359	417	1,039	1,418
Outside services and consultants	454	374	1,221	1,163
Loan expense	820	855	2,276	2,376
FDIC insurance expense	254	423	944	1,219
Other losses	1,088	143	1,365	180
Other expenses	1,652	1,522	4,675	4,115

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Total other expenses	12,313	11,257	33,058	30,995
Income Before Income Tax	4,652	4,354	12,319	9,601
Income tax expense	1,235	1,075	3,044	2,016
Net Income	3,417	3,279	9,275	7,585
Preferred stock dividend and discount accretion	(710)	(353)	(1,263)	(1,057)
Net Income Available to Common Shareholders	\$ 2,707	\$ 2,926	\$ 8,012	\$ 6,528
Basic Earnings Per Share	\$ 0.82	\$ 0.89	\$ 2.44	\$ 1.99
Diluted Earnings Per Share	0.80	0.88	2.37	1.96

See notes to condensed consolidated financial statements

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Condensed Consolidated Statement of Stockholders Equity****(Unaudited)**

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

	Preferred Stock	Common Stock	Additional Paid-in Capital	Comprehensive Income	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balances, December 31, 2010	\$ 18,217	\$ 1,122	\$ 10,356		\$ 80,240	\$ 2,348	\$ 112,283
Net income				\$ 9,275	9,275		9,275
Redemption of preferred stock	(18,750)						(18,750)
Issuance of preferred stock	12,500						12,500
Other comprehensive income, net of tax:							
Unrealized gain on securities				7,871		7,871	7,871
Unrealized losses on derivative instruments				(2,268)		(2,268)	(2,268)
Comprehensive income				\$ 14,878			
Amortization of unearned compensation			77				77
Issuance of restricted shares		3	57				60
Exercise of stock options		1	54				55
Tax benefit related to stock options			8				8
Stock option expense			27				27
Cash dividends on preferred stock (5.00%)					(730)		(730)
Cash dividends on common stock (\$.52 per share)					(1,728)		(1,728)
Accretion of discount on preferred stock	533				(533)		
Balances, September 30, 2011	\$ 12,500	\$ 1,126	\$ 10,579		\$ 86,524	\$ 7,951	\$ 118,680

See notes to condensed consolidated financial statements

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Condensed Consolidated Statements of Cash Flows**

(Dollar Amounts in Thousands)

	Nine Months Ended September 30	
	2011	2010
	(Unaudited)	(Unaudited)
Operating Activities		
Net income	\$ 9,275	\$ 7,585
Items not requiring (providing) cash		
Provision for loan losses	4,444	8,890
Depreciation and amortization	1,868	1,715
Share based compensation	27	20
Mortgage servicing rights impairment	(464)	409
Deferred income tax		(923)
Premium amortization on securities available for sale, net	1,612	1,326
Gain on sale of investment securities	(1,754)	(467)
Gain on sale of mortgage loans	(3,986)	(5,529)
Proceeds from sales of loans	178,239	188,564
Loans originated for sale	(174,253)	(184,368)
Change in cash surrender value of life insurance	236	(566)
(Gain) loss on sale of other real estate owned	126	(352)
Net change in		
Interest receivable	(132)	(195)
Interest payable	(199)	(369)
Other assets	(1,590)	5,010
Other liabilities	1,416	1,776
Net cash provided by operating activities	14,865	22,526
Investing Activities		
Purchases of securities available for sale	(170,689)	(165,749)
Proceeds from sales, maturities, calls, and principal repayments of securities available for sale	134,583	157,412
Purchase of securities held to maturity	(2,437)	(15,332)
Proceeds from maturities of securities held to maturity	1,400	13,500
(Purchase) proceeds from the sale of Federal Home Loan Bank stock	1,274	(78)
Net change in loans	(44,766)	(40,260)
Proceeds on the sale of OREO and repossessed assets	2,008	2,982
Purchases of premises and equipment	(1,548)	(2,020)
Purchases of bank owned life insurance	(3,000)	
Purchases and assumption of ATSB		3,406
Net cash used in investing activities	(83,175)	(46,139)
Financing Activities		
Net change in		
Deposits	4,251	(50,242)
Borrowings	75,423	25,774
Redemption of preferred stock	(18,750)	
Issuance of preferred stock	12,500	
Proceeds from issuance of stock	115	120
Tax benefit from issuance of stock	8	77
Dividends paid on common shares	(1,728)	(1,679)

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Dividends paid on preferred shares	(730)	(937)
Net cash provided by (used in) financing activities	71,089	(26,887)
Net Change in Cash and Cash Equivalent	2,779	(50,500)
Cash and Cash Equivalents, Beginning of Period	15,683	68,702
Cash and Cash Equivalents, End of Period	\$ 18,462	\$ 18,202
Additional Cash Flows Information		
Interest paid	\$ 12,832	\$ 16,643
Income taxes paid	2,100	2,180
Transfer of loans to other real estate owned	4,273	7,937
See notes to condensed consolidated financial statements		

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements**

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

Note 1 - Accounting Policies

The accompanying condensed consolidated financial statements include the accounts of Horizon Bancorp (Horizon or the Company) and its wholly-owned subsidiaries, including Horizon Bank, N.A. (Bank). All inter-company balances and transactions have been eliminated. The results of operations for the periods ended September 30, 2011 and September 30, 2010 are not necessarily indicative of the operating results for the full year of 2011 or 2010. 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 2010 filed with the Securities and Exchange Commission on March 11, 2011. The consolidated condensed balance sheet of Horizon as of December 31, 2010 has been derived from the audited balance sheet of Horizon as of that date.

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

	Three months ended September 30		Nine months ended September 30	
	2011 (Unaudited)	2010 (Unaudited)	2011 (Unaudited)	2010 (Unaudited)
Basic earnings per share				
Net income	\$ 3,417	\$ 3,279	\$ 9,275	\$ 7,585
Less: Preferred stock dividends and accretion of discount	710	353	1,263	1,057
Net income available to common shareholders	\$ 2,707	\$ 2,926	\$ 8,012	\$ 6,528
Weighted average common shares outstanding	3,295,130	3,279,201	3,289,911	3,275,969
Basic earnings per share	\$ 0.82	\$ 0.89	\$ 2.44	\$ 1.99
Diluted earnings per share				
Net income available to common shareholders	\$ 2,707	\$ 2,926	\$ 8,012	\$ 6,528
Weighted average common shares outstanding	3,295,130	3,279,201	3,289,911	3,275,969
Effect of dilutive securities:				
Warrants	72,589	42,397	74,519	31,953
Restricted stock	1,955	14,295	6,078	12,910
Stock options	6,579	741	6,803	2,998
Weighted average shares outstanding	3,376,253	3,336,634	3,377,311	3,323,830
Diluted earnings per share	\$ 0.80	\$ 0.88	\$ 2.37	\$ 1.96

At September 30, 2011 and 2010, there were 20,500 shares and 48,000 shares that were not included in the computation of diluted earnings per share because they were non-dilutive.

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(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, 2010 Annual Report on Form 10-K.

Reclassifications

Certain reclassifications have been made to the 2010 consolidated financial statements to be comparable to 2011. These reclassifications had no effect on net income.

Note 2 Securities

The fair value of securities is as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2011 (Unaudited)				
Available for sale				
U.S. Treasury and federal agencies	\$ 10,818	\$ 358	\$	\$ 11,176
State and municipal	136,147	7,648	(45)	143,750
Federal agency collateralized mortgage obligations	87,688	2,407		90,095
Federal agency mortgage-backed pools	175,090	6,633		181,723
Private labeled mortgage-backed pools	3,817	116		3,933
Corporate notes	42		(17)	25
Total available for sale investment securities	\$ 413,602	\$ 17,162	\$ (62)	\$ 430,702
Held to maturity, State and Municipal	\$ 10,632	\$	\$	\$ 10,632
December 31, 2010				
Available for sale				
U.S. Treasury and federal agencies	\$ 24,727	\$ 643	\$ (119)	\$ 25,251
State and municipal	132,380	1,511	(2,402)	131,489
Federal agency collateralized mortgage obligations	100,106	1,945	(214)	101,837
Federal agency mortgage-backed pools	114,390	3,865	(360)	117,895
Private labeled mortgage-backed pools	5,197	126		5,323
Corporate notes	555		(6)	549
Total available for sale investment securities	\$ 377,355	\$ 8,090	\$ (3,101)	\$ 382,344
Held to maturity, State and Municipal	\$ 9,595	\$	\$	\$ 9,595

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

Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other-than-temporary impairment is identified. At September 30, 2011, 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 United States Department of the Treasury (U.S. Treasury) and federal agencies, securities of state and municipal governmental agencies, and federal agency mortgage-backed pools were caused by interest rate volatility and not a decline in credit quality. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. The Company expects to recover the amortized 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, 2011.

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

The amortized cost and fair value of securities available for sale and held to maturity at September 30, 2011 and December 31, 2010, 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, 2011 (Unaudited)		December 31, 2010	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for sale				
Within one year	\$ 1,070	\$ 1,079	\$ 855	\$ 866
One to five years	27,187	28,257	28,240	28,949
Five to ten years	51,311	54,380	44,179	44,450
After ten years	67,439	71,235	84,388	83,024
	147,007	154,951	157,662	157,289
Federal agency collateralized mortgage obligations	87,688	90,095	100,106	101,837
Federal agency mortgage-backed pools	175,090	181,723	114,390	117,895
Private labeled mortgage-backed pools	3,817	3,933	5,197	5,323
Total available for sale investment securities	\$ 413,602	\$ 430,702	\$ 377,355	\$ 382,344
Held to maturity				
Within one year	\$ 10,532	\$ 10,532	\$ 9,495	\$ 9,495
One to five years	100	100	100	100
Total held to maturity investment securities	\$ 10,632	\$ 10,632	\$ 9,595	\$ 9,595

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	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2011 (Unaudited)						
U.S. Treasury and federal agencies	\$	\$	\$	\$	\$	\$
State and municipal	2,984	(41)	495	(4)	3,479	(45)
Federal agency collateralized mortgage obligations						
Federal agency mortgage-backed pools			25		25	
Corporate notes	26	(17)			26	(17)
Total temporarily impaired securities	\$ 3,010	\$ (58)	\$ 520	\$ (4)	\$ 3,530	\$ (62)

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	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2010						
U.S. Treasury and federal agencies	\$ 9,881	\$ (119)	\$	\$	\$ 9,881	\$ (119)
State and municipal	60,401	(2,370)	568	(32)	60,969	(2,402)
Federal agency collateralized mortgage obligations	21,130	(214)			21,130	(214)
Federal agency mortgage-backed pools	27,033	(360)	32		27,065	(360)
Corporate notes	26	(6)			26	(6)
Total temporarily impaired securities	\$ 118,471	\$ (3,069)	\$ 600	\$ (32)	\$ 119,071	\$ (3,101)

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

	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
Sales of securities available for sale (Unaudited)				
Proceeds	\$ 153,299	\$ 146,811	\$ 170,689	\$ 165,749
Gross gains	1,115	464	1,754	599
Gross losses		128		132

Note 3 Loans

	September 30 2011 (Unaudited)	December 31 2010
Commercial		
Working capital and equipment	\$ 167,387	\$ 151,414
Real estate, including agriculture	167,924	167,785
Tax exempt	3,474	2,925
Other	6,581	7,894
Total	345,366	330,018
Real estate		
1-4 family	161,166	157,478
Other	4,263	4,957
Total	165,429	162,435
Consumer		
Auto	134,718	136,014
Recreation	4,795	6,086
Real estate/home improvement	27,378	29,184
Home equity	91,125	90,580
Unsecured	3,200	3,091
Other	2,718	1,726
Total	263,934	266,681
Mortgage warehouse	151,111	123,743
Total	151,111	123,743
Total loans	925,840	882,877
Allowance for loan losses	(19,110)	(19,064)
Loans, net	\$ 906,730	\$ 863,813

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,

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the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

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

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HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

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

Real Estate and Consumer

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

Mortgage Warehousing

Horizon's mortgage warehouse lending has specific mortgage companies as customers of Horizon Bank. Individual mortgage loans originated by these mortgage companies are funded as a secured borrowing with pledge of collateral under Horizon's agreement with the mortgage company. Each individual mortgage is assigned to Horizon until the loan is sold to the secondary market by the mortgage company. In addition, Horizon takes possession of each original note and forwards such note to the end investor once the mortgage company has sold the loan. At the time a loan is transferred to the secondary market, the mortgage company repurchases the loan under its option within the agreement. Due to the repurchase feature contained in the agreement, the transaction does not qualify as a sale and therefore is accounted for as a secured borrowing with pledge of collateral pursuant to the agreement with the mortgage company. When the individual loan is sold to the end investor by the mortgage company the proceeds from the sale of the loan are received by Horizon and used to payoff 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 is typically less than 30 days.

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

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

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

September 30, 2011 (unaudited)	Loan Balance	Interest Due	Deferred Fees / (Costs)	Recorded Investment
Owner occupied real estate	\$ 128,696	\$ 385	\$ 28	\$ 129,109
Non owner occupied real estate	141,643	377	84	142,104
Residential spec homes	2,598	2		2,600
Development & spec land loans	7,548	10		7,558
Commercial and industrial	64,765	227	4	64,996
Total commercial	345,250	1,001	116	346,367
Residential mortgage	157,870	579	64	158,513
Residential construction	7,495	13		7,508
Mortgage warehouse	151,111			151,111
Total real estate	316,476	592	64	317,132
Direct installment	23,994	82	(357)	23,719
Direct installment purchased	1,100			1,100
Indirect installment	127,665	397	1	128,063
Home equity	112,272	533	(741)	112,064
Total consumer	265,031	1,012	(1,097)	264,946
Total loans	926,757	2,605	(917)	928,445
Allowance for loan losses	(19,110)			(19,110)
Net loans	\$ 907,647	\$ 2,605	\$ (917)	\$ 909,335

December 31, 2010	Loan Balance	Interest Due	Deferred Fees / (Costs)	Recorded Investment
Owner occupied real estate	\$ 125,883	\$ 442	\$ 26	\$ 126,351
Non owner occupied real estate	136,986	364	87	137,437
Residential spec homes	2,257	4	(2)	2,259
Development & spec land loans	6,439	14		6,453
Commercial and industrial	58,336	234	6	58,576
Total commercial	329,901	1,058	117	331,076
Residential mortgage	154,891	592	76	155,559
Residential construction	7,467	13	1	7,481
Mortgage warehouse	123,743	332		124,075
Total real estate	286,101	937	77	287,115
Direct installment	23,527	97	(338)	23,286

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Direct installment purchased	1,869			1,869
Indirect installment	128,122	491	7	128,620
Home equity	114,202	563	(708)	114,057
Total consumer	267,720	1,151	(1,039)	267,832
Total loans	883,722	3,146	(845)	886,023
Allowance for loan losses	(19,064)			(19,064)
Net loans	\$ 864,658	\$ 3,146	\$ (845)	\$ 866,959

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Note 4 Allowance for Loan Losses

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

	Three Months Ended		Nine Months Ended	
	September 30 2011 (Unaudited)	September 30 2010 (Unaudited)	September 30 2011 (Unaudited)	September 30 2010 (Unaudited)
Balance at beginning of the period	\$ 18,586	\$ 16,543	\$ 19,064	\$ 16,015
Loans charged-off:				
Commercial				
Owner occupied real estate	65	350	189	1,308
Non owner occupied real estate	196		310	288
Residential development				780
Development & Spec Land Loans				907
Commercial and industrial	17	150	227	
Total commercial	278	500	726	3,283
Real estate				
Residential mortgage	86	86	837	683
Residential construction				
Mortgage warehouse				
Total real estate	86	86	837	683
Consumer				
Direct Installment	78	91	480	430
Direct Installment Purchased				
Indirect Installment	494	460	1,280	2,189
Home Equity	359	215	1,888	1,083
Total consumer	931	766	3,648	3,702
Total loans charged-off	1,295	1,352	5,211	7,668
Recoveries of loans previously charged-off:				
Commercial				
Owner occupied real estate		5	18	5
Non owner occupied real estate				
Residential development				66
Development & Spec Land Loans				
Commercial and industrial	9	15	14	15
Total commercial	9	20	32	86
Real estate				
Residential mortgage			10	1

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Residential construction				
Mortgage warehouse				
Total real estate			10	1
Consumer				
Direct Installment	16	9	83	49
Direct Installment Purchased				
Indirect Installment	179	147	568	646
Home Equity	51	6	120	11
Total consumer	246	162	771	706
Total loan recoveries	255	182	813	793
Net loans charged-off	1,040	1,170	4,398	6,875
Provision charged to operating expense	1,564	2,657	4,444	8,890
Balance at the end of the period	\$ 19,110	\$ 18,030	\$ 19,110	\$ 18,030

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Management's general practice is to proactively charge down loans individually evaluated for impairment 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 of 1-4 family first and junior lien mortgages to the net realizable value less costs to sell when the loan is 180 days past due, charge-off of unsecured open-end loans when the loan is 90 days past due, and charge down to the net realizable value when other secured loans are 90 days past due. Loans at these respective delinquency thresholds for which the Company can clearly document that the loan is both well-secured and in the process of collection, such that collection will occur regardless of delinquency status, need not be 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, 2011 (Unaudited)	Commercial	Real Estate	Mortgage Warehousing	Consumer	Total Allowance
Allowance For Loan Losses					
Ending allowance balance attributable to loans:					
Individually evaluated for impairment	\$ 1,806	\$	\$	\$	\$ 1,806
Collectively evaluated for impairment	6,345	2,457	1,477	7,025	17,304
Total ending allowance balance	\$ 8,151	\$ 2,457	\$ 1,477	\$ 7,025	\$ 19,110
Loans:					
Individually evaluated for impairment	\$ 12,562	\$	\$	\$	\$ 12,562
Collectively evaluated for impairment	333,805	166,021	151,111	264,946	915,883
Total ending loans balance	\$ 346,367	\$ 166,021	\$ 151,111	\$ 264,946	\$ 928,445

December 31, 2010	Commercial	Real Estate	Mortgage Warehousing	Consumer	Total Allowance
Allowance For Loan Losses					
Ending allowance balance attributable to loans:					
Individually evaluated for impairment	\$ 1,457	\$	\$	\$	\$ 1,457
Collectively evaluated for impairment	6,097	2,379	1,435	7,696	17,607

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Total ending allowance balance	\$ 7,554	\$ 2,379	\$ 1,435	\$ 7,696	\$ 19,064
Loans:					
Individually evaluated for impairment	\$ 8,123	\$	\$	\$	\$ 8,123
Collectively evaluated for impairment	322,953	163,040	124,075	267,832	877,900
Total ending loans balance	\$ 331,076	\$ 163,040	\$ 124,075	\$ 267,832	\$ 886,023

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Note 5 Non-performing Assets and Impaired Loans

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

September 30, 2011 (Unaudited)	Nonaccrual	Loans Past Due Over 90 Days Still Accruing	Non Performing TDR s	Performing TDR s	Total Non-Performing Loans
Commercial					
Owner occupied real estate	\$ 2,734	\$	\$	\$	\$ 2,734
Non owner occupied real estate	7,685		217		7,902
Residential development					
Development & Spec Land Loans	90				90
Commercial and industrial	384		144	841	1,369
Total commercial	10,893		361	841	12,095
Real estate					
Residential mortgage	3,395		1,312	2,059	6,766
Residential construction	142			293	435
Mortgage warehouse					
Total real estate	3,537		1,312	2,352	7,201
Consumer					
Direct Installment	259	1			260
Direct Installment Purchased					
Indirect Installment	1,131	40			1,171
Home Equity	1,979	56		849	2,884
Total Consumer	3,369	97		849	4,315
Total	\$ 17,799	\$ 97	\$ 1,673	\$ 4,042	\$ 23,611

December 31, 2010	Nonaccrual	Loans Past Due Over 90 Days Still Accruing	Non Performing TDR s	Performing TDR s	Total Non-Performing Loans
Commercial					
Owner occupied real estate	\$ 1,358	\$	\$	\$	\$ 1,358
Non owner occupied real estate	5,439		421		5,860
Residential development	16				16
Development & Spec Land Loans	250				250
Commercial and industrial	445		153		598
Total commercial	7,508		574		8,082

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Real estate					
Residential mortgage	5,278	222	241	3,380	9,121
Residential construction	205				205
Mortgage warehouse					
Total real estate	5,483	222	241	3,380	9,326
Consumer					
Direct Installment	251	23			274
Direct Installment Purchased		5			5
Indirect Installment	1,328	98			1,426
Home Equity	2,103	10	37	165	2,315
Total Consumer	3,682	136	37	165	4,020
Total	\$ 16,673	\$ 358	\$ 852	\$ 3,545	\$ 21,428

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HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

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

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

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

The Company's TDRs are considered impaired loans and included in the allowance methodology using the guidance for impaired loans. At September 30, 2011 the type of concessions the Company has made on restructured loans has been temporary rate reductions and/or reductions in monthly payments. Any modification to a loan that is a concession and is not in the normal course of lending is considered a restructured loan. A restructured loan is returned to accruing status after six consecutive payments but is still reported as TDR unless the loan bears interest at a market rate. As of September 30, 2011, the Company had \$5.7 million in TDRs and \$4.0 million were performing according to the restructured terms. The financial statement impact of non-performing TDRs was not material for the nine months ending September 30, 2011. There was \$271,000 of specific reserves for commercial TDRs at September 30, 2011 due to the value of the collateral.

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

Loans classified as troubled debt restructuring during the three and nine months ended September 30, 2011, segregated by class, are shown in the table below.

(Dollars in thousands)	Three Months Ended September 30, 2011 (Unaudited)		Nine Months Ended September 30, 2011 (Unaudited)	
	Number of Defaults	Unpaid Principal Balance	Number of Defaults	Unpaid Principal Balance
Commercial				
Owner occupied real estate		\$		\$
Non owner occupied real estate				
Residential development				
Development & Spec Land Loans				
Commercial and industrial			1	841
Total commercial			1	841
Real estate				
Residential mortgage			2	174
Residential construction				
Mortgage warehouse				
Total real estate			2	174
Consumer				
Direct Installment				
Direct Installment Purchased				
Indirect Installment				
Home Equity	1	76	8	724
Total Consumer	1	76	8	724
Total	1	\$ 76	11	\$ 1,739

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

(Dollars in thousands)	Three Months Ended September 30, 2011 (Unaudited)		Nine Months Ended September 30, 2011 (Unaudited)	
	Number of Defaults	Unpaid Principal Balance	Number of Defaults	Unpaid Principal Balance
Commercial				
Owner occupied real estate		\$		\$
Non owner occupied real estate				
Residential development				

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Development & Spec Land Loans					
Commercial and industrial			2		361
Total commercial			2		361
Real estate					
Residential mortgage			2		1,143
Residential construction					
Mortgage warehouse					
Total real estate			2		1,143
Consumer					
Direct Installment					
Direct Installment Purchased					
Indirect Installment					
Home Equity	1	26	2		65
Total Consumer	1	26	2		65
Total	1	\$ 26	6	\$	1,569

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

September 30, 2011 (Unaudited)	Unpaid Principal Balance	Recorded Investment	Allowance For Loan Loss Allocated	Nine Months Ending Average Balance in Impaired Loans	Interest Income Recognized	Three Months Ending Average Balance in Impaired Loans	Interest Income Recognized
With no recorded allowance Commercial							
Owner occupied real estate	\$ 1,315	\$ 1,314	\$	\$ 856	\$ 32	\$ 1,224	\$ 31
Non owner occupied real estate	2,403	2,625		985	89	1,683	85
Residential development				9			
Development & Spec Land Loans		111		69			
Commercial and industrial	1,154	1,156		1,099	47	1,091	47
Total commercial	4,872	5,206		3,018	168	3,998	163
With an allowance recorded Commercial							
Owner occupied real estate	1,420	1,420	460	1,234		1,449	
Non owner occupied real estate	5,499	5,538	996	4,859		4,943	
Residential development							
Development & Spec Land Loans	90	90	125	179		90	
Commercial and industrial	234	308	225	393		284	
Total commercial	7,243	7,356	1,806	6,665		6,766	
Total	\$ 12,115	\$ 12,562	\$ 1,806	\$ 9,683	\$ 168	\$ 10,764	\$ 163

December 31, 2010	Unpaid Principal Balance	Recorded Investment	Allowance For Loan Loss Allocated	Twelve Months Ending Average Balance in Impaired Loans	Interest Income Recognized
With no recorded allowance Commercial					
Owner occupied real estate	\$ 720	\$ 721	\$	\$ 2,434	\$ 19
Non owner occupied real estate	928	929		1,195	36
Residential development					
Development & Spec Land Loans				770	
Commercial and industrial	118	118		785	
Total commercial	1,766	1,768		5,184	55
With an allowance recorded Commercial					
Owner occupied real estate	639	640	385	68	15
Non owner occupied real estate	4,932	4,970	665	2,677	115
Residential development	16	16	16	7	2

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Development & Spec Land Loans	250	250	126	250	
Commercial and industrial	479	479	265	316	13
Total commercial	6,316	6,355	1,457	3,318	145
Total	\$ 8,082	\$ 8,123	\$ 1,457	\$ 8,502	\$ 200

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

September 30, 2011 (Unaudited)	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial						
Owner occupied real estate	\$ 59	\$ 144	\$	\$ 203	\$ 128,493	\$ 128,696
Non owner occupied real estate					141,643	141,643
Residential development					2,598	2,598
Development & Spec Land Loans					7,548	7,548
Commercial and industrial	238			238	64,527	64,765
Total commercial	297	144		441	344,809	345,250
Real estate						
Residential mortgage	1,275			1,275	156,595	157,870
Residential construction	293			293	7,202	7,495
Mortgage warehouse					151,111	151,111
Total real estate	1,568			1,568	314,908	316,476
Consumer						
Direct Installment	128	35	1	164	23,830	23,994
Direct Installment Purchased	20	18		38	1,062	1,100
Indirect Installment	1,357	198	40	1,595	126,070	127,665
Home Equity	424	52	56	532	111,740	112,272
Total consumer	1,929	303	97	2,329	262,702	265,031
Total	\$ 3,794	\$ 447	\$ 97	\$ 4,338	\$ 922,419	\$ 926,757

December 31, 2010	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial						
Owner occupied real estate	\$ 229	\$	\$	\$ 229	\$ 125,654	\$ 125,883
Non owner occupied real estate	461			461	136,525	136,986
Residential development					2,257	2,257
Development & Spec Land Loans					6,439	6,439
Commercial and industrial	74			74	58,262	58,336
Total commercial	764			764	329,137	329,901
Real estate						
Residential mortgage	317	91	222	630	154,261	154,891
Residential construction	293			293	7,174	7,467
Mortgage warehouse					123,743	123,743

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Total real estate	610	91	222	923	285,178	286,101
Consumer						
Direct Installment	294	156	23	473	23,054	23,527
Direct Installment Purchased	51	31	5	87	1,782	1,869
Indirect Installment	2,360	433	98	2,891	125,231	128,122
Home Equity	899	218	10	1,127	113,075	114,202
Total consumer	3,604	838	136	4,578	263,142	267,720
Total	\$ 4,978	\$ 929	\$ 358	\$ 6,265	\$ 877,457	\$ 883,722

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

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

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

Commercial loan officers are responsible for reviewing their loan portfolios and report any adverse material change to the COO or Loan Committee. When circumstances warrant a change in the credit quality grade, loan officers are required to notify the COO and the Credit Department of the change in the loan grade. Downgrades are accepted immediately by the COO however, lenders must present their factual information to either the Loan Committee or the COO when recommending an upgrade. One of the requirements for a loan officer to meet the annual bonus criteria is that the loan officer did not have any of his/her loans downgraded by either Internal Loan Review or Bank Regulators to a classified grade; that is, substandard, doubtful or loss.

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

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

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

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

Risk Grade 1: Excellent (Pass)

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

Risk Grade 2: Good (Pass)

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

Risk Grade 3: Satisfactory (Pass)

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Loans supported by financial statements (audited or unaudited) that indicate average or slightly below average risk and having some deficiency or vulnerability to changing economic conditions; loans with some weakness but offsetting features of other support are readily available; loans that are meeting the terms of repayment, but which may be susceptible to deterioration if adverse factors are encountered.

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Loans may be graded Satisfactory when there is no recent information on which to base a current risk evaluation and the following conditions apply:

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

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

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

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

Risk Grade 4: Satisfactory/Monitored (Pass)

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

Risk Grade 5: Special Mention

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

Risk Grade 6: Substandard

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

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

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

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

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

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

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

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

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

The lender is seriously contemplating foreclosure or legal action due to the apparent deterioration in the loan.

There is a significant deterioration in market conditions to which the borrower is highly vulnerable.

Risk Grade 7: Doubtful

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

Loans have all of the weaknesses of those classified as Substandard. However, based on existing conditions, these weaknesses make full collection of principal highly improbable.

The primary source of repayment is gone, and there is considerable doubt as to the quality of the secondary source of repayment.

The possibility of loss is high but because of certain important pending factors which may strengthen the loan, loss classification is deferred until the exact status of repayment is known.

Risk Grade 8: Loss

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

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September 30, 2011 (Unaudited)	Pass	Special Mention	Substandard	Doubtful	Total
Commercial					
Owner occupied real estate	\$ 104,849	\$ 4,438	\$ 19,409	\$	\$ 128,696
Non owner occupied real estate	114,652	11,882	15,109		141,643
Residential development	597	531	1,470		2,598
Development & Spec Land Loans	2,351	863	4,334		7,548
Commercial and industrial	54,839	2,771	7,155		64,765
Total commercial	277,288	20,485	47,477		345,250
Real estate					
Residential mortgage	151,104		6,766		157,870
Residential construction	7,060		435		7,495
Mortgage warehouse	151,111				151,111
Total real estate	309,275		7,201		316,476
Consumer					
Direct Installment	23,734		260		23,994
Direct Installment Purchased	1,100				1,100
Indirect Installment	126,494		1,171		127,665
Home Equity	109,388		2,884		112,272
Total Consumer	260,716		4,315		265,031
Total	\$ 847,279	\$ 20,485	\$ 58,993	\$	\$ 926,757

December 31, 2010	Pass	Special Mention	Substandard	Doubtful	Total
Commercial					
Owner occupied real estate	\$ 94,722	\$ 13,656	\$ 17,506	\$	\$ 125,883
Non owner occupied real estate	119,041	6,107	11,838		136,986
Residential development	834	537	886		2,257
Development & Spec Land Loans	4,378	746	1,315		6,439
Commercial and industrial	45,831	6,856	5,649		58,336
Total commercial	264,805	27,902	37,195		329,901
Real estate					
Residential mortgage	145,770		9,121		154,891
Residential construction	7,262		205		7,467
Mortgage warehouse	123,743				123,743
Total real estate	276,775		9,326		286,101
Consumer					
Direct Installment	23,253		274		23,527
Direct Installment Purchased	1,864		5		1,869
Indirect Installment	126,696		1,426		128,122
Home Equity	111,888		2,314		114,202

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Total Consumer	263,701		4,019		267,720
Total	\$ 805,281	\$ 27,902	\$ 50,539	\$	\$ 883,722

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Note 6 Derivative financial instruments

Cash Flow Hedges

As a strategy to maintain acceptable levels of exposure to the risk of changes in future cash flow due to interest rate fluctuations, the Company entered into interest rate swap agreements for a portion of its floating rate debt. The agreements provide for the Company to receive interest from the counterparty at three month LIBOR and to pay interest to the counterparty at a weighted average fixed rate of 5.63% on a notional amount of \$30.6 million at September 30, 2011. Under these agreements, the Company pays or receives the net interest amount monthly, with the monthly settlements included in interest expense.

Management has designated the interest rate swap agreement as a cash flow hedging instrument. For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of the other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings. At September 30, 2011, the Company's cash flow hedge was effective and is not expected to have a significant impact the Company's net income over the next 12 months.

Fair Value Hedges

Fair value hedges are intended to reduce the interest rate risk associated with the underlying hedged item. The Company enters into fixed rate loan agreements as part of its lending activities. To mitigate the risk of changes in fair value based on fluctuations in interest rates, the Company has entered into interest rate swap agreements on individual loans, converting the fixed rate loans to a variable rate. For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative as well as the offsetting gain or loss on the hedged item attributable to the hedged risk are recognized in current earnings. At September 30, 2011, the Company's fair value hedges were effective and are not expected to have a significant impact on the Company's net income over the next 12 months.

The change in fair value of both the hedge instruments and the underlying loan agreements are recorded as gains or losses in interest income. The fair value hedges are considered to be highly effective, and any hedge ineffectiveness was deemed not material. The notional amounts of the loan agreements being hedged were \$47.6 million at September 30, 2011.

Other Derivative Instruments

The Company enters into non-hedging derivatives in the form of mortgage loan forward sale commitments with investors and commitments to originate mortgage loans as part of its mortgage banking business. At September 30, 2011, the Company's fair value of these derivatives was recorded and over the next 12 months is not expected to have a significant impact on the Company's net income.

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

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

	Asset Derivative September 30, 2011		Liability Derivatives September 30, 2011	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments (Unaudited)				
Interest rate contracts	Loans	\$ 974	Other liabilities	\$ 2,374
Interest rate contracts	Other Assets	1,401	Other liabilities	4,866
Total derivatives designated as hedging instruments		2,375		7,240
Derivatives not designated as hedging instruments				
Mortgage loan contracts	Other assets	749	Other liabilities	
Total derivatives not designated as hedging instruments		749		
Total derivatives		\$ 3,124		\$ 7,240

	Asset Derivative December 31, 2010		Liability Derivatives December 31, 2010	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments				
Interest rate contracts	Loans	\$ 1,388	Other liabilities	\$ 2,039
Interest rate contracts	Other Assets	651	Other liabilities	1,376
Total derivatives designated as hedging instruments		2,039		3,415
Derivatives not designated as hedging instruments				
Mortgage loan contracts	Other assets	407	Other liabilities	
Total derivatives not designated as hedging instruments		407		
Total derivatives		\$ 2,446		\$ 3,415

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

Amount of Loss Recognized in Other Comprehensive Income on Derivative	Amount of Loss Recognized in Other Comprehensive Income on
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Derivative in cash flow hedging relationship	(Effective Portion) Three Months Ended September 30		Derivative (Effective Portion) Nine Months Ended September 30	
	2011 (Unaudited)	2010 (Unaudited)	2011 (Unaudited)	2010 (Unaudited)
Interest rate contracts	\$ (1,951)	\$ (900)	\$ (2,268)	\$ (1,557)

FASB Accounting Standards Codification (ASC) Topic 820-10-20 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Topic 820-10-55 establishes a fair value hierarchy that emphasizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value.

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Derivative in fair value hedging relationship	Location of gain (loss) recognized on derivative	Amount of Gain (Loss) Recognized on Derivative		Amount of Gain (Loss) Recognized on Derivative	
		Three Months Ended September 30		Nine Months Ended September 30	
		2011 (Unaudited)	2010 (Unaudited)	2011 (Unaudited)	2010 (Unaudited)
Interest rate contracts	Interest income - loans	\$ 394	\$ 560	\$ 335	\$ 1,773
Interest rate contracts	Interest income - loans	(394)	(560)	(335)	(1,773)
Total		\$	\$	\$	\$

Derivative not designated as hedging relationship	Location of gain (loss) recognized on derivative	Amount of Gain (Loss) Recognized on Derivative		Amount of Gain (Loss) Recognized on Derivative	
		Three Months Ended September 30		Nine Months Ended September 30	
		2011 (Unaudited)	2010 (Unaudited)	2011 (Unaudited)	2010 (Unaudited)
Mortgage contracts	Other income - gain on sale of loans	\$ 359	\$ (40)	\$ 1,157	\$ 560
Total		\$ 359	\$ (40)	\$ 1,157	\$ 560

Note 7 Disclosures about fair value of assets and liabilities

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

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

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

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying financial statements, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Available for sale securities

When quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities include U.S. Treasury and federal agency securities, state and municipal securities, federal agency mortgage obligations and mortgage-backed pools, and corporate notes. Level 2 securities are valued by a third party pricing service commonly used in the banking industry utilizing observable inputs. Observable inputs include dealer quotes, market spreads, cash flow analysis, the U.S.

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Treasury yield curve, trade execution data, market consensus prepayment spreads and available credit information and the bond's terms and conditions. The pricing provider utilizes evaluated pricing models that vary based on asset class. These models incorporate available market information including quoted prices of securities with similar characteristics and, because many fixed-income securities do not trade on a daily basis, apply available information through processes such as benchmark curves, benchmarking of like securities, sector grouping, and matrix pricing. In addition, model processes, such as an option adjusted spread model is used to develop prepayment and interest rate scenarios for securities with prepayment features.

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Hedged loans

Certain fixed rate loans have been converted to variable rate loans by entering into interest rate swap agreements. The fair value of those fixed rate loans is based on discounting the estimated cash flows using interest rates determined by the respective interest rate swap agreement. Loans are classified within Level 3 of the valuation hierarchy based on the unobservable inputs used.

Interest rate swap agreements

The fair value of the Company's interest rate swap agreements is estimated by a third party using inputs that are primarily unobservable and cannot be corroborated by observable market data and, therefore, are classified within Level 3 of the valuation hierarchy.

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

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2011 (Unaudited)				
Available-for-sale securities				
U.S. Treasury and federal agencies	\$ 11,176	\$	\$ 11,176	\$
State and municipal	143,750		143,750	
Federal agency collateralized mortgage obligations	90,095		90,095	
Federal agency mortgage-backed pools	181,723		181,723	
Private labeled mortgage-backed pools	3,933		3,933	
Corporate notes	25		25	
Total available-for-sale securities	430,702		430,702	
Hedged loans	53,555			53,555
Forward sale commitments	749			749
Interest rate swap agreements	(7,241)			(7,241)
Commitments to originate loans				
December 31, 2010				
Available-for-sale securities				
U.S. Treasury and federal agencies	\$ 25,251	\$	\$ 25,251	\$
State and municipal	131,489		131,489	
Federal agency collateralized mortgage obligations	101,837		101,837	
Federal agency mortgage-backed pools	117,895		117,895	
Private labeled mortgage-backed pools	5,323		5,323	
Corporate notes	549	456	20	
Total available-for-sale securities	382,344	456	381,815	

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Hedged loans	50,088	50,088
Forward sale commitments	407	407
Interest rate swap agreements	(3,415)	(3,415)
Commitments to originate loans		

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The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the accompanying condensed consolidated balance sheet using significant unobservable (level 3) inputs (Unaudited):

	Hedged Loans	Forward Sale Commitments	Interest Rate Swaps	Commitments to Originate Loans
Beginning balance December 31, 2010	\$ 50,088	\$ 407	\$ (3,415)	\$
Total realized and unrealized gains and losses				
Included in net income	(410)	(126)	410	(56)
Included in other comprehensive income, gross			451	
Purchases, issuances, and settlements	(352)			
Principal payments	(915)			
Ending balance March 31, 2011	48,411	281	(2,554)	(56)
Total realized and unrealized gains and losses				
Included in net income	351	174	(351)	(8)
Included in other comprehensive income, gross			(941)	
Purchases, issuances, and settlements	1,200			
Principal payments	(344)			
Ending balance June 30, 2011	49,618	455	(3,846)	(64)
Total realized and unrealized gains and losses				
Included in net income	393	294	(393)	64
Included in other comprehensive income, gross			(3,001)	
Purchases, issuances, and settlements	1,797			
Principal payments	(628)			
Ending balance September 30, 2011	\$ 51,180	\$ 749	\$ (7,240)	\$

	Hedged Loans	Forward Sale Commitments	Interest Rate Swaps	Commitments to Originate Loans
Beginning balance December 31, 2009	\$ 31,153	\$ 265	\$ (715)	\$ (135)
Total realized and unrealized gains and losses				
Included in net income	403	141	(403)	97
Included in other comprehensive income, gross			(420)	
Purchases, issuances, and settlements	7,991			
Principal payments	(216)			
Ending balance March 31, 2010	39,331	406	(1,538)	(38)
Total realized and unrealized gains and losses				
Included in net income	810	324	(810)	38
Included in other comprehensive income, gross			(2,186)	
Purchases, issuances, and settlements	4,041			
Principal payments	(284)			

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Ending balance June 30, 2010	43,898	730	(4,534)	
Total realized and unrealized gains and losses				
Included in net income	560	(40)	(560)	
Included in other comprehensive income, gross			(1,385)	
Purchases, issuances, and settlements	7,135			
Principal payments	(235)			
Ending balance September 30, 2010	\$ 51,358	\$ 690	\$ (6,479)	\$

Realized gains and losses included in net income for the periods are reported in the condensed consolidated statements of income as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
	2011	2010	2011	2010
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Non Interest Income				
Total gains and losses from:				
Hedged loans	\$ 394	\$ 560	\$ 335	\$ 1,773
Fair value interest rate swap agreements	(394)	(560)	(335)	(1,773)
Derivative loan commitments	359	(40)	1,157	560
	\$ 359	\$ (40)	\$ 1,157	\$ 560

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Certain other assets are measured at fair value on a nonrecurring basis in the ordinary course of business and are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2011 (Unaudited)				
Impaired loans	\$ 12,115	\$	\$	\$ 12,115
December 31, 2010				
Impaired loans	\$ 9,919	\$	\$	\$ 9,919

Impaired (collateral dependent): Fair value adjustments for impaired and non-accrual loans typically occur when there is evidence of impairment. Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. The Company measures fair value based on the value of the collateral securing the loans. Collateral may be in the form of real estate or personal property, including equipment and inventory. The value of the collateral is determined based on internal estimates as well as third-party appraisals or non-binding broker quotes. These measurements were classified as Level 3. The fair value of the Company's other real estate owned is determined using Level 3 inputs, which include current and prior appraisals net of estimated costs to sell.

Note 8 Fair Value of Financial Instruments

The estimated fair value amounts of the Company's financial instruments were determined using available market information, current pricing information applicable to Horizon and various valuation methodologies. Where market quotations were not available, considerable management judgment was involved in the determination of estimated fair values. Therefore, the estimated fair value of financial instruments shown below may not be representative of the amounts at which they could be exchanged in a current or future transaction. Due to the inherent uncertainties of expected cash flows of financial instruments, the use of alternate valuation assumptions and methods could have a significant effect on the estimated fair value amounts.

The estimated fair values of financial instruments, as shown below, are not intended to reflect the estimated liquidation or market value of Horizon taken as a whole. The disclosed fair value estimates are limited to Horizon's significant financial instruments at September 30, 2011 and December 31, 2010. These include financial instruments recognized as assets and liabilities on the consolidated balance sheet as well as certain off-balance sheet financial instruments. The estimated fair values shown below do not include any valuation of assets and liabilities, which are not financial instruments as defined by the FASB ASC fair value hierarchy.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Cash and Due from Banks The carrying amounts approximate fair value.

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Held-to-Maturity Securities For debt securities held to maturity, fair values are based on quoted market prices or dealer quotes. For those securities where a quoted market price is not available, carrying amount is a reasonable estimate of fair value based upon comparison with similar securities.

Loans Held for Sale The carrying amounts approximate fair value.

Net Loans The fair value of portfolio loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. The carrying amounts of loans held for sale approximate fair value.

FHLB and FRB Stock Fair value of FHLB and FRB stock is based on the price at which it may be resold to the FHLB and FRB.

Interest Receivable/Payable The carrying amounts approximate fair value.

Deposits The fair value of demand deposits, savings accounts, interest-bearing checking accounts and money market deposits is the amount payable on demand at the reporting date. The fair value of fixed maturity certificates of deposit is estimated by discounting the future cash flows using rates currently offered for deposits of similar remaining maturity.

Borrowings Rates currently available to Horizon for debt with similar terms and remaining maturities are used to estimate fair values of existing borrowings.

Subordinated Debentures Rates currently available for debentures with similar terms and remaining maturities are used to estimate fair values of existing debentures.

Commitments to Extend Credit and Standby Letter of Credit The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. Due to the short-term nature of these agreements, carrying amounts approximate fair value.

The estimated fair values of Horizon's financial instruments are as follows:

	September 30, 2011 (Unaudited)		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets				
Cash and due from banks	\$ 18,462	\$ 18,462	\$ 15,683	\$ 15,683
Investment securities available for sale	430,702	430,702	382,344	382,344
Investment securities held to maturity	10,632	10,632	9,595	9,595
Loans held for sale	12,300	12,300	18,833	18,833
Loans, net	906,730	904,362	863,813	867,054
Stock in FHLB and FRB	12,390	12,390	13,664	13,664
Interest receivable	6,651	6,651	6,519	6,519

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Liabilities				
Non-interest bearing deposits	\$ 121,483	\$ 121,483	\$ 107,606	\$ 107,606
Interest-bearing deposits	868,266	869,990	877,892	854,617
Borrowings	336,095	364,090	260,741	289,381
Subordinated debentures	30,653	30,473	30,584	30,734
Interest payable	582	582	781	781

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Note 9 Other Comprehensive Income (Loss)

	Three Months Ended		Nine Months Ended	
	September 30 2011 (Unaudited)	September 30 2010 (Unaudited)	September 30 2011 (Unaudited)	September 30 2010 (Unaudited)
Unrealized gains on securities:				
Unrealized holding gains arising during the period	\$ 5,303	\$ 3,494	\$ 13,863	\$ 4,875
Less: reclassification adjustment for gains realized in net income	1,115	336	1,754	467
	4,188	3,158	12,109	4,408
Unrealized gain (loss) on derivative instruments	(3,002)	(1,385)	(3,489)	(3,992)
Net unrealized gains	1,186	1,773	8,620	416
Tax benefit	(415)	(621)	(3,017)	(146)
Other comprehensive income	\$ 771	\$ 1,152	\$ 5,603	\$ 270

	September 30 2011 (Unaudited)	December 31 2010
Unrealized gain on securities available for sale	\$ 17,098	\$ 4,989
Unrealized gain (loss) on derivative instruments	(4,866)	(1,377)
Tax effect	(4,281)	(1,264)
Total accumulated other comprehensive income	\$ 7,951	\$ 2,348

Note 10 Future accounting matters

Goodwill: In September 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-08 *Intangibles - Goodwill and Other (Topic 350) - Testing Goodwill for Impairment*. ASU 2011-08 allows an entity the option to make a qualitative evaluation about the likelihood of goodwill impairment to determine whether it should calculate the fair value of the reporting unit. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. We are assessing the impact of ASU 2011-08 on our goodwill impairment test but do not expect an impact on our financial condition or results of operations.

Comprehensive Income: In June 2011, the FASB issued ASU No. 2011-05 *Comprehensive Income (Topic 220) - Presentation of Comprehensive Income*. ASU 2011-05 requires that all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. ASU 2011-05 is effective retrospectively for fiscal years, and interim periods within those years, beginning after December 15, 2011. We are assessing the impact of ASU 2011-05 on our comprehensive income presentation.

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Fair Value Measurements: In May 2011, the FASB issued ASU No. 2011-04 *Fair Value Measurement (Topic 820) - Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. ASU 2011-04 changes the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. Consequently, the amendments in this update result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs (International Financial Reporting Standards). ASU 2011-04 is effective prospectively during interim and annual periods beginning on or after December 15, 2011. Early application by public entities is not permitted. We are assessing the impact of ASU 2011-04 on our fair value disclosures.

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Notes to Condensed Consolidated Financial Statements

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

Transfers and Servicing: In April 2011, the FASB issued ASU No. 2011-03 *Transfers and Servicing (Topic 860) - Reconsideration of Effective Control for Repurchase Agreement*. ASU 2011-03 removes from the assessment of effective control the criterion relating to the transferor's ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee. ASU 2011-03 is effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. We are assessing the impact of ASU 2011-03 on our financial condition, results of operations, and disclosures.

Receivables: In April 2011, the FASB issued ASU No. 2011-02 *Receivables (Topic 310) - A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*. ASU 2011-02 clarifies whether loan modifications constitute troubled debt restructurings. In evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude that both of the following exist: (a) the restructuring constitutes a concession; and (b) the debtor is experiencing financial difficulties. ASU 2011-02 was effective for the first interim and annual period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. The impact of ASU 2011-02 on our disclosures is reflected in Note 5 Non-performing Assets and Impaired Loans.

Note 11 SBLF Offering and TARP Repurchase

On August 25, 2011, we completed the sale of 12,500 shares of Senior Non-Cumulative Perpetual Preferred Stock, Series B (Series B Preferred Stock), for aggregate consideration of \$12.5 million, to the U.S. Treasury pursuant to the Small Business Lending Fund program. Concurrently with this transaction, we redeemed all 18,750 shares of our Fixed Rate Cumulative Perpetual Preferred Stock, Series A (Series A Preferred Stock), that remained outstanding under the TARP Capital Purchase Program. The redemption of the Series A Preferred stock was funded by the \$12.5 million in proceeds from the sale of the Series B Preferred Stock together with other available funds.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward Looking Statements

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, with respect to Horizon Bancorp (Horizon or the Company) and Horizon Bank, N.A. (the Bank). Horizon intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Reform Act of 1995, and is including this statement for the purposes of these safe harbor provisions. Statements in this report should be considered in conjunction with the other information available about Horizon, including the information in the other filings we make with the Securities and Exchange Commission. The forward-looking statements are based on management's expectations and are subject to a number of risks and uncertainties. We have tried, wherever possible, to identify such statements by using words such as anticipate, expect, estimate, project, intend, plan, believe, could, will and similar expressions in connection with our discussion of future operating or financial performance. Although management believes that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from those expressed or implied in such statements.

Actual results may differ materially, and adversely or positively, from the expectations of the Company that are expressed or implied by any forward-looking statement. Risks, uncertainties, and factors that could cause the Company's actual results to vary materially from those expressed or implied by any forward-looking statement include but not limited to:

the use of proceeds of future offerings of securities;

the unknown future direction of interest rates and the timing and magnitude of any changes in interest rates;

changes in competitive conditions;

the introduction, withdrawal, success and timing of asset/liability management strategies or of mergers and acquisitions and other business initiatives and strategies;

changes in customer borrowing, repayment, investment and deposit practices;

changes in fiscal, monetary and tax policies;

changes in financial and capital markets;

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deterioration in general economic conditions, either nationally or locally, resulting in, among other things, credit quality deterioration;

capital management activities, including possible future sales of new securities, or possible repurchases or redemptions by the Company of outstanding debt or equity securities;

risks of expansion through acquisitions and mergers, such as unexpected credit quality problems of the acquired loans or other assets, unexpected attrition of the customer base of the acquired institution or branches, and difficulties in integration of the acquired operations;

factors that may cause the Company to incur impairment charges on its investment securities;

the impact, extent and timing of technological changes

electronic, cyber and physical security breaches;

claims and litigation liabilities, including related costs, expenses, settlements and judgments, or the outcome of matters before regulatory agencies, whether pending or commencing in the future;

actions of the Federal Reserve Board;

changes in accounting principles and interpretations;

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potential increases of federal deposit insurance premium expense, and possible future special assessments of FDIC premiums, either industry wide or specific to the Company's banking subsidiary;

actions of the regulatory authorities under the Dodd-Frank Wall Street Reform and Consumer Protection Act and the Federal Deposit Insurance Act and other possible legislative and regulatory actions and reforms;

the continued availability of earnings and excess capital sufficient for the lawful and prudent declaration and payment of cash dividends; and

other factors and risks described under the caption "Risk Factors" in this report and in any of our subsequent reports that we have made or make with the Securities and Exchange Commission ("SEC").

Because such forward-looking statements are subject to risks and uncertainties, actual results may differ materially from those expressed or implied by such statements. The foregoing list of important factors is not exclusive and you are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this document or, in the case of documents incorporated by reference, the dates of those documents. We do not undertake to update any forward-looking statements, whether written or oral, that may be made from time to time by or on behalf of us. For a detailed discussion of the risks and uncertainties that may cause our actual results or performance to differ materially from the results or performance expressed or implied by forward-looking statements, see "Risk Factors" in this report and in the subsequent reports we file with the SEC.

Overview

Horizon is a registered bank holding company incorporated in Indiana and headquartered in Michigan City, Indiana. Horizon provides a broad range of banking services in Northwestern Indiana and Southwestern Michigan through its bank subsidiary. Horizon operates as a single segment, which is commercial banking. Horizon's Common Stock is traded on the NASDAQ Global Market under the symbol HBNC. The Bank was chartered as a national banking association in 1873 and has operated continuously since that time. The Bank is a full-service commercial bank offering commercial and retail banking services, corporate and individual trust and agency services, and other services incident to banking.

Horizon continues to operate in a challenging economic and banking environment. Within the Company's primary market areas of Northwest Indiana and Southwest Michigan, unemployment rates increased during 2009 and have remained at high levels during 2010 and the first nine months of 2011. This rise in unemployment has been driven by factors including slowdowns in the steel and recreational vehicle industries as well as a continued lower activity in the housing industry. The Company's higher than historical levels of non-performing loans at September 30, 2011 and over the past two years can be attributed to the continued slow economy and continued high local unemployment causing lower business revenues and increased bankruptcies. Despite these economic factors, Horizon continued to post record positive results through the first nine months of 2011.

Following are some highlights of Horizons financial performance through the third quarter of 2011:

Third quarter 2011 net income was \$3.4 million or \$.80 diluted earnings per share, a 4.2% increase in net income from the same period in 2010 and the highest quarterly net income in the Company's history.

For the first nine months of 2011, net income was \$9.3 million or \$2.37 diluted earnings per share, a 22.3% increase in net income from the same period in 2010 and the highest year-to-date nine-month net income in the Company's history.

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Total loans increased \$86.8 million during the quarter to \$925.8 million at September 30, 2011.

Total assets grew to a record \$1.49 billion at September 30, 2011 compared to \$1.41 billion at June 30, 2011.

Net interest income, after provisions for loan losses, for the nine months of 2011 was \$30.1 million compared with \$25.7 million for the same period in the prior year.

The provision for loan losses decreased to \$4.4 million for the first nine months of 2011 compared to \$8.9 million for the same period in 2010.

In August, the Company redeemed all of the US Treasury's preferred stock investment under the TARP Capital Purchase Program using \$6.25 million in cash and a \$12.5 million investment by the US Treasury under the Small Business Lending Fund.

The Company increased its quarterly dividend to \$0.18 per share, its 103rd consecutive quarterly cash dividend to Horizon's shareholders.

Horizon's tangible book value per share rose to \$29.68 compared with \$26.50 at the close of the third quarter of 2010.

Horizon's capital ratios, including Tier 1 Capital to total risk weighted assets of 12.37%, continue to be well above the regulatory standards for well-capitalized banks.

Critical Accounting Policies

The notes to the consolidated financial statements included in Item 8 of the Company's Annual Report on Form 10-K for 2010 contain a summary of the Company's significant accounting policies. Certain of these policies are important to the portrayal of the Company's financial condition, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Management has identified the allowance for loan losses, intangible assets and hedge accounting as critical accounting policies.

Allowance for Loan Losses

An allowance for loan losses is maintained to absorb probable incurred loan losses inherent in the loan portfolio. The determination of the allowance for loan losses is a critical accounting policy that involves management's ongoing quarterly assessments of the probable incurred losses inherent in the loan portfolio. The identification of loans that have probable incurred losses is subjective; therefore, a general reserve is maintained to cover all probable losses within the entire loan portfolio. Horizon utilizes a loan grading system that helps identify, monitor and address asset quality problems in an adequate and timely manner. Each quarter, various factors affecting the quality of the loan portfolio are reviewed. Large credits are reviewed on an individual basis for loss potential. Other loans are reviewed as a group based upon previous trends of loss experience. Horizon also reviews the current and anticipated economic conditions of its lending market as well as transaction risk to

determine the effect they may have on the loss experience of the loan portfolio.

Goodwill and Intangible Assets

Management believes that the accounting for goodwill and other intangible assets also involves a higher degree of judgment than most other significant accounting policies. FASB ASC 350-10 establishes standards for the amortization of acquired intangible assets and impairment assessment of goodwill. At September 30, 2011, Horizon had core deposit intangibles of \$2.4 million subject to amortization and \$5.9 million of goodwill, which is not subject to amortization. Goodwill arising from business combinations represents the value attributable to unidentifiable intangible assets in the business acquired. Horizon's goodwill relates to the value inherent in the banking industry and that value is dependent upon the ability of Horizon to provide quality, cost effective banking services in a competitive marketplace. The goodwill value is supported by revenue that is in part driven by the volume of business transacted. A decrease in earnings resulting from a decline in the customer base or the inability to deliver cost effective services over sustained periods can lead

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to impairment of goodwill that could adversely affect earnings in future periods. FASB ASC 350-10 requires an annual evaluation of goodwill for impairment. The evaluation of goodwill for impairment requires the use of estimates and assumptions. Market price at the close of business on September 30, 2011 was \$26.50 per share compared to a book value of \$32.20 per common share. Horizon reported record earnings for the eleventh consecutive year in 2010 and the first nine months of 2011 were the highest first nine months of net income in the Company's history, therefore, the Company believes the below book market price relates to an overall decline in the financial industry sector and is not specific to Horizon.

The financial markets are currently reflecting significantly lower valuations for the stocks of financial institutions, when compared to historic valuation metrics, largely driven by the constriction in available credit and losses suffered related to residential mortgage markets. The Company's stock activity, as well as the price, has been affected by the economic conditions affecting the banking industry. Management believes this downturn has impacted the Company's stock and has concluded that the recent stock price is not indicative or reflective of fair value (per ASC Topic 820 Fair Value).

Horizon has concluded that, based on its own internal evaluation the recorded value of goodwill is not impaired.

Mortgage Servicing Rights

Servicing assets are recognized as separate assets when rights are acquired through purchase or through the sale of financial assets on a servicing-retained basis. Capitalized servicing rights are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated regularly for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying servicing rights by predominant characteristics, such as interest rates, original loan terms and whether the loans are fixed or adjustable rate mortgages. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. When the book value of an individual stratum exceeds its fair value, an impairment reserve is recognized so that each individual stratum is carried at the lower of its amortized book value or fair value. In periods of falling market interest rates, accelerated loan prepayment can adversely affect the fair value of these mortgage-servicing rights relative to their book value. In the event that the fair value of these assets was to increase in the future, Horizon can recognize the increased fair value to the extent of the impairment allowance but cannot recognize an asset in excess of its amortized book value. Future changes in management's assessment of the impairment of these servicing assets, as a result of changes in observable market data relating to market interest rates, loan prepayment speeds, and other factors, could impact Horizon's financial condition and results of operations either positively or negatively.

Generally, when market interest rates decline and other factors favorable to prepayments occur, there is a corresponding increase in prepayments as customers refinance existing mortgages under more favorable interest rate terms. When a mortgage loan is prepaid, the anticipated cash flows associated with servicing that loan are terminated, resulting in a reduction of the fair value of the capitalized mortgage servicing rights. To the extent that actual borrower prepayments do not react as anticipated by the prepayment model (i.e., the historical data observed in the model does not correspond to actual market activity), it is possible that the prepayment model could fail to accurately predict mortgage prepayments and could result in significant earnings volatility. To estimate prepayment speeds, Horizon utilizes a third-party prepayment model, which is based upon statistically derived data linked to certain key principal indicators involving historical borrower prepayment activity associated with mortgage loans in the secondary market, current market interest rates and other factors, including Horizon's own historical prepayment experience. For purposes of model valuation, estimates are made for each product type within the mortgage servicing rights portfolio on a monthly basis. In addition, on a quarterly basis Horizon engages a third party to independently test the value of its servicing asset.

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Derivative Instruments

As part of the Company's asset/liability management program, Horizon utilizes, from time-to-time, interest rate floors, caps or swaps to reduce the Company's sensitivity to interest rate fluctuations. These are derivative instruments, which are recorded as assets or liabilities in the consolidated balance sheets at fair value. Changes in the fair values of derivatives are reported in the consolidated income statements or other comprehensive income (OCI) depending on the use of the derivative and whether the instrument qualifies for hedge accounting. The key criterion for the hedge accounting is that the hedged relationship must be highly effective in achieving offsetting changes in those cash flows that are attributable to the hedged risk, both at inception of the hedge and on an ongoing basis.