HORIZON BANCORP /IN/
Form 10-Q
November 07, 2013
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HORIZON BANCORP

FORM 10-Q

United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

QUARTERLY REPORT UNDER SECTION 13 OR 15 (d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2013

Commission file number 0-10792

HORIZON BANCORP

(Exact name of registrant as specified in its charter)

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

incorporation or organization)	**Identification No.)**
515 Franklin Square, Michigan City, Indiana	**46360**
(Address of principal executive offices)	**(Zip Code)**

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

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

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

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

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

Large Accelerated Filer ¨	Accelerated Filer x
Non-accelerated Filer ¨ Do not check if smaller reporting company	Smaller Reporting Company ¨

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 8,695,721 shares of Common Stock, no par value, at November 7, 2013.

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PART 1 FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

HORIZON BANCORP AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(Dollar Amounts in Thousands)

	September 30 2013 (Unaudited)	December 31 2012
Assets		
Cash and due from banks	**$ 40,500**	$ 30,735
Investment securities, available for sale	**514,144**	482,801
Investment securities, held to maturity	**9,910**	
Loans held for sale	**4,594**	13,744
Loans, net of allowance for loan losses of $17,848 and $18,270	**1,063,571**	1,172,447
Premises and equipment	**43,473**	42,184
Federal Reserve and Federal Home Loan Bank stock	**14,184**	13,333
Goodwill	**19,748**	19,748
Other intangible assets	**3,477**	4,048
Interest receivable	**7,506**	7,716
Cash value life insurance	**35,945**	35,192
Other assets	**23,972**	26,279
Total assets	**$ 1,781,024**	$ 1,848,227
Liabilities		
Deposits		
Non-interest bearing	**$ 223,354**	$ 209,200
Interest bearing	**1,104,966**	1,084,953
Total deposits	**1,328,320**	1,294,153
Borrowings	**242,505**	345,764
Subordinated debentures	**32,448**	32,331
Interest payable	**488**	560
Other liabilities	**13,804**	16,451
Total liabilities	**1,617,565**	1,689,259
Commitments and contingent liabilities		
Stockholders Equity		
Preferred stock, Authorized, 1,000,000 shares Series B shares $.01 par value, $1,000 liquidation value Issued 12,500 shares	**12,500**	12,500

Common stock, no par value Authorized, 22,500,000 shares Issued, 8,695,721 and 8,693,471 shares Outstanding, 8,619,716 and 8,617,466 shares		
Additional paid-in capital	**32,237**	31,965
Retained earnings	**118,157**	105,402
Accumulated other comprehensive income	**565**	9,101
Total stockholders equity	**163,459**	158,968
Total liabilities and stockholders equity	**$ 1,781,024**	$ 1,848,227

See notes to condensed consolidated financial statements

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HORIZON BANCORP AND SUBSIDIARIES

Condensed Consolidated Statements of Income

(Dollar Amounts in Thousands, Except Per Share Data)

	Three Months Ended September 30		Nine Months Ended September 30	
	2013 (Unaudited)	**2012 (Unaudited)**	**2013 (Unaudited)**	**2012 (Unaudited)**
Interest Income				
Loans receivable	**$ 14,843**	$ 15,527	**$ 48,189**	$ 42,386
Investment securities				
Taxable	**2,084**	2,178	**6,153**	6,738
Tax exempt	**1,114**	1,014	**3,105**	2,944
Total interest income	**18,041**	18,719	**57,447**	52,068
Interest Expense				
Deposits	**1,395**	1,638	**4,320**	4,803
Borrowed funds	**1,465**	1,597	**4,369**	4,635
Subordinated debentures	**512**	485	**1,504**	1,427
Total interest expense	**3,372**	3,720	**10,193**	10,865
Net Interest Income	**14,669**	14,999	**47,254**	41,203
Provision for loan losses	**104**	1,041	**2,917**	1,809
Net Interest Income after Provision for Loan Losses	**14,565**	13,958	**44,337**	39,394
Non-interest Income				
Service charges on deposit accounts	**1,083**	1,002	**2,984**	2,477
Wire transfer fees	**169**	248	**562**	643
Interchange fees	**1,123**	885	**3,049**	2,227
Fiduciary activities	**953**	971	**3,140**	2,928
Gain on sale of investment securities (includes $6 and $374 for the three and nine months ended 2013 and $2 for the three and nine months ended 2012, respectively, related to accumulated other comprehensive earnings reclasifications)	**6**	2	**374**	2
Gain on sale of mortgage loans	**1,667**	4,436	**7,580**	10,121
Mortgage servicing income net of impairment	**348**	(355)	**813**	(95)
Increase in cash value of bank owned life insurance	**278**	300	**787**	760

Other income	**283**	221	**930**	344
Total non-interest income	**5,910**	7,710	**20,219**	19,407
Non-interest Expense				
Salaries and employee benefits	**7,694**	7,905	**22,919**	20,407
Net occupancy expenses	**1,172**	1,186	**3,778**	3,216
Data processing	**766**	754	**2,184**	1,883
Professional fees	**357**	366	**1,310**	1,483
Outside services and consultants	**436**	624	**1,634**	1,621
Loan expense	**1,040**	1,311	**3,556**	2,879
FDIC insurance expense	**270**	291	**821**	798
Other losses	**55**	309	**146**	501
Other expense	**2,271**	2,094	**6,487**	5,392
Total non-interest expense	**14,061**	14,840	**42,835**	38,180
Income Before Income Tax	**6,414**	6,828	**21,721**	20,621
Income tax expense (includes $2 and $131 for the three and nine months ended 2013 and $0 for the three and nine months ended 2012, respectively, related to income tax expense from reclassification items)	**1,629**	1,978	**5,960**	6,248
Net Income	**4,785**	4,850	**15,761**	14,373
Preferred stock dividend and discount accretion	**(66)**	(63)	**(308)**	(325)
Net Income Available to Common Shareholders	**$ 4,719**	$ 4,787	**$ 15,453**	$ 14,048
Basic Earnings Per Share	**$ 0.55**	$ 0.56	**$ 1.79**	$ 1.81
Diluted Earnings Per Share	**0.52**	0.54	**1.72**	1.75

See notes to condensed consolidated financial statements

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HORIZON BANCORP AND SUBSIDIARIES

Condensed Consolidated Statements of Comprehensive Income

(Dollar Amounts in Thousands)

	Three Months Ended September 30		Nine Months Ended September 30	
	2013 (Unaudited)	**2012 (Unaudited)**	**2013 (Unaudited)**	**2012 (Unaudited)**
Net Income	**$ 4,785**	$ 4,850	**$ 15,761**	$ 14,373
Other Comprehensive Income (Loss)				
Change in fair value of derivative instruments:				
Change in fair value of derivative instruments for the period	**38**	(259)	**2,058**	(904)
Income tax effect	**(13)**	90	**(720)**	316
Changes from derivative instruments	**25**	(169)	**1,338**	(588)
Change in securities available-for-sale:				
Unrealized appreciation (depreciation) for the period	**(959)**	2,453	**(15,566)**	4,533
Reclassification adjustment for securities gains realized in income	**6**	2	**374**	2
Income tax effect	**334**	(860)	**5,318**	(1,588)
Unrealized gains (losses) on available-for-sale securities	**(619)**	1,595	**(9,874)**	2,947
Other Comprehensive Income (Loss), Net of Tax	**(594)**	1,426	**(8,536)**	2,359
Comprehensive Income	**$ 4,191**	$ 6,276	**$ 7,225**	$ 16,732

See notes to condensed consolidated financial statements

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HORIZON BANCORP AND SUBSIDIARIES

Condensed Consolidated Statement of Stockholders Equity

(Unaudited)

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

	Preferred Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balances, January 1, 2013	**$ 12,500**	**$ 31,965**	**$ 105,402**	**$ 9,101**	**$ 158,968**
Net income			15,761		15,761
Other comprehensive income (loss), net of tax				(8,536)	(8,536)
Amortization of unearned compensation		207			207
Exercise of stock options		34			34
Stock option expense		31			31
Cash dividends on preferred stock (3.29%)			(308)		(308)
Cash dividends on common stock ($.31 per share)			(2,698)		(2,698)
Balances, September 30, 2013	**$ 12,500**	**$ 32,237**	**$ 118,157**	**$ 565**	**$ 163,459**

See notes to condensed consolidated financial statements

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HORIZON BANCORP AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(Dollar Amounts in Thousands)

	Nine Months Ended September 30	
	2013 (Unaudited)	2012 (Unaudited)
Operating Activities		
Net income	$ 15,761	$ 14,373
Items not requiring (providing) cash		
Provision for loan losses	2,917	1,809
Depreciation and amortization	2,522	1,988
Share based compensation	31	25
Mortgage servicing rights impairment (recovery)	(208)	369
Premium amortization on securities available for sale, net	2,221	2,387
Gain on sale of investment securities	(374)	(2)
Gain on sale of mortgage loans	(7,580)	(10,121)
Proceeds from sales of loans	306,505	293,909
Loans originated for sale	(289,775)	(283,788)
Change in cash value of life insurance	(753)	(727)
(Gain) loss on sale of other real estate owned	(270)	(5)
Net change in		
Interest receivable	210	(757)
Interest payable	(72)	(107)
Other assets	8,493	217
Other liabilities	326	(2,112)
Net cash provided by operating activities	39,954	17,458
Investing Activities		
Purchases of securities available for sale	(152,275)	(96,713)
Proceeds from sales, maturities, calls, and principal repayments of securities available for sale	103,893	92,734
Purchase of securities held to maturity	(9,910)	
Proceeds from maturities of securities held to maturity		4,177
Purchase of Federal Reserve Bank stock	(851)	
Net change in loans	101,796	(66,596)
Proceeds on the sale of OREO and repossessed assets	2,138	2,661
Purchases of premises and equipment	(3,033)	(4,520)
Acquisition of Heartland		26,283
Net cash provided by (used in) by investing activities	41,758	(41,974)

Financing Activities

Net change in				
Deposits		**34,167**		**85,861**
Borrowings		**(103,142)**		**(38,078)**
Proceeds from issuance of stock		**34**		**341**
Dividends paid on common shares		**(2,698)**		**(2,168)**
Dividends paid on preferred shares		**(308)**		**(325)**
Net cash provided by (used in) financing activities		**(71,947)**		**45,631**
Net Change in Cash and Cash Equivalent		**9,765**		**21,115**
Cash and Cash Equivalents, Beginning of Period		**30,735**		**20,447**
Cash and Cash Equivalents, End of Period	**$**	**40,500**	**$**	**41,562**
Additional Cash Flows Information				
Interest paid	**$**	**10,265**	**$**	**10,882**
Income taxes paid		**3,100**		**3,925**
Transfer of loans to other real estate owned		**2,528**		**3,486**

See notes to condensed consolidated financial statements

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HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Note 1 Accounting Policies

The accompanying 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, 2013 and September 30, 2012 are not necessarily indicative of the operating results for the full year of 2013 or 2012. 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 2012 filed with the Securities and Exchange Commission on March 12, 2013. The consolidated condensed balance sheet of Horizon as of December 31, 2012 has been derived from the audited balance sheet as of that date.

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

	Three months ended September 30		Nine months ended September 30	
	2013 (Unaudited)	**2012 (Unaudited)**	**2013 (Unaudited)**	**2012 (Unaudited)**
Basic earnings per share				
Net income	**$ 4,785**	$ 4,850	**$ 15,761**	$ 14,373
Less: Preferred stock dividends and accretion of discount	**66**	63	**308**	325
Net income available to common shareholders	**$ 4,719**	$ 4,787	**$ 15,453**	$ 14,048
Weighted average common shares outstanding (1)(2)	**8,618,969**	8,503,475	**8,617,972**	7,758,537
Basic earnings per share	**$ 0.55**	$ 0.56	**$ 1.79**	$ 1.81

Diluted earnings per share				
Net income available to common shareholders	**$ 4,719**	$ 4,787	**$ 15,453**	$ 14,048
Weighted average common shares outstanding [1][2]	**8,618,969**	8,503,475	**8,617,972**	7,758,537
Effect of dilutive securities:				
Warrants	**314,353**	269,431	**299,704**	231,037
Restricted stock	**40,833**	30,971	**39,883**	19,317
Stock options	**45,056**	34,782	**41,069**	26,105
Weighted average shares outstanding	**9,019,211**	8,838,659	**8,998,628**	8,034,996
Diluted earnings per share	**$ 0.52**	$ 0.54	**$ 1.72**	$ 1.75

(1) Adjusted for 3:2 stock split on November 9, 2012

(2) Includes average shares issued for the Heartland acquisition for the three and nine months ending September 30, 2012

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HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

For the nine months ended September 30, 2013 and 2012, there were no shares and 12,750 shares, respectively, which were not included in the computation of diluted earnings per share because they were non-dilutive.

Horizon has share-based employee compensation plans, which are described in the notes to the financial statements included in the December 31, 2012 Annual Report on Form 10-K.

Reclassifications

Certain reclassifications have been made to the 2012 consolidated financial statements to be comparable to 2013. These reclassifications had no effect on net income.

Note 2 Acquisition

On July 17, 2012, Horizon closed its acquisition of Heartland Bancshares, Inc. and Horizon Bank N.A. s acquisition of Heartland Community Bank, through mergers effective as of that date. Under the final terms of the acquisition, the exchange ratio was 0.81 shares of Horizon s common stock for each share of Heartland common stock outstanding. Heartland shares outstanding at the closing were 1,442,449, and the shares of Horizon common stock issued to Heartland shareholders totaled 1,168,383. Horizon s stock price was $16.83 per share at the close of business on July 17, 2012. Based upon these numbers, the total value of the consideration, including the retirement of TARP, for the acquisition was $26.9 million. For the year ended December 31, 2012, the Company had approximately $1.5 million in costs related to the acquisition. These expenses are classified in the non-interest expense section of the income statement primarily located in the salaries and employee benefits, professional services and other expense line items. As a result of the acquisition, the Company has the opportunity to increase its deposit base and reduce transaction costs. The Company also expects to continue reducing costs through economies of scale.

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

ASSETS	
Cash and due from banks	$ 33,531
Investment securities, available for sale	63,707
Commercial	70,343
Residential mortgage	20,838
Consumer	23,423

Total loans	114,604
Premises and equipment	2,647
FRB and FHLB stock	943
Goodwill	13,838
Core deposit intangible	2,332
Interest receivable	820
Cash value life insurance	4,012
Other assets	9,210
Total assets purchased	$ 245,644
Common shares issued	$ 19,668
Retirement of TARP preferred shares	7,248
Total estimated purchase price	$ 26,916
LIABILITIES	
Deposits	
Non-interest bearing	$ 59,350
NOW accounts	42,681
Savings and money market	61,465
Certificates of deposits	47,749
Total deposits	211,245
Borrowings	1,186
Subordinated debentures	1,537
Interest payable	90
Other liabilities	4,670
Total liabilities assumed	$ 218,728

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Of the total estimated purchase price of $26.9 million, $2.3 million has been allocated to core deposit intangible. Additionally, $13.8 million has been allocated to goodwill and $10.8 million of the purchase price is deductible and was assigned to the business assets. The core deposit intangible will be amortized over seven years on a straight line basis.

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

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

The Company acquired the $131.1 million loan portfolio at a fair value discount of $16.5 million. The performing portion of the portfolio, $95.4 million, had an estimated fair value of $91.6 million. The excess of expected cash flows above the fair value of the performing portion of loans will be accreted to interest income over the remaining lives of the loans in accordance with ASC 310-20.

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

The following table details the acquired loans that are accounted for in accordance with ASC 310-30 (formerly Statement of Position SOP 03-3) as of July 17, 2012.

Contractually required principal and interest at acquisition	$ 35,574
Contractual cash flows not expected to be collected (nonaccretable differences)	5,264
Expected cash flows at acquisition	30,310
Interest component of expected cash flows (accretable discount)	7,494

Fair value of acquired loans accounted for under ASC 310-30	$ 22,816

Pro-forma statements were determined to be impracticable due to the materiality of the transaction.

The carrying amount of those loans is included in the balance sheet amounts of loans receivable at September 30, 2013. The amounts of loans at September 30, 2013, are as follows:

Commercial	$ 44,717
Real estate	13,146
Consumer	12,612
Outstanding balance	$ 70,475
Carrying amount, net of allowance of $488	$ 69,987

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HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Accretable yield, or income expected to be collected, is as follows:

Balance at December 31, 2012	$ 6,111
Additions	
Accretion	(1,016)
Reclassification from nonaccreatable difference	
Disposals	(1,629)
Balance at September 30, 2013	$ 3,466

During the nine months ended September 30, 2013, the Company increased the allowance for loan losses by a charge to the income statement of $1.6 million. No allowances for loan losses were reversed for the nine months ended 2013.

Note 3 Securities

The fair value of securities is as follows:

September 30, 2013	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Available for sale				
U.S. Treasury and federal agencies	$ 43,161	$ 243	$ (647)	$ 42,757
State and municipal	176,711	5,505	(2,699)	179,517
Federal agency collateralized mortgage obligations	111,266	1,293	(1,777)	110,782
Federal agency mortgage-backed pools	176,880	3,907	(1,593)	179,194
Private labeled mortgage-backed pools	1,290	44		1,334
Corporate notes	532	28		560
Total available for sale investment securities	$ 509,840	$ 11,020	$ (6,716)	$ 514,144
Held to maturity, State and Municipal	$ 9,910	$	$	$ 9,910

December 31, 2012

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
U.S. Treasury and federal agencies	$ 51,458	$ 351	$ (30)	$ 51,779
State and municipal	162,147	10,842	(84)	172,905
Federal agency collateralized mortgage obligations	95,337	1,533	(39)	96,831
Federal agency mortgage-backed pools	152,372	6,847	(15)	159,204
Private labeled mortgage-backed pools	1,960	71		2,031
Corporate notes	32	19		51
Total available for sale investment securities	$ 463,306	$ 19,663	$ (168)	$ 482,801

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, 2013, no individual investment security had an unrealized loss that was determined to be other-than-temporary.

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

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HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

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, 2013.

The amortized cost and fair value of securities available for sale and held to maturity at September 30, 2013 and December 31, 2012, 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, 2013		December 31, 2012	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for sale				
Within one year	$ 3,968	$ 3,987	$ 4,358	$ 4,368
One to five years	49,167	49,763	49,415	50,673
Five to ten years	99,931	102,194	98,551	104,258
After ten years	67,338	66,890	61,313	65,436
	220,404	222,834	213,637	224,735
Federal agency collateralized mortgage obligations	111,266	110,782	95,337	96,831
Federal agency mortgage-backed pools	176,880	179,194	152,372	159,204
Private labeled mortgage-backed pools	1,290	1,334	1,960	2,031
Total available for sale investment securities	$ 509,840	$ 514,144	$ 463,306	$ 482,801
Held to maturity				
Within one year	$ 9,910	$ 9,910	$	$
One to five years				
Total held to maturity investment securities	$ 9,910	$ 9,910	$	$

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.

September 30, 2013	Less than 12 Months Fair Value	Unrealized Losses	12 Months or More Fair Value	Unrealized Losses	Total Fair Value	Unrealized Losses
U.S. Treasury and federal agencies	$ 27,836	$ (647)	$	$	$ 27,836	$ (647)
State and municipal	53,822	(2,686)	1,033	(13)	54,855	(2,699)
Federal agency collateralized mortgage obligations	56,488	(1,645)	4,499	(132)	60,987	(1,777)
Federal agency mortgage-backed pools	52,517	(1,593)			52,517	(1,593)
Total temporarily impaired securities	$ 190,663	$ (6,571)	$ 5,532	$ (145)	$ 196,195	$ (6,716)

December 31, 2012	Less than 12 Months Fair Value	Unrealized Losses	12 Months or More Fair Value	Unrealized Losses	Total Fair Value	Unrealized Losses
U.S. Treasury and federal agencies	$ 13,064	$ (30)	$	$	$ 13,064	$ (30)
State and municipal	11,928	(84)			11,928	(84)
Federal agency collateralized mortgage obligations	12,719	(39)			12,719	(39)
Federal agency mortgage-backed pools	4,126	(15)			4,126	(15)
Total temporarily impaired securities	$ 41,837	$ (168)	$	$	$ 41,837	$ (168)

	Three months ended September 30 2013	2012	Nine months ended September 30 2013	2012
Sales of securities available for sale (Unaudited)				
Proceeds	**$ 648**	$	**$ 23,853**	$
Gross gains	**6**		**382**	
Gross losses			**(8)**	

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HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Note 4 Loans

	September 30 2013	December 31 2012
Commercial		
Working capital and equipment	**$ 239,305**	$ 198,805
Real estate, including agriculture	**243,262**	247,108
Tax exempt	**3,093**	4,579
Other	**13,924**	9,979
Total	**499,584**	460,471
Real estate		
1-4 family	**184,928**	185,940
Other	**4,326**	3,774
Total	**189,254**	189,714
Consumer		
Auto	**137,991**	142,149
Recreation	**4,955**	5,163
Real estate/home improvement	**31,045**	29,989
Home equity	**98,657**	104,974
Unsecured	**3,785**	4,194
Other	**2,557**	2,615
Total	**278,990**	289,084
Mortgage warehouse	**113,591**	251,448
Total loans	**1,081,419**	1,190,717
Allowance for loan losses	**(17,848)**	(18,270)
Loans, net	**$ 1,063,571**	$ 1,172,447

Commercial

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

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

HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Real Estate and Consumer

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

Mortgage Warehousing

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

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

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HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

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

September 30, 2013	Loan Balance	Interest Due	Deferred Fees / (Costs)	Recorded Investment
Owner occupied real estate	$ 153,113	$ 226	$ 212	$ 153,551
Non owner occupied real estate	229,654	175	430	230,259
Residential spec homes	242			242
Development & spec land loans	15,621	39	43	15,703
Commercial and industrial	100,194	732	75	101,001
Total commercial	498,824	1,172	760	500,756
Residential mortgage	179,964	567	409	180,940
Residential construction	8,881	17		8,898
Mortgage warehouse	113,591	480		114,071
Total real estate	302,436	1,064	409	303,909
Direct installment	28,968	92	(278)	28,782
Direct installment purchased	331			331
Indirect installment	129,450	306		129,756
Home equity	120,222	517	297	121,036
Total consumer	278,971	915	19	279,905
Total loans	1,080,231	3,151	1,188	1,084,570
Allowance for loan losses	(17,848)			(17,848)
Net loans	$ 1,062,383	$ 3,151	$ 1,188	$ 1,066,722

December 31, 2012	Loan Balance	Interest Due	Deferred Fees / (Costs)	Recorded Investment
Owner occupied real estate	$ 162,694	$ 503	$ 485	$ 163,682
Non owner occupied real estate	201,763	467	276	202,506
Residential spec homes	1,056	8		1,064
Development & spec land loans	6,963	11		6,974
Commercial and industrial	87,082	380	152	87,614

Total commercial	459,558	1,369	913	461,840
Residential mortgage	181,450	565	583	182,598
Residential construction	7,681	13		7,694
Mortgage warehouse	251,448	480		251,928
Total real estate	440,579	1,058	583	442,220
Direct installment	27,831	115	(204)	27,742
Direct installment purchased	429			429
Indirect installment	133,481	370		133,851
Home equity	126,588	605	959	128,152
Total consumer	288,329	1,090	755	290,174
Total loans	1,188,466	3,517	2,251	1,194,234
Allowance for loan losses	(18,270)			(18,270)
Net loans	$ 1,170,196	$ 3,517	$ 2,251	$ 1,175,964

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HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Note 5 Allowance for Loan Losses

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

	Three Months Ended September 30		Nine Months Ended September 30	
	2013 (Unaudited)	2012 (Unaudited)	2013 (Unaudited)	2012 (Unaudited)
Balance at beginning of the period	$ 18,880	$ 18,374	$ 18,270	$ 18,882
Loans charged-off:				
Commercial				
Owner occupied real estate		92	138	95
Non owner occupied real estate	539	81	730	109
Residential development				
Development & Spec Land Loans	182		182	
Commercial and industrial	35	221	948	548
Total commercial	756	394	1,998	752
Real estate				
Residential mortgage	43	247	602	451
Residential construction				
Mortgage warehouse				
Total real estate	43	247	602	451
Consumer				
Direct Installment	87	90	282	261
Direct Installment Purchased				
Indirect Installment	329	313	953	922
Home Equity	306	123	945	1,010
Total consumer	722	526	2,180	2,193
Total loans charged-off	1,520	1,167	4,780	3,396
Recoveries of loans previously charged-off:				

Commercial				
Owner occupied real estate	15		61	352
Non owner occupied real estate	35		38	7
Residential development				
Development & Spec Land Loans				
Commercial and industrial	101	61	248	114
Total commercial	151	61	347	473
Real estate				
Residential mortgage	3	42	11	74
Residential construction				
Mortgage warehouse				
Total real estate	3	42	11	74
Consumer				
Direct Installment	10	28	458	63
Direct Installment Purchased				
Indirect Installment	157	173	529	563
Home Equity	63	16	95	100
Total consumer	230	217	1,082	726
Total loan recoveries	384	320	1,440	1,273
Net loans charged-off	1,136	847	3,340	2,123
Provision charged to operating expense				
Commercial	741	625	1,543	320
Real estate	(381)	254	606	900
Consumer	(256)	162	769	589
Total provision charged to operating expense	104	1,041	2,917	1,809
Balance at the end of the period	$ 17,848	$ 18,568	$ 17,848	$ 18,568

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HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

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

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

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

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

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

September 30, 2013	Commercial	Real Estate	Mortgage Warehousing	Consumer	Total
Allowance For Loan Losses					
Ending allowance balance attributable to loans:					
Individually evaluated for impairment	$ 1,316	$	$	$	$ 1,316
Collectively evaluated for impairment	6,347	3,238	1,686	5,261	16,532
Total ending allowance balance	$ 7,663	$ 3,238	$ 1,686	$ 5,261	$ 17,848

Loans:					
Individually evaluated for impairment	$ 7,919	$	$	$	$ 7,919
Collectively evaluated for impairment	492,837	189,838	114,071	279,905	1,076,651
Total ending loans balance	$ 500,756	$ 189,838	$ 114,071	$ 279,905	$ 1,084,570

December 31, 2012	**Commercial**	**Real Estate**	**Mortgage Warehousing**	**Consumer**	**Total**
Allowance For Loan Losses					
Ending allowance balance attributable to loans:					
Individually evaluated for impairment	$ 1,945	$	$	$	$ 1,945
Collectively evaluated for impairment	5,826	3,204	1,705	5,590	16,325
Total ending allowance balance	$ 7,771	$ 3,204	$ 1,705	$ 5,590	$ 18,270
Loans:					
Individually evaluated for impairment	$ 10,597	$	$	$	$ 10,597
Collectively evaluated for impairment	451,243	190,292	251,928	290,174	1,183,637
Total ending loans balance	$ 461,840	$ 190,292	$ 251,928	$ 290,174	$ 1,194,234

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HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Note 6 Non-performing Loans and Impaired Loans

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

September 30, 2013	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	$ 464	$	$ 82	$ 783	$ 1,329
Non owner occupied real estate	2,829		825		3,654
Residential development					
Development & Spec Land Loans	170				170
Commercial and industrial	1,953		781		2,734
Total commercial	5,416		1,688	783	7,887
Real estate					
Residential mortgage	3,436	2	2,693	1,678	7,809
Residential construction			284		284
Mortgage warehouse					
Total real estate	3,436	2	2,977	1,678	8,093
Consumer					
Direct Installment	249				249
Direct Installment Purchased					
Indirect Installment	657				657
Home Equity	3,228		1,321	1,046	5,595
Total Consumer	4,134		1,321	1,046	6,501
Total	$ 12,986	$ 2	$ 5,986	$ 3,507	$ 22,481

December 31, 2012	Nonaccrual

		Loans Past Due Over 90 Days Still Accruing	Non Performing TDR s	Performing TDR s	Total Non-Performing Loans
Commercial					
Owner occupied real estate	$ 2,800	$	$ 1,272	$ 819	$ 4,891
Non owner occupied real estate	1,705		1,605	446	3,756
Residential development					
Development & Spec Land Loans	705				705
Commercial and industrial	544		797		1,341
Total commercial	5,754		3,674	1,265	10,693
Real estate					
Residential mortgage	4,565	2	2,536	1,761	8,864
Residential construction			291		291
Mortgage warehouse					
Total real estate	4,565	2	2,827	1,761	9,155
Consumer					
Direct Installment	138	26			164
Direct Installment Purchased					
Indirect Installment	866	26			892
Home Equity	2,051		148	676	2,875
Total Consumer	3,055	52	148	676	3,931
Total	$ 13,374	$ 54	$ 6,649	$ 3,702	$ 23,779

HORIZON BANCORP AND SUBSIDIARIES

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

Included in the $13.0 million of non-accrual loans and the $6.0 million of non-performing TDR s at September 30, 2013 were $1.6 million and $857,000, respectively, of loans acquired for which accretable yield was recognized.

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 the payment is delinquent in excess of 90 days or the loan has had the accrual of interest discontinued by management. The officer responsible for the loan and the Chief Operating Officer or the Senior Vice President of Operations must review all loans placed on non-accrual status. Subsequent payments on non-accrual loans are recorded as a reduction of principal, and interest income is recorded only after principal recovery is reasonably assured. Nonaccrual loans are returned to accrual status when, in the opinion of management, the financial position of the borrower indicates there is no longer any reasonable doubt as to the timely collection of interest or principal in accordance with the loan terms. The Company requires a period of satisfactory performance of not less than nine months before returning a nonaccrual loan to accrual status.

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

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

Loans for which it is probable that the Company will not collect all principal and interest due according to contractual terms, including 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, 2013, the type of concessions the Company has made on restructured loans has been temporary rate reductions and/or reductions in monthly payments and there have been no restructured loans with modified recorded balances. 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 nine consecutive payments but is still reported as TDR unless the loan bears interest at a market rate. As of September 30, 2013, the Company had $9.5 million in TDRs and $3.5 million were performing according to the restructured terms and no TDR s were returned to accrual status in the first nine months of 2013. There was $440,000 million of specific reserves allocated to TDRs at September 30, 2013 based on the collateral deficiencies.

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

Loans transferred and classified as troubled debt restructured loans during the nine months ended September 30, 2013 and 2012, segregated by class, are shown in the table below.

	September 30, 2013		September 30, 2012	
	Number of Defaults	Unpaid Principal Balance	Number of Defaults	Unpaid Principal Balance
Commercial				
Owner occupied real estate	**2**	**$ 81**	3	$ 1,472
Non owner occupied real estate	**1**	**68**	3	637
Residential development				
Development & Spec Land Loans				
Commercial and industrial				
Total commercial	**3**	**149**	6	2,109
Real estate				
Residential mortgage	**8**	**1,132**	1	582
Residential construction				
Mortgage warehouse				
Total real estate	**8**	**1,132**	1	582
Consumer				
Direct Installment				
Direct Installment Purchased				
Indirect Installment				
Home Equity	**7**	**1,882**		
Total Consumer	**7**	**1,882**		
Total	**18**	**$ 3,163**	7	$ 2,691

Troubled debt restructured loans which had payment defaults during the nine months ended September 30, 2013 and 2012, segregated by class, are shown in the table below. Default occurs when a loan is 90 days or more past due or has been transferred to nonaccrual.

	September 30, 2013		September 30, 2012	
	Number of Defaults	Unpaid Principal Balance	Number of Defaults	Unpaid Principal Balance
Commercial				
Owner occupied real estate	**2**	**$ 81**	3	$ 1,473
Non owner occupied real estate	**1**	**68**	2	261
Residential development				
Development & Spec Land Loans				
Commercial and industrial				
Total commercial	**3**	**149**	5	1,734
Real estate				
Residential mortgage	**4**	**400**	2	677
Residential construction				
Mortgage warehouse				
Total real estate	**4**	**400**	2	677
Consumer				
Direct Installment				
Direct Installment Purchased				
Indirect Installment				
Home Equity	**4**	**1,175**		
Total Consumer	**4**	**1,175**		
Total	**11**	**$ 1,724**	7	$ 2,411

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

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

				Three Months Ending		Nine Months Ending	
September 30, 2013	**Unpaid Principal Balance**	**Recorded Investment**	**Allowance For Loan Loss Allocated**	**Average Balance in Impaired Loans**	**Cash/ Accrual Interest Income Recognized**	**Average Balance in Impaired Loans**	**Cash/ Accrual Interest Income Recognized**
With no recorded allowance							
Commercial							
Owner occupied real estate	$ 1,329	$ 1,331	$	$ 1,959	16	$ 2,685	$ 43
Non owner occupied real estate	3,167	3,170		3,814	8	3,298	21
Residential development							
Development & Spec Land Loans	21	21		24		25	
Commercial and industrial	546	561		1,297		1,311	
Total commercial	5,063	5,083		7,094	24	7,319	64
With an allowance recorded							
Commercial							
Owner occupied real estate				(1)			
Non owner occupied real estate	487	487	302	491		502	
Residential development							
Development & Spec Land Loans	149	149	48	173		165	
Commercial and industrial	2,188	2,200	966	2,379		1,808	23
Total commercial	2,824	2,836	1,316	3,042		2,475	23
Total	$ 7,887	$ 7,919	$ 1,316	$ 10,136	$ 24	$ 9,794	$ 87

				Three Months Ending		Nine Months Ending	
September 30, 2012	**Unpaid Principal**	**Recorded Investment**	**Allowance For Loan Loss**	**Average Balance in**	**Cash/ Accrual Interest**	**Average Balance in**	**Cash/ Accrual Interest**

	Balance		Allocated	Impaired Loans	Income Recognized	Impaired Loans	Income Recognized
With no recorded allowance							
Commercial							
Owner occupied real estate	$ 4,457	$ 4,460	$	$ 3,810	$	$ 1,978	$ 3
Non owner occupied real estate	2,521	2,542		2,429	70	1,920	72
Residential development							
Development & Spec Land Loans	131	131		109		37	
Commercial and industrial	456	471		382		129	
Total commercial	7,565	7,604		6,730	70	4,064	75
With an allowance recorded							
Commercial							
Owner occupied real estate	903	903	450	910		1,109	1
Non owner occupied real estate	2,938	2,938	1,065	2,943		2,843	
Residential development							
Development & Spec Land Loans	658	658	615	660		523	6
Commercial and industrial	801	801	273	801		807	
Total commercial	5,300	5,300	2,403	5,314		5,282	7
Total	$ 12,865	$ 12,904	$ 2,403	$ 12,044	$ 70	$ 9,346	$ 82

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

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

September 30, 2013	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	$ 99	$	$	$ 99	$ 153,014	$ 153,113
Non owner occupied real estate	45			45	229,609	229,654
Residential development					242	242
Development & Spec Land Loans					15,621	15,621
Commercial and industrial	13			13	100,181	100,194
Total commercial	157			157	498,667	498,824
Real estate						
Residential mortgage	695	351	2	1,048	178,916	179,964
Residential construction					8,881	8,881
Mortgage warehouse					113,591	113,591
Total real estate	695	351	2	1,048	301,388	302,436
Consumer						
Direct Installment	122	13		135	28,833	28,968
Direct Installment Purchased					331	331
Indirect Installment	894	60		954	128,496	129,450
Home Equity	173	227		400	119,822	120,222
Total consumer	1,189	300		1,489	277,482	278,971
Total	$ 2,041	$ 651	$ 2	$ 2,694	$ 1,077,537	$ 1,080,231
Percentage of total loans	0.19%	0.06%	0.00%	0.25%	99.75%	

December 31, 2012	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total

Commercial						
Owner occupied real estate	$ 2,207	$ 19	$	$ 2,226	$ 160,468	$ 162,694
Non owner occupied real estate	669	147		816	200,947	201,763
Residential development					1,056	1,056
Development & Spec Land Loans					6,963	6,963
Commercial and industrial	538	16		554	86,528	87,082
Total commercial	3,414	182		3,596	455,962	459,558
Real estate						
Residential mortgage	167		2	169	181,281	181,450
Residential construction					7,681	7,681
Mortgage warehouse					251,448	251,448
Total real estate	167		2	169	440,410	440,579
Consumer						
Direct Installment	240	64	26	330	27,501	27,831
Direct Installment Purchased					429	429
Indirect Installment	1,105	177	26	1,308	132,173	133,481
Home Equity	1,072	321		1,393	125,195	126,588
Total consumer	2,417	562	52	3,031	285,298	288,329
Total	$ 5,998	$ 744	$ 54	$ 6,796	$ 1,181,670	$ 1,188,466
Percentage of total loans	0.50%	0.06%	0.00%	0.57%	99.43%	

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

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

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

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

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

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

For real estate and consumer loans, Horizon uses a grading system based on delinquency. Loans that are 90 days or more past due, on non-accrual, or are classified as a TDR 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.

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Risk Grade 3: Satisfactory (Pass)

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

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

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

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

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

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

Risk Grade 4: Satisfactory/Monitored (Pass)

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

Risk Grade 5: Special Mention

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

Risk Grade 6: Substandard

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

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

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

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

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

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

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

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

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

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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The following table presents loans by credit grades.

September 30, 2013	Pass	Special Mention	Substandard	Doubtful	Total
Commercial					
Owner occupied real estate	$ 142,836	$ 2,600	$ 7,677	$	$ 153,113
Non owner occupied real estate	210,632	3,119	15,903		229,654
Residential development	242				242
Development & Spec Land Loans	13,844	94	1,683		15,621
Commercial and industrial	90,221	5,410	4,563		100,194
Total commercial	457,775	11,223	29,826		498,824
Real estate					
Residential mortgage	172,155		7,809		179,964
Residential construction	8,597		284		8,881
Mortgage warehouse	113,591				113,591
Total real estate	294,343		8,093		302,436
Consumer					
Direct Installment	28,719		249		28,968
Direct Installment Purchased	331				331
Indirect Installment	128,793		657		129,450
Home Equity	114,627		5,595		120,222
Total Consumer	272,470		6,501		278,971
Total	$ 1,024,587	$ 11,223	$ 44,420	$	$ 1,080,231
Percentage of total loans	94.85%	1.04%	4.11%	0.00%	

December 31, 2012	Pass	Special Mention	Substandard	Doubtful	Total
Commercial					
Owner occupied real estate	$ 137,664	$ 6,407	$ 17,029	$ 1,594	$ 162,694
Non owner occupied real estate	171,319	19,440	10,717	287	201,763
Residential development	405		651		1,056

Development & Spec Land Loans	3,171	178	3,614		6,963
Commercial and industrial	78,810	3,136	5,136		87,082
Total commercial	391,369	29,161	37,147	1,881	459,558
Real estate					
Residential mortgage	172,586		8,864		181,450
Residential construction	7,390		291		7,681
Mortgage warehouse	251,448				251,448
Total real estate	431,424		9,155		440,579
Consumer					
Direct Installment	27,667		164		27,831
Direct Installment Purchased	429				429
Indirect Installment	132,589		892		133,481
Home Equity	123,713		2,875		126,588
Total Consumer	284,398		3,931		288,329
Total	$ 1,107,191	$ 29,161	$ 50,233	$ 1,881	$ 1,188,466
Percentage of total loans	93.16%	2.45%	4.23%	0.16%	

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Note 7 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 6.14% on a notional amount of $30.5 million at September 30, 2013 and December 31, 2012. Under the 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 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, 2013 the Company s cash flow hedge was effective and is not expected to have a significant impact on 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 policy. 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, 2013 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 $90.3 million at September 30, 2013 and $81.0 million at December 31, 2012.

Other Derivative Instruments

The Company enters into non-hedging derivatives in the form of mortgage loan forward sale commitments with investors and commitments to originate mortgage loans as part of its mortgage banking business. At September 30, 2013, the Company s fair value of these derivatives were recorded and over the next 12 months are 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, 2013		Liability Derivatives September 30, 2013	
	Balance Sheet Location	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Derivatives designated as hedging instruments (Unaudited)				
Interest rate contracts	Loans	$ 23	Other liabilities	$ 579
Interest rate contracts	Other Assets	556	Other liabilities	3,435
Total derivatives designated as hedging instruments		579		4,014
Derivatives not designated as hedging instruments				
Mortgage loan contracts	Other assets	619	Other liabilities	
Total derivatives not designated as hedging instruments		619		
Total derivatives		$ 1,198		$ 4,014

	Asset Derivative December 31, 2012		Liability Derivatives December 31, 2012	
	Balance Sheet Location	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Derivatives designated as hedging instruments (Unaudited)				
Interest rate contracts	Loans	$ 279	Other liabilities	$ 2,214
Interest rate contracts	Other Assets	1,935	Other liabilities	5,493
		2,214		7,707

Total derivatives designated as hedging instruments				
Derivatives not designated as hedging instruments				
Mortgage loan contracts	Other assets	858	Other liabilities	
Total derivatives not designated as hedging instruments		858		
Total derivatives		$ 3,072		$ 7,707

The effect of the derivative instruments on the condensed consolidated statement of income for the three and nine month periods ending 2013 and 2012 is as follows:

	Comprehensive Income on Derivative (Effective Portion) Three Months Ended September 30		**Comprehensive Income on Derivative (Effective Portion) Nine Months Ended September 30**	
Derivative in cash flow hedging relationship	**2013 (Unaudited)**	**2012 (Unaudited)**	**2013 (Unaudited)**	**2012 (Unaudited)**
Interest rate contracts	$ 25	$ (169)	$ 1,338	$ (588)

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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ivative in fair value hedging tionship	**Location of gain (loss) recognized on derivative**	**Amount of Gain (Loss) Recognized on Derivative Three Months Ended September 30**		**Amount of Gain (Loss) Recogn on Derivative Nine Months Ended Septembe**	
		2013 (Unaudited)	**2012 (Unaudited)**	**2013 (Unaudited)**	**2012 (Unaudite**
rest rate contracts	Interest income - loans	$ 211	$ 112	$ (1,635)	$ 3
est rate contracts	Interest income - loans	(211)	(112)	1,635	(3
l		$	$	$	$

ivative not designated as ging relationship	**Location of gain (loss) recognized on derivative**	**Amount of Gain (Loss) Recognized on Derivative Three Months Ended September 30**		**Amount of Gain (Loss) Recogn on Derivative Nine Months Ended Septembe**	
		2013 (Unaudited)	**2012 (Unaudited)**	**2013 (Unaudited)**	**2012 (Unaudite**
tgage contracts	Other income - gain on sale of loans	$ 169	$ 320	$ (239)	$ 6

Note 8 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 condensed consolidated financial statements, as well as the general classification of such instruments pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the period ended September 30, 2013. For assets classified within Level 3 of the fair value hierarchy, the process used to develop the reported fair value is described below.

Available for sale securities

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

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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 2 of the valuation hierarchy based on the unobservable inputs used.

Interest rate swap agreements

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

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

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2013				
Available-for-sale securities				
U.S. Treasury and federal agencies	$ 42,757	$	$ 42,757	$
State and municipal	179,517		179,517	
Federal agency collateralized mortgage obligations	110,782		110,782	
Federal agency mortgage-backed pools	179,194		179,194	
Private labeled mortgage-backed pools	1,334		1,334	
Corporate notes	560		560	
Total available-for-sale securities	514,144		514,144	
Hedged loans	89,718		89,718	
Forward sale commitments	619		619	

Interest rate swap agreements	(4,014)		(4,014)	
Commitments to originate loans				
December 31, 2012				
Available-for-sale securities				
U.S. Treasury and federal agencies	$ 51,779	$	$ 51,779	$
State and municipal	172,905		172,905	
Federal agency collateralized mortgage obligations	96,831		96,831	
Federal agency mortgage-backed pools	159,204		159,204	
Private labeled mortgage-backed pools	2,031		2,031	
Corporate notes	51		51	
Total available-for-sale securities	482,801		482,801	
Hedged loans	81,018		81,018	
Forward sale commitments	858		858	
Interest rate swap agreements	(7,707)		(7,707)	
Commitments to originate loans				

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Transfers between levels

Transfers between Levels 1, 2 and 3 and the reasons for those transfers are as follows:

December 31, 2012	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Reason for Transfer**
Transfers to level:				
Hedged loans	$	$ 59,911	$	(a)
Forward sale commitments		510		(b)
Interest rate swap agreements		(6,464)		(a)
Commitments to originate loans		(71)		(b)
Total transfers to level	$	$ 53,886	$	

(a) - Valuation determined by widely accepted techniques including discounted cash flow analysis on expected cash flows of each derivative and observable market rate inputs such as yield curves and contractual terms on each instrument.

(b) - Valuation determined by quoted prices for similar loans in the secondary market with an expected fallout rate (interest rate locked pipeline loans not expected to close). Fallout rate is not considered a significant input to the fair value in its entirety.

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:

	Hedged Loans	**Forward Sale Commitments**	**Interest Rate Swaps**	**Commitments to Originate Loans**
Beginning balance December 31, 2011	$ 54,362	$ 662	$ (7,101)	$

Total realized and unrealized gains and losses				
Included in net income	(74)	(152)	74	(71)
Included in other comprehensive income, gross			563	
Purchases, issuances, and settlements	6,114			
Principal payments	(491)			
Transfers out to Level 2	(59,911)	(510)	6,464	71
Ending balance December 31, 2012	$	$	$	$

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**	
Non Interest Income	**2013 (Unaudited)**	**2012 (Unaudited)**	**2013 (Unaudited)**	**2012 (Unaudited)**
Total gains and losses from:				
Hedged loans	$ 211	$ 112	$ (1,635)	$ 336
Fair value interest rate swap agreements	(211)	(112)	1,635	(336)
Derivative loan commitments	169	320	(239)	600
	$ 169	$ 320	$ (239)	$ 600

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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, 2013				
Impaired loans	$ 6,571	$	$	$ 6,571
Mortgage servicing rights	6,302			6,302
December 31, 2012				
Impaired loans	$ 8,652	$	$	$ 8,652
Mortgage servicing rights	5,145			5,145

Impaired (collateral dependent): Loans for which it is probable that the Company will not collect all principal and interest due according to contractual terms 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.

If the impaired loan is identified as collateral dependent, then the fair value method of measuring the amount of impairment is utilized. This method requires obtaining a current independent appraisal of the collateral and applying a discount factor to the value.

Impaired loans that are collateral dependent are classified within Level 3 of the fair value hierarchy when impairment is determined using the fair value method. Fair value adjustments on impaired loans were $1.3 million at September 30, 2013 and $1.9 million at December 31, 2012.

Mortgage Servicing Rights (MSRs): MSRs do not trade in an active market with readily observable prices. Accordingly, the fair value of these assets is classified as Level 3. The Company determines the fair value of MSRs using an income approach model based upon the Company s month-end interest rate curve and prepayment assumptions. The model utilizes assumptions to estimate future net servicing income cash flows, including estimates of time decay, payoffs and changes in valuation inputs and assumptions. The Company reviews the valuation assumptions against this market data for reasonableness and adjusts the assumptions if deemed appropriate. The carrying amount of the MSR s fair value increased by $208,000 during the first nine months of 2013 and decreased by $369,000 during the first nine months of 2012.

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The following table presents qualitative information about unobservable inputs used in recurring and nonrecurring Level 3 fair value measurements, other than goodwill.

	Fair Value at September 30, 2013	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Impaired loans	$ 6,571	Collateral based measurement	Discount to reflect current market conditions and ultimate collectability	10% - 15%(12%)
Mortgage servicing rights	$ 6,302	Discounted cashflows	Discount rate, Constant prepayment rate, Probably of default	10% - 15%(12%), 4% - 7%(4.6%), 1% - 10%(4.5%)

	Fair Value at December 31, 2012	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Impaired loans	$ 8,652	Collateral based measurement	Discount to reflect current market conditions and ultimate collectability	10% - 15%(12%)
Mortgage servicing rights	$ 5,145	Discounted cashflows	Discount rate, Constant prepayment rate, Probably of default	10% - 15%(12%), 4% - 7%(4.6%), 1% - 10%(4.5%)

Note 9 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, 2013 and December 31, 2012. 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.

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.

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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 following table presents estimated fair values of the Company s financial instruments and the level within the fair value hierarchy in which the fair value measurements fall (unaudited).

	September 30, 2013			
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash and due from banks	$ 40,500	$ 40,500	$	$
Investment securities, held to maturity	9,910			9,910
Loans held for sale	4,594			4,594
	973,300			996,408

Loans excluding loan level hedges, net				
Stock in FHLB and FRB	14,184		14,184	
Interest receivable	7,506		7,506	
Liabilities				
Non-interest bearing deposits	$ 223,354	$ 223,354	$	$
Interest-bearing deposits	1,104,966		1,060,853	
Borrowings	242,505		245,043	
Subordinated debentures	32,448		32,483	
Interest payable	488		488	

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	December 31, 2012			
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash and due from banks	$ 30,735	$ 30,735	$	$
Loans held for sale	13,744			13,744
Loans excluding loan level hedges, net	1,089,215			1,118,255
Stock in FHLB and FRB	13,333		13,333	
Interest receivable	7,716		7,716	
Liabilities				
Non-interest bearing deposits	$ 209,200	$ 209,200	$	$
Interest-bearing deposits	1,084,953		1,092,184	
Borrowings	345,764		352,891	
Subordinated debentures	32,331		32,268	
Interest payable	560		560	

Note 10 Other Comprehensive Income

	Accumulated Other Comprehensive Income [1]		
Unaudited	Unrealized Gains (Losses) on Securities Available-for-Sale	Unrealized Gains (Losses) on Derivative Instruments	Total
Balance at December 31, 2012	$ 12,671	$ (3,570)	$ 9,101
Other comprehensive income (loss) before reclassifications	(9,631)	1,338	(8,293)
Amounts reclassified from other comprehensive income	(243)		(243)
Period change	(9,874)	1,338	(8,536)

Balance at September 30, 2013	$ 2,797	$ (2,232)	$ 565
Balance at December 31, 2011	$ 11,036	$ (3,194)	$ 7,842
Other comprehensive income (loss) before reclassifications	2,947	(588)	2,359
Amounts reclassified from other comprehensive income			
Period change	2,947	(588)	2,359
Balance at September 30, 2012	$ 13,983	$ (3,782)	$ 10,201

(1) All amounts are net of tax. Related income tax expense or benefit is calculated using a combined Federal and State income tax rate approximating 35%.

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Details About Accumulated Other Comprehensive Income Components Unaudited	Amount Reclassified from Accumulated Other Comprehensive Income For the Three Months Ended September 30, 2013	2012	Affected Line Items in the Statement of Net Income
Securities available-for-sale [1]			
Net securities gains reclassified into earnings	$ 6	$	Gain on sale of investment securities
Related income tax expense	(2)		Income tax expense
Net effect on accumulated other comprehensive income for the period	4		Net of tax
Total reclassifications for the period	$ 4	$	Net of tax

(1) For additional detail related to unrealized gains on securities and related amounts reclassified from accumulated other comprehensive income see Note 3, Securities

Details About Accumulated Other Comprehensive Income Components Unaudited	Amount Reclassified from Accumulated Other Comprehensive Income For the Nine Months Ended September 30, 2013	2012	Affected Line Items in the Statement of Net Income
Securities available-for-sale [1]			
Net securities gains reclassified into earnings	$ 374	$	Gain on sale of investment securities
Related income tax expense	(131)		Income tax expense
Net effect on accumulated other comprehensive income for the period	243		Net of tax
Total reclassifications for the period	$ 243	$	Net of tax

(1) For additional detail related to unrealized gains on securities and related amounts reclassified from accumulated other comprehensive income see Note 3, Securities

Note 11 Future accounting matters

Accounting Standards Update No. 2013-04 Liabilities (Topic 405) On February 28, 2013, FASB issued ASU 2013-04. The amendments in this Update provide guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this Update is fixed at the reporting date, except for obligations addressed within existing guidance in U.S. GAAP. The guidance requires an entity to measure those obligations as the sum of the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and any additional amount the reporting entity expects to pay on behalf of its co-obligors.

The guidance in this Update also requires an entity to disclose the nature and amount of the obligation as well as other information about those obligations. This Accounting Standards Update is the final version of Proposed Accounting Standards Update EITF12D Liabilities (Topic 405) which has been deleted.

The amendments in this Update are effective for fiscal years beginning after December 31, 2013. Early adoption is permitted. The Company will adopt the methodologies prescribed by this ASU by the date required, and does not anticipate that the ASU will have a material effect on its financial position or results of operations.

Accounting Standards Update No. 2013-07 Presentation of Financial Statements (Topic 205) On April 22, 2013, FASB issued ASU 2013-07. The objective of this Update is to clarify when an entity should apply the liquidation basis of accounting and to provide principles for the measurement of assets and liabilities under the liquidation basis of accounting, as well as any required disclosures. This Accounting Standards Update is the final version of Proposed Accounting Standards Update 2012-210 Presentation of Financial Statements (Topic 205), which has been deleted.

The amendments are effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein. Entities should apply the requirements prospectively from the day that liquidation becomes imminent. Early adoption is permitted. The Company will adopt the methodologies prescribed by this ASU by the date required, and does not anticipate that the ASU will have a material effect on its financial position or results of operations.

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Accounting Standards Update No. 2013-10 Derivatives and Hedging (Topic 815) In July 2013, FASB issued ASU 2013-10. The objective of this Update is to provide for the inclusion of the Fed Funds Effective Swap Rate Overnight Index Swap Rate (OIS) as a U.S. benchmark interest rate for hedge accounting purposes, in addition to U.S. Treasury (UST) or London Interbank Offered Rate (LIBOR) indices. The Update also removes a restriction stating that entities must use the same rates for similar hedges, offering greater flexibility in hedge accounting.

The amendments in this Update are effective prospectively for qualifying new or re-designated hedging relationships entered into on or after July 17, 2013. The Company has adopted the applicable methodologies prescribed by this ASU and does not anticipate that the ASU will have a material effect on its financial position or results of operations.

Accounting Standards Update No. 2013-11 Income Taxes (Topic 740) In July 2013, FASB issued ASU 2013-11. This update pertains to the unrecognized tax benefit when a net operating loss carry forward, a similar tax loss or a tax credit carry forward exists. The ASU is intended to end the varying ways that entities present these situations since GAAP is non-specific and leads to diversity in practice. The new standard deems that any unrecognized tax benefit or portion of an unrecognized tax benefit should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carry forward, a similar tax loss, or a tax credit carry forward except for certain defined situations.

The amendments in this Update are effective for fiscal years beginning after December 15, 2013. Early adoption is permitted. The Company will adopt the methodologies prescribed by this ASU by the date required, and does not anticipate that the ASU will have a material effect on its financial position or results of operations.

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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 any discussi 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, 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 are not limited to:

- economic conditions and their impact on Horizon and its customers;
- changes in the level and volatility of interest rates, spreads on earning assets and interest-bearing liabilities, and interest rate sensitivity;
- estimates of fair value of certain of Horizon s assets and liabilities;
- volatility and disruption in financial markets;

prepayment speeds, loan originations, credit losses and market values, collateral securing loans and other assets;

sources of liquidity;

potential risk of environmental liability related to lending activities;

changes in the competitive environment in Horizon s market areas and among other financial service providers;

legislation and/or regulation affecting the financial services industry as a whole, and Horizon and its subsidiaries in particular, including the effects resulting from the reforms enacted by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) and the adoption of regulations by regulatory bodies under the Dodd-Frank Act;

the impact of the Basel III capital rules as adopted by the federal banking agencies;

changes in regulatory supervision and oversight, including monetary policy and capital requirements;

changes in accounting policies or procedures as may be adopted and required by regulatory agencies;

rapid technological developments and changes;

containing costs and expenses;

the slowing or failure of economic recovery;

the ability of the U.S. federal government to manage federal debt limits; and

the risks of expansion through mergers and acquisitions, including unexpected credit quality problems with acquired loans, difficulty integrating acquired operations and material differences in the actual financial results of such transactions compared with Horizon s initial expectations, including the full realization of anticipated cost savings.

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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 Item 1A of Part I of our 2012 Annual Report on Form 10-K 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 Northwest and Central 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 and Central Indiana and Southwest Michigan, unemployment rates increased during 2009 and have remained elevated through the first nine months of 2013. This rise in unemployment has been driven by multiple factors including slowdowns in commercial industries as well as a continued lower activity in the housing and construction industries. The Company s higher than historical level of non-performing loans since 2009 can be attributed to the continued sluggish U.S. economy and high local unemployment and bankruptcy levels, which have resulted in lower business revenues. Additionally, performing troubled debt restructurings and the acquisition of Heartland on July 17, 2012, further added to the non-performing credits. Despite these economic factors and events, Horizon has continued to post record results through the first nine months of 2013.

On July 17, 2012, Horizon completed the acquisition of Heartland Bancshares, Inc. and its wholly owned subsidiary, Heartland Community Bank, which was merged into Horizon Bank. Under the final terms of the acquisition, the exchange ratio was 0.81 shares of Horizon s common stock for each outstanding share of Heartland common stock. Heartland shares outstanding at the closing were 1,442,449, and the shares of Horizon common stock issued to Heartland shareholders totaled 1,168,383. Horizon s stock price was $16.83 per share at the close of business on July 17, 2012. Based upon these numbers, the total value of the consideration, including the retirement of TARP, for the acquisition was $26.9 million.

Following are some highlights of Horizon s financial performance through the third quarter of 2013:

Third quarter 2013 net income declined 1.3% compared to the same period in 2012 to $4.8 million or $.52 diluted earnings per share, with the decline primarily reflecting lower income from residential lending, including mortgage warehousing, as demand for mortgage refinancing slowed.

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Net income for the first nine months of 2013 rose 9.7% compared to the same period in 2012 to $15.8 million, the highest first nine months of net income in the Company s history, or $1.72 diluted earnings per share.

Net interest income, before provision for loan losses, for the first nine months of 2013 was $47.3 million compared with $41.2 million for the same period of 2012, partially reflecting commercial loan growth that helped offset lower mortgage business revenue.

Non-interest income rose 4.2% to $20.2 million for the first nine months of 2013 compared with $19.4 million for the same period of 2012, partially reflecting growth in fees from debit and credit card interchange and income growth from fiduciary activities, partially offset by a decline in gains on sale of mortgage loans.

Return on average assets was 1.09% for the third quarter of 2013 and 1.20% for the first nine months of 2013.

Return on average common equity was 12.60% for the third quarter of 2013 and 13.82% for the first nine months of 2013.

Purchase mortgage originations for the third quarter of 2013 increased 7.7% to $73.3 million, representing 69.5% of total mortgage originations compared to $68.0 million or 51.4% of total mortgage originations for the same period of 2012.

Kalamazoo and Indianapolis markets posted quarterly loan growth of $2.2 million and $8.9 million and year over year loan growth of $17.9 million and $34.4 million to $106.9 million and $68.3 million, respectively.

Tangible book value per share increased to $14.82 at September 30, 2013, compared to $14.42 and $13.85 at June 30, 2013 and September 30, 2012, respectively.

Horizon Bank s capital ratios, including Tier 1 Capital to Average Assets of 9.13% and Total Capital to Risk Weighted Assets of 14.09% as of September 30, 2013, 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 2012 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 as critical accounting policies the allowance for loan losses, intangible assets, mortgage servicing rights, hedge accounting and valuation measurements.

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.

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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, 2013, Horizon had core deposit intangibles of $3.5 million subject to amortization and $19.7 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 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, 2013 was $23.35 per share compared to a book value of $17.52 per common share. Horizon reported record earnings for the thirteenth consecutive year in 2012, and the first nine months of 2013 were the highest first nine months of net income in the Company s history.

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,

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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.

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.

Horizon s accounting policies related to derivatives reflect the guidance in FASB ASC 815-10. Derivatives that qualify for the hedge accounting treatment are designated as either: a hedge of the fair value of the recognized asset or liability or of an unrecognized firm commitment (a fair value hedge) or a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability (a cash flow hedge). For fair value hedges, the cumulative change in fair value of both the hedge instruments and the underlying loans is recorded in non-interest income. For cash flow hedges, changes in the fair values of the derivative instruments are reported in OCI to the extent the hedge is effective. The gains and losses on derivative instruments that are reported in OCI are reflected in the consolidated income statement in the periods in which the results of operations are impacted by the variability of the cash flows of the hedged item. Generally, net interest income is increased or decreased by amounts receivable or payable with respect to the derivatives, which qualify for hedge accounting. At inception of the hedge, Horizon establishes the method it uses for assessing the effectiveness of the hedging derivative and the measurement approach for determining the ineffective aspect of the hedge. The ineffective portion of the hedge, if any, is recognized currently in the consolidated statements of income. Horizon excludes the time value expiration of the hedge when measuring ineffectiveness.

Valuation Measurements

Valuation methodologies often involve a significant degree of judgment, particularly when there are no observable active markets for the items being valued. Investment securities, residential mortgage loans held for sale and derivatives are carried at fair value, as defined in FASB ASC 820, which requires key judgments affecting how fair value for such assets and liabilities is determined. In addition, the outcomes of valuations have a direct bearing on the carrying amounts of goodwill, mortgage servicing rights, and pension and other post-retirement benefit obligations. To determine the values of these assets and liabilities, as well as the extent, to which related assets may be impaired, management makes assumptions and estimates related to discount rates, asset returns, prepayment speeds and other factors. The use of different discount rates or other valuation assumptions could produce significantly different results, which could affect Horizon s results of operations.

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Financial Condition

On September 30, 2013, Horizon s total assets were $1.8 billion, a decrease of approximately $67.2 million compared to December 31, 2012. This decrease was primarily due to the reduction of $137.9 million in mortgage warehouse loans, partially offset by an increase in commercial loans of $39.1 million.

Investment securities were comprised of the following as of:

	September 30, 2013		December 31, 2012	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for sale				
U.S. Treasury and federal agencies	$ 43,161	$ 42,757	$ 51,458	$ 51,779
State and municipal	176,711	179,517	162,147	172,905
Federal agency collateralized mortgage obligations	111,266	110,782	95,337	96,831
Federal agency mortgage-backed pools	176,880	179,194	152,372	159,204
Private labeled mortgage-backed pools	1,290	1,334	1,960	2,031
Corporate notes	532	560	32	51
Total available for sale investment securities	$ 509,840	$ 514,144	$ 463,306	$ 482,801
Held to maturity, State and Municipal	$ 9,910	$ 9,910	$	$

Total investment securities increased by approximately $41.3 million at September 30, 2013 compared to December 31, 2012 as excess cash was deployed into investment securities during the nine month period.

Net loans decreased $108.9 million since December 31, 2012. This decrease was the result of a reduction in mortgage warehouse loans of $137.9 million, consumer loans of $10.1 million and residential mortgage loans of $460,000, partially offset by an increase in commercial loans of $39.1 million. The decrease in the Company s mortgage warehousing business reflects lower demand from increased long-term interest rate movements, seasonality and the decline in the demand for mortgage refinance business. The decrease in consumer and residential mortgage loans resulted from loan payments and payoffs outpacing origination volume. The increase in commercial loans was due in part to increased calling efforts to grow Horizon s market share within the Company s footprint. Additionally, Horizon s growth markets, particularly Kalamazoo, MI and Indianapolis, IN, significantly increased their respective loan portfolios during the first nine months of 2013.

Total deposits increased $34.2 million during the first nine months of 2013. This increase was the result of non-interest bearing deposit accounts increasing by $14.2 million due to increased calling and marketing efforts. Interest bearing deposit accounts increased by $20.0 million during the first nine months of 2013 due to an increase of $46.3 million in consumer demand deposits partially offset by a decrease in time deposits of $26.3 million. Additionally, Horizon s growth markets of Kalamazoo, MI and Indianapolis, IN increased their respective deposit balances during first nine months of 2013.

The Company s borrowings decreased $103.3 million from December 31, 2012 as the short-term funding needed for mortgage warehouse loans declined and deposits increased. At September 30, 2013, the Company had $32.5 million of short-term funds borrowed compared to $132.7 million at December 31, 2012. The Company s level of borrowings is influenced by increases or decreases in the level of mortgage warehouse lending activity and outstanding balances. In addition, the Company s current balance sheet strategy is to utilize a reasonable level of short-term borrowings during extended low rate environments in addition to what is needed for the fluctuations in mortgage warehouse lending.

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Stockholders equity totaled $163.5 million at September 30, 2013 compared to $159.0 million at December 31, 2012. The increase in stockholders equity during the period was the result of the generation of net income partially offset by a decrease in accumulated other comprehensive income and dividends declared. For the three month period ended September 30, 2013, the ratio of average stockholders equity to average assets was 9.22% compared to 8.71% for the three month period ended December 31, 2012. Book value per common share at September 30, 2013 increased to $17.52 compared to $17.00 at December 31, 2012.

Results of Operations

Overview

Consolidated net income for the three-month period ended September 30, 2013 was $4.8 million, a decrease of 1.3% from the $4.9 million for the same period in 2012. Earnings per common share for the three months ended September 30, 2013 were $0.55 basic and $0.52 diluted, compared to $0.56 basic and $0.54 diluted for the same three-month period in 2012. The decrease in net income for the third quarter of 2013 primarily reflected the decline in mortgage warehouse activity as mortgage warehouse balances decreased from $244.2 million as of September 30, 2012 to $113.6 million as of September 30, 2013 and the decrease in gain on sale of mortgage loans of $2.8 million from $4.4 million in the third quarter of 2012 to $1.7 million in the third quarter of 2013.

Consolidated net income for the nine-month period ended September 30, 2013 was $15.8 million, an increase of 9.7% from the $14.4 million for the same period in 2012. Earnings per common share for the nine months ended September 30, 2013 were $1.79 basic and $1.72 diluted, compared to $1.81 basic and $1.75 diluted for the same nine-month period in 2012. Diluted earnings per share decreased by $.03 compared with the same nine-month period in 2012 due to an increase in dilutive shares and additional shares issued in the Heartland acquisition. Growth in commercial loans and realizing the synergies from the Heartland transaction contributed to the increase in net income for the first nine months of 2013 as income from residential lending activity, including mortgage warehousing decreased.

Net Interest Income

The largest component of net income is net interest income. Net interest income is the difference between interest income, principally from loans and investment securities, and interest expense, principally on deposits and borrowings. Changes in the net interest income are the result of changes in volume and the net interest spread, which affects the net interest margin. Volume refers to the average dollar levels of interest-earning assets and interest-bearing liabilities. Net interest spread refers to the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities. Net interest margin refers to net interest income divided by average interest-earning assets and is influenced by the level and relative mix of interest-earning assets and interest-bearing liabilities.

Net interest income during the three months ended September 30, 2013 was $14.7 million, a decrease of $330,000 from the $15.0 million earned during the same period in 2012. Yields on the Company s interest-earning assets decreased by 9 basis points to 4.61% from 4.70% for the three months ended September 30, 2013 and 2012, respectively. Interest income decreased $678,000 from $18.7 million for the three months ended September 30, 2012 to $18.0 million for the same period in 2013. The decrease in interest income primarily reflects the decline in mortgage warehouse activity as mortgage warehouse balances decreased from $244.2 million as of September 30, 2012 to $113.6 million as of September 30, 2013, partially offset by the recognition of approximately $1.0 million of interest income from Heartland loan valuation discounts being accreted and loans paying off before their scheduled maturity and an increase in income on commercial loans. In addition, the asset yields on non-taxable investment securities decreased 56 basis points from 5.27% in the third quarter of 2012 to 4.71% in the third quarter of 2013.

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Rates paid on interest-bearing liabilities decreased by seven basis points for the three months ended September 30, 2013 compared to the same period in 2012 due to the lower short-term interest rate environment. Interest expense decreased $348,000 from $3.7 million for the three months ended September 30, 2012 to $3.4 million for the same period in 2013. This decrease was due to the lower amount of average interest-bearing liabilities during the period and the lower rates being paid on the Company s interest bearing liabilities. The net interest margin decreased one basis point from 3.79% for the three months ended September 30, 2012 to 3.78% for the same period in 2013. The decrease in the margin for the three months ended September 30, 2013 compared to the same period in 2012 was due to the decline in mortgage warehouse activity as mortgage warehouse balances decreased $130.6 million from $244.2 million as of September 30, 2012 to $113.6 million as of September 30, 2013, partially offset by the recognition of approximately $1.0 million of interest income from Heartland loan valuation discounts being accreted and loans paying off before their scheduled maturity, along with a reduction in the rate paid on interest bearing liabilities. Excluding the interest income recognized from the loan discounts, the margin would have been 3.52% for the three-month period ending September 30, 2013.

The following are the average balance sheets for the three months ending:

	Three Months Ended September 30, 2013			Three Months Ended September 30, 2012		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
ASSETS						
Interest-earning assets						
Federal funds sold	$ 10,140	$ 6	0.23%	$ 13,854	$ 8	0.23%
Interest-earning deposits	6,834	2	0.12%	6,252	2	0.13%
Investment securities - taxable	356,275	2,076	2.31%	383,200	2,168	2.25%
Investment securities - non-taxable (1)	146,622	1,114	4.71%	121,428	1,014	5.27%
Loans receivable (2)(3)(4)	1,087,930	14,843	5.42%	1,112,712	15,527	5.56%
Total interest-earning assets (1)	1,607,801	18,041	4.61%	1,637,446	18,719	4.70%
Noninterest-earning assets						
Cash and due from banks	24,619			21,385		
Allowance for loan losses	(18,910)			(18,195)		
Other assets	133,890			121,919		

	$ 1,747,400			$ 1,762,555		
LIABILITIES AND SHAREHOLDERS EQUITY						
Interest-bearing liabilities						
Interest-bearing deposits	$ 1,081,256	$ 1,395	0.51%	$ 1,041,268	$ 1,638	0.63%
Borrowings	236,071	1,465	2.46%	324,975	1,597	1.96%
Subordinated debentures	32,425	512	6.26%	33,353	485	5.78%
Total interest-bearing liabilities	1,349,752	3,372	0.99%	1,399,596	3,720	1.06%
Noninterest-bearing liabilities						
Demand deposits	224,622			196,640		
Accrued interest payable and other liabilities	11,904			17,435		
Shareholders equity	161,122			148,884		
	$ 1,747,400			$ 1,762,555		
Net interest income/spread		$ 14,669	3.62%		$ 14,999	3.64%
Net interest income as a percent of average interest earning assets (1)			3.78%			3.79%

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(1) Securities balances represent daily average balances for the fair value of securities. The average rate is calculated based on the daily average balance for the amortized cost of securities. Interest rate is presented on a tax equivalent basis.
(2) Includes fees on loans. The inclusion of loan fees does not have a material effect on the average interest rate.
(3) Non-accruing loans for the purpose of the computations above are included in the daily average loan amounts outstanding. Loan totals are shown net of unearned income and deferred loans fees.
(4) Loan fees and late fees included in interest on loans.

Net interest income during the nine months ended September 30, 2013 was $47.3 million, an increase of $6.1 million over the $41.2 million earned during the same period in 2012. Yields on the Company s interest-earning assets increased by 13 basis points to 4.90% for the nine months ended September 30, 2013 from 4.77% for the same period in 2012. Interest income increased $5.4 million from $52.1 million for the nine months ended September 30, 2012 to $57.4 million for the same period in 2013. This increase was primarily due to an increase in interest earning assets and the recognition of approximately $5.4 million of interest income from Heartland loan valuation discounts being accreted and loans paying off before their scheduled maturity.

Rates paid on interest-bearing liabilities decreased by 13 basis points for the nine months ended September 30, 2013 compared to the same period in 2012 due to the lower short-term interest rate environment. Interest expense decreased $672,000 from $10.9 million for the nine-months ended September 30, 2012 to $10.2 million for the same period in 2013. This decrease was due to lower rates being paid on the Company s interest bearing liabilities, partially offset with a higher volume of interest bearing liabilities. The net interest margin increased 26 basis points from 3.80% for the nine months ended September 30, 2012 to 4.06% for the same period in 2013. The increase in the margin for the nine months ended September 30, 2013 compared to the same period in 2012 was due to the recognition of approximately $5.4 million of interest income from Heartland loan valuation discounts being accreted and loans paying off before their scheduled maturity, along with a reduction in the rate paid on interest bearing liabilities. Excluding the interest income recognized from the loan discounts, the margin would have been 3.61% for the nine-month period ending September 30, 2013.

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The following are the average balance sheets for the nine months ending:

	Nine Months Ended September 30, 2013			Nine Months Ended September 30, 2012		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
ASSETS						
Interest-earning assets						
Federal funds sold	$ 9,480	$ 11	0.16%	$ 6,870	$ 13	0.25%
Interest-earning deposits	8,186	5	0.08%	3,533	4	0.15%
Investment securities - taxable	365,569	6,137	2.24%	358,935	6,721	2.50%
Investment securities - non-taxable (1)	133,011	3,105	4.88%	111,750	2,944	4.89%
Loans receivable (2)(3)(4)	1,100,923	48,189	5.86%	1,009,052	42,386	5.62%
Total interest-earning assets (1)	1,617,169	57,447	4.90%	1,490,140	52,068	4.77%
Noninterest-earning assets						
Cash and due from banks	24,588			17,708		
Allowance for loan losses	(18,980)			(18,970)		
Other assets	133,544			95,986		
	$ 1,756,321			$ 1,584,864		
LIABILITIES AND SHAREHOLDERS EQUITY						
Interest-bearing liabilities						
Interest-bearing deposits	$ 1,091,635	$ 4,320	0.53%	$ 958,651	$ 4,803	0.67%
Borrowings	239,323	4,369	2.44%	299,074	4,635	2.07%
Subordinated debentures	32,386	1,504	6.21%	31,606	1,427	6.03%
Total interest-bearing liabilities	1,363,344	10,193	1.00%	1,289,331	10,865	1.13%
Noninterest-bearing liabilities						
Demand deposits	215,869			154,244		
	13,657			13,387		

Accrued interest payable and other liabilities						
Shareholders equity	163,451			134,820		
	$ 1,756,321			$ 1,591,782		
Net interest income/spread		$ 47,254	3.90%		$ 41,203	3.65%
Net interest income as a percent of average interest earning assets (1)			4.06%			3.80%

(1) Securities balances represent daily average balances for the fair value of securities. The average rate is calculated based on the daily average balance for the amortized cost of securities. Interest rate is presented on a tax equivalent basis.
(2) Includes fees on loans. The inclusion of loan fees does not have a material effect on the average interest rate.
(3) Non-accruing loans for the purpose of the computations above are included in the daily average loan amounts outstanding. Loan totals are shown net of unearned income and deferred loans fees.
(4) Loan fees and late fees included in interest on loans.

Provision for Loan Losses

Horizon assesses the adequacy of its Allowance for Loan and Lease Losses (ALLL) by regularly reviewing the performance of its loan portfolios. During the third quarter of 2013, a provision for loan losses of $104,000 was required to adequately fund the ALLL compared to a provision of $1.0 million for the same period of 2012. Commercial loan net charge-offs during the third quarter of 2013 were $605,000, residential mortgage loan net charge-offs were $40,000, and consumer loan net charge-offs were $492,000 and were predominantly provided for in previous periods. The lower provision for loan losses in the third quarter of 2013 compared to the third quarter of 2012 was primarily due to continued improvement of nonperforming and substandard loans. The ALLL balance at September 30, 2013 was $17.8 million or 1.64% of total loans. This compares to an ALLL balance of $18.3 million at December 31, 2012 or 1.52% of total loans and $18.6

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million at September 30, 2012 or 1.58% of total loans. The increase in the ratio at September 30, 2013 compared to December 31, 2012 and September 30, 2012 was primarily due to a decrease in total loans of $118.4 million and $87.2 million respectively.

For the nine months ended September 30, 2013, the provision for loan losses totaled $2.9 million compared to $1.8 million in the prior year for the same period. The higher provision for loan losses during the nine months ended September 30, 2013 was related to organic growth in the Company s loan portfolio and $1.6 million of additional loan loss provision expense related to credit losses from certain Heartland loans that exceeded the loan valuation discounts recorded at the time of the acquisition.

No assurance can be given that Horizon will not, in any particular period, sustain loan losses that are significant in relation to the amount reserved, or that subsequent evaluations of the loan portfolio, in light of factors then prevailing, including economic conditions and management s ongoing quarterly assessments of the portfolio, will not require increases in the allowance for loan losses. Horizon considers the allowance for loan losses to be appropriate to cover probable incurred losses in the loan portfolio as of September 30, 2013.

Non-performing loans totaled $22.5 million as of September 30, 2013, down from $23.8 million as of December 31, 2012 and $24.0 million as of September 30, 2012. Compared to December 31, 2012, non-performing commercial loans and real estate loans decreased by $2.8 million and $1.1 million, respectively, partially offset by an increase of $2.6 million in non-performing consumer loans. The increase in non-performing consumer loans from December 31, 2012 was primarily due to the addition of three large home equity lines of credit totaling $2.0 million, which have specific reserves included in the allowance for loan losses.

Excluding Heartland loans, non-performing loans totaled $16.3 million at September 30, 2013, a decrease of $236,000 from $16.5 million at December 31, 2012 and a decrease of $2.8 million from $19.1 million at September 30, 2012. As a percentage of total loans, non-performing loans were 2.07% at September 30, 2013, up from 1.97% at December 31, 2012 and 2.05% at September 30, 2012.

At September 30, 2013, loans acquired in the Heartland acquisition represented $6.2 million in non-performing, $12.2 million in substandard and $231,000 in delinquent loans, which compares to $7.3 million in non-performing, $18.1 million in substandard and $3.4 million in delinquent loans represented at December 31, 2012.

Other Real Estate Owned (OREO) totaled $1.4 million on September 30, 2013, down from $2.6 million on December 31, 2012 and up from $2.7 million on September 30, 2012.

Non-interest Income

The following is a summary of changes in non-interest income:

	Three Months Ended September 30 2013	September 30 2012	Amount Change	Percent Change
Non-interest Income				
Service charges on deposit accounts	**$ 1,083**	$ 1,002	$ 81	8.1%
Wire transfer fees	**169**	248	(79)	-31.9%
Interchange fees	**1,123**	885	238	26.9%
Fiduciary activities	**953**	971	(18)	-1.9%
Gain on sale of securities	**6**	2	4	200.0%
Gain on sale of mortgage loans	**1,667**	4,436	(2,769)	-62.4%
Mortgage servicing net of impairment	**348**	(355)	703	-198.0%
Increase in cash surrender value of bank owned life insurance	**278**	300	(22)	-7.3%
Other income	**283**	221	62	28.1%
Total non-interest income	**$ 5,910**	$ 7,710	$ (1,800)	-23.3%

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Service charges on deposit accounts were $81,000 higher and interchange fees were $238,000 higher during the third quarter of 2013 compared to the same period in 2012 primarily due to an increase in transaction accounts and volume. The residential mortgage loan activity during the third quarter of 2013 generated $1.7 million of income from the gain on sale of mortgage loans, down $2.8 million from the same period in 2012. The reduction in the gain on sale of mortgages was primarily due to the decrease in the percentage earned on the sale of these loans due to a rapid increase in interest rates against uncommitted, unfunded loans and, to a lesser extent, the decrease in overall origination volume. Loans originated for sale during the third quarter of 2013 were $91.8 million compared to $105.2 million for the same period in 2012. Mortgage servicing net of impairment increased by $703,000 during the third quarter of 2013 compared to the same period in 2012 due to an impairment recovery of $506,000 and an increase of $197,000 in servicing income realized. In addition, there was a larger portfolio of mortgage loans serviced during the third quarter of 2013 compared to the same period of 2012.

	Nine Months Ended			
	September 30 2013	**September 30 2012**	**Amount Change**	**Percent Change**
Non-interest Income				
Service charges on deposit accounts	**$ 2,984**	$ 2,477	$ 507	20.5%
Wire transfer fees	**562**	643	(81)	-12.6%
Interchange fees	**3,049**	2,227	822	36.9%
Fiduciary activities	**3,140**	2,928	212	7.2%
Gain on sale of securities	**374**	2	372	NM
Gain on sale of mortgage loans	**7,580**	10,121	(2,541)	-25.1%
Mortgage servicing net of impairment	**813**	(95)	908	-955.8%
Increase in cash surrender value of bank owned life insurance	**787**	760	27	3.6%
Other income	**930**	344	586	170.3%
Total non-interest income	**$ 20,219**	$ 19,407	$ 812	4.2%

Service charges on deposit accounts were $507,000 higher and interchange fees were $822,000 higher during the first nine months of 2013 compared to the same period in 2012 primarily due to an increase in transaction accounts and volume. Fiduciary activities increased $212,000 during the first nine months of 2013 compared to the same period in 2012 due to customer and market value growth. In addition, Horizon incurred a gain on the sale of securities of $374,000 during the first nine months of 2013 as the result of an analysis that determined that market conditions provided the opportunity to add gains to capital without negatively impacting long-term earnings. The residential mortgage loan activity during the first nine months of 2013 generated $7.6 million of income from the gain on sale of mortgage loans, down $2.5 million from the same period in 2012. The reduction in the gain on sale of mortgages was due to less favorable pricing on loans sold and a decrease in overall origination volume compared to the same period in 2012. Loans originated for sale during the first nine months of 2013 were $289.8 million compared to $283.8 million for the same period in 2012. Mortgage servicing net of impairment increased by $908,000 during the first nine months of 2013 compared to the same period due to an impairment recovery of $577,000 and an increase of $331,000 in servicing income realized. In addition, there was a larger portfolio of mortgage loans serviced during the first nine months of 2013 compared to the same period of 2012. Other income increased $586,000 primarily due to $270,000 of gains on the sale of other real estate owned and $232,000 of recoveries from loans that had been charged off by Heartland prior to the acquisition.

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Non-interest Expense

The following is a summary of changes in non-interest expense:

	Three Months Ended			
	September 30 2013	**September 30 2012**	**Amount Change**	**Percent Change**
Non-interest expense				
Salaries	**$ 5,282**	$ 5,191	$ 91	1.8%
Commission and bonuses	**1,165**	1,484	(319)	-21.5%
Employee benefits	**1,247**	1,230	17	1.4%
Net occupancy expenses	**1,172**	1,186	(14)	-1.2%
Data processing	**766**	754	12	1.6%
Professional fees	**357**	366	(9)	-2.5%
Outside services and consultants	**436**	624	(188)	-30.1%
Loan expense	**1,040**	1,311	(271)	-20.7%
FDIC deposit insurance	**270**	291	(21)	-7.2%
Other losses	**55**	309	(254)	-82.2%
Other expense	**2,271**	2,094	177	8.5%
Total non-interest expense	**$ 14,061**	$ 14,840	$ (779)	-5.2%

Total non-interest expenses were $779,000 lower in the third quarter of 2013 compared to the third quarter of 2012. Salaries, commissions and employee benefits decreased $211,000 compared to the same quarter in 2012 primarily due to the decrease in commissions earned as a result of lower mortgage lending activity. The decrease in loan expense during the third quarter of 2013 compared to the prior year was related to a decrease in loan origination, collection and workout costs. Other losses decreased $257,000 in the third quarter of 2013 compared to the same period in 2012 primarily due to a reduction in repurchase and make-whole demands from end investors of sold loans.

	Nine Months Ended			
	September 30 2013	**September 30 2012**	**Amount Change**	**Percent Change**
Non-interest expense				
Salaries	**$ 15,743**	$ 13,331	$ 2,412	18.1%

Commission and bonuses	**3,304**	3,450	(146)	-4.2%
Employee benefits	**3,872**	3,626	246	6.8%
Net occupancy expenses	**3,778**	3,216	562	17.5%
Data processing	**2,184**	1,883	301	16.0%
Professional fees	**1,310**	1,483	(173)	-11.7%
Outside services and consultants	**1,634**	1,621	13	0.8%
Loan expense	**3,556**	2,879	677	23.5%
FDIC deposit insurance	**821**	798	23	2.9%
Other losses	**146**	501	(355)	-70.9%
Other expense	**6,487**	5,392	1,095	20.3%
Total non-interest expense	**$ 42,835**	$ 38,180	$ 4,655	12.2%

Total non-interest expenses were $4.7 million higher in the first nine months of 2013 compared to the same period of 2012. Salaries, commissions and employee benefits increased $2.5 million compared to the same period in 2012 primarily due to changes to annual merit pay, employee benefits costs and commissions earned. In addition, compensation and net occupancy expenses were higher due to the Heartland acquisition and directly related to Horizon s investment in growth markets. The increase in the nine months of 2013 in

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outside services and consultants of $173,000 compared to the same period in the prior year was due to growth and increased products and services provided by the Company. The increase in loan expense during the first nine months of 2013 of $677,000 was related to an increase in loan origination, indirect dealer fees, collection and workout costs. Other losses decreased $358,000 in the first nine months of 2013 compared to the previous year primarily due to a reduction in repurchase and make-whole demands from end investors of sold loans. Other expenses increased $938,000 in the first nine months of 2013 compared to the same period in 2012 primarily due to the Company s growth and expansion efforts.

Income Taxes

Income tax expense for the third quarter of 2013 was $1.6 million compared to $2.0 million of tax expense for same period of 2012. The effective tax rate for the third quarter of 2013 was 25.4% compared to 29.0% in the same period of 2012. The decrease in the effective tax rate is primarily due to tax planning strategies executed in the third quarter of 2013 including a captive real estate investment trust subsidiary (REIT) and a captive insurance subsidiary reducing both the federal and state tax liabilities.

Income tax expense for the first nine months of 2013 was $6.0 million compared to $6.2 million of tax expense for same period of 2012. The effective tax rate for the first nine months of 2013 was 27.4% compared to 30.3% in the same period of 2012. The decrease in the effective tax rate is primarily due to tax planning strategies implemented in the first nine months of 2013 including a captive real estate investment trust subsidiary (REIT) and a captive insurance subsidiary reducing both the federal and state tax liabilities.

Liquidity

The Bank maintains a stable base of core deposits provided by long-standing relationships with individuals and local businesses. These deposits are the principal source of liquidity for Horizon. Other sources of liquidity for Horizon include earnings, loan repayment, investment security sales and maturities, proceeds from the sale of residential mortgage loans, and borrowing relationships with correspondent banks, including the FHLB. During the nine months ended September 30, 2013, cash and cash equivalents increased by approximately $9.8 million. At September 30, 2013, in addition to liquidity available from the normal operating, funding, and investing activities of Horizon, the Bank had approximately $328.9 million in unused credit lines with various money center banks, including the FHLB and the FRB Discount Window compared to $349.6 million at December 31, 2012 and $364.1 million at September 30, 2012.

Capital Resources

The capital resources of Horizon and the Bank exceeded regulatory capital ratios for well capitalized banks at September 30, 2013. Stockholders equity totaled $163.5 million as of September 30, 2013, compared to $159.0

million as of December 31, 2012. For the three months ended September 30, 2013, the ratio of average stockholders equity to average assets was 9.22% compared to 8.71% for the three months ended December 31, 2012. The increase in stockholders equity during the period was the result of the generation of net income partially offset by a decrease in accumulated other comprehensive income and dividends declared.

The Company currently intends to continue its participation in the Small Business Lending Fund, pursuant to which it issued preferred stock to the US Treasury, since the growth in the Company s small business lending has reduced the dividend cost. For the three months ending September 30, 2013, the dividend cost was approximately $65,690, or 2.1% annualized. For the fourth quarter of 2013, the dividend cost will be approximately $62,500, or 2.0% annualized. For the first quarter of 2014, the dividend cost will be approximately $31,250, or 1.0% annualized. The Company plans to reserve cash for the ability to redeem this preferred stock if and when the cost of this capital exceeds other forms of capital.

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Horizon declared common stock dividends in the amount of $0.31 per share during the first nine months of 2013 compared to $0.27 for the same period of 2012. The dividend payout ratio (dividends as a percent of basic earnings per share) was 17.3% and 15.1% for the first nine months of 2013 and 2012, respectively. For additional information regarding dividends, see Horizon s Annual Report on Form 10-K for 2012.

Basel III

On July 2, 2013, the Board of Governors of the Federal Reserve System announced its approval of the final rule to implement the Basel III regulatory capital reforms, among other changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Office of the Comptroller of the Currency, as well as the Federal Deposit Insurance Corporation, adopted the new rule on July 9, 2013. The approved rule includes a new minimum ratio of common equity Tier 1 capital to risk-weighted assets of 4.5% as well as a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets. The rule also raises the minimum ratio of Tier 1 capital to risk-weighted assets from 4% to 6% and includes a minimum leverage ratio of 4% for all banking institutions

The phase-in for banking organizations such as Horizon and the Bank will not begin until January 2015, while the phase-in period for larger banks starts in January 2014. Horizon and the Bank are currently evaluating the impact of the implementation of the new capital and liquidity standards.

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Quantitative and Qualitative Disclosures About Market Risk

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Refer to Horizon s 2012 Annual Report on Form 10-K for analysis of its interest rate sensitivity. Horizon believes there have been no significant changes in its interest rate sensitivity since it was reported in its 2012 Annual Report on Form 10-K.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation Of Disclosure Controls And Procedures

Based on an evaluation of disclosure controls and procedures as of September 30, 2013, Horizon s Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of Horizon s disclosure controls (as defined in Exchange Act Rule 13a-15(e) of the Securities Exchange Act of 1934 (the Exchange Act)). Based on such evaluation, such officers have concluded that, as of the evaluation date, Horizon s disclosure controls and procedures are effective to ensure that the information required to be disclosed by Horizon in the reports it files under the Exchange Act is recorded, processed, summarized and reported within the time specified in Securities and Exchange Commission rules and forms and are designed to ensure that information required to be disclosed in those reports is accumulated and communicated to management as appropriate to allow timely decisions regarding disclosure.

Changes In Internal Control Over Financial Reporting

Horizon s management, including its Chief Executive Officer and Chief Financial Officer, also have concluded that during the fiscal quarter ended September 30, 2013, there have been no changes in Horizon s internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, Horizon s internal control over financial reporting.

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Part II Other Information

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ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

There have been no material changes from the factors previously disclosed under Item 1A of Horizon s Annual Report on Form 10-K for 2012.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not Applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable

ITEM 5. OTHER INFORMATION

Not Applicable

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HORIZON BANCORP AND SUBSIDIARIES

Part II Other Information

For the Three and Nine Months Ended September 30, 2013

ITEM 6. EXHIBITS

(a) Exhibits

Exhibit No.	Description
31.1	Certification of Craig M. Dwight
31.2	Certification of Mark E. Secor
32	Certification of Chief Executive and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	Interactive Data Files*

* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files in Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

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SIGNATURES

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

	HORIZON BANCORP
Dated: November 7, 2013	/s/ Craig M. Dwight Craig M. Dwight Chief Executive Officer
Dated: November 7, 2013	/s/ Mark E. Secor Mark E. Secor Chief Financial Officer

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INDEX TO EXHIBITS

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