First Internet Bancorp
Form 10-Q
May 07, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
p QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period March 31, 2015
OR
.. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period From $\qquad$ to $\qquad$ .

Commission File Number 001-35750
First Internet Bancorp
(Exact Name of Registrant as Specified in Its Charter)
Indiana
20-3489991
(State or Other Jurisdiction of
Incorporation or Organization)
(I.R.S. Employer

8888 Keystone Crossing, Suite 1700
Indianapolis, Indiana
(Address of Principal Executive Offices)
46240
(Zip Code)
(317) 532-7900
(Registrant's Telephone Number, Including Area Code)
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files).

Yes p No "
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).

Non-accelerated Filer " (Do not check if a 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 p

As of May 4, 2015, the registrant had 4,484,513 shares of common stock issued and outstanding.

## Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q may contain forward-looking statements with respect to the financial condition, results of operations, plans, objectives, future performance, or business of First Internet Bancorp ("we," "our," "us" or the "Company"). Forward-looking statements are generally identifiable by the use of words such as "anticipate," "believe," "could," "estimate," "expect," "intend," "may," "plan," "should," "will," "would," or other similar expressions. Forward-looki statements are not a guarantee of future performance or results, are based on information available at the time the statements are made, and involve known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from the information in the forward-looking statements. Factors that may cause such differences include: failures of or interruptions in the communications and information systems on which we rely to conduct our business; our plans to grow our commercial real estate and commercial and industrial loan portfolios; competition with national, regional, and community financial institutions; the loss of any key members of senior management; fluctuations in interest rates; general economic conditions and risks relating to the regulation of financial institutions. Additional factors that may affect our results include those discussed in our most recent Annual Report on Form 10-K under the heading "Risk Factors" and in other reports filed with the Securities and Exchange Commission ("SEC"). All statements in this Quarterly Report on Form 10-Q, including forward-looking statements, speak only as of the date they are made, and the Company undertakes no obligation to update any statement in light of new information or future events.
(i)

## PART I

## ITEM 1.FINANCIAL STATEMENTS

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

|  | March 31, <br> 2015 <br> (Unaudited) | $\begin{aligned} & \text { December 31, } \\ & 2014 \end{aligned}$ |
| :---: | :---: | :---: |
| Assets |  |  |
| Cash and due from banks | \$1,472 | \$ 1,940 |
| Interest-bearing demand deposits | 38,100 | 26,349 |
| Total cash and cash equivalents | 39,572 | 28,289 |
| Interest-bearing time deposits | 2,000 | 2,000 |
| Securities available-for-sale, at fair value (amortized cost of \$163,067 and \$137,727, respectively) | 163,676 | 137,518 |
| Loans held-for-sale (includes \$26,771 and \$32,618 at fair value, respectively) | 27,584 | 34,671 |
| Loans receivable | 767,682 | 732,426 |
| Allowance for loan losses | (6,378 | ) $(5,800$ |
| Net loans receivable | 761,304 | 726,626 |
| Accrued interest receivable | 3,040 | 2,833 |
| Federal Home Loan Bank of Indianapolis stock | 5,350 | 5,350 |
| Cash surrender value of bank-owned life insurance | 12,423 | 12,325 |
| Premises and equipment, net | 7,040 | 7,061 |
| Goodwill | 4,687 | 4,687 |
| Other real estate owned | 4,488 | 4,488 |
| Accrued income and other assets | 4,513 | 4,655 |
| Total assets | \$ 1,035,677 | \$970,503 |
| Liabilities and Shareholders' Equity |  |  |
| Liabilities |  |  |
| Noninterest-bearing deposits | \$19,178 | \$21,790 |
| Interest-bearing deposits | 801,991 | 736,808 |
| Total deposits | 821,169 | 758,598 |
| Advances from Federal Home Loan Bank | 106,921 | 106,897 |
| Subordinated debt | 2,894 | 2,873 |
| Accrued interest payable | 104 | 97 |
| Accrued expenses and other liabilities | 5,227 | 5,253 |
| Total liabilities | 936,315 | 873,718 |
| Commitments and Contingencies |  |  |
| Shareholders' Equity |  |  |
| Preferred stock, no par value; 4,913,779 shares authorized; issued and outstanding none | - | - |
| Voting common stock, no par value; $45,000,000$ shares authorized; $4,484,513$ and 4,439,575 shares issued and outstanding, respectively | 72,032 | 71,774 |
| Nonvoting common stock, no par value; 86,221 shares authorized; issued and outstanding - none | - | - |
| Retained earnings | 26,938 | 25,146 |
| Accumulated other comprehensive income (loss) | 392 | (135 |


| Total shareholders' equity | 99,362 | 96,785 |
| :--- | :--- | :--- |
| Total liabilities and shareholders' equity | $\$ 1,035,677$ | $\$ 970,503$ |

Total liabilities and shareholders' equity
See Notes to Condensed Consolidated Financial Statements

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[^0]$\qquad$

| First Internet Bancorp |  |  |
| :--- | :--- | :--- |
| Condensed Consolidated Statements of Comprehensive Income - Unaudited <br> (Dollar amounts in thousands) | Three Months Ended March |  |
|  | 31, |  |
|  | 2015 | 2014 |
| Net income | $\$ 2,063$ | $\$ 600$ |
| Other comprehensive income | 818 | 925 |
| Net unrealized holding gains on securities available-for-sale | - | $(359$ |
| Reclassification adjustment for gains realized | - | 63 |
| Net unrealized holding gains on securities available-for-sale for which an | 818 | 629 |
| other-than-temporary impairment has been recognized in income | 291 | 224 |
| Other comprehensive income before income tax | 527 | 405 |
| Income tax provision | $\$ 2,590$ | $\$ 1,005$ |

See Notes to Condensed Consolidated Financial Statements

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First Internet Bancorp
Condensed Consolidated Statements of Shareholders' Equity - Unaudited Three Months Ended March 31, 2015
(Dollar amounts in thousands except per share data)


See Notes to Condensed Consolidated Financial Statements
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First Internet Bancorp
Condensed Consolidated Statements of Cash Flows - Unaudited
(Dollar amounts in thousands)


See Notes to Condensed Consolidated Financial Statements

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

## Note 1: Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles ("GAAP") for interim financial information and pursuant to the rules and regulations of the SEC. Accordingly, they do not include all of the information or footnotes necessary for a complete presentation of financial condition, results of operations, or cash flows in accordance with U.S. GAAP. In our opinion, all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation have been included. The results of operations for the three months ended March 31, 2015 are not necessarily indicative of the results expected for the year ending December 31, 2015 or any other period. The March 31, 2015 condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the First Internet Bancorp Annual Report on Form 10-K for the year ended December 31, 2014.

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

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

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

Certain reclassifications have been made to the 2014 financial statements to conform to the 2015 financial statement presentation. These reclassifications had no effect on net income.

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Note 2: Earnings Per Share
Earnings per share of common stock are based on the weighted-average number of basic shares and dilutive shares outstanding during the period.

The following is a reconciliation of the weighted-average common shares for the basic and diluted earnings per share computations for the three months ended March 31, 2015 and 2014:

|  | Three Months Ended <br> March 31, |
| :--- | :--- | :--- |
|  | 2015 |, 2014

Note 3: $\quad$ Securities
Securities at March 31, 2015 and December 31, 2014 are as follows:
March 31, 2015

|  | Amortized <br> Cost | Gross Unrealized <br> Gains |  | Losses |
| :--- | :--- | :--- | :--- | :--- |

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The carrying value of securities at March 31, 2015 is shown below by their contractual maturity date. Actual maturities will differ because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

|  | Available-for-Sale |  |
| :--- | :--- | :--- |
|  | Amortized | Fair |
|  | Cost | Value |
| Within one year | $\$-$ | $\$-$ |
| One to five years | - | - |
| Five to ten years | 10,739 | 10,630 |
| After ten years | 17,499 | 17,433 |
|  | 28,238 | 28,063 |
| Mortgage-backed securities | 112,401 | 113,132 |
| Asset-backed securities | 19,428 | 19,457 |
| Other securities | 3,000 | 3,024 |
| Totals | $\$ 163,067$ | $\$ 163,676$ |

Gross gains of $\$ 0$ and $\$ 1.4$ million, and gross losses of $\$ 0$ and $\$ 1.0$ million resulting from sales of available-for-sale securities were realized for the three months ended March 31, 2015 and 2014, respectively.

Certain investments in debt securities are reported in the condensed consolidated financial statements at an amount less than their historical cost. Total fair value of these investments at March 31, 2015 and December 31, 2014 was $\$ 49.7$ million and $\$ 86.9$ million, which is approximately $30 \%$ and $63 \%$, respectively, of the Company's available-for-sale investment portfolio. These declines primarily resulted from fluctuations in market interest rates after purchase.

Except as discussed below, management believes the declines in fair value for these securities are temporary.
Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period in which the other-than-temporary impairment ("OTTI") is identified.

The following tables show the Company's investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at March 31, 2015 and December 31, 2014:

|  | March 31, 2015 |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Less Than 12 Months |  | 12 Months or Longer |  | Total |  |
|  | Fair | Unrealized | Fair | Unrealized | Fair | Unrealized |
|  | Value | Losses | Value | Losses | Value | Losses |
| Securities available-for-sale U.S. Government-sponsored agencies | \$15,621 | \$(109 | ) $\$ 8,582$ | \$(196 | ) $\$ 24,203$ | \$(305 |
| Mortgage-backed securities | 4,772 | (7 | ) 20,719 | (228 | 25,491 | (235 |
|  | \$20,393 | \$(116 | \$29,301 | \$(424 | \$49,694 | \$(540 |
|  | December 31, 2014 |  |  |  |  |  |
|  | Less Than 12 Months |  | 12 Months or Longer |  | Total |  |
|  | Fair | Unrealized | Fair | Unrealized | Fair | Unrealized |
|  | Value | Losses | Value | Losses | Value | Losses |

Securities available-for-sale

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| U.S. Government-sponsored agencies | \$801 | \$(10 | ) | \$8,719 | \$(247 | ) | \$9,520 | \$(257 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Mortgage-backed securities | 51,204 | (57 | ) | 21,237 | (311 | ) | 72,441 | (368 |
| Asset-backed securities | 4,912 | (1 | ) | - | - |  | 4,912 | (1 |
|  | \$56,917 | \$ 68 | ) | \$29,956 | \$(558 | ) | \$86,873 | \$(626 |

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## U. S. Government-Sponsored Agencies

The unrealized losses on the Company's investments in securities issued by U.S. Government-sponsored agencies were caused by interest rate changes. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Company does not intend to sell the investments and it is not likely that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at March 31, 2015.

## Mortgage-Backed Securities

The unrealized losses on the Company's investments in mortgage-backed securities were caused by interest rate changes. The Company expects to recover the amortized cost bases 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 bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at March 31, 2015.

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

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

## Credit Losses Recognized on Investments

Certain debt securities have experienced fair value deterioration due to credit losses and other market factors, but are not considered other-than-temporarily impaired.

The following tables provide information about debt securities for which only a credit loss was recognized in income and other losses are recorded in accumulated other comprehensive loss. The Company did not own any OTTI securities during the three months ended March 31, 2015.

Accumulated Credit Losses
Credit losses on debt securities held
January 1, 2014
\$1,183
Realized losses related to OTTI
March 31, 2014
There were no amounts reclassified from accumulated other comprehensive income during the three months ended March 31, 2015. Amounts reclassified from accumulated other comprehensive loss and the affected line items in the condensed consolidated statements of income during the three months ended March 31, 2014, were as follows: Details About Accumulated Other Comprehensive Amounts Reclassified from Loss Components

Affected Line Item in the Statements of Income

Three Months Ended March 31, 2014

| Unrealized gains and losses on securities available  <br> for sale $\$ 359$ |  |  |
| :--- | :--- | :--- |
| Gain realized in earnings | 359 | Gain on sale of securities |
| Total reclassified amount before tax | 126 | Income Before Income Taxes |
| Tax expense $\$ 233$ | Income Tax Provision |  |
| Total reclassifications out of accumulated other <br> comprehensive loss |  | Net Income |

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## Note 4: Loans Receivable

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

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

Categories of loans include:

|  | March 31, <br> 2015 | December 31, <br> 2014 |
| :--- | :--- | :--- |
| Commercial loans |  |  |
| Commercial and industrial | $\$ 83,849$ | $\$ 77,232$ |
| Owner-occupied commercial real estate | 38,536 | 34,295 |
| Investor commercial real estate | 18,491 | 22,069 |
| Construction | 26,847 | 24,883 |
| Single tenant lease financing | 227,229 | 192,608 |
| Total commercial loans | 394,952 | 351,087 |
| Consumer loans |  |  |
| Residential mortgage | 215,910 | 220,612 |
| Home equity | 54,838 | 58,434 |
| Other consumer | 97,192 | 97,094 |
| Total consumer loans | 367,940 | 376,140 |
|  |  |  |
| Total loans | 762,892 | 727,227 |
| Deferred loan origination costs and premiums and discounts on purchased loans | 4,790 | 5,199 |
| Allowance for loan losses | $(6,378$ | $)$ |
| Net loans receivable | $\$ 761,304$ | $\$ 726,626$ |

The risk characteristics of each loan portfolio segment are as follows:
Commercial and Industrial: Commercial and industrial loans' source of repayment are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected, and the collateral securing these loans may fluctuate in value. Loans are made for working capital, equipment purchases, or other purposes. Most commercial and industrial loans are secured by the assets being financed and may incorporate a personal guarantee.

Owner-occupied Commercial Real Estate: The primary source of repayment is the cash flow from the ongoing operations and activities conducted by the borrower, or an affiliate of the borrower, who owns the property. This portfolio is diverse in terms of property type and geographic location and often times are secured by recreational facilities, retail establishments and office buildings.

Investor Commercial Real Estate: These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. These loans may also incorporate a personal guarantee. This portfolio typically involves higher loan principal amounts, and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Investor commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The

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properties securing the Company's investor commercial real estate portfolio are diverse in terms of property type and geographic location. Management monitors and evaluates commercial real estate loans based on property financial performance, collateral value, and other risk grade criteria. As a general rule, the Company avoids financing special use projects or properties outside of its designated market areas (Central Indiana and Phoenix, Arizona, as well as markets adjacent to these area) unless other underwriting factors are present to help mitigate risk.

Construction: Construction loans are secured by real estate made to finance land development in preparation to erecting new structures or the on-site construction of industrial, commercial or residential. These loans are typically made for vacant land, as well as the acquisition and improvement of developed and undeveloped property. The cash flows of borrowers, however, may not be as expected, and the collateral securing these loans may fluctuate in value. Single Tenant Lease Financing: These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Unlike the owner-occupied and investor commercial real estate loan portfolios, these loans are financed for properties supporting the operations and activities of an individual business with strong creditworthiness and are typically nationally branded. Similar to the other loan portfolios, management monitors and evaluates these loans based on property financial performance, collateral value, and other risk grade criteria.

Residential Mortgage: 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. Repayment of these loans is primarily dependent on the financial circumstances 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 residential property values. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers in geographically diverse locations throughout the country.
Home Equity: Home equity loans and lines of credit are typically secured by a subordinate interest in 1-4 family residences. The properties securing the Company's home equity portfolio are generally geographically diverse as the Company offers these products on a nationwide basis. Repayment of home equity loans and lines of credit may be impacted by changes in property values on residential properties and unemployment levels, among other economic conditions and financial circumstances in the market.
Other Consumer: These loans primarily consist of consumer loans and credit cards. Consumer loans may be secured by consumer assets such as horse trailers or recreational vehicles. Some consumer loans are unsecured, such as small installment loans and certain lines of credit. Repayment of consumer loans is primarily dependent upon the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers in geographically diverse locations throughout the country.
Allowance for Loan Losses Methodology
Company policy is designed to ensure that an adequate allowance for loan losses ("ALLL") is maintained. The portfolio is segmented by loan type. The required ALLL for types of performing homogeneous loans which do not have a specific reserve is determined by applying a factor based on average historical losses, adjusted for current economic factors and portfolio trends. Management believes the historical loss experience methodology is appropriate in the current economic environment as it captures loss rates that are comparable to the current period being analyzed. Management adds qualitative factors for observable trends, changes in internal practices, changes in delinquencies and impairments, and external factors. Observable factors include changes in the composition and size of portfolios, as well as loan terms or concentration levels. The Company evaluates the impact of internal changes such as management and staff experience levels or modification to loan underwriting processes. Delinquency trends are scrutinized for both volume and severity of past due, nonaccrual, or classified loans as well as any changes in the value of underlying collateral. Finally, the Company considers the effect of other external factors such as national, regional, and local economic and business conditions, as well as competitive, legal, and regulatory requirements. Loans that are considered to be impaired are evaluated to determine the need for a specific allowance by applying at least one of three methodologies: present value of future cash flows; fair value of collateral less cost to sell; or the loan's observable market price. All troubled debt restructurings ("TDR") are considered impaired loans. Loans evaluated for impairment are removed from other pools to prevent double-counting.

Provision for Loan Losses

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

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

Policy for Charging Off Loans
The Company's policy is to charge off a loan at any point in time when it no longer can be considered a bankable asset, meaning collectible within the parameters of policy. A secured loan is generally charged down to the estimated fair value of the collateral, less costs to sell, no later than when it is 120 days past due as to principal or interest. An unsecured loan generally is charged off no later than when it is 180 days past due as to principal or interest.

The following tables present changes in the balance of the ALLL during the three month periods ended March 31, 2015 and 2014:

Three Months Ended March 31, 2015

| CommercialOwner-occupielhvestor | Single |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
| and | commercial | commercial Construction tenant | ResidentialHome | Other |  |
| industrial | real estate | real estate | letal | mortgage equity | consumer |


| Allowance <br> for loan <br> losses: <br> Balance, <br> beginning of <br> period | $\$ 920$ | $\$ 345$ | $\$ 261$ | $\$ 330$ | $\$ 2,061$ | $\$ 985$ | $\$ 207$ | $\$ 691$ | $\$ 5,800$ |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Provision <br> (credit) <br> charged to | 90 | 46 | $(43$ | $)$ | 29 | 391 | $(194$ | $)$ | $(4$ | $)$ |
| expense |  |  |  |  |  |  |  |  |  |  |
| Losses <br> charged off | - | - | - | - | - | $(71$ | $)$ |  |  |  |
| Recoveries <br> Balance, end <br> of period | $\$ 1,010$ | $\$ 391$ | $\$ 218$ | $\$ 359$ | $\$ 2,452$ | $\$ 988$ | $\$ 203$ | $\$ 757$ | $\$ 6,378$ |  |

Three Months Ended March 31, 2014

| CommerciaOwner-occupiethvestor | Single |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
| and | commercial | commercial Construction lenant $^{l}$ | Residential Home | Other |
| and | mortgage equity | consumer |  |  | Total

Allowance
for loan
losses:
Balance,

| beginning of <br> period | $\$ 819$ | $\$ 290$ | $\$ 219$ | $\$ 277$ | $\$ 1,731$ | $\$ 1,008$ | $\$ 211$ | $\$ 871$ | $\$ 5,426$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
|  | 52 | 15 | 12 | 15 | 137 | $(40$ | $)$ | $(26$ | $)$ |

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The following tables present the recorded investment in loans based on portfolio segment and impairment method as of March 31, 2015, and December 31, 2014 :

March 31, 2015


Loans:
Ending
balance:
collectively $\begin{array}{llllllll}\$ 83,849 & \$ 38,536 & \$ 18,408 & \$ 26,847 & \$ 227,229 & \$ 214,852 & \$ 54,838 & \$ 97,041\end{array} \$ 761,600$
evaluated for
impairment
Ending
balance:
$\begin{array}{llllllllll}\begin{array}{l}\text { individually } \\ \text { evaluated for } \\ \text { impairment }\end{array} & - & 83 & - & - & 1,058 & - & 151 & 1,292 \\ \begin{array}{l}\text { Ending } \\ \text { balance }\end{array} & \$ 83,849 & \$ 38,536 & \$ 18,491 & \$ 26,847 & \$ 227,229 & \$ 215,910 & \$ 54,838 & \$ 97,192 & \$ 762,892\end{array}$
Allowance
for loan
losses:
Ending
balance:
$\begin{array}{llllllllll}\text { collectively } & \$ 1,010 & \$ 391 & \$ 218 & \$ 359 & \$ 2,452 & \$ 988 & \$ 203 & \$ 738 & \$ 6,359\end{array}$
evaluated for
impairment
Ending
balance:

| individually <br> evaluated for <br> impairment | - | - | - | - | - | - | 19 | 19 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Ending <br> balance | $\$ 1,010$ | $\$ 391$ | $\$ 218$ | $\$ 359$ | $\$ 2,452$ | $\$ 988$ | $\$ 203$ | $\$ 757$ |$\$ \$ 6,378$

December 31, 2014

| CommerciaOwner-occupiledestor | Single |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
| and | commercial | commercialConstructionant | tenant | Residential Home | Other |
| industrial | real estate | real estate | lease | mortgage equity | consumer |

Loans:
Ending
balance:
collectively $\begin{array}{llllllll} & \$ 77,232 & \$ 34,295 & \$ 21,982 & \$ 24,883 & \$ 192,608 & \$ 219,473 & \$ 58,434\end{array} \$ 96,789 \quad \$ 725,696$
evaluated for
impairment
$\begin{array}{lllllllllll}\text { Ending } & - & - & 8 & - & & & & & & \end{array}$
balance:
individually
evaluated for
impairment
$\begin{array}{llllllllll}\text { Ending } \\ \text { balance } & \$ 77,232 & \$ 34,295 & \$ 22,069 & \$ 24,883 & \$ 192,608 & \$ 220,612 & \$ 58,434 & \$ 97,094 & \$ 727,227\end{array}$
Allowance for
loan losses:
Ending
balance:

| collectively <br> evaluated for <br> impairment | $\$ 920$ | $\$ 345$ | $\$ 261$ | $\$ 330$ | $\$ 2,061$ | $\$ 985$ | $\$ 207$ | $\$ 676$ | $\$ 5,785$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Ending <br> balance: <br> individually <br> evaluated for <br> impairment | - | - | - | - | - | - | - | 15 | 15 |
| Ending <br> balance | $\$ 920$ | $\$ 345$ | $\$ 261$ | $\$ 330$ | $\$ 2,061$ | $\$ 985$ | $\$ 207$ | $\$ 691$ | $\$ 5,800$ |

The Company utilizes a risk grading matrix to assign a risk grade to each of its commercial loans. Loans are graded on a scale of 1 to 9 . A description of the general characteristics of the nine risk grades is as follows:
"Pass" (Grades 1-5) - Higher quality loans that do not fit any of the other categories described below.
"Special Mention" (Grade 6) - Loans that possess some credit deficiency or potential weakness which deserve close attention.

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"Substandard" (Grade 7) - Loans that possess a defined weakness or weaknesses that jeopardize the liquidation of the debt. Loans characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected. Loans that are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any.
"Doubtful" (Grade 8) - Such loans have been placed on nonaccrual status and may be heavily dependent upon collateral possessing a value that is difficult to determine or based upon some near-term event which lacks clear certainty. These loans have all of the weaknesses of those classified as Substandard; however, based on existing conditions, these weaknesses make full collection of the principal balance highly improbable.
"Loss" (Grade 9) - Loans that are considered uncollectible and of such little value that continuing to carry them as assets is not warranted.

## Nonaccrual Loans

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

The following tables present the credit risk profile of the Company's commercial loan portfolio based on rating category as of March 31, 2015 and December 31, 2014 :

March 31, 2015

|  | Commercial and industrial | Owner-occupied commercial real estate | Investor commercial real estate | Construction | Single tenant lease financing | Total |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Rating: |  |  |  |  |  |  |
| 1-5 Pass | \$83,849 | \$ 38,519 | \$ 16,921 | \$26,477 | \$227,229 | \$392,995 |
| 6 Special Mention | - | - | - | 370 | - | 370 |
| 7 Substandard | - | 17 | 1,57 | - | - | 1,587 |
| 8 Doubtful | - | - | - | - | - | - |
| Total | \$83,849 | \$ 38,536 | \$ 18,491 | \$26,847 | \$227,229 | \$394,952 |

December 31, 2014

|  | Commercial <br> and industrial | Owner-occupied Investor <br> commercial real <br> estate | commercial <br> real estate | Construction | Single tenant <br> lease financing | Total |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |

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The following tables present the Company's loan portfolio delinquency analysis as of March 31, 2015 and December 31, 2014:

March 31, 2015

|  | 30-59 <br> Days <br> Past Due | 60-89 <br> Days <br> Past Due | 90 Days or More Past Due | Total <br> Past Due | Current | Total <br> Loans <br> Receivable | Nonaccrual Loans | Total Loans 90 Days or More Past Due and Accruing |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Commercial and industrial | \$- | \$- | \$- | \$- | \$83,849 | \$83,849 | \$- | \$ - |
| Owner-occupied commercial real estate | - | - | - | - | 38,536 | 38,536 | - | - |
| Investor commercial real estate | - | - | - | - | 18,491 | 18,491 | 83 | - |
| Construction | - | - | - | - | 26,847 | 26,847 | - | - |
| Single tenant lease financing | - | - | - | - | 227,229 | 227,229 | - | - |
| Residential mortgage | 36 | - | - | 36 | 215,874 | 215,910 | 61 | - |
| Home equity | - | - | - | - | 54,838 | 54,838 | - | - |
| Other consumer | 76 | 45 | 52 | 173 | 97,019 | 97,192 | 102 | - |
| Total | \$112 | \$45 | \$52 | \$209 | \$762,683 | \$762,892 | \$246 | \$- |

December 31, 2014

|  | $\begin{aligned} & 30-59 \\ & \text { Days } \\ & \text { Past Due } \end{aligned}$ | $\begin{aligned} & 60-89 \\ & \text { Days } \\ & \text { Past Due } \end{aligned}$ | 90 Days <br> or More <br> Past Due | Total <br> Past Due | Current | Total <br> Loans <br> Receivable | Nonaccrual Loans | Total Loans 90 Days or More Past Due and Accruing |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Commercial and industrial | \$- | \$- | \$- | \$- | \$77,232 | \$77,232 | \$- | \$- |
| Owner-occupied commercial real estate | - | - | - | - | 34,295 | 34,295 | - | - |
| Investor commercial real estate | - | - | - | - | 22,069 | 22,069 | 87 | - |
| Construction | - | - | - | - | 24,883 | 24,883 | - | - |
| Single tenant lease financing | - | - | - | - | 192,608 | 192,608 | - | - |
| Residential mortgage | 161 | - | 57 | 218 | 220,394 | 220,612 | 25 | 57 |
| Home equity | - | - | - | - | 58,434 | 58,434 | - | - |
| Other consumer | 249 | 56 | 53 | 358 | 96,736 | 97,094 | 123 | 4 |
| Total | \$410 | \$56 | \$110 | \$576 | \$726,651 | \$727,227 | \$235 | \$ 61 |

## Impaired Loans

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

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

The following table presents the Company's impaired loans as of March 31, 2015 and December 31, 2014:
March 31, 2015
$\begin{array}{llllll}\text { Recorded } & \text { Unpaid } & \text { Principal } & \text { Specific } & \text { Recorded } & \text { Unpaid } \\ \text { Balance } & \text { Principal } & \text { Specific } \\ \text { Balance } & \text { Allowance } & \text { Balance } & \text { Balance } & \text { Allowance }\end{array}$
Loans without a specific valuation allowance

| Investor commercial real estate | $\$ 83$ | $\$ 83$ | $\$-$ | $\$ 87$ | $\$ 87$ | $\$-$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Residential mortgage | 1,058 | 1,065 | - | 1,139 | 1,146 | - |
| Other consumer | 112 | 211 | - | 268 | 338 | - |
| Total | 1,253 | 1,359 | - | 1,494 | 1,571 | - |
| Loans with a specific valuation <br> allowance |  |  |  |  |  |  |
| Other consumer | 39 | 67 | 19 | 37 | 51 | 15 |
| Total | 39 | 67 | 19 | 37 | 51 | 15 |
| Total impaired loans | $\$ 1,292$ | $\$ 1,426$ | $\$ 19$ | $\$ 1,531$ | $\$ 1,622$ | $\$ 15$ |

The table below presents average balances and interest income recognized for impaired loans during the three month periods ended March 31, 2015 and March 31, 2014:

|  | March 31, 2015 |  | March 31, 2014 |  |
| :---: | :---: | :---: | :---: | :---: |
|  |  |  | Three Months |  |
|  | Ended |  | Ended |  |
|  | Average | Interest | Average | Interest |
|  | Balance | Income | Balance | Income |
| Loans without a specific valuation allowance |  |  |  |  |
| Investor commercial real estate | \$85 | \$2 | \$ 1,052 | \$- |
| Residential mortgage | 1,060 | 2 | 1,162 | 7 |
| Other consumer | 121 | 3 | 296 | 4 |
| Total | 1,266 | 7 | 2,510 | 11 |
| Loans with a specific valuation allowance |  |  |  |  |
| Residential mortgage | - | - | 26 | - |
| Other consumer | 53 | 1 | 78 | - |
| Total | 53 | 1 | 104 | - |
| Total impaired loans | \$1,319 | \$8 | \$2,614 | \$11 |

## Troubled Debt Restructurings ("TDRs")

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

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

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

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financial status or the loan may be restructured to secure additional collateral and/or guarantees to support the debt, or a combination of the two.

Loans classified as new TDRs during the three months ended March 31, 2015 and 2014 are shown in the table below. The 2015 and 2014 modifications consisted solely of maturity date concessions.

|  | New TDRs During the Three Months Ended |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | March 31, 2015 |  |  | March 31, 2014 |  |  |
|  | Number of Contracts | Recorded <br> Balance <br> Before | Recorded <br> Balance <br> After | Number of Contracts | Recorded <br> Balance <br> Before | Recorded Balance After |
| Residential mortgage | 1 | \$57 | \$57 | \$- | \$- | \$- |
| Other consumer | - | - | - | 1 | 21 | 21 |
| Total loans | 1 | \$57 | \$57 | 1 | \$21 | \$21 |

There were no TDR loans which had payment defaults during the three months ended March 31, 2015 and 2014. Default occurs when a loan is 90 days or more past due or transferred to nonaccrual within twelve months of restructuring.

Note 5: Premises and Equipment
Premises and equipment at March 31, 2015 and December 31, 2014 consisted of the following:
$\left.\begin{array}{lll} & \text { March 31, } & \text { December 31, } \\ & 2015 & 2014 \\ \text { Land } & \$ 2,500 & \$ 2,500 \\ \text { Building and improvements } & 3,135 & 3,018 \\ \text { Furniture and equipment } & 5,380 & 5,277 \\ \text { Less: accumulated depreciation } & (3,975 & (3,734 \\ & \$ 7,040 & \$ 7,061\end{array}\right)$

## Note 6: Goodwill

The change in the carrying amount of goodwill for the periods ended March 31, 2015 and December 31, 2014 were:

Balance as of January 1, 2014
Changes in goodwill during the year
Balance as of December 31, 2014
Changes in goodwill during the period
Balance as of March 31, 2015
-
4,687
\$4,687

Goodwill is tested for impairment on an annual basis as of August 31, or whenever events or changes in circumstances indicate the carrying amount of goodwill exceeds its implied fair value. No events or changes in circumstances have occurred since the August 31, 2014 annual impairment test that would suggest it was more likely than not goodwill impairment existed.

Note 7: Benefit Plans
Employment Agreement
The Company has entered into an employment agreement with its Chief Executive Officer that provides for the continuation of salary and certain benefits for a specified period of time under certain conditions. Under the terms of

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the agreement, these payments could occur in the event of a change in control of the Company, as defined, along with other specific conditions.

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## 2013 Equity Incentive Plan

The 2013 Equity Incentive Plan (the "2013 Plan") authorizes the issuance of 750,000 shares of the Company's common stock in the form of equity-based awards to employees, directors, and other eligible persons. Under the terms of the 2013 Plan, the pool of shares available for issuance may be used for available types of equity awards under the 2013 Plan, which includes stock options, stock appreciation rights, restricted stock awards, stock unit awards, and other stock-based awards. All employees, consultants, and advisors of the Company or any subsidiary, as well as all non-employee directors of the Company, are eligible to receive awards under the 2013 Plan.

The Company recorded $\$ 0.3$ million and $\$ 0.1$ million of share-based compensation expense for the three month periods ended March 31, 2015 and 2014, respectively, related to awards made under the 2013 Plan.

The following table summarizes the status of the 2013 Plan awards as of March 31, 2015, and activity for the three months ended March 31, 2015:

| Restricted <br> Stock Units | Weighted-AveragRestricted |  | Weighted-Average ${ }_{\text {Deferred }}$ |  |  | Weighted-Average Grant Date Fair |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Grant Date Fair | Stock |  | Grant Dat | Deferred Stock Units | Grant Date Fair <br> Value Per |
|  | Value Per Share | Awards |  | Value Per |  | Share |
| - | \$ - | 20,777 |  | \$ 25.09 | - | \$ - |
| 30,858 | 18.86 | 46,988 |  | 16.69 | 4 | 15.44 |
| - | - | (30,332 |  | 20.96 | (4) | ) 15.44 |
| - | - | - |  | - | - | - |
| , 30,858 | \$ 18.86 | 37,433 |  | \$ 17.89 | - | \$ - |

At March 31, 2015, the total unrecognized compensation cost related to nonvested awards was $\$ 1.2$ million, with a weighted-average expense recognition period of 2.5 years.

## Directors Deferred Stock Plan

Until January 1, 2014, the Company had a stock compensation plan for members of the Board of Directors ("Directors Deferred Stock Plan"). The Company reserved 180,000 shares of common stock that could have been issued pursuant to the Directors Deferred Stock Plan. The plan provided directors the option to elect to receive up to $100 \%$ of their annual retainer in either common stock or deferred stock rights. Deferred stock rights were to be settled in common stock following the end of the deferral period payable on the basis of one share of common stock for each deferred stock right.

The following is an analysis of deferred stock rights related to the Directors Deferred Stock Plan for the three months ended March 31, 2015 :

|  | Deferred Stock <br> Rights |
| :--- | :--- |
| Outstanding, beginning of period | 80,528 |
| Granted | 291 |
| Exercised | - |
| Outstanding, end of period | 80,819 |

All deferred stock rights granted during the 2015 period were additional rights issued in lieu of cash dividends payable on outstanding deferred stock rights.

Note 8: $\quad$ Fair Value of Financial Instruments
ASC Topic 820, Fair Value Measurement, 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 also specifies a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

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

Level
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 and inputs used for assets measured at fair value on a recurring basis and recognized in the accompanying condensed consolidated balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy.

## Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid mutual funds. 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. Government-sponsored agencies, mortgage and asset-backed securities and certain corporate securities. Matrix pricing is a mathematical technique widely used in the banking industry to value investment securities without relying exclusively on quoted prices for specific investment securities but also on the investment securities' relationship to other benchmark quoted investment securities.

In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. Fair values are calculated using discounted cash flows. Discounted cash flows are calculated based off of the anticipated future cash flows updated to incorporate loss severities. Rating agency and industry research reports as well as default and deferral activity are reviewed and incorporated into the calculation.

## Loans Held-for-Sale

The fair value of loans held-for-sale is determined using quoted prices for similar assets, adjusted for specific attributes of that loan (Level 2).

## Forward Contracts

The fair values of forward contracts on to-be-announced securities are determined using quoted prices in active markets, or benchmarked thereto (Level 1).

## Interest Rate Lock Commitments

The fair values of interest rate lock commitments ("IRLCs") are determined using the projected sale price of individual loans based on changes in market interest rates, projected pull-through rates (the probability that an IRLC will ultimately result in an originated loan), the reduction in the value of the applicant's option due to the passage of time, and the remaining origination costs to be incurred based on management's estimate of market costs (Level 3).

The following tables present the fair value measurements of assets and liabilities recognized in the accompanying condensed consolidated balance sheets measured at fair value on a recurring basis and the level within the fair value

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hierarchy in which the fair value measurements fall at March 31, 2015 and December 31, 2014:

|  | Fair <br> Value |  | March 31, 2015 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | Fair Value Measurements Using |  |  |  |
|  |  |  | Quoted Prices in Active | Significant |  |  |
|  |  |  | Markets for |  | Other | Unobservable |
|  |  |  | Identical |  | Observable | Inputs |
|  |  |  | Assets |  | Inputs | (Level 3) |
|  |  |  | (Level 1) |  | (Level 2) |  |
| U.S. Government-sponsored agencies | \$28,063 |  | \$- |  | \$28,063 | \$- |
| Mortgage-backed securities | 113,132 |  | - |  | 113,132 | - |
| Asset-backed securities | 19,457 |  | - |  | 19,457 | - |
| Other securities | 3,024 |  | 3,024 |  | - | - |
| Total available-for-sale securities | 163,676 |  | 3,024 |  | 160,652 | - |
| Loans held-for-sale (mandatory pricing agreements) | 26,771 |  | - |  | 26,771 | - |
| Forward contracts | (402 | ) | (402 |  | - | - |
| Interest rate lock commitments | 913 |  | - |  | - | 913 |


| U.S. Government-sponsored agencies | $\$ 13,552$ | $\$-$ | $\$ 13,552$ | $\$-$ |
| :--- | :--- | :--- | :--- | :--- |
| Mortgage-backed securities | 117,048 | - | 117,048 | - |
| Asset-backed securities | 4,912 | - | 4,912 | - |
| Other securities | 2,006 | 2,006 | - | - |
| Total available-for-sale securities | 137,518 | 2,006 | 135,512 | - |
| Loans held-for-sale (mandatory pricing | 32,618 | - | 32,618 | - |
| agreements) | $(405$ | $)$ | $(405$ | - |
| Forward contracts | - | - | - |  |
| Interest rate lock commitments | 521 |  |  | 521 |

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

Balance, January 1, 2015
Three Months Ended Securities Interest Rate Available-for- Lock
Sale Commitments
Total realized and unrealized gains (losses)
Included in net income
\$— \$521

Included in other comprehensive income (loss)
Balance, March 31, 2015
\$- \$913

| Balance, January 1, 2014 | $\$ 1,673$ | $\$ 79$ |
| :--- | :--- | :--- |
| Total realized and unrealized gains (losses) | - | 91 |
| Included in net income | 138 | - |
| Included in other comprehensive income (loss) | $\$ 1,811$ | $\$ 170$ |

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Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a nonrecurring basis and recognized in the accompanying condensed consolidated balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy.

## Impaired Loans (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, less costs to sell, 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.

The following tables present the fair value measurements of impaired loans recognized in the accompanying condensed consolidated balance sheets measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fell at March 31, 2015 and December 31, 2014:

|  |  | March 31, 201 |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  |  | Fair Value Me | urements U |  |
|  |  | Quoted Prices <br> in Active | Significant |  |
|  | Fair | Markets for | Other | Unobservable |
|  | Value | Identical | Observable | Inputs |
|  |  | Assets | Inputs | (Level 3) |
|  |  | (Lev |  |  |
| Impaired loans | \$20 | \$- | \$- | \$20 |
|  |  | December 31, |  |  |
|  |  | Fair Value Me | urements U |  |
|  |  | Quoted Prices |  |  |
|  |  | in Active | Significant | Significant |
|  |  | Markets for | Other | Unobservable |
|  | Value | Identical | Observable | Inputs |
|  |  | Assets | Inputs | (Level 3) |
|  |  | Assets | (Level 2) | (Level 3) |
| Impaired loans | \$- | \$- | \$- | \$- |
| Impaired loans |  | \$- |  | \$- |

Unobservable (Level 3) Inputs
The following tables present quantitative information about unobservable inputs used in recurring and nonrecurring Level 3 fair value measurements other than goodwill.

|  | Fair Value at <br> March 31, 2015 | Valuation <br> Technique | Unobservable Inputs | Range |
| :---: | :---: | :---: | :---: | :---: |
| Collateral dependent impaired loans | \$20 | Fair value of collateral | Discount for type of property and current | 30\%-70\% |


|  |  | market conditions |  |  |
| :--- | :--- | :--- | :--- | :--- |
| IRLCs | 913 | Discounted cash flow | Loan closing rates | $45 \%-97 \%$ |
|  | Fair Value at | Valuation | Unobservable | Range |
| IRLCs | December 31, 2014 | Technique | Inputs | Discounted cash flow |
|  | $\$ 521$ | Loan closing rates | $40 \%-95 \%$ |  |

The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying condensed consolidated balance sheets at amounts other than fair value:

## Cash and Cash Equivalents

For these instruments, the carrying amount is a reasonable estimate of fair value.
Loans Held-for-Sale
The fair value of these loans approximates carrying value.
Interest-Bearing Time Deposits
The fair value of these financial instruments approximates carrying value.

## Loans Receivable

The fair value of loans receivable is estimated by discounting future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings and remaining maturities.

## Accrued Interest Receivable

The fair value of these financial instruments approximates carrying value.
Federal Home Loan Bank Stock
The fair value approximates carrying value.
Deposits
The fair value of noninterest-bearing and interest-bearing demand deposits, savings and money market accounts approximates carrying value. The fair value of fixed maturity certificates of deposit and brokered deposits are estimated using rates currently offered for deposits of similar remaining maturities.

Advances from Federal Home Loan Bank
The fair value of fixed rate advances is estimated using rates currently available for advances with similar remaining maturities. The carrying value of variable rate advances approximates fair value.

Accrued Interest Payable
The fair value of these financial instruments approximates carrying value.

## Subordinated Debt

The fair value of our subordinated debt is estimated using discounted cash flow analysis, based on current borrowing rates for similar types of debt instruments.

Commitments

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The fair value of commitments to extend credit are based on fees currently charged to enter into similar agreements with similar maturities and interest rates. The Company determined that the fair value of commitments was zero based on the contractual value of outstanding commitments at each of March 31, 2015 and December 31, 2014.

The following schedule includes the carrying value and estimated fair value of all financial assets and liabilities at March 31, 2015 and December 31, 2014:

|  | March 31, 2015 |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Fair Value Measurements Using |  |  |  |
|  |  | Quoted Prices <br> In Active | Significant |  |
|  | Carrying | Market for | Other | Unobservable |
|  | Amount | Identical | Observable | Inputs |
|  |  | Assets | Inputs | (Level 3) |
|  |  | (Level | (Level 2) |  |
| Cash and cash equivalents | \$39,572 | \$39,572 | \$- | \$- |
| Interest-bearing time deposits | 2,000 | 2,000 | - | - |
| Loans held-for-sale (best efforts pricing agreements) | 813 | - | 813 | - |
| Loans receivable | 767,682 | - | - | 766,823 |
| Accrued interest receivable | 3,040 | 3,040 | - | - |
| Federal Home Loan Bank of Indianapolis stock | 5,350 | - | 5,350 | - |
| Deposits | 821,169 | 406,268 | - | 417,021 |
| Advances from Federal Home Loan Bank | 106,921 | - | 106,943 | - |
| Subordinated debt | 2,894 | - | 3,079 | - |
| Accrued interest payable | 104 | 104 | - | - |
|  | December 31, 2014 |  |  |  |
|  | Fair Value Measurements Using |  |  |  |
|  |  | Quoted Prices | Significant |  |
|  |  | In Active | Other | Significant Unobservable |
|  | Amount | Identical | Observable | Inputs |
|  |  | Assets | Inputs | (Level 3) |
|  |  | (Level 1) | (Level 2) |  |
| Cash and cash equivalents | \$28,289 | \$28,289 | \$- | \$- |
| Interest-bearing time deposits | 2,000 | 2,000 | - | - |
| Loans held-for-sale (best efforts pricing agreements) | 2,053 | - | 2,053 | - |
| Loans receivable | 732,426 | - | - | 733,538 |
| Accrued interest receivable | 2,833 | 2,833 | - | - |
| Federal Home Loan Bank of Indianapolis stock | 5,350 | - | 5,350 | - |
| Deposits | 758,598 | 383,847 | - | 377,067 |
| Advances from Federal Home Loan Bank | 106,897 | - | 107,743 | - |
| Subordinated debt | 2,873 | - | 3,094 | - |
| Accrued interest payable | 97 | 97 | - | - |

## Note 9: Derivative Financial Instruments

The Company uses derivative financial instruments to help manage exposure to interest rate risk and the effects that changes in interest rates may have on net income and the fair value of assets and liabilities. The Company enters into forward contracts for the future delivery of mortgage loans to third party investors and enters into IRLCs with potential borrowers to fund specific mortgage loans that will be sold into the secondary market. The forward contracts are entered into in order to economically hedge the effect of changes in interest rates resulting from the Company's commitment to fund the loans.

Each of these items are considered derivatives, but are not designated as accounting hedges, and are recorded at fair value with changes in fair value reflected in noninterest income on the condensed consolidated statements of income. The fair value of derivative instruments with a positive fair value are reported in accrued income and other assets in the condensed consolidated balance sheets while derivative instruments with a negative fair value are reported in accrued expenses and other liabilities in the condensed consolidated balance sheets.

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At March 31, 2015 and December 31, 2014, the notional amount and fair value of IRLCs and forward contracts utilized by the Company were as follows:

## Asset Derivatives

Derivatives not designated as hedging instruments IRLCs

| March 31, 2015 |  |
| :--- | :--- |
| Notional | Fair |
| Amount | Value |

$\$ 38,643 \quad \$ 913$
December 31, 2014

| Notional | Fair |
| :--- | :--- |
| Amount | Value |

Liability Derivatives
Derivatives not designated as hedging instruments
Forward contracts
$\$ 67,500$
(402
) 55,012
(405
Fair values of derivative financial instruments were estimated using changes in mortgage interest rates from the date the Company entered into the IRLC and the balance sheet date. Periodic changes in the fair value of the derivative financial instruments on the condensed consolidated statements of income for the three month periods ended March 31, 2015 and 2014 were as follows:

Amount of gain / (loss) recognized in the three months ended March 31, 2015 March 31, 2014

## Asset Derivatives

Derivatives not designated as hedging instruments
IRLCs
\$392
\$91
Forward contracts
Liability Derivatives
Derivatives not designated as hedging instruments
Forward contracts
\$3
\$—

## Note 10: Subordinated Debenture

On June 28, 2013, the Company entered into a subordinated debenture purchase agreement with a third party and issued a subordinated debenture in the principal amount of $\$ 3$ million, which bears interest at a fixed annual rate of $8.00 \%$, and is scheduled to mature on June 28,2021 ; however, the Company can repay the debenture without premium or penalty at any time after June 28,2016 . The debenture qualifies for treatment as Tier 2 capital for regulatory capital purposes. The purchase agreement and the debenture contain customary subordination provisions and events of default; however, the right of the investor to accelerate the payment of the debenture is limited to bankruptcy or insolvency.

As partial inducement for the third party to purchase the debenture, the Company issued to the third party a warrant to purchase up to 48,750 shares of common stock at an initial per share exercise price equal to $\$ 19.33$. The warrant became exercisable on June 28, 2014 and, unless previously exercised, will expire on June 28, 2021. The Company has the right to force an exercise of the warrant after the debenture has been repaid in full if the 20-day volume-weighted average price of a share of its common stock exceeds $\$ 30.00$.

The Company used the Black-Scholes option pricing model to assign a fair value of $\$ 0.3$ million to the warrant as of June 28, 2013. The following assumptions were used to value the warrant: a risk-free interest rate of $0.66 \%$ per the U.S. Treasury yield curve in effect at the date of issuance, an expected dividend yield of $1.19 \%$ calculated using the dividend rate and stock price at the date of the issuance, and an expected volatility of $34 \%$ based on the estimated volatility of the Company's stock over the expected term of the warrant, which is estimated to be three years.

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Note 11: Accounting Developments
Accounting Standards Update ("ASU" or "Update") 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs (April 2015)

This Update is part of an initiative to reduce complexity in accounting standards (the "Simplification Initiative") implemented by the Financial Accounting Standards Board. The objective of the Simplification Initiative is to identify, evaluate, and improve areas of generally accepted accounting principles ("GAAP") for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users of financial statements. To simplify presentation of debt issuance costs, the amendments in this Update require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this Update. The ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015. The amendments in this Update should be applied retrospectively to all periods presented, beginning after December 15, 2015. Adoption of the ASU is not expected to have a significant effect on the Company's consolidated financial statements.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF - OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated and condensed financial statements and related notes appearing elsewhere in this report. This discussion and analysis includes certain forward-looking statements that involve risks, uncertainties, and assumptions. You should review the "Risk Factors" section of our Annual Report on Form 10-K for the year ended December 31, 2014 for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by such forward-looking statements. See also "Cautionary Note Regarding Forward-Looking Statements" at the beginning of this report.

## Overview

First Internet Bancorp ("we," "our," "us," or the "Company") is a bank holding company that conducts its business activities through its wholly-owned subsidiary, First Internet Bank of Indiana, an Indiana chartered bank (the "Bank"). The Bank was the first state-chartered, Federal Deposit Insurance Corporation ("FDIC") insured Internet bank and commenced banking operations in 1999. The Company was incorporated under the laws of the State of Indiana on September 15, 2005. On March 21, 2006, we consummated a plan of exchange by which we acquired all of the outstanding shares of the Bank.
We offer a full complement of products and services on a nationwide basis. We conduct our deposit operations primarily over the Internet and have no traditional branch offices. In recent years, we have added commercial real estate ("CRE") lending, including nationwide single tenant lease financing, and commercial and industrial ("C\&I") lending, including asset based lending and business banking/treasury management services to meet the needs of high-quality commercial borrowers and depositors.
Our business model is significantly different from that of a typical community bank. We do not have a conventional brick and mortar branch system; rather, we operate through our scalable Internet banking platform. The market area for our residential real estate lending, consumer lending, and deposit gathering activities is the entire United States. We also offer single tenant lease financing on a nationwide basis. Our other commercial banking activities, including CRE loans and C\&I loans, corporate credit cards, and corporate treasury management services, are offered by our commercial banking team to businesses primarily within Central Indiana, Phoenix, Arizona and markets adjacent to these areas.

## Results of Operations

The following table contains a review of the Company's financial performance for the five most recent quarters. Three Months Ended
(dollars in thousands except for
and per share data)
Income Statement Summary:

| Net interest income | $\$ 6,774$ | $\$ 6,375$ | $\$ 5,673$ | $\$ 5,373$ | $\$ 4,866$ |
| :--- | :--- | :--- | :--- | :--- | :--- |
| Provision (credit) for loan losses | 442 | 387 | $(112$ | $)$ | $(73$ |
| Noninterest income | 3,148 | 2,098 | 1,943 | 1,622 | 147 |
| Noninterest expense | 6,257 | 5,879 | 5,785 | 5,560 | 5,438 |
| Income tax provision | 1,160 | 742 | 661 | 531 | 192 |
| Net income | $\$ 2,063$ | $\$ 1,465$ | $\$ 1,282$ | $\$ 977$ | $\$ 600$ |
| Per share and share information |  |  |  |  |  |
| Earnings per share - basic | $\$ 0.46$ | $\$ 0.33$ | $\$ 0.29$ | $\$ 0.22$ | $\$ 0.13$ |
| Earnings per share - diluted | 0.46 | 0.32 | 0.28 | 0.22 | 0.13 |
| Dividends declared per share | 0.06 | 0.06 | 0.06 | 0.06 | 0.06 |
| Book value per common share <br> Tangible book value per common | 22.16 | 21.80 | 21.35 | 21.25 | 20.60 |
| share 1 | 21.11 | 20.74 | 20.29 | 20.19 | 19.54 |
| Common shares outstanding | $4,484,513$ | $4,439,575$ | $4,439,575$ | $4,449,619$ | $4,449,619$ |
| Average common shares outstanding: |  |  |  |  |  |
| Basic | $4,516,776$ | $4,499,316$ | $4,497,762$ | $4,496,219$ | $4,494,670$ |
|  |  |  |  |  |  |

$\begin{array}{ll}\text { Diluted } & 4,523,246 \\ \text { Performance ratios }\end{array}$
Performance ratios

| Return on average assets | 0.84 |  | 0.62 |  | 0.59 |  | 0.45 |  | 0.30 | \% |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Return on average shareholders' equity | 8.55 | \% | 6.07 | \% | 5.36 |  |  | \% | 2.64 | \% |
| Return on average tangible common equity ${ }^{1}$ | 8.98 | \% | 6.38 | \% | 5.64 |  | 4.46 | \% | 2.79 | \% |
| Net interest margin | 2.84 | \% | 2.78 | \% | 2.68 | \% | 2.61 | \% | 2.51 | \% |
| Capital ratios <br> Tangible common equity to tangible assets ${ }^{1}$ | 9.18 | \% | 9.54 | \% | 9.77 | \% | 10.41 | \% | 10.31 | \% |
| Leverage ratio | 9.52 | \% | 9.87 | \% | 10.52 | \% | 10.45 | \% | 10.88 | \% |
| Common equity tier 1 capital ratio | 11.99 | \% | 12.55 | \% | 13.22 | \% | 14.03 | \% | 15.14 | \% |
| Tier 1 capital ratio | 11.99 | \% | 12.55 | \% | 13.22 | \% | 14.03 | \% | 15.14 | \% |
| Total risk-based capital ratio | 13.18 |  | 13.75 | \% | 14.45 | \% | 15.30 | \% | 16.57 | \% |

${ }^{1}$ This information represents a non-GAAP financial measure. See the "Reconciliation of Non-GAAP Financial Measures" for a reconciliation of these measures to their most directly comparable GAAP measures.

During the first quarter 2015, net income was $\$ 2.1$ million, or $\$ 0.46$ per diluted share, compared to first quarter 2014 net income of $\$ 0.6$ million, or $\$ 0.13$ per diluted share. The increase in net income of $\$ 1.5$ million, or $243.8 \%$, was due to increases in net interest income and noninterest income, partially offset by increases in the provision for loan losses and noninterest expense. Return on average assets and return on average shareholders' equity were $0.84 \%$ and $8.55 \%$, respectively, for the first quarter 2015 compared to $0.30 \%$ and $2.64 \%$, respectively, for the first quarter 2014.

Average Balance Sheets and Net Interest Income Analysis
For the periods presented, the following table provides the average balances of interest-earning assets and interest-bearing liabilities and the related yields and cost of funds. The table does not reflect any effect of income taxes. Balances are based on the average of daily balances. Nonaccrual loans are included in average loan balances.

Consolidated Average Balance Sheets and Net Interest Income Analysis
(dollars in thousands)

Assets
Interest-earning assets

| Loans, including loans | $\$ 780,302$ | 4.36 | $\%$ | $\$ 745,561$ | 4.23 | $\%$ | $\$ 537,620$ | 4.62 | $\%$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| held-for-sale | 145,241 | 2.02 | $\%$ | 129,692 | 1.88 | $\%$ | 144,213 | 2.11 | $\%$ |
| Securities - taxable | - | 0.00 | $\%$ | - | 0.00 | $\%$ | 7,241 | 3.25 | $\%$ |
| Securities - non-taxable | 41,643 | 0.73 | $\%$ | 34,242 | 0.59 | $\%$ | 97,432 | 0.40 | $\%$ |
| Other earning assets | 967,186 | 3.85 | $\%$ | 909,495 | 3.76 | $\%$ | 786,506 | 3.63 | $\%$ |
| Total interest-earning assets |  |  |  |  |  |  |  |  |  |
|  | $(5,883$ | $)$ |  | $(5,535$ | $)$ |  | $(5,450$ | $)$ |  |
| Allowance for loan losses | 34,548 |  |  | $\$ 938,685$ |  |  | 37,954 |  |  |
| Noninterest earning-assets | 3,54, | $\$ 819,010$ |  |  |  |  |  |  |  |

Liabilities
Interest-bearing liabilities

| Regular savings accounts | $\$ 22,099$ | 0.59 | $\%$ | $\$ 19,545$ | 0.59 | $\%$ | $\$ 18,541$ | 0.61 | $\%$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Interest-bearing demand deposits | 75,405 | 0.55 | $\%$ | 68,968 | 0.55 | $\%$ | 70,347 | 0.55 | $\%$ |
| Money market accounts | 274,312 | 0.73 | $\%$ | 274,015 | 0.73 | $\%$ | 262,982 | 0.73 | $\%$ |
| Certificates and brokered deposits | 390,101 | 1.38 | $\%$ | 363,212 | 1.41 | $\%$ | 328,092 | 1.56 | $\%$ |
| Total interest-bearing deposits | 761,917 | 1.04 | $\%$ | 725,740 | 1.05 | $\%$ | 679,962 | 1.11 | $\%$ |
| Other borrowed funds | 109,787 | 1.70 | $\%$ | 91,700 | 1.45 | $\%$ | 25,156 | 4.95 | $\%$ |
| Total interest-bearing liabilities | 871,704 | 1.12 | $\%$ | 817,440 | 1.09 | $\%$ | 705,118 | 1.25 | $\%$ |
| Noninterest-bearing deposits | 22,265 |  |  | 21,118 |  |  | 18,159 |  |  |
| Other noninterest-bearing | 4,038 |  |  | 4,295 |  |  | 3,679 |  |  |
| liabilities | 898,007 |  |  | 842,853 |  |  | 726,956 |  |  |
| Total liabilities |  |  |  |  |  |  |  |  |  |
| Shareholders' equity | 97,844 |  | 95,832 |  |  | 92,054 |  |  |  |
| Total liabilities and shareholders' | $\$ 995,851$ |  | $\$ 938,685$ |  |  | $\$ 819,010$ |  |  |  |
| equity |  |  |  |  |  |  |  |  |  |


| Interest rate spread ${ }^{1}$ | 2.73 | $\%$ | 2.67 | $\%$ | 2.38 | $\%$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Net interest margin $^{2}$ | 2.84 | $\%$ | 2.78 | $\%$ | 2.51 | $\%$ |

${ }^{1}$ Yield on total interest-earning assets minus cost of total interest-bearing liabilities
${ }^{2}$ Net interest income divided by total interest-earning assets

## Rate/Volume Analysis

The following table illustrates the impact of changes in the volume of interest-earning assets and interest-bearing liabilities and interest rates on net interest income for the periods indicated. The change in interest not due solely to volume or rate has been allocated in proportion to the absolute dollar amounts of the change in each.


Net interest income for the first quarter 2015 was $\$ 6.8$ million, increasing $\$ 1.9$ million, or $39.2 \%$, compared to first quarter 2014 net interest income of $\$ 4.9$ million. Net interest margin was $2.84 \%$ for the first quarter 2015 compared to $2.51 \%$ for the first quarter 2014. The increases in net interest income and net interest margin were primarily driven by an increase of $\$ 180.7$ million, or $23.0 \%$, in the balance of average interest-earning assets for the first quarter 2015 compared to the first quarter 2014 as well as changes in the composition of the Company's balance sheet which resulted in an increase in the yield earned on interest-earning assets and a decrease in the cost of funds related to interest-bearing liabilities.

The increase in net interest income for the first quarter 2015, as compared to the first quarter 2014, was the result of a $\$ 2.2$ million, or $30.6 \%$, increase in total interest income to $\$ 9.2$ million for the first quarter 2015 from $\$ 7.0$ million for the first quarter 2014. The increase in total interest income was partially offset by a $\$ 0.2$ million, or $11.4 \%$, increase in total interest expense to $\$ 2.4$ million for the first quarter 2015 from $\$ 2.2$ million for the first quarter 2014.

The increase in total interest income was due primarily to an increase in interest earned on loans resulting from an increase of $\$ 242.7$ million, or $45.1 \%$, in the average balance of loans, including loans held-for-sale, for the first quarter 2015 compared to the first quarter 2014. This was partially offset by a decline in interest income earned on investment securities resulting from a decrease in both the average balance of securities, which declined $\$ 6.2$ million, or $4.1 \%$, and the yield earned on investment securities, which declined 14 bps, for the first quarter 2015 compared to the first quarter 2014.

The increase in total interest expense was driven primarily by an increase in interest expense related to other borrowed funds as a result of a $\$ 84.6$ million, or $336.4 \%$, increase in the average balance of other borrowed funds for the first

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quarter 2015 compared to first quarter 2014, partially offset by a decline of 325 bps in the cost of funds related to these borrowings. Interest expense related to interest-bearing deposits also contributed to the increase in total interest expense due to an $\$ 82.0$ million, or $12.1 \%$, increase in average interest-bearing deposits for the first quarter 2015 compared to the first quarter 2014, partially offset by a decline of 7 bps in the cost of interest-bearing deposits.

Noninterest Income
The following table presents noninterest income for the three months ended March 31, 2015 and for the prior four quarters.

| (dollars in thousands) | Three Months Ended |  |  |  |  |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :---: | :---: | :---: | :---: |
|  | March 31, | December 31, September | June 30, 2014 | March 31, |  |  |  |  |  |
|  | 2015 | 2014 | 30,2014 |  | $\$ 167$ |  |  |  |  |
| Service charges and fees | $\$ 176$ | $\$ 174$ | $\$ 179$ | $\$ 187$ | 900 |  |  |  |  |
| Mortgage banking activities | 2,886 | 1,842 | 1,638 | 1,229 | 359 |  |  |  |  |
| Gain on sale of securities | - | - | 54 | 125 | $(13$ |  |  |  |  |
| Loss on asset disposals | $(14$ | $)$ | $(19$ | $)$ | $(28$ |  |  |  |  |
| Other | 100 | 101 | 100 | 99 | 98 |  |  |  |  |
| Total noninterest income | $\$ 3,148$ | $\$ 2,098$ | $\$ 1,943$ | $\$ 1,622$ | $\$ 1,511$ |  |  |  |  |

During the first quarter 2015, noninterest income totaled $\$ 3.1$ million, representing an increase of $\$ 1.6$ million, or $108.3 \%$, compared to $\$ 1.5$ million for the the first quarter 2014. The increase in noninterest income was driven by an increase of $\$ 2.0$ million, or $220.7 \%$, in mortgage banking revenue resulting from an improvement in gain on sale margin and higher origination volumes. The increase in mortgage banking revenue was partially offset by a $\$ 0.4$ million decline in gains related to the sales of securities.

## Noninterest Expense

The following table presents noninterest expense for the three months ended March 31, 2015 and for the prior four quarters.

| (dollars in thousands) | Three Months Ended |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | $\begin{aligned} & \text { March 31, } \\ & 2015 \end{aligned}$ | $\begin{aligned} & \text { December 31, } \\ & 2014 \end{aligned}$ | September $30,2014$ | June 30, 2014 | March 31, <br> 2014 |
| Salaries and employee benefits | \$3,578 | \$3,129 | \$3,265 | \$2,948 | \$3,007 |
| Marketing, advertising and promotion | 452 | 307 | 381 | 387 | 380 |
| Consulting and professional fees | 592 | 595 | 409 | 465 | 433 |
| Data processing | 248 | 277 | 244 | 239 | 234 |
| Loan expenses | 181 | 168 | 208 | 136 | 114 |
| Premises and equipment | 642 | 733 | 741 | 761 | 701 |
| Deposit insurance premium | 150 | 154 | 155 | 138 | 144 |
| Other | 414 | 516 | 382 | 486 | 425 |
| Total noninterest expense | \$6,257 | \$5,879 | \$5,785 | \$5,560 | \$5,438 |

Noninterest expense for the first quarter 2015 was $\$ 6.3$ million, compared to $\$ 5.4$ million for the first quarter 2014. The increase of $\$ 0.9$ million, or $15.1 \%$, compared to March 31, 2014 was due to an increase of $\$ 0.6$ million in salaries and employee benefits and an increase of $\$ 0.2$ million in consulting and professional fees. The increase in salaries and employee benefits was attributable to increased headcount driven by the Company's continued growth and higher equity compensation expense. The increase in consulting and professional fees was due primarily to an increase in legal and consulting expenses associated with the Company's expansion over the last twelve months.

Financial Condition
The following table presents summary balance sheet data for the last five quarters. (dollars in thousands)
Balance Sheet Data:
Total assets
Loans receivable
Securities available-for-sale
Loans held-for-sale
Noninterest-bearing deposits
Interest-bearing deposits
Total deposits
Shareholders' equity

| March 31, | December 31, | September 30, | June 30, | March 31, |
| :--- | :--- | :--- | :--- | :--- |
| 2015 | 2014 | 2014 | 2014 | 2014 |
| $\$ 1,035,677$ | $\$ 970,503$ | $\$ 926,883$ | $\$ 868,107$ | $\$ 848,119$ |
| 767,682 | 732,426 | 695,929 | 631,678 | 532,249 |
| 163,676 | 137,518 | 128,203 | 159,528 | 204,869 |
| 27,584 | 34,671 | 27,547 | 21,466 | 17,273 |
| 19,178 | 21,790 | 20,359 | 19,065 | 17,047 |
| 801,991 | 736,808 | 717,611 | 725,108 | 710,605 |
| 821,169 | 758,598 | 737,970 | 744,173 | 727,652 |
| 99,362 | 96,785 | 94,774 | 94,534 | 91,644 |

Total assets were $\$ 1.0$ billion at March 31, 2015, compared to $\$ 970.5$ million at December 31, 2014, representing an increase of $\$ 65.2$ million, or $6.7 \%$. The increase in total assets was due to increases of $\$ 35.3$ million, or $4.8 \%$, in loans receivable, $\$ 26.2$ million, or $19.0 \%$, in securities available-for-sale, and $\$ 11.8$ million, or $44.6 \%$, in interest-bearing cash balances, offset partially by a decline of $\$ 7.1$ million, or $20.4 \%$, in loans held-for-sale.

Loan Portfolio Analysis
The following table provides a detailed listing of the Company's loan portfolio for the last five quarters.
(dollars in
thousands)
March 31, 2015
Commercial
loans
$\begin{array}{lllllllll}\text { Commercial and } \\ \text { industrial }\end{array} \$ 83,849 \quad 11.0 \% ~ \$ 77,232 \quad 10.6 \% ~ \$ 72,099 \quad 10.4 \% \$ 71,997 \quad 11.5 \% ~ \$ 63,373 \quad 12.0 \%$
Owner-occupied
commercial real $38,536 \quad 5.1 \quad \% \quad 34,295 \quad 4.7$ \% $31,637 \quad 4.6 \quad \% \quad 26,629 \quad 4.2 \quad \% \quad 24,976 \quad 4.7 \quad \%$
estate
Investor
commercial real 18,49
estate
$\begin{array}{lllllllllllllllll}\text { Construction } & 26,847 & 3.5 & \% & 24,883 & 3.4 & \% & 17,936 & 2.6 & \% & 24,371 & 3.9 & \% & 22,460 & 4.2 & \%\end{array}$
$\begin{array}{llllllllllllllll}\text { Single tenant } \\ \text { lease financing }\end{array} 2227,229 \quad 29.8 \% 192,608 \quad 26.6 \% 165,738 \quad 24.0 \% 143,547 \quad 22.9 \% 105,847 \quad 20.1 \%$
lease financing
Total
$\begin{array}{lllllllllllllll}\text { commercial } & 394,952 & 51.8 & \% & 351,087 & 48.3 & \% & 307,977 & 44.6 & \% & 285,011 & 45.5 & \% & 242,875 & 46.0\end{array}$
loans
Consumer loans

| Residential mortgage | 215,910 | 28.3 \% | 220,612 | 30.3 \% | 220,499 | 31.9 \% | 175,114 | 27.9 \% | 143,355 | 27.2 \% |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Home equity | 54,838 | 7.2 \% | 58,434 | 8.0 \% | 61,799 | 9.0 \% | 63,725 | 10.2 \% | 36,676 | 7.0 \% |
| Other consumer | 97,192 | 12.7 \% | 97,094 | 13.4 \% | 100,074 | 14.5 \% | 102,843 | 16.4 \% | 104,694 | 19.8 \% |
| Total consumer loans | 367,940 | 48.2 \% | 376,140 | 51.7 \% | 382,372 | 55.4 \% | 341,682 | 54.5 \% | 284,725 | 54.0 \% |
|  | 4,790 |  | 5,199 |  | 5,580 |  | 4,985 |  | 4,649 |  |

Deferred loan
origination costs
and premiums
and discounts on
purchased loans

| Total loans <br> receivable | 767,682 | 732,426 | 695,929 | 631,678 | 532,249 |
| :--- | :--- | :--- | :--- | :--- | :--- |
| Allowance for <br> loan losses | $(6,378 \quad)$ | $(5,800 \quad)$ | $(5,464 \quad)$ | $(5,140 \quad)$ | $(5,388 \quad)$ |
| Net loans <br> receivable | $\$ 761,304$ | $\$ 726,626$ | $\$ 690,465$ | $\$ 626,538$ | $\$ 526,861$ |

Total loans receivable as of March 31, 2015 were $\$ 767.7$ million, increasing $\$ 35.3$ million, or $4.8 \%$, compared to $\$ 732.4$ million as of December 31, 2014. Total commercial loans increased $\$ 43.9$ million, or $12.5 \%$, as of March 31, 2015 as compared to December 31, 2014 due to increases of $\$ 34.6$ million, or $18.0 \%$, in single tenant lease financing, $\$ 6.6$ million, or $8.6 \%$, in commercial and industrial, and $\$ 4.2$ million, or $12.4 \%$, in owner-occupied commercial real estate. These increases were partially offset by a decline of $\$ 3.6$ million, or $16.2 \%$, in investor commercial real estate.

Total consumer loans declined $\$ 8.2$ million, or $2.2 \%$, as of March 31, 2015 as compared to December 31, 2014 due primarily to decreases of $\$ 4.7$ million, or $2.1 \%$, in residential mortgages and $\$ 3.6$ million, or $6.2 \%$, in home equity loans.

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Asset Quality and Allowance for Loan Losses
(dollars in thousands)

| March 31, | December 31, | September 30, |
| :--- | :--- | :--- | :--- | :--- |
| 2015 | 2014 | 2014 |, | June 30, 2014 |
| :--- |
| 2014 |

Nonaccrual loans
Commercial loans:
Investor commercial real estate
Total commercial loans
Consumer loans:
Residential mortgage
Other consumer
Total consumer loans
Total nonaccrual loans
Past Due 90 days and accruing loans Consumer loans:

| Residential mortgage | - | 57 | 96 | - | - |
| :--- | :--- | :--- | :--- | :--- | :--- |
| Other consumer | - | 4 | 5 | 17 | 23 |
| Total consumer loans | - | 61 | 101 | 17 | 23 |
| Total past due 90 days and accruing | - | 61 | 101 | 17 | 23 |
| loans |  |  |  |  |  |
| Total nonperforming loans | 246 | 296 | 400 | 1,177 | 1,352 |


| Other real estate owned |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Investor commercial real estate | 4,488 | 4,488 | 4,488 | 4,371 | 4,283 |  |
| Residential mortgage | - | - | 57 | 293 | 368 |  |
| Total other real estate owned | 4,488 | 4,488 | 4,545 | 4,664 | 4,651 |  |
| Other nonperforming assets | 84 | 82 | 122 | 120 | 909 |  |
| Total nonperforming assets | \$4,818 | \$4,866 | \$5,067 | \$5,961 | \$6,912 |  |
| Total nonperforming loans to total loans receivable | 0.03 | \% 0.04 | \% 0.06 | \% 0.19 | \% 0.26 | \% |
| Total nonperforming assets to total | 0.47 | \% 0.50 | \% 0.55 | \% 0.69 | \% 0.81 | \% |

Troubled Debt Restructurings

| (dollars in thousands) | $\begin{aligned} & \text { March 31, } \\ & 2015 \end{aligned}$ | $\begin{aligned} & \text { December 31, } \\ & 2014 \end{aligned}$ | September $30,2014$ | June 30, 2014 | March 31, <br> 2014 |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Troubled debt restructurings - no |  | \$5 | \$25 | \$26 | \$26 |
| Troubled debt restructurings - pe | 1,164 | 1,125 | 1,154 | 1,189 | 1,229 |
| Total troubled debt restructurings | \$ 1,169 | \$ 1,130 | \$ 1,179 | \$1,215 | \$1,255 |

Total nonperforming loans declined $\$ 0.1$ million, or $16.9 \%$, to $\$ 0.2$ million as of March 31, 2015 compared to $\$ 0.3$ million as of December 31, 2014. Total nonperforming assets declined less than $\$ 0.1$ million, or $1.0 \%$, to $\$ 4.8$ million as of March 31, 2015 compared to $\$ 4.9$ million as of December 31, 2014. The decreases in nonperforming loans and nonperforming assets were due primarily to a decline in loans 90 days past due and accruing. As a result, the ratio of

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nonperforming loans to total loans receivable improved to $0.03 \%$ as of March 31, 2015 compared to $0.04 \%$ as of December 31, 2014 and the ratio of nonperforming assets to total assets improved to $0.47 \%$ as of March 31, 2015 compared to $0.50 \%$ as of December 31, 2014.

As of March 31, 2015 and December 31, 2014, the Company had one commercial property in other real estate owned with a carrying value of $\$ 4.5$ million. This property consists of two buildings which are residential units adjacent to a university

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campus. Improvements to the property have been made in collaboration with the university and the property continues to be occupied.

The allowance for loan losses was $\$ 6.4$ million as of March 31, 2015 compared to $\$ 5.8$ million as of December 31, 2014. The increase of $\$ 0.6$ million, or $10.0 \%$, was due primarily to the continued growth in commercial loan balances. The allowance for loan losses as a percentage of total loans receivable increased to $0.83 \%$ as of March 31, 2015 compared to $0.79 \%$ as of December 31, 2014, and as a percentage of nonperforming loans increased to $2,592.7 \%$ as of March 31, 2015 compared to 1,959.5\% as of December 31, 2014.

Nonperforming loans are comprised of total nonaccrual loans and loans 90 days past due and accruing. Nonperforming assets include nonperforming loans, other real estate owned and other nonperforming assets which consist of impaired investment securities and repossessed assets. Impaired investment securities were sold during the second quarter 2014.

Investment Securities
The following table presents the book value and approximate fair value of our investment portfolio by security type for the last five quarters.
(dollars in thousands)

| Amortized Cost | March 31, <br> Securities available-for-sale | 2015 |
| :--- | :--- | :--- | :--- | :--- | :--- |

The approximate fair value of investment securities available-for-sale increased $\$ 26.2$ million, or $19.0 \%$, to $\$ 163.7$ million as of March 31, 2015 compared to $\$ 137.5$ million as of December 31, 2014. The increase was due primarily to increases of $\$ 14.5$ million in U.S. Government-sponsored agency securities and $\$ 14.5$ million in asset-backed securities. During the first quarter 2015, the Company deployed funds generated through deposit growth to purchase securities in order to enhance net interest income while supporting liquidity and interest rate risk management.

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Deposits

The following table presents the composition of the Company's deposit base for the last five quarters.

| (dollars in thousands) | March 31, 2015 |  |  | December 31, 2014 |  | September 30, 2014 |  |  | June 30, 2014 |  |  | March 31, 2014 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Regular savings accounts | \$23,367 | 2.8 | \% | \$20,776 | 2.7 | \% | \$ 17,503 | 2.4 | \% | \$ 16,861 | 2.3 | \% | \$21,790 | 3.0 | \% |
| Noninterest-bearing deposits | 19,178 | 2.3 | \% | 21,790 | 2.9 |  | 20,359 | 2.8 | \% | 19,065 | 2.6 | \% | 17,047 | 2.3 | \% |
| Interest-bearing demand deposits | 82,982 | 10.1 | \% | 74,238 | 9.8 | \% | 71,762 | 9.7 | \% | 73,843 | 9.9 | \% | 76,447 | 10.5 | \% |
| Money market accounts | 280,740 | 34.2 | \% | 267,046 | 35.2 | \% | 275,901 | 37.4 | \% | 267,854 | 36.0 | \% | 271,698 | 37.3 | \% |
| Certificates of deposit | 401,347 | 48.9 | \% | 361,202 | 47.6 | \% | 334,636 | 45.3 | \% | 348,752 | 46.9 | \% | 322,883 | 44.4 | \% |
| Brokered deposits | 13,555 | 1.7 | \% | 13,546 | 1.8 | \% | 7,809 | 2.4 | \% | 17,798 | 2. | \% | 7,787 | 2.5 | \% |
| Total | \$821,169 | 100.0 | \% | \$758,598 | 100.0 | \% | \$737,970 | 100 |  | \$744,173 | 100 |  | \$727,652 | 100.0 |  |

Total deposits increased $\$ 62.6$ million, or $8.2 \%$, to $\$ 821.2$ million as of March 31,2015 as compared to $\$ 758.6$ million as of December 31, 2014. This increase was due primarily to increases of $\$ 40.1$ million, or $11.1 \%$, in certificates of deposit, $\$ 13.7$ million, or $5.1 \%$, in money market accounts, and $\$ 8.7$ million, or $11.8 \%$, in interest-bearing demand deposits.

## Capital

The Company and the Bank are subject to various regulatory capital requirements administered by state and federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weighting and other factors.

The Basel III Capital Rules became effective for the Company and the Bank on January 1, 2015, subject to a phase-in period for certain provisions. Quantitative measures established by the Basel III Capital Rules to ensure capital adequacy require the maintenance of minimum amounts and ratios of Common Equity Tier 1 capital, Tier 1 capital and Total capital, as defined in the regulations, to risk-weighted assets, and of Tier 1 capital to adjusted quarterly average assets ("Leverage Ratio").

When fully phased in on January 1, 2019, the Basel III Capital Rules will require the Company and the Bank to maintain: 1) a minimum ratio of Common Equity Tier 1 capital to risk-weighted assets of $4.5 \%$, plus a $2.5 \%$ "capital conservation buffer" (resulting in a minimum ratio of Common Equity Tier 1 capital to risk-weighted assets of $7.0 \%$ upon full implementation); 2) a minimum ratio of Tier 1 capital to risk-weighted assets of $6.0 \%$, plus the capital conservation buffer (resulting in a minimum Tier 1 capital ratio of $8.5 \%$ upon full implementation); 3) a minimum ratio of Total capital to risk-weighted assets of $8.0 \%$, plus the capital conservation buffer (resulting in a minimum Total capital ratio of $10.5 \%$ upon full implementation); and 4) a minimum Leverage Ratio of $4.0 \%$.

The implementation of the capital conservation buffer will begin on January 1, 2016 at the $0.625 \%$ level and be phased in over a four-year period increasing by increments of that amount on each subsequent January 1 until it reaches $2.5 \%$ on January 1, 2019. The capital conservation buffer is designed to absorb losses during periods of
economic stress. Failure to maintain the minimum Common Equity Tier 1 ratio plus the capital conservation buffer will result in potential restrictions on a banking institution's ability to pay dividends, repurchase stock and/or pay discretionary compensation to its employees.

The following table presents actual and required capital ratios as of March 31, 2015 for the Company and the Bank under the Basel III Capital Rules. The minimum required capital amounts presented include the minimum required capital levels as of March 31, 2015 based on the phase-in provisions of the Basel III Capital Rules and the minimum required capital levels as of January 1, 2019 when the Basel III Capital Rules have been fully phased-in. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules.

| (dollars in thousands) | Actual |  |  | Minimum Capital Required - Basel III Phase-In Schedule |  |  | Minimum Capital Required - Basel III Fully Phased-In |  |  | Required to be Considered Well Capitalized |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Capital Amount | Ratio |  | Capital <br> Amount | Ratio |  | Capital <br> Amount | Ratio |  | Capital Amount | Ratio |  |
| As of March 31, 2015: Common Equity Tier 1 to risk-weighted assets |  |  |  |  |  |  |  |  |  |  |  |  |
| Consolidated | \$94,282 | 11.99 | \% | \$35,391 | 4.50 | \% | \$55,053 | 7.00 | \% | N/A | N/A |  |
| Bank | 86,068 | 10.98 | \% | 35,281 | 4.50 | \% | 54,881 | 7.00 | \% | 50,961 | 6.50 | \% |

Tier 1 capital to risk-weighted assets

| Consolidated | 94,282 | 11.99 | $\%$ | 47,188 | 6.00 | $\%$ | 66,850 | 8.50 | $\%$ | N/A | N/A |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Bank | 86,068 | 10.98 | $\%$ | 47,041 | 6.00 | $\%$ | 66,641 | 8.50 | $\%$ | 62,721 | 8.00 | $\%$ |

Total capital to risk-weighted assets

| Consolidated | 103,671 | 13.18 | $\%$ | 62,917 | 8.00 | $\%$ | 82,579 | 10.50 | $\%$ | N/A | N/A |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Bank | 92,457 | 11.79 | $\%$ | 62,721 | 8.00 | $\%$ | 82,322 | 10.50 | $\%$ | 78,402 | 10.00 | $\%$ |

Leverage ratio
$\begin{array}{lllllllllllll}\text { Consolidated } & 94,282 & 9.52 & \% & 39,624 & 4.00 & \% & 39,624 & 4.00 & \% & \text { N/A } & \text { N/A } & \\ \text { Bank } & 86,068 & 8.71 & \% & 39,538 & 4.00 & \% & 39,538 & 4.00 & \% & 49,422 & 5.00 & \%\end{array}$
The following table presents actual and required capital ratios as of December 31, 2014 for the Company and the Bank under the regulatory capital rules then in effect.


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## Shareholders' Dividends

The Company's Board of Directors declared a cash dividend for the first quarter 2015 of $\$ 0.06$ per share of common stock payable April 15, 2015 to shareholders of record on March 31, 2015. Subsequent to March 31, 2015, the Company's Board of Directors also declared a cash dividend for the second quarter 2015 of $\$ 0.06$ per share of common stock payable July 15,2015 to shareholders of record on June 30, 2015. The Company expects to continue to pay dividends on a quarterly basis; however, the declaration and amount of any future dividends will be determined by the Board of Directors on the basis of financial condition, earnings, regulatory constraints, and other factors.

## Capital Resources

We believe our capital resources are sufficient to meet our current and expected needs, including any cash dividends we may pay. However, we may require additional capital resources to accommodate continued growth.

## Liquidity

Liquidity management is the process used by the Company to manage the continuing flow of funds necessary to meet its financial commitments on a timely basis and at a reasonable cost while also maintaining safe and sound operations. Our liquidity, represented by cash and investment securities, is a product of our operating, investing and financing activities. Our primary sources of funds are deposits, principal and interest payments on loans and investment securities, maturing loans and investment securities, access to wholesale funding sources and collateralized borrowings. While scheduled payments and maturities of loans and investment securities are relatively predictable sources of funds, deposit flows are greatly influenced by general interest rates, economic conditions and competition. Therefore, we supplement deposit growth and enhance interest rate risk management through borrowings, which are generally advances from the Federal Home Loan Bank.

We maintain cash and investment securities that qualify as liquid assets to maintain adequate liquidity to ensure safe and sound operations and meet our financial commitments. At March 31, 2015, on a consolidated basis, the Company had $\$ 205.2$ million in cash, interest-bearing time deposits and investment securities available-for-sale and $\$ 27.6$ million in loans held-for-sale that were generally available for our cash needs. We can also generate funds from wholesale funding sources and collateralized borrowings. At March 31, 2015, the Bank had the ability to borrow an additional $\$ 167.7$ million in advances from the Federal Home Loan Bank and correspondent bank Fed Funds lines of credit.

The Company is a separate legal entity from the Bank and must provide for its own liquidity. In addition to its own operating expenses, many of which are paid to the Bank, the Company is responsible for paying any dividends declared to its common stockholders and interest and principal on outstanding debt. The Company's primary sources of funds are cash maintained at the holding company level and dividends from the Bank, the payment of which is subject to regulatory limits. At March 31, 2015, the Company, on an unconsolidated basis, had $\$ 9.3$ million in cash generally available for its cash needs, which is in excess of its current annual regular shareholder dividend and operating expenses.

We use our sources of funds primarily to meet ongoing financial commitments, including withdrawals by depositors, credit commitments to borrowers, operating expenses and capital expenditures. At March 31, 2015, approved outstanding loan commitments, including unused lines of credit, amounted to $\$ 114.8$ million. Certificates of deposit scheduled to mature in one year or less at March 31, 2015 totaled $\$ 238.8$ million. Generally, we believe that a majority of maturing deposits will remain with the Bank.

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Management is not aware of any other events or regulatory requirements that, if implemented, are likely to have a material effect on either the Company's or the Bank's liquidity.

## Reconciliation of Non-GAAP Financial Measures

The Management's Discussion and Analysis contains financial information determined by methods other than in accordance with U.S. generally accepted accounting principles ("GAAP"). Non-GAAP financial measures, specifically tangible common equity, tangible assets, tangible book value per common share, return on average tangible common equity and tangible common equity to tangible assets are used by the Company's management to measure the strength of its capital and its ability to generate earnings on tangible capital invested by its shareholders. Although we believe these non-GAAP measures provide a greater understanding of its business, they should not be considered a substitute for financial measures determined in accordance with GAAP, nor are they necessarily comparable to non-GAAP performance measures that may be presented by other companies. Reconciliations of these non-GAAP financial measures to the most directly comparable GAAP financial measures are included in the following table for the past five quarters.

| (dollars in thousands, except share data) | March 31, 2015 |  | $\begin{aligned} & \text { December 31, } \\ & 2014 \end{aligned}$ |  | $\begin{aligned} & \text { September 30, } \\ & 2014 \end{aligned}$ |  | June 30, 2014 |  | $\begin{aligned} & \text { March 31, } \\ & 2014 \end{aligned}$ |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Total equity - GAAP | \$99,362 |  | \$96,785 |  | \$94,774 |  | \$94,534 |  | \$91,644 |  |
| Adjustments: |  | ) | (4) |  |  | ) |  | ) |  | ) |
| Tangible common equity | \$94,675 |  | \$92,098 |  | \$90,087 |  | \$89,847 |  | \$86,957 |  |
| Total assets - GAAP | \$ 1,035,677 |  | \$970,503 |  | \$926,883 |  | \$868,107 |  | \$848,119 |  |
| Adjustments: Goodwill | (4,687 | ) | (4,687 | ) | (4,687 | ) | (4,687 | ) | (4,687 | ) |
| Tangible assets | \$ 1,030,990 |  | \$965,816 |  | \$922,196 |  | \$863,420 |  | \$843,432 |  |
| Total common shares outstanding | 4,484,513 |  | 4,439,575 |  | 4,439,575 |  | 4,449,619 |  | 4,449,619 |  |
| Book value per common share Effect of goodwill | \$22.16 | ) | $\$ 21.80$ | ) | $\$ 21.35$ | ) | $\$ 21.25$ | ) | $\$ 20.60$ | ) |
| Tangible book value per common share | \$21.11 |  | \$20.74 |  | \$20.29 |  | \$20.19 |  | \$ 19.54 |  |


| Total shareholders' equity to asset ratio | 9.59 | \% | 9.97 | \% | 10.23 | \% | 10.89 | \% | 10.81 | \% |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Effect of goodwill | (0.41 | ) | (0.43 | ) | (0.46 | ) | (0.48 | ) | (0.50 | ) |
| Tangible common equity to tangible assets ratio | 9.18 | \% | 9.54 | \% | 9.77 | \% | 10.41 | \% | 10.31 | \% |
| Total average equity - GAAP | \$97,844 |  | \$95,832 |  | \$94,840 |  | \$92,641 |  | \$92,054 |  |
| Adjustments: <br> Average goodwill | (4,687 | ) | (4,687 | ) | (4,687 | ) | (4,687 | ) | (4,687 | ) |
| Average tangible common equity | \$93,157 |  | \$91,145 |  | \$90,153 |  | \$87,954 |  | \$87,367 |  |
| Return on average shareholders' equity | 8.55 | \% | 6.07 | \% | 5.36 | \% | 4.23 | \% | 2.64 | \% |
| Effect of goodwill | 0.43 | \% | 0.31 | \% | 0.28 | \% | 0.23 | \% | 0.15 | \% |
| Return on average tangible common equity | 8.98 | \% | 6.38 | \% | 5.64 | \% | 4.46 | \% | 2.79 | \% |

Critical Accounting Policies and Estimates
There have been no material changes in our critical accounting policies from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2014.

Future Accounting Pronouncement
Refer to Note 11 of the condensed consolidated financial statements.

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## Off-Balance Sheet Arrangements

In the ordinary course of business, the Company enters into financial transactions to extend credit and forms of commitments that may be considered off-balance sheet arrangements. We enter into forward contracts relating to our mortgage banking business to hedge the exposures we have from commitments to extend new residential mortgage loans to our customers and from our mortgage loans held-for-sale. At March 31, 2015 and December 31, 2014, we had commitments to sell residential real estate loans of $\$ 67.5$ million and $\$ 55.1$ million, respectively. These contracts mature in less than one year. We do not believe that off-balance sheet arrangements have had or are reasonably likely to have a material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates, foreign exchange rates and equity prices. The primary source of market risk for the Company is interest rate risk. Interest rate risk is the risk to earnings and the value of the Company's equity resulting from changes in market interest rates and arises in the normal course of business to the extent that there are timing and volume differences between the amount of our interest-earning assets and the amount of interest-bearing liabilities that are prepaid, withdrawn, re-priced or mature in specified periods. We seek to achieve consistent growth in net interest income and equity while managing volatility arising from shifts in market interest rates.
We monitor the Company's interest rate risk position using income simulation models and economic value of equity ("EVE") sensitivity analysis that capture both short-term and long-term interest rate risk exposure. Income simulation involves forecasting net interest income ("NII") under a variety of interest rate scenarios. We use EVE sensitivity analysis to understand the impact of changes in interest rates on long-term cash flows, income and capital. EVE is calculated by discounting the cash flows for all balance sheet instruments under different interest-rate scenarios. Modeling the sensitivity of NII and EVE to changes in market interest rates is highly dependent on the assumptions incorporated into the modeling process. We continually review and refine the assumptions used in our interest rate risk modeling.
Presented below is the estimated impact on the Company's NII and EVE position as of March 31, 2015, assuming parallel shifts in interest rates:

| NII - next twelve months | $(3.87$ | $) \%$ | 1.30 | $\%$ | 1.86 | $\%$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| EVE | $(3.85$ | $) \%$ | 0.36 | $\%$ | 0.18 | $\%$ |

${ }^{1}$ Because certain current interest rates are at or below $1.00 \%$, the 100 basis point downward shock assumes that certain corresponding interest rates approach an implied floor that, in effect, reflects a decrease of less than the full 100 basis point downward shock.
Our objective is to manage the balance sheet with a bias toward asset sensitivity while simultaneously balancing the potential earnings impact of this strategy. A "risk-neutral" position refers to the absence of a strong bias toward either asset or liability sensitivity. An "asset sensitive" position refers to when the characteristics of the balance sheet are expected to generate higher net interest income when interest rates, primarily short-term rates, increase as rates earned on interest-earning assets would reprice upward more quickly or in greater quantities than rates paid on interest-bearing liabilities would reprice. A "liability sensitive" position refers to when the characteristics of the balance sheet are expected to generate lower net interest income when short-term interest rates increase as rates paid on interest-bearing liabilities would reprice upward more quickly or in greater quantities than rates earned on interest-earning assets.

## ITEM 4. CONTROLS AND PROCEDURES

## Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized, and reported within the time period specified in SEC rules and forms. These controls and procedures are also designed to ensure that such information is accumulated and communicated to our management, including our principal executive and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating disclosure controls and procedures, we have recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. Management is required to apply judgment in evaluating its controls and procedures.

We performed an evaluation under the supervision and with the participation of our management, including our principal executive and principal financial officers, to assess the effectiveness of the design and operation of our disclosure controls and procedures under the Exchange Act. Based on that evaluation, our management, including our principal executive and principal financial officer, concluded that our disclosure controls and procedures were effective as of March 31, 2015.

Changes in Internal Control Over Financial Reporting
There has been no change in our internal control over financial reporting during the three months ended March 31, 2015 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II

## ITEM 1.LEGAL PROCEEDINGS

We are not party to any material legal proceedings. From time to time, the Bank is a party to legal actions arising from its normal business activities.

## ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors previously disclosed in Part I, Item 1A, of our Annual Report on Form 10-K for the year ended December 31, 2014.
ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS
Under our 2013 Equity Plan, employees may elect for the Company to withhold shares to satisfy minimum statutory federal, state, and local tax withholding obligations arising from the vesting of equity awards, including restricted stock awards. The following table provides information with respect to shares withheld by the Company to satisfy these obligations to the extent employees elected for the Company to withhold such shares. These repurchases were not part of any publicly announced stock repurchase program.

Period
January 1 to January 31, 2015
February 1 to February 28, 2015
March 1 to March 31, 2015
Total
ITEM 3. DEFAULTS UPON SENIOR SECURITIES
None.
ITEM 4. MINE SAFETY DISCLOSURES
Not Applicable.
ITEM 5. OTHER INFORMATION
None.

## ITEM 6. EXHIBITS

Unless otherwise indicated, all documents incorporated into this quarterly report on Form 10-Q by reference to a document filed with the SEC pursuant to the Exchange Act are located under SEC file number 1-35750.

Exhibit No. Description
$3.1 \quad$ Articles of Incorporation of First Internet Bancorp (incorporated by reference to Exhibit 3.1 to registration statement on Form 10 filed November 30, 2012)
by reference to Exhibit 3.2 to annual report on Form 10-K for the year ended December 31, 2012)
$10.1 \quad 2015$ Senior Executive Cash Incentive Plan
10.2 Form of Management Incentive Award Agreement - Restricted Stock Units under 2013 Equity Incentive Plan
31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32.1 Section 1350 Certifications
101.INS XBRL Instance Document
101.SCH XBRL Taxonomy Extension Schema
101.CAL XBRL Taxonomy Extension Calculation Linkbase
101.DEF XBRL Taxonomy Extension Definition Linkbase
101.LAB XBRL Taxonomy Extension Label Linkbase
101.PRE XBRL Taxonomy Extension Presentation Linkbase

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

FIRST INTERNET BANCORP

Date: 5/7/2015
By /s/ David B. Becker David B. Becker, Chairman, President and Chief Executive Officer

Date: 5/7/2015
By /s/ Kenneth J. Lovik
Kenneth J. Lovik,
Senior Vice President \& Chief Financial Officer (Principal Financial Officer)

## EXHIBIT INDEX

| Exhibit No.Description <br> Articles of Incorporation of First Internet Bancorp (incorporated by <br> reference to Exhibit 3.1 to registration statement on Form 10 filed November <br> 3.1 | Method of Filing |
| :--- | :--- | :--- |
| 30, 2012) |  | Incorporated by Reference


[^0]:    See Notes to Condensed Consolidated Financial Statements

