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1ST INDEPENDENCE FINANCIAL GROUP, INC.

Form 10-K

March 28, 2007

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

FORM 10-K

Annual Report Pursuant to Section 13
or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2006
Commission file number: 0-26570

1ST INDEPENDENCE FINANCIAL GROUP, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

61-1284899
(I.R.S. Employer Identification No.)

8620 Biggin Hill Lane
Louisville, Kentucky
(Address of principal executive offices)

40220-4117
(Zip Code)

Registrant's telephone number, including area code: (502)753-0500

Securities registered pursuant to Section 12(b) of the Act:

Title of Class -----	Name of each exchange on which registered -----
Common Stock, par value \$0.10 per share	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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Large accelerated filer Accelerated filer Non-accelerated filer

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

The aggregate market value of the voting common stock held by non-affiliates of the registrant was approximately \$27,977,262 as of June 30, 2006.

The number of shares outstanding of the registrant's common stock as of March 15, 2007 was 1,995,594.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of this Report on Form 10-K, to the extent not set forth herein, is incorporated herein by reference to the registrant's definitive proxy statement to be filed in connection with the annual meeting of stockholders to be held May 17, 2007.

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1ST INDEPENDENCE FINANCIAL GROUP, INC.

FORM 10-K

For the Year Ended December 31, 2006

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PART I

Item 1. Business.

General

1st Independence Financial Group, Inc. (the "Company") was organized as a Delaware corporation in June 1995 and is a bank holding company based in Louisville, Kentucky which owns 1st Independence Bank, Inc. (the "Bank"). During 2004, the Company merged with Independence Bancorp, New Albany, Indiana. The Bank currently serves its customers through a network of eight branch offices located in Harrodsburg, Lawrenceburg and Louisville (Stony Brook main office branch and St. Matthews branch office), Kentucky and New Albany, Jeffersonville, Marengo and Clarksville, Indiana. The Bank also operates a mortgage division, 1st Independence Mortgage, which originates one-to-four family residential mortgage loans. 1st Independence Mortgage operates throughout the Bank's branch network. The Bank also offers limited trust services. On November 1, 2004, the Bank formed a title insurance company, Foundation Title Company, LLC, located in Jeffersonville, Indiana. The Company decided to exit the title insurance business at the end of November 2005 and sold the title insurance company at its carrying value.

The Company provides commercial and retail banking services, with an emphasis on commercial real estate loans, one-to-four family residential mortgage loans via 1st Independence Mortgage, home equity loans and lines of credit and consumer loans as well as certificates of deposit, checking accounts, money-market accounts and savings accounts within its market area. At December 31, 2006, the Company had total assets, deposits and equity of \$342.8 million, \$254.1 million, and \$40.3 million, respectively. The Company's business is conducted principally through the Bank. Unless otherwise indicated, all references to the Company refer collectively to the Company and the Bank and its subsidiaries.

In January 2005, the Company completed the sale of its entire interest in its majority owned subsidiary, Citizens Financial Bank, Inc., Glasgow, Kentucky ("Citizens") to another financial institution for \$2.3 million. The sale of Citizens reflected the Company's revised strategic plan to exit the south central Kentucky market and to focus on the growing markets of southern Indiana, central Kentucky, and greater Louisville, Kentucky. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets", the financial position and results of operations of Citizens prior to the sale were removed from the detail line items in the Company's financial statements and presented separately as "subsidiary held for disposal." In a related transaction the Bank purchased in January 2005 a commercial building located in Louisville, Kentucky, for \$2.3 million from an affiliate of the financial institution which purchased Citizens. The Bank moved its finance and accounting, loan and deposit operations, and mortgage banking operations into the building in April 2005. The Bank also received regulatory approval during the second quarter of 2005 to establish a full service branch at this location which it opened in November 2005. See note 3 to the Company's consolidated financial statements, presented herein, for additional information. Additionally, the financial tables also presented herein, have been revised to reflect the discontinued operations of Citizens prior to the sale.

Market Area and Competition

The competition for deposit products comes from other insured financial institutions such as commercial banks, thrift institutions, credit unions, and multi-state regional banks in the Company's market area of Anderson, Jefferson, and Mercer Counties in Kentucky and Floyd, Clark and Crawford Counties in Indiana. Deposit competition also includes a number of insurance products sold

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by local agents and investment products such as mutual funds and other securities sold by local and regional brokers. Loan competition varies depending upon market conditions and comes from other insured financial institutions such as commercial banks, thrift institutions, credit unions, multi-state regional banks, and mortgage bankers.

Analysis of Loan Portfolio. The following table (in thousands except percentages) sets forth information concerning the composition of the Company's loan portfolio in dollar amounts and in percentages of the total loan portfolio as of the dates indicated. Loan balances related to the discontinued operations of Citizens have been eliminated.

	December 31,							
	2006		2005		2004		2003	
	Amount	Percent of Total loans	Amount	Percent of Total loans	Amount	Percent of Total loans	Amount	Percent of Total loans
Real estate:								
Commercial	\$ 49,943	18%	\$ 46,731	17%	\$ 35,746	15%	\$13,128	
Residential	121,216	45	128,949	48	125,433	53	61,495	
Construction	64,244	23	51,877	19	33,600	14	2,977	
Commercial	20,393	7	23,757	9	21,040	9	3,365	
Consumer								
Home equity	14,026	5	16,615	6	16,672	7	1,963	
Other	4,401	2	1,960	1	3,706	2	1,327	
Total loans	274,223	100%	269,889	100%	236,197	100%	84,255	
Less: allowance for loan losses	3,745		2,911		2,549		391	
Loans, net	\$270,478		\$266,978		\$233,648		\$83,864	
Loans held for sale	\$1,227		\$1,278		\$2,344		\$ -	

Loan Maturity Tables

The following table (in thousands) sets forth the maturity of the Company's loan portfolio at December 31, 2006. The table does not include prepayments or scheduled principal repayments. Adjustable-rate mortgage loans are shown as maturing based on contractual maturities.

	Due within 1	Due after 1	Due after 5	Total
	year	through 5	years	
	-----	-----	-----	-----
Real estate:				
Commercial	\$16,156	\$13,421	\$ 20,366	\$ 49,943
Residential	19,637	13,292	88,287	121,216
Construction	47,899	13,512	2,833	64,244
Commercial	11,156	3,760	5,477	20,393
Consumer	2,100	14,154	2,173	18,427
Total	\$96,948	\$58,139	\$119,136	\$274,223

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The following table (in thousands) sets forth as of December 31, 2006 the dollar amount of all loans that are due after December 31, 2007 and have either fixed rates of interest or floating or adjustable interest rates.

	Fixed rates -----	Floating or adjustable rates -----	Total -----
Real estate:			
Commercial	\$ 7,745	\$ 26,042	\$ 33,787
Residential	28,428	73,150	101,578
Construction	1,354	14,992	16,346
Commercial	5,725	3,512	9,237
Consumer	3,194	13,133	16,327
	-----	-----	-----
Total	\$46,446 =====	\$130,829 =====	\$177,275 =====

Commercial Real Estate Loans. The commercial real estate loans originated are generally made to individuals, small businesses and partnerships located in the Company's primary market area. Such loans are generally secured by first mortgages on apartment buildings, office buildings, churches and other properties. Adjustable-rate loans for this type of lending have a margin that is 50 to 150 basis points higher than the margin added to single-family owner-occupied property loans. Commercial real estate loans are typically adjustable-rate loans with terms of 25 years or less and loan-to-value ratios typically not exceeding 80%. At December 31, 2006, commercial real estate loans totaled approximately \$49.9 million or 18% of the total loan portfolio.

Commercial real estate lending entails significant additional risks as compared to one- to four-family residential lending. For example, such loans typically involve large loans to single borrowers or related borrowers, the payment experience on such loans is typically dependent on the successful operation of the project, and these risks can be significantly affected by the supply and demand conditions in the market for commercial property.

Loans secured by commercial real estate generally involve a greater degree of risk than residential mortgage loans and carry larger loan balances. This increased credit risk is a result of several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income producing properties, and the increased difficulty of evaluating and monitoring these types of loans. If the cash flow from the project is reduced, the borrower's ability to repay the loan may be impaired. To minimize these risks, the Company generally limits loans of this type to its market area and to borrowers with which it has substantial experience and expertise in the commercial real estate market. The Company's underwriting procedures require verification of the borrower's credit history, income, financial statements, banking relationships, credit references, and income projections for the property. It is their current practice to obtain personal guarantees from all principals obtaining this type of loan. The Company also obtains appraisals on each property.

Included in the commercial real estate loan category are agricultural loans. At December 31, 2006, agricultural loans totaled \$2.1 million, or less than 1% of the Company's loan portfolio.

Residential Loans. The Company's residential loans consist of one- to four-family residential mortgage loans that are secured by property located in its primary market area. The Company generally originates one- to four-family residential mortgage loans without private mortgage insurance in amounts up to 85% of the lesser of the appraised value or selling price of the mortgaged property. Loans in excess of 89.9% of the value of the mortgaged property typically carry higher rates commensurate with the higher risk associated with this type of loan. At December 31, 2006, one-to four-family residential mortgage loans totaled approximately \$121.2 million, or 45% of the total loan portfolio.

The Company offers three types of residential adjustable rate mortgage

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loans, all of which use the index value of the Weekly Average Yield on United States Treasury Securities Adjusted to a Constant Maturity of One Year plus a set margin added to it. The interest rates on these loans have an initial adjustment period of between one and five years, and generally adjust annually thereafter, with a maximum adjustment of 2% per year and a maximum increase of 5% over the life of the loan. The index margin on a non owner-occupied one- to four-family property loan is generally 50 basis points higher than on an owner-occupied property loan. The Company's adjustable-rate one-to- four family and multi-family mortgage loans are for terms of up to 30 years, amortized on a monthly basis, with principal and interest due each month. Borrowers may refinance or prepay loans at their option without penalty. All fixed rate one-to-four family loans with a term of ten to thirty years are originated and sold on the secondary market through 1st Independence Mortgage. At December 31, 2006, loans held for sale totaled approximately \$1.2 million.

Loan originations are generally obtained from existing and walk-in customers, members of the local community, and referrals from realtors, builders, depositors and borrowers within the Company's market area. Mortgage loans originated and held by the Company in its portfolio generally include due-on-sale clauses which gives it the contractual right to deem the loan immediately due and payable in the event that the borrower sells or otherwise transfers an interest in the property to a third party.

During periods of rising interest rates, the risk of default on adjustable-rate loans may increase due to increases in interest costs to borrowers. Further, adjustable-rate loans that provide for initial rates of interest below the fully indexed rates may be subject to increased risk of delinquency or default as the higher, fully indexed rate of interest subsequently replaces the lower, initial rate.

Construction and Land Development Loans. The Company engages in construction lending involving loans to qualified borrowers for construction of one- to four-family dwellings, multi-family residential units, commercial buildings and churches, and single family subdivision land development loans with the intent of such loans converting to permanent financing upon completion of construction. All construction and development loans are secured by a first lien on the property under construction. Loan proceeds are disbursed in increments as construction progresses and as inspections warrant. At December 31, 2006, construction loans totaled approximately \$64.2 million, or 23%, of the Company's total loan portfolio.

Construction/permanent loans generally have adjustable or fixed interest rates and are underwritten in accordance with the same terms and requirements as permanent mortgages, except the loans generally provide for disbursement in stages during a construction period of up to twelve months, during which the borrower is not required to make monthly principal payments. Accrued interest must be paid at completion of construction to the first day of the following month, and monthly payments start the first day of the following month if the loan is converted to permanent financing. Borrowers must satisfy all credit requirements that would apply to permanent mortgage loan financing for the subject property and must execute a construction loan agreement.

Construction financing generally is considered to involve a higher degree of risk of loss than long term financing on improved, occupied real estate. Risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property's value at completion of construction or development and the estimated cost (including interest) of construction. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction cost proves to be inaccurate, the Company may be required to advance funds beyond the amount originally committed to permit completion of the development. The Company has sought to minimize this risk by requiring precise construction cost estimates, specifications, and drawing plans from qualified borrowers in their market area along with tighter underwriting guidelines relating to borrower cash flow and net worth.

Commercial Loans. The Company originates fixed-rate and adjustable-rate commercial loans secured by commercial properties. These loans are typically

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originated with maximum loan-to-value ratios of 80% of the value of the respective property. At December 31, 2006, commercial loans totaled approximately \$20.4 million, or 7%, of the total loan portfolio.

Loans secured by commercial properties generally have larger balances and involve a greater degree of risk than one- to four-family residential mortgage loans. Of primary concern in commercial lending are the borrower's creditworthiness and the feasibility and cash flow potential of the project. Payments on loans secured by income properties often depend on successful operation and management of the properties. As a result, repayment of such loans may be subject to a greater extent than residential real estate loans to adverse conditions in the real estate market or the economy. To monitor cash flows on income properties, the Company requires borrowers and loan guarantors, if any, to provide annual financial statements on commercial loans. In reaching a decision on whether to make a commercial loan, the Company considers the net operating income of the property, the borrower's expertise, credit history and profitability and the value of the underlying property. The Company generally requires an environmental survey for all commercial loans over \$500,000.

Consumer Lending. The Company originates consumer loans on either a secured or unsecured basis with revolving home equity lines of credit composing the majority of the consumer loan portfolio. The Company generally makes certificate of deposit loans for terms of up to the terms of the certificate of deposit collateralizing the loan and up to the face amount of the certificate. The interest rate charged on these loans is typically up to 2% higher than the rate paid on the certificate. These loans generally mature concurrently with the certificate of deposit on demand and the account must be assigned to the Company as collateral for the loan. At December 31, 2006, consumer loans totaled approximately \$18.4 million, or 7%, of the total loan portfolio.

Consumer loans may entail greater risk than residential loans, particularly in the case of consumer loans that are unsecured or secured by assets that depreciate rapidly. Repossessed collateral for a defaulted consumer loan may not be sufficient for repayment of the outstanding loan, and the remaining deficiency may not be collectible.

Loan Approval Authority and Underwriting. The Company has established various lending limits for its officers and maintains a loan committee that consists of the President and Chief Executive Officer, the Executive Vice President and Chief Lending Officer, the Executive Vice President and Chief Credit Officer and other officers of the Bank. The loan committee approves loans that exceed the limits established for individual officers. In January 2005, the loan policy was amended to provide for two classes of secured loans. Class I loans are those secured by investment grade securities, securities listed on the major stock exchanges, deposit accounts, life insurance cash surrender value, and real estate mortgages meeting certain loan to value ratios. Class II loans consist of all other asset-based lending. The loan committee may approve Class I and Class II loans of \$3,000,000 and \$2,000,000, respectively. At the same time, approval limits for unsecured loans were increased to \$25,000. The Bank's directors' loan committee, which consists of six outside Bank directors, must approve all loans that exceed the lending limits of the loan committee.

For all loans originated by the Company, upon receipt of a completed loan application from a prospective borrower, a credit report is generally ordered, income and certain other information is verified and, if necessary, additional financial information is requested. An appraisal of the real estate intended to be used as security for the proposed loan is obtained. All appraisals are reviewed by the Bank's loan officers designated by the Bank's Board of Directors. An independent appraiser designated and approved by the Bank's Board of Directors is utilized for all real estate mortgage loans. For construction/permanent loans, the funds advanced during the construction phase are disbursed based upon various stages of completion in accordance with the results of inspection reports that are based upon physical inspection of the construction by an independent contractor hired by the Bank or in some cases by an officer of the Bank. For real estate loans, the Bank requires either title insurance or a title opinion. Borrowers must also obtain fire and casualty, hazard or flood insurance (for loans on property located in a flood zone, flood

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insurance is required) prior to the closing of the loan.

Loan Commitments. The Company issues written commitments to prospective borrowers on all approved commercial real estate loans in excess of \$500,000. Generally, the commitment requires acceptance within 20 days of the date of issuance. At December 31, 2006, the Company had approximately \$71 million of commitments to cover originations and unused lines of credit.

Nonperforming and Problem Assets

Loan Delinquencies. The Company's collection procedures provide that when a loan is 10 days past due, a notice of nonpayment is sent. Delinquent notices are sent if the loan becomes delinquent for more than 30 days and generally the borrower will receive a letter or be personally contacted by an officer of the Bank. If payment is still delinquent after 60 days, the customer will again receive a letter and/or telephone call and may receive a visit from an officer representative of the Bank. If the delinquency continues, similar subsequent efforts are made to eliminate the delinquency. If the loan continues in a delinquent status for 90 days past due and no repayment plan is in effect, management will generally initiate legal proceedings.

Loans are reviewed on a monthly basis by management and are generally placed on a non-accrual status when the loan becomes more than 90 days delinquent and, in the opinion of management, the collection of additional interest is doubtful. Interest accrued and unpaid at the time a loan is placed on non-accrual status is charged against interest income. Subsequent interest payments are applied to the outstanding principal balance.

Nonperforming Assets. The following table (in thousands except percentages) sets forth information regarding nonaccrual loans, other real estate owned and certain other repossessed assets and loans. Nonperforming asset balances related to the discontinued operations of Citizens have been eliminated. Additionally, as of the dates indicated, the Company had no loans categorized as troubled debt restructurings within the meaning of Statement of Financial Accounting Standards ("SFAS") No. 15 and impaired loans within the meaning of SFAS No. 114, as amended by SFAS No. 118, were approximately \$3.4 million at December 31, 2006.

	December, 31			
	2006	2005	2004	2003
Nonaccrual loans	\$3,698	\$1,140	\$893	\$ -
Accruing loans past due 90 days or more	31	130	332	472
Total nonperforming loans	3,729	1,270	1,225	472
Other real estate owned	433	-	-	-
Total nonperforming assets	\$4,162	\$1,270	\$1,225	\$472
Total nonperforming loans to total loans	1.36%	0.47%	0.52%	0.56%
Total nonperforming assets to total assets	1.21%	0.38%	0.41%	0.36%

In addition to the nonperforming loans discussed above, there were loans for which payments were current or less than 90 days past due where borrowers are experiencing financial difficulties. At December 31, 2006, these loans totaled approximately \$11.1 million. These loans are monitored by management and considered in determining the level of the allowance for loan losses. Management does not believe these loans represent a significant exposure

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to loss.

Classified Assets. Federal regulations provide for a classification system for problem assets of insured institutions that covers all problem assets. Under this classification system, problem assets of insured institutions are classified as "substandard," "doubtful," or "loss." An asset is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the "distinct possibility" that the insured institution will sustain "some loss" if the deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in those classified substandard, with the added characteristic that the weaknesses present make "collection or liquidation in full," on the basis of currently existing facts, conditions, and values, "highly questionable and improbable." Assets classified as loss are those considered "uncollectible" and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. Assets may be designated "special mention" because of potential weaknesses that do not currently warrant classification in one of the aforementioned categories.

When an insured institution classifies problem assets as either substandard or doubtful, it may establish general allowances for loan losses in an amount deemed prudent by management. General allowances represent loss allowances which have been established to recognize the inherent risk associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. When an insured institution classifies problem assets as loss, it is required either to establish a specific allowance for losses equal to 100% of that portion of the asset so classified or to charge off such amount. The Company's determination as to the classification of its assets and the amount of its valuation allowances is subject to review by the Federal Deposit Insurance Corporation ("FDIC") and the Kentucky Office of Financial Institutions which may order the establishment of additional general or specific loss allowances. A portion of general loss allowances established to cover possible losses related to assets classified as substandard or doubtful may be included in determining an institution's regulatory capital, while specific valuation allowances for loan losses generally do not qualify as regulatory capital.

Allowance for Loan Losses. It is management's policy to provide for losses on loans in its loan portfolio. A provision for loan losses is charged to operations based on management's evaluation of the losses that may be incurred in the Company's loan portfolio. Such evaluation, which includes a review of all loans of which full collectibility of interest and principal may not be reasonably assured, considers the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, current economic conditions, and the relationship of the allowance for loan losses to outstanding loans.

The following table (in thousands except percentages) sets forth information with respect to the Company's allowance for loan losses at the dates and for the periods indicated below. Balances related to the discontinued operations of Citizens have been eliminated.

	Year ended December 31, ----- 2006 ----	Year ended December 31, ----- 2005 ----	Three months ended December 31, ----- 2004 ----
Allowance for loan losses			
Balance at beginning of period	\$2,911	\$2,549	\$2,560

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Allowance of acquired company	-	-	-
Provision for loan losses	847	354	-
Net charge-offs (recoveries):			
Residential	16	(11)	9
Commercial	1	2	-
Consumer	(4)	1	2
	-----	-----	-----
Balance at end of period	\$3,745	\$2,911	\$2,549
	=====	=====	=====
Total loans outstanding	\$274,223	\$269,889	\$236,197
	=====	=====	=====
Average loans outstanding	\$276,629	\$257,333	\$224,201
	=====	=====	=====
Allowance for loan losses to period-end loans	1.37%	1.08%	1.08%
	=====	=====	=====
Net loans charged off to average loans	0.00%	0.00%	0.00%
	=====	=====	=====

Management will continue to review the entire loan portfolio to determine the extent, if any, to which further additional loss provisions may be deemed necessary. There can be no assurance that the allowance for loan losses will be adequate to cover losses that may in fact be realized in the future and that additional provisions for losses will not be required.

Analysis of the Allowance for Loan Losses

The following table (in thousands except percentages) sets forth the allocation of the allowance by category, which management believes can be allocated only on an approximate basis. The allocation of the allowance to each category is not necessarily indicative of future loss and does not restrict the use of the allowance to absorb losses in any category. Balances related to the discontinued operations of Citizens have been eliminated.

	December 31,							
	2006		2005		2004		2003	
	Amount	Percent of Total loans	Amount	Percent of Total loans	Amount	Percent of Total loans	Amount	Percent Total l
	-----	-----	-----	-----	-----	-----	-----	-----
Real estate:								
Commercial	\$1,508	18%	\$ 715	17%	\$ 651	15%	\$ 61	16%
Residential	832	45	581	48	255	53	285	73
Construction	358	23	153	19	358	14	14	3
Commercial	856	7	859	9	957	9	16	4
Consumer	191	7	603	7	328	9	15	4
	-----	---	-----	---	-----	---	-----	---
Total allowance for loan losses	\$3,745	100%	\$2,911	100%	\$2,549	100%	\$391	100%
	=====	===	=====	===	=====	===	=====	===

Return on Equity and Assets Ratios

Ratios have been adjusted to reflect the discontinued operations of Citizens.

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	Year ended December 31, 2006 ----	Year ended December 31, 2005 ----	Three months ended December 31, 2004 ----
Average equity to average assets	11.57%	11.59%	12.76%
Return on average equity	4.93	11.92	2.51
Return on average assets	0.57	1.38	0.32
Dividend payout ratio	31.96	16.83	0.00

Investment Activities

The Company is required under federal regulations to maintain a sufficient amount of liquid assets that may be invested in specified short-term securities and certain other investments. However, the Federal Deposit Insurance Corporation ("FDIC") does not prescribe by regulation to a minimum or percentage of liquid assets. The level of liquid assets varies depending upon several factors, including: (i) the yields on investment alternatives, (ii) management's judgment as to the attractiveness of the yields then available in relation to other opportunities, (iii) expectation of future yield levels, and (iv) management's projections as to the short-term demand for funds to be used in loan origination and other activities. Investment securities, including mortgage-backed securities, are classified at the time of purchase, based upon management's intentions and abilities, as securities held to maturity or securities available for sale. Debt securities acquired with the intent and ability to hold to maturity are classified as held to maturity and are stated at cost and adjusted for amortization of premium and accretion of discount, which are computed using the level yield method and recognized as adjustments of interest income. All other debt securities are classified as available for sale to serve principally as a source of liquidity.

Current regulatory and accounting guidelines regarding investment securities (including mortgage backed securities) require the Company to categorize securities as "held to maturity," "available for sale" or "trading." As of December 31, 2006, the Company had securities (including mortgage-backed securities) classified as "held to maturity" and "available for sale" in the amount of \$1.9 million and \$16.4 million, respectively and had no securities classified as "trading." Securities classified as "available for sale" are reported for financial reporting purposes at the fair market value with net changes in the fair market value from period to period included as a separate component of stockholders' equity, net of income taxes. At December 31, 2006, the Company's securities available for sale had an amortized cost of \$16.5 million and fair market value of \$16.4 million. Changes in the fair market value of securities available for sale do not affect the Company's net income. In addition, changes in the fair market value of securities available for sale do not affect the Bank's regulatory capital requirements or its loan-to-one borrower limit.

At December 31, 2006, the Company's investment portfolio policy allowed investments in instruments such as: (i) U.S. Treasury obligations, (ii) U.S. federal agency or federally sponsored agency obligations, (iii) local municipal obligations, (iv) mortgage-backed securities, (v) banker's acceptances, (vi) certificates of deposit, (vii) equity investments, and (viii) investment grade corporate bonds and commercial paper. The board of directors may authorize additional investments.

As a source of liquidity and to supplement the Company's lending activities, the Company has invested in residential mortgage-backed securities. Mortgage-backed securities can serve as collateral for borrowings and, through repayments, as a source of liquidity. Mortgage-backed securities represent a participation interest in a pool of single-family or other type of mortgages. Principal and interest payments are passed from the mortgage originators, through intermediaries (generally quasi-governmental agencies) that pool and repackage the participation interests in the form of securities to investors.

Mortgage-backed securities typically are issued with stated principal amounts. The securities are backed by pools of mortgages that have loans with

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interest rates that are within a set range and have varying maturities. The underlying pool of mortgages can be composed of either fixed rate or adjustable rate mortgage loans. Mortgage-backed securities are generally referred to as mortgage participation certificates or pass-through certificates. The interest rate risk characteristics of the underlying pool of mortgages (i.e., fixed rate or adjustable rate) and the prepayment risk, are passed on to the certificate holder. The life of a mortgage-backed pass-through security is equal to the life of the underlying mortgages. Expected maturities will differ from contractual maturities due to scheduled repayments and because borrowers may have the right to call or prepay obligations with or without prepayment penalties. Mortgage-backed securities issued by quasi-governmental agencies, make up a majority of the pass-through certificates market.

At December 31, 2006, the Company's securities portfolio did not contain securities of any issuer, other than those issued by U.S. government or its agencies, with an aggregate book value in excess of 10% of the Company's equity.

Investment Portfolio. The following table (in thousands) sets forth the carrying value of the Company's investment securities at the dates indicated. Balances related to the discontinued operations of Citizens have been eliminated.

	December 31,		
	2006	2005	2004
Investment securities available for sale:			
Mortgage-backed	\$11,795	\$11,556	\$18,011
U.S. government and federal agencies	1,985	1,974	2,525
Municipal bonds	2,641	2,610	505
Equity	-	-	5,682
Total	\$16,421	\$16,140	\$26,723
Investment securities held to maturity:			
Mortgage-backed	\$ -	\$ -	\$ 2
Municipal bonds	1,900	1,975	2,148
Total	\$ 1,900	\$ 1,975	\$ 2,150
Total investment securities	\$18,321	\$18,115	\$28,873

Investment Portfolio Maturities. The following table sets forth information regarding the scheduled maturities, carrying values, market value and weighted average yields for the Company's investment securities portfolio at December 31, 2006. The following table does not take into consideration the effects of scheduled repayments or the effects of possible prepayments.

	December 31, 2006						
	One Year or Less		More Than One to Five Years		More Than Five to Ten Years		More Than Ten Years
	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value
Available-for-sale securities:							
Mortgage-backed securities	\$ 24	5.00%	\$ 76	7.01%	\$3,806	4.78%	\$7,88
U.S government and federal							

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agencies	986	3.07	998	5.24	-	-	
Municipal bonds	184	2.15	-	-	820	3.57%	1,63
	-----	-----	-----	-----	-----	-----	-----
Total	\$1,194	2.97%	\$1,074	5.37%	\$4,626	4.57%	\$9,52
	=====	=====	=====	=====	=====	=====	=====
Held-to-maturity securities:							
Mortgage-backed securities	\$ -	-%	\$ -	-%	\$ -	-%	\$ -
Municipal bonds	90	4.92	50	5.12	1,504	4.35	25
	-----	-----	-----	-----	-----	-----	-----
Total	\$ 90	4.92%	\$ 50	5.12%	\$1,504	4.35%	\$ 25
	=====	=====	=====	=====	=====	=====	=====

Sources of Funds

General. Deposits are the major external source of the Company's funds for lending and other investment purposes. The Company derives funds from amortization and prepayment of loans and, to a much lesser extent, maturities of investment securities, borrowings, mortgage-backed securities and operations. Scheduled loan principal repayments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are significantly influenced by general interest rates and market conditions.

Deposits. Consumer and commercial deposits are attracted principally from within the Company's primary market area through the offering of a selection of deposit instruments including regular savings accounts, money market accounts, and term certificate accounts. Deposit account terms vary according to the minimum balance required, the time period the funds must remain on deposit, and the interest rate, among other factors. At December 31, 2006, the Company had brokered deposits totaling \$23.7 million.

The following table (in thousands) sets forth the amount of the Company's certificates of deposit of \$100,000 or more by time remaining until maturity as of December 31, 2006.

	Amount

3 months or less	\$26,206
Over 3 through 6 months	6,899
Over 6 through 12 months	22,571
Over 12 months	5,253

Total	\$60,929
	=====

The following table (in thousands except rates) sets forth the Company's average balances and interest rates for interest-bearing demand deposits and time deposits for the periods indicated. Balances related to the discontinued operations of Citizens have been eliminated.

	Year ended		Year ended		Three months	
	December 31, 2006		December 31, 2005		ended December 31, 2004	
	Average	Average	Average	Average	Average	Average
	balance	rate	balance	rate	balance	rate
	-----	----	-----	----	-----	----
Demand and savings	\$ 61,710	2.96%	\$ 59,520	1.85%	\$ 48,633	1.15%
Time	187,463	4.39	177,801	3.24	155,491	2.61
	-----	-----	-----	-----	-----	-----
	\$249,173	4.04	\$237,321	2.89	\$204,124	2.27

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Short-Term Borrowings. Deposits are the primary source of funds for the Company's lending and investment activities and for its general business purposes. The Company can also obtain advances from the Federal Home Loan Bank of Cincinnati ("FHLB") and other short-term borrowings, such as federal funds purchased and issuance of securities sold under repurchase agreements to supplement its supply of lendable funds and to also supplement short-term liquidity. A pledge of the Bank's stock in the FHLB and a portion of its first mortgage loans typically secure FHLB advances. At December 31, 2006, the Company's short-term borrowings totaled \$36.5 million; of which \$35.0 million were short-term FHLB advances. See note 10 to the consolidated financial statements for additional information.

Information regarding short-term FHLB advances follows:

	Year ended December 31, 2006 ----	Year ended December 31, 2005 ----	Three months ended December 31, 2004 ----
Amount outstanding:			
Period end	\$35,000	\$18,000	\$22,500
Maximum month end balance during period	35,000	28,000	22,500
Average balance during Period	18,216	16,541	19,575
Weighted average interest rate:			
Period end	5.44%	4.33%	2.42%
During the period	5.20	3.43	2.14

Personnel

As of December 31, 2006, the Company had 85 full-time equivalent employees. None of the Company's employees are represented by a collective bargaining group. The Company believes that its relationship with its employees is good.

Regulation of the Company

General. The Company is a registered bank holding company subject to regulation under the Bank Holding Company Act of 1956, as amended (the "BHC Act"). In addition, the Company is subject to the provisions of Kentucky's banking laws regulating bank acquisitions and various activities of controlling bank shareholders. As a bank holding company, the Company is subject to regulation, supervision, and examination by the Board of Governors of the Federal Reserve System (the "FRB") and is required to file periodic reports with the FRB. The Kentucky Office of Financial Institutions ("KOFI") may also conduct examinations of the Company to determine whether it is in compliance with applicable Kentucky banking laws and regulations. In addition, the FRB has enforcement authority over the Company and any of its non-financial institution subsidiaries. This regulation and oversight is intended primarily for the protection of the depositors of the Bank and not for the benefit of the Company's stockholders.

The Gramm-Leach-Bliley Act, which became effective in March 2001, permits greater affiliation among banks, securities firms, insurance companies, and other companies under a new type of financial services company known as a "financial holding company." A financial holding company essentially is a bank holding company with significantly expanded powers. Financial holding companies are authorized by statute to engage in a number of financial activities previously impermissible for bank holding companies, including securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; and merchant banking activities.

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The act also permits the FRB and the Treasury Department to authorize additional activities for financial holding companies if they are "financial in nature" or "incidental" to financial activities. A bank holding company may become a financial holding company if each of its subsidiary banks is well capitalized, well managed, and has at least a "satisfactory" CRA rating. A financial holding company must provide notice to the FRB within 30 days after commencing activities previously determined by statute or by the FRB and the Department of the Treasury to be permissible. The Company has not submitted notice to the FRB of its intent to be deemed a financial holding company.

Regulatory Capital Requirements. The FRB has adopted capital adequacy guidelines pursuant to which it assesses the adequacy of capital in examining and supervising a bank holding company and in analyzing applications to it under the Bank Holding Company Act. The FRB's capital adequacy guidelines are similar to those imposed on the Bank. See "Regulation of the Bank - Regulatory Capital Requirements."

Restrictions on Dividends. The FRB has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the FRB's view that a bank holding company should pay cash dividends only to the extent that the holding company's net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the holding company's capital needs, asset quality and overall financial condition. The FRB also indicated that it would be inappropriate for a company experiencing serious financial problems to borrow funds to pay dividends. Accordingly, the Company's ability to pay dividends is dependent on the Bank's ability to pay dividends to the Company. Furthermore, under the federal prompt corrective action regulations, the FRB may prohibit a bank holding company from paying any dividends if the holding company's bank subsidiary is classified as "undercapitalized."

Acquisition of Banks. The BHC Act also requires a bank holding company to obtain prior approval from the FRB before acquiring direct or indirect ownership or control of more than 5% of the voting shares of any bank which is not already majority owned or controlled by that bank holding company. Acquisition of any additional banks would require prior approval from both the FRB and the KOFI.

Non-Banking Activities. A bank holding company is generally prohibited from engaging in, or acquiring, direct or indirect control of more than 5% of the voting securities of any company engaged in non-banking activities. One of the principal exceptions to this prohibition is for activities found by the FRB to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Some of the principal activities that the FRB has determined by regulation to be so closely related to banking are: (i) making or servicing loans; (ii) performing certain data processing services; (iii) providing discount brokerage services; (iv) acting as fiduciary, investment or financial advisor; (v) leasing personal or real property; (vi) making investments in corporations or projects designed primarily to promote community welfare; and (vii) acquiring a savings and loan association.

Regulation of the Bank

General. Set forth below is a brief description of certain laws that relate to the regulation of the Bank. The description does not purport to be complete and is qualified in its entirety by reference to applicable laws. The Bank is a Kentucky state-chartered stock-form commercial bank and its deposit accounts are insured under the Deposit Insurance Fund ("DIF"). The Bank is subject to extensive regulation and supervision by the KOFI as its chartering agency, and by the FDIC, as its deposit insurer. The Bank must file reports with the KOFI and the FDIC concerning its activities and financial condition, in addition to obtaining regulatory approvals prior to entering into certain transactions such as mergers with, or acquisitions of, other depository institutions. The deposits of the Bank are insured by the FDIC to the maximum extent provided by law.

Federal and Kentucky banking laws and regulations control, among other things, the Bank's required reserves, investments, loans, mergers and

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consolidations, issuance of securities, payment of dividends and other aspects of the Bank's operations. The regulatory structure also gives the respective regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Supervision, regulation and examination of the Bank by the bank regulatory agencies are intended primarily for the protection of depositors rather than for holders of the Company's stock or for the Company as the holder of the stock of the Bank.

Insurance of Deposit Accounts. The FDIC has adopted a risk-based insurance assessment system. The FDIC assigns an institution to one of three capital categories, consisting of (1) well capitalized, (2) adequately capitalized, or (3) undercapitalized, and one of three supervisory subcategories within each capital group, based on the institution's financial information, as of the reporting period ending seven months before the assessment period. The supervisory subgroup to which an institution is assigned is based on the supervisory evaluation provided to the FDIC by the institution's primary federal regulator, and information which the FDIC determines to be relevant to the institution's financial condition and the risk posed to the deposit insurance funds. An institution's assessment rate depends on the capital category and supervisory category to which it is assigned. Assessment rates are determined semiannually by the FDIC.

Under the Federal Deposit Insurance Act, insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order, or condition imposed by the FDIC. The Bank does not know of any practice, condition, or violation that might lead to the termination of deposit insurance.

Regulatory Capital Requirements. The FDIC has adopted regulations requiring institutions under their respective jurisdictions to maintain specified minimum ratios of capital to total assets and capital to risk-weighted assets. Specifically, all savings institutions and banks must maintain the following ratios: (1) Tier 1 or core capital equal to at least 4% (3% if the institution has received the highest rating on its most recent examination) of total adjusted assets; and (2) total capital (defined as Tier 1 capital plus supplementary Tier 2 capital) equal to 8% of total risk-weighted assets. At December 31, 2006, the Bank was in compliance with the capital requirements of the FDIC.

Dividend and Other Capital Distribution Limitations. The KOFI imposes restrictions on the ability of Kentucky commercial banks to pay dividends and to make other capital distributions. In general, banks are prohibited from paying any dividends or other capital distributions if, after the distribution, they would be undercapitalized under applicable federal law.

In addition, under applicable provisions of Kentucky law, the prior approval of the KOFI is required if the total of all dividends declared by the Bank in any calendar year exceeds its respective net profits, as defined, for that year combined with its retained net profits for the preceding two calendar years, less any required transfers to surplus or a fund for the retirement of any preferred stock. At January 1, 2007, the Bank could pay dividends to the Company of approximately \$7,883,000, without regulatory approval.

Federal Home Loan Bank System. The Bank is a member of the FHLB of Cincinnati, which is one of twelve (12) regional federal home loan banks that administer the home financing credit function of savings associations. Each FHLB serves as a reserve or central bank for its members within its assigned region. It is funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB System. It makes loans to members (i.e., advances) in accordance with policies and procedures established by the Board of Directors of the FHLB.

As a member, the Bank is required to purchase and maintain stock in the FHLB of Cincinnati in an amount equal to at least 1% of aggregate unpaid residential mortgage loans, home purchase contracts or similar obligations at the beginning of each year.

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Federal Reserve System. The FRB requires all depository institutions to maintain non-interest bearing reserves at specified levels against their transaction accounts (primarily checking, NOW, and Super NOW checking accounts) and non-personal time deposits. At December 31, 2006, the Bank was in compliance with these FRB requirements.

Transactions with Affiliates

Under current federal law, transactions between depository institutions, such as the Bank, and their affiliates are governed by Sections 23A and 23B of the Federal Reserve Act. An affiliate is any company or entity that controls, is controlled by, or is under common control with the financial institution, other than a subsidiary. Generally, a bank's subsidiaries are not treated as affiliates unless they are engaged in activities as principal that are not permissible for national banks. In a holding company context, at a minimum, the parent holding company of a bank, and any companies that are controlled by such parent holding company, are affiliates of the bank. Generally, Section 23A limits the extent to which the bank or its subsidiaries may engage in "covered transactions" with any one affiliate to an amount equal to 10% of such bank's capital stock and surplus, and contains an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus. The term "covered transaction" includes the making of loans or other extensions of credit to an affiliate; the purchase of assets from an affiliate; the purchase of, or an investment in, the securities of an affiliate; the acceptance of securities of an affiliate as collateral for a loan or extension of credit to any person; or issuance of a guarantee, acceptance, or letter of credit on behalf of an affiliate. Section 23A also establishes specific collateral requirements for loans or extensions of credit to, or guarantees, or acceptances on letters of credit issued on behalf of an affiliate. Section 23B requires that covered transactions and a broad list of other specified transactions be on terms substantially the same as or no less favorable to, the bank or its subsidiary as similar transactions with non-affiliates.

The Sarbanes-Oxley Act of 2002 generally prohibits loans by the Company to its executive officers and directors. However, the Sarbanes-Oxley Act contains a specific exemption for loans made by the Bank to its executive officers and directors in compliance with federal banking laws. Section 22(h) of the Federal Reserve Act governs a bank's loans to directors, executive officers, and principal shareholders. Under Section 22(h), loans to directors, executive officers, and shareholders who control, directly or indirectly, 10% or more of voting securities of a bank, and certain related interests of any of the foregoing, may not exceed, together with all other outstanding loans to such persons and affiliated entities, the bank's total capital and surplus. Section 22(h) also prohibits loans above amounts prescribed by the appropriate federal banking agency to directors, executive officers, and shareholders who control 10% or more of voting securities of a bank, and their respective related interests, unless such loan is approved in advance by a majority of the board of directors of the bank. Any "interested" director may not participate in the voting. The loan amount (which includes all other outstanding loans to such person) as to which such prior board of director approval is required, is the greater of \$25,000 or 5% of capital and surplus or any loans over \$500,000. Further, pursuant to Section 22(h), loans to directors, executive officers, and principal shareholders must be made on terms substantially the same as those offered in comparable transactions to other persons. There is an exception for loans made pursuant to a benefit or compensation program that is widely available to all employees of the institution and does not give preference to executive officers over other employees. Section 22(g) of the Federal Reserve Act places additional limitations on loans to executive officers.

Available Information

The Company files annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports with the United States Securities and Exchange Commission (the "SEC") pursuant to Section

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13(a) or 15(d) of the Securities Exchange Act of 1934. Such reports can be read and copied at the public reference facilities maintained by the SEC at the Public Reference Room, 100 F Street, NE, Washington, D. C. 20549. Information regarding the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-732-0330. These reports are also available at the SEC's website at www.sec.gov. You also may obtain electronic or paper copies of our reports free of charge by contacting John F. Barron, Senior Vice President and Controller, 1st Independence Financial Group, Inc., 8620 Biggin Hill Lane, Louisville, Kentucky 40220-4117.

Item 1A. Risk Factors.

Risks Related to our Business

We are subject to extensive regulation that could limit or restrict our activities and impose financial requirements or limitations on the conduct of our business, which limitations or restrictions could adversely affect our profitability.

As a bank holding company, we are primarily regulated by the Board of Governors of the Federal Reserve System. Our subsidiary is primarily regulated by the FDIC and the Kentucky Office of Financial Institutions. Our compliance with Federal Reserve Board, FDIC and Kentucky banking regulations is costly. A failure to comply with the banking regulations may limit our growth and restrict certain of our activities, including payment of dividends, mergers and acquisitions, investments, loans and interest rates charged, interest rates paid on deposits and locations of offices. We are also subject to the capital requirements of our regulators.

The laws and regulations applicable to the banking industry could change at any time, and we cannot predict the effects of these changes on our business and profitability. Because government regulation greatly affects our business and financial results, our cost of compliance could adversely affect our ability to operate profitably and a failure to comply could limit our ability to implement our business strategy. See the caption entitled "Regulatory Matters" included in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of this report, which is Part II, Item 7 of this report, for further information.

Our business strategy includes the continuation of growth plans, and our financial condition and results of operations could be negatively affected if we fail to grow.

We have grown rapidly in terms of branch expansion, total assets, net loans, and deposits. We may not be able to continue to grow at the same rate that we have grown in the past. We currently serve our customers through a network of eight banking offices, consisting of two full-service banking locations in Louisville, Kentucky, and one full-service banking location in each of New Albany, Jeffersonville, and Clarksville, Indiana. We also have one full-service banking location in Harrodsburg, Kentucky, Lawrenceburg, Kentucky, and Marengo, Indiana. Our business strategy calls for continued expansion and the opening of additional branches during the next three to five years. We have not yet attempted to establish branches in any of the other counties in Kentucky or southern Indiana. Our branch expansion strategy entails other risks, including:

- o the entrance into new markets where we lack experience;
- o the experience of unexpected competition;
- o the introduction of new products and services into our business with which we have no prior experience;
- o the time and costs of evaluating new markets, hiring experienced local management and opening new offices;

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- o the ability to implement and improve our operational, credit, financial, management and other internal risk controls and processes and our reporting systems and procedures;
- o the ability to manage a growing number of client relationships;
- o the ability to recruit and retain additional experienced bankers to accommodate growth;
- o the ability to maintain controls and procedures sufficient to accommodate an increase in expected loan volume and infrastructure;
- o the diversion of our management's attention from our existing businesses as a result of our growth strategy;
- o the additional expenditures our asset growth may require to expand our administrative and operational infrastructure; and
- o the ability to maintain cost controls and asset quality while attracting additional loans and deposits on favorable terms.

The occurrence of any of these factors could have an adverse effect on our financial condition. We can provide no assurance that we will be able to overcome the risks associated with growth or any other problems encountered in executing our growth strategy.

Our recent results do not indicate our future results, and may not provide guidance to assess the risk of an investment in our common stock.

We are unlikely to sustain our historical rate of growth, and may not even be able to expand our business at all. Further, our recent growth may distort some of our historical financial ratios and statistics. In the future, we may not have the ability to find suitable expansion opportunities. Various factors, such as economic conditions, regulatory and legislative considerations and competition, may also impede or prohibit our ability to expand our market presence. If we are not able to successfully grow and expand our business, our financial condition and results of operations could be adversely affected.

Our business would be harmed if we lost the services of any of our senior management team and are unable to recruit or retain suitable replacements.

We believe that our success to date and our prospects for future success depend significantly on the efforts of our senior management team, which includes N. William White, our President and Chief Executive Officer, R. Michael Wilbourn, our Executive Vice President and Chief Financial Officer, Gregory A. DeMuth, our Executive Vice President and Chief Lending Officer of the Bank, David M. Hall, our Executive Vice President-Retail Banking of the Bank, Kathy L. Beach, our Executive Vice President and Chief Operations Officer, Alan D. Shepard, our Executive Vice President and Chief Credit Officer of the Bank and certain of our senior bankers. We have \$0.5 million of key-man life insurance on both Mr. White and Mr. Wilbourn. There is no assurance, however, that \$0.5 million would be enough to compensate us for the loss of Mr. White or Mr. Wilbourn. We do not have key-man insurance on any other officer of the Company or the Bank. In addition to their skills and experience as bankers, these persons provide us with extensive community ties upon which our competitive strategy is based.

A significant portion of our loan portfolio is secured by real estate, and events that negatively impact the real estate market could hurt our business.

A significant portion of our loan portfolio is secured by real estate. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. A weakening of the real estate market in our market areas could result in an increase in the number of borrowers who default on their loans and a reduction in the value of the collateral securing their loans, which in turn could have an adverse effect

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on our profitability and asset quality. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values, our earnings and capital could be adversely affected. Acts of nature, including hurricanes, tornados, earthquakes, fires and floods, which may cause uninsured damage and other loss of value to real estate that secures these loans, may also negatively impact our financial condition. Additionally, a slowdown in real estate activity in the markets we serve may also negatively impact our financial condition.

An economic downturn, either nationally or in the local market area, could adversely affect our financial condition, results of operations and cash flows.

Deterioration in local, regional, national or global economic conditions could result in, among other things, an increase in loan delinquencies, a change in the housing turnover rate or a reduction in the level of available wholesale deposits. If the communities in which we operate do not grow, or if the prevailing local or national economic conditions are unfavorable, our business strategy may not succeed. A weakening of the employment market in our primary market area could result in an increase in the number of borrowers who default on their loans. Further, the banking industry is affected by general economic conditions such as inflation, interest rates, recession, unemployment and other factors beyond our control. Moreover, we cannot give any assurance that we will benefit from any market growth or favorable economic conditions in our primary market areas even if they do occur.

Our cost of funds for banking operations may increase as a result of general economic conditions, interest rates and competitive pressures.

In the past, the Bank has relied heavily on brokered certificates of deposits and borrowings for the funds necessary for banking operations. As a general matter, deposits are a cheaper source of funds than brokered certificates of deposit or borrowings, because interest rates paid for deposits are typically less than interest rates charged for brokered certificates of deposit or borrowings. Our business strategy includes funding more of our operations with deposits; however, we cannot provide any assurances that we will be able attract sufficient deposits.

Competition from other financial institutions and others may adversely affect our profitability.

The banking business generally, and because of its desirability and the opportunities for growth, the Louisville, Kentucky and southern Indiana market area in particular, is highly competitive, and we experience strong competition from many other financial institutions. We compete with commercial banks, credit unions, savings and loan associations, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market funds and other financial institutions, which operate in our primary market area and elsewhere.

We compete with these institutions to make loans and to attract new customers and in pricing loans and deposits. Many of our competitors are well-established and much larger financial institutions and can offer customers more attractive pricing terms. While we believe we can and do successfully compete with these other financial institutions in our markets, we may face a competitive disadvantage as a result of our smaller size.

We also compete with private lenders, mezzanine and venture capital firms and angel investors in some of our lending divisions, including our community redevelopment lending and mezzanine financing divisions. Many of these competitors are subject to minimal or no regulation and may be able

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to make accommodations for customers that we are unable to make.

We are currently subject to claims regarding the merger of Independence Bancorp with Harrodsburg First Financial Bancorp, Inc. that could result in substantial defense, judgment or settlement costs.

On or about May 28, 2004, a complaint was filed in the Circuit Court of Anderson County in the Commonwealth of Kentucky by Larry Sutherland, Judy Sutherland, John Henry Disponett, Brenda Disponett, Todd Hyatt, Lois Ann Disponett, Sue Saufley, and Hugh Coomer. Soon thereafter, an amended complaint was filed which added Lois Hawkins and Norma K. Barnett as plaintiffs. The lawsuit arises from offers to purchase securities made by us in connection with an offer to purchase up to 300,000 shares of our stock in a tender offer on or about May 28, 2003. The Plaintiffs allege that we made certain material misrepresentations in connection with certain statements made in the tender offer. The Plaintiffs are seeking to recover compensatory and punitive damages in connection with the shares they sold in the tender offer and their attorneys' fees.

On April 14, 2006 a partial summary judgment was entered against the plaintiffs. In the partial summary judgment, the Circuit Court held that the only remedy available to the plaintiffs is the return of the stock upon the tender of the consideration received by the Plaintiffs in exchange for the stock. Subsequent to the partial summary judgment, the plaintiffs amended their complaint to allege certain additional material misrepresentations had been made by the Company. This matter is currently scheduled for trial in July 2007. If we are ultimately unsuccessful in this litigation, it may have a negative effect on our results of operations or cash flows.

Risks Related to Our Industry

Our profitability is vulnerable to interest rate fluctuations.

Most of our assets and liabilities are monetary in nature, and thus subject us to significant risks from changes in interest rates. Consequently, our results of operations can be significantly affected by changes in interest rates and our ability to manage interest rate risk. Changes in market interest rates, or changes in the relationships between short-term and long-term market interest rates, or changes in the relationship between different interest rate indices can affect the interest rates charged on interest-earning assets differently than the interest paid on interest-bearing liabilities. This difference could result in an increase in interest expense relative to interest income or a decrease in interest rate spread. In addition to affecting our profitability, changes in interest rates can impact the valuation of our assets and liabilities. A discussion of how we measure our exposure to interest rate changes is provided in Part II, Item 7 of this report.

We could suffer loan losses from a decline in credit quality.

We could sustain losses if borrowers, guarantors or related parties fail to perform in accordance with the terms of their loans. We have adopted underwriting and credit monitoring procedures and policies, including the establishment and review of the allowance for credit losses, that we believe are appropriate to minimize this risk by assessing the likelihood of nonperformance, tracking loan performance and diversifying our credit portfolio. These policies and procedures, however, may not prevent unexpected losses that could materially adversely affect our results of operations and financial condition.

If our allowance for loan losses is not sufficient to cover actual loan losses,

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our earnings could decrease.

We manage our credit exposure through careful monitoring of loan applicants and loan concentrations in particular industries, and through loan approval and review procedures. We have established an evaluation process designed to determine the adequacy of our allowance for loan losses. While this evaluation process uses historical and other objective information, the classification of loans and the establishment of loan losses is an estimate based on experience, judgment and expectations regarding our borrowers, the economies in which we and our borrowers operate, as well as the judgment of our regulators.

There is no precise method of predicting loan losses, so we cannot assure you that our loan loss allowance will be sufficient to absorb future loan losses or prevent a material adverse effect on our business, financial condition or results of operations.

Failure to achieve and maintain effective internal controls in accordance with Section 404 of the Sarbanes-Oxley Act could have a material adverse effect on our ability to report our financial results timely and accurately and on our stock price.

Section 404 of the Sarbanes-Oxley Act requires annual assessments of the effectiveness of our internal control over financial reporting and a report by our independent registered public accounting firm regarding their opinion of the effectiveness of our internal control over financial reporting based upon their audit. We are required to complete our initial assessment by the filing of our Form 10-K for the year ended December 31, 2007 and to obtain the opinion of our independent registered public accounting firm by the filing of our Form 10-K for the year ended December 31, 2008. During the course of our assessment, we may identify deficiencies in our internal controls over financial reporting which we may not be able to remediate in time to meet this deadline. A failure to maintain adequate internal controls may result in material misstatements in our financial statements and a failure to meet our reporting obligations. As a result investors may lose confidence in our reported financial information and our stock price could decline.

Our operations could be interrupted if our network or computer systems fail or experience a security breach.

Our computer systems and network infrastructure could be vulnerable to unforeseen problems. Our operations are dependent upon our ability to protect our computer equipment against damage from fire, power loss, telecommunications failure or a similar catastrophic event. Any damage or failure that causes an interruption in our operations could result in a loss of customers and thereby have a material adverse effect on our business, operating results and financial condition.

Risks Relating to an Investment in Our Common Stock

Additional growth may require us to raise additional capital in the future, but that capital may not be available when it is needed, which could adversely affect our financial condition and results of operations.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. We anticipate that our current capital resources will satisfy our capital requirements for the foreseeable future. We may at some point, however, need to raise additional capital to support our continued growth. Our ability to raise capital, if needed, will depend on conditions in the capital markets at that time, which are outside our control, and on our financial performance.

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Accordingly, we cannot assure you of our ability to raise capital, if needed, on terms acceptable to us. If we cannot raise capital when needed, our ability to implement our business strategy could be materially impaired.

Our stock price may fluctuate and be volatile.

The prices at which our common stock has traded may not be indicative of future market prices. The trading price of our common stock has, in the past, and could continue in the future to fluctuate significantly. Volatility in our stock price could result from the following factors, among others:

- o variations in quarterly operating results;
- o changes in financial estimates by securities analysts;
- o the operating and stock price performance of other companies in the banking industry; and
- o general stock market or economic conditions.

The stock market in recent years has experienced price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of affected companies.

Our ability to pay dividends is limited, and we may be unable to pay future dividends if we decide to do so.

Our ability to continue our current dividends is limited by regulatory restrictions, by the bank's ability to pay dividends to us based on its capital position and profitability, and by our need to maintain sufficient capital to support the bank's operations. The ability of the bank to pay dividends to us is limited by its obligations to maintain sufficient capital and by other restrictions on its dividends that are applicable to banks that are regulated by the FDIC. If the bank does not satisfy these regulatory requirements it will be unable to pay dividends to us and we will be unable to pay dividends on our common stock to you.

The holders of our junior subordinated debentures have rights that are senior to those of our common shareholders.

As of December 31, 2006 we had \$9.3 million of trust preferred securities outstanding. Payments of the principal and interest on the trust preferred securities are conditionally guaranteed by us. Further, the junior subordinated debentures are senior to our shares of common stock. We have the right to defer payment of interest on the junior subordinated debentures for a period not exceeding 20 consecutive quarters. If we defer, or fail to make, interest payments on the junior subordinated debentures, we will be prohibited, subject to certain exceptions, from paying cash dividends on our common stock until we pay all deferred interest and resume interest payments on the junior subordinated debentures.

We have implemented anti-takeover devices that could make it more difficult for another company to purchase us, even though such a purchase may increase shareholder value.

In many cases, shareholders would receive a premium for their shares if we were purchased by another company. However, state and federal law and our certificate of incorporation and bylaws make it difficult for anyone to purchase us without approval of our board of directors. For example, our articles of incorporation divide the board of directors into three classes of directors serving staggered three-year terms with approximately one-third of the board of directors elected at each annual meeting of shareholders. The classification of directors makes it more difficult for

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shareholders to change the composition of the board of directors. As a result, at least two annual meetings of shareholders would be required for the shareholders to change a majority of the directors, whether or not a change in the board of directors would be beneficial and whether or not a majority of shareholders believe that such a change would be desirable. In addition, our certificate of incorporation provides that in no event shall any record owner of any outstanding common stock which is beneficially owned, directly or indirectly, by a person who beneficially owns in excess of 10% of the then outstanding shares of common stock be entitled or permitted to any vote with respect to the shares held in excess of the 10% limit. Consequently, a takeover attempt may prove difficult, and shareholders may not realize the highest possible price for their securities.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

The Company's corporate office is located at 8620 Biggin Hill Lane in Louisville, Kentucky where the Company's finance and accounting, loan and deposit operations, mortgage operations and a full service banking office (Stony Brook Branch) are located. The Company conducts its banking business through eight full service banking offices located in Harrodsburg, Lawrenceburg and two locations in Louisville, Kentucky (St. Matthews Branch and Stony Brook Branch) and Jeffersonville, New Albany, Marengo and Clarksville, Indiana. 1st Independence Mortgage conducts its business throughout the Bank's branch network.

The location of the Company's properties, the approximate square footage and whether owned or leased is described in the following table:

Location -----	Nature -----	Square Feet -----	Status -----
Harrodsburg, Kentucky 104 South Chiles Street	Branch banking facility	12,636	Owned
Lawrenceburg, Kentucky 1015 Crossroad Drive	Branch banking facility	2,550	Owned
Louisville, Kentucky (Stony Brook Branch) 8620 Biggin Hill Lane	Corporate office (including finance and accounting, loan and deposit operations), mortgage operations and branch banking facility	14,190	Owned
Louisville, Kentucky (St. Matthews Branch) 4220 Shelbyville Road	Branch banking facility	3,606	Leased
Clarksville, Indiana 1325 Veterans Parkway	Branch banking facility	2,817	Leased
Jeffersonville, Indiana 1711 East 10th Street	Branch banking facility	3,562	Leased
Marengo, Indiana 309 South Bradley Street	Branch banking facility	5,856	Owned

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New Albany, Indiana
3801 Charlestown Road

Branch banking facility

11,200

Leased

See note 8 to the Company's consolidated financial statements herein for additional information. The New Albany, Indiana branch is leased from Chalfant Industries, Inc., a company owned by the Company's Chairman of the Board of Directors.

Item 3. Legal Proceedings.

The Company, from time to time, is a party to ordinary routine litigation, which arises in the normal course of business, such as claims to enforce liens, condemnation proceedings on properties in which the Company holds security interests, claims involving the making and servicing of real property loans, and other issues incident to its business. Except as discussed below, there were no potentially material lawsuits or other legal proceedings pending or known to be contemplated against the Company at December 31, 2006.

On or about May 28, 2004, a complaint was filed in the Circuit Court of Anderson County in the Commonwealth of Kentucky by Larry Sutherland, Judy Sutherland, John Henry Disponett, Brenda Disponett, Todd Hyatt, Lois Ann Disponett, Sue Saufley, and Hugh Coomer. Soon thereafter, an amended complaint was filed which added Lois Hawkins and Norma K. Barnett as plaintiffs. The lawsuit arises from offers to purchase securities made by the Company in connection with an offer to purchase up to 300,000 shares of its stock in a tender offer on or about May 28, 2003. The Plaintiffs allege that the Company made certain material misrepresentations in connection with certain statements made in the tender offer. The Plaintiffs are seeking to recover compensatory and punitive damages in connection with the shares it sold in the tender offer and their attorneys' fees. On April 14, 2006 a partial summary judgment was entered against the plaintiffs. In the partial summary judgment, the Circuit Court held that the only remedy available to the plaintiffs is the return of the stock upon the tender of the consideration received by the plaintiffs in exchange for the stock. Subsequent to the partial summary judgment, the plaintiffs amended their complaint to allege certain additional material misrepresentations had been made by the Company. This matter is currently scheduled for trial in July 2007. Based upon the advice of counsel, management records an estimate of the amount of ultimate expected loss for litigation, if any. Management, after discussion with legal counsel, believes the ultimate result of this litigation will not have a material adverse effect on the Company's financial position, results of operations or cash flows. However, events could occur that could cause any estimate of ultimate loss to differ materially in the near term.

Item 4. Submission of Matters to a Vote of Security Holders.

No matters were submitted to a vote of security holders during the fourth quarter ended December 31, 2006.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Since its issuance in October 1995, the Company's common stock has traded on the NASDAQ Global Market System. The Company's trading symbol is FIFG. The quarterly high and low sales prices for the Company's common stock as reported by NASDAQ and any dividends declared during the quarter are set forth in the table below.

	Quarter Ended			
	3/31	6/30	9/30	12/31
2006	-----	-----	-----	-----
----	----	----	----	----

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High	\$19.00	\$18.80	\$18.00	\$17.90
Low	17.49	16.20	15.67	16.40
Cash dividend declared per share	0.08	0.08	0.08	0.08

Quarter Ended

2005	3/31	6/30	9/30	12/31
High	\$19.99	\$23.05	\$20.50	\$20.00
Low	18.21	17.41	19.00	18.00
Cash dividend declared per share	0.16	0.08	0.08	0.08

The number of shareholders of record of common stock as of December 31, 2006, was approximately 410. This does not reflect the number of persons or entities who held stock in nominee or "street" name through various brokerage firms. At December 31, 2006, there were 1,995,594 shares outstanding. The Company's ability to pay dividends to stockholders is dependent upon the dividends it receives from the Bank. The payment of cash dividends by the Bank is limited by regulations of the FDIC. See "Regulations of the Bank - Dividend and Other Capital Distribution Limitations."

Set forth below is information as of December 31, 2006 with respect to compensation plans under which equity securities of the Company are authorized for issuance.

Equity Compensation Plan Information

	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of remaining future iss equity comp [excluding reflected
Equity compensation plans approved by stockholders:			
2004 Omnibus Stock Option Plan	51,550	\$ 11.83	223
1996 Stock Option Plan	81,000	16.50	30
Restricted Stock Plan	-	-	76
Equity compensation plans not approved by stockholders	n/a	n/a	
Total	132,550	\$ 14.69	329

(1) No longer eligible for grant as of January 28, 2007.

Performance Graph

The following Performance Graph and related information shall not be deemed "soliciting material" or to be "filed" with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or Securities Exchange Act of

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1934, each as amended, except to the extent that the Company specifically incorporates it by reference into such filing.

Comparative Stock Performance Graph

The following performance graph compares the performance of the Company's Common Stock to the NASDAQ Market Index (U.S.) and the NASDAQ Financial Stocks Index for the five year period ended December 31, 2006. The graph assumes an investment of \$100 in each of the Company's Common Stock, the NASDAQ Market Index (U.S.) and the NASDAQ Financial Stocks Index on December 31, 2001 and that all dividends were reinvested.

[GRAPHIC OMITTED]

	12/31/01 -----	12/31/02 -----	12/31/03 -----	12/31/04 -----	12/31/05 -----
1st Independence Financial Group, Inc.	\$100.00	\$121.29	\$221.53	\$187.85	\$186.9
NASDAQ Market Index (U.S.)	100.00	69.13	103.36	112.49	114.8
NASDAQ Financial Stocks Index	100.00	102.98	139.28	162.56	166.4

Item 6. Selected Financial Data.

Selected Consolidated Financial Data
(in thousands except per share data)

	Year ended December 31,		Three months ended December 31,		Year ended
	2006	2005	2004	2004	2003
	-----	-----	-----	-----	-----
Results of operations:					
Net interest income	\$ 10,623	\$ 10,252	\$ 2,330	\$ 4,678	\$ 4,678
Provision for loan losses	847	354	-	1,203	1,203
Noninterest income	1,791	6,957	538	682	682
Noninterest expense	8,839	10,093	2,537	6,026	6,026
Net income (loss)	1,940	4,481	240	(1,093)	(1,093)
Per Share Data:					
Income (loss) from continuing operations					
Basic	\$ 1.00	\$ 2.38	\$ 0.13	\$ (0.84)	\$ (0.84)
Diluted	0.99	2.33	0.12	(0.84)	(0.84)
Income from subsidiary held for disposal					
Basic	0.00	0.00	0.00	0.02	0.02
Diluted	0.00	0.00	0.00	0.02	0.02
Net income (loss)					
Basic	1.00	2.37	0.13	(0.83)	(0.83)
Diluted	0.99	2.32	0.13	(0.83)	(0.83)
Weighted average shares outstanding					
Basic	1,941	1,889	1,864	1,318	1,318
Diluted	1,957	1,929	1,917	1,318	1,318
Book value - end of period	\$ 20.20	\$ 19.61	\$ 19.68	\$ 19.38	\$ 19.38
Market value - end of period	16.40	18.50	18.98	20.00	20.00
Cash dividends declared	0.32	0.40	0.00	0.38	0.38
Dividend payout ratio	31.96%	16.83%	0.00%	(47.30)%	(47.30)%

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Balance Sheet Data:	At December 31,			At S
	2006	2005	2004	2004
Total assets	\$342,806	\$336,187	\$337,191	\$320,032
Securities	18,321	18,115	28,873	29,478
Loans, excluding held for sale	274,223	269,889	236,197	213,719
Allowance for loan losses	3,745	2,911	2,549	2,560
Deposits	254,077	264,323	223,308	219,817
Short-term borrowings	36,526	18,747	23,233	7,121
Long-term borrowings	10,279	13,279	14,247	14,234
Stockholders' equity	40,303	38,261	37,706	37,081
Shares outstanding at end of period	1,996	1,951	1,916	1,913
			Three months ended	
	Year ended December 31,		December 31,	Year end
Financial Performance Ratios:	2006	2005	2004	2004
Return on average assets	0.57%	1.38%	0.32%	(0.68)%
Return on average stockholders' equity	4.93	11.92	2.51	(4.58)
Net interest margin	3.40	3.44	3.45	3.13
Efficiency ratio (1)	71.20	81.88	88.46	112.28
Asset Quality Ratios (2):				
Nonperforming loans to total loans	1.36%	0.47%	0.52%	0.57%
Nonperforming assets to total assets	1.21	0.38	0.41	0.44
Net charge-offs (recoveries) to average loans	0.00	0.00	0.00	0.07
Allowance for loans losses to total loans (excluding held for sale)	1.37	1.08	1.08	1.20
Allowance for loans losses to nonperforming loans (3)	100.43	229.21	208.08	210.01
Liquidity and Capital Ratios:				
Loans to deposits	107.93%	102.11%	105.77%	97.23%
Average stockholders' equity to average total assets	11.57	11.59	12.76	14.79
Tangible equity to assets (4)	8.47	8.01	7.81	8.01
Leverage ratio	11.60	10.20	9.60	9.90
Tier 1 risk-based capital ratio	14.60	13.10	13.30	13.90
Total risk-based capital ratio	15.90	15.10	15.60	16.20

(1) Efficiency ratio is noninterest expense divided by net interest income plus noninterest income gains and losses).

(2) At period end, except for net charge-offs to average loans.

(3) Nonperforming loans consist of nonaccrual loans, loans contractually past due 90 days or more

(4) Calculated by dividing stockholders' equity less goodwill and core deposit intangibles by total

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation.

The following is a discussion of the consolidated financial condition and results of operations of the Company for the periods presented, and certain factors that may affect the Company's prospective financial condition. This section should be read in conjunction with the consolidated financial statements and the notes thereto appearing elsewhere or incorporated by reference in this Annual Report on Form 10-K including note 1 which describes the Company's significant accounting policies including its use of estimates. See the caption entitled "Critical Accounting Policies and Estimates" in this section for

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further information. The following discussion contains statements which are forward-looking rather than historical fact. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies, and expectations of the Company, are generally identified by use of the words "plan," "believe," "expect," "intend," "anticipate," "estimate," "project," or similar expressions. These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and involve risks and uncertainties that could render them materially different, including, but not limited to, changes in general economic conditions; interest rates, deposit flows, loan demand, real estate values, competition and demand for financial services and loan, deposit, and investment products in the Company's local markets; changes in the quality and composition of the loan or investment portfolios; changes in accounting principles, policies, or guidelines; changes in legislation and regulation; changes in the monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board; war or terrorist activities; and other economic, competitive, governmental, regulatory, geopolitical, and technological factors affecting the Company's operations, pricing, and services, and other risks as detailed in the Company's various Securities and Exchange Commission filings.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this filing. Except as required by applicable law or regulation, the Company undertakes no obligation to update these forward-looking statements to reflect events or circumstances that occur after the date on which such statements were made.

General

The Company provides commercial and retail banking services, including commercial real estate loans, one-to-four family residential mortgage loans via 1st Independence Mortgage, home equity loans and lines of credit and consumer loans as well as certificates of deposit, checking accounts, money-market accounts and savings accounts within its market area. At December 31, 2006, the Company had total assets, deposits and stockholders' equity of \$342.8 million, \$254.1 million, and \$40.3 million, respectively. The Company's business is conducted principally through the Bank. Unless otherwise indicated, all references to the Company refer collectively to the Company and the Bank.

The Company is currently a defendant in a lawsuit that asserts that the Company made certain material misrepresentations in connection with its offer to purchase up to 300,000 shares of stock in a tender offer in May 2003. The plaintiffs are seeking to recover damages in connection with the shares they sold in the tender offer and attorneys fees. This matter is currently scheduled for trial in July 2007. Based upon the advice of counsel, management records an estimate of the amount of ultimate expected loss for litigation, if any. Management has not recorded a loss provision for this litigation as, after discussion with legal counsel, management believes the ultimate result of this litigation will not have a material adverse effect on the Company's financial position, results of operations or cash flows. Events could occur that could cause the estimate of ultimate loss to differ materially in the near term.

In January 2005, the Company sold its interest in Citizens Financial Bank, Inc., Glasgow, Kentucky ("Citizens") to another financial institution for \$2.3 million. The sale of Citizens reflected the Company's revised strategic plan to exit the south central Kentucky market and to focus on the growing markets of southern Indiana, central Kentucky, and greater Louisville, Kentucky.

The Bank also purchased property and a building, located in Louisville, Kentucky, that was previously used as an operations center and retail branch of an affiliate of the financial institution that purchased Citizens. The purchase price of the building and property was \$2.3 million. The Bank moved its finance and accounting, loan and deposit operations, and mortgage banking operations into the building in April 2005. The Bank also received regulatory approval during the second quarter of 2005 to establish a full service branch at this location and subsequently opened the branch in November 2005.

Critical Accounting Policies and Estimates

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The discussion and analysis of the Company's financial condition and results of operations is based upon the Company's consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

On an ongoing basis, management evaluates the Company's accounting policies and estimates it uses to prepare the consolidated financial statements. In general, management's estimates are based on historical experience, on information from regulators and third party professionals and other assumptions believed to be reasonable under the circumstances. Actual results could differ from those estimates.

The following critical accounting policies affect the Company's more significant judgements and estimates used to prepare the consolidated financial statements:

Other Than Temporary Impairment of Securities. Securities are evaluated periodically to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent. It indicates that the prospects for a near term recovery of value are not necessarily favorable, or that there is a lack of evidence to support fair values equal to, or greater than, the carrying value of the investment. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding charge to earnings is recognized.

Allowance for Loan Losses. Determining the amount of the allowance for loan losses necessarily involves a high degree of judgment. To assess the adequacy of the allowance, management uses historical information as well as the prevailing business environment, as it is affected by changing economic conditions and various external factors, which may impact the portfolio in ways currently unforeseen. The allowance is increased by provisions for loan losses and by recoveries of loans previously charged-off and reduced by loans charged-off. For a full discussion of the methodology of assessing the adequacy of the allowance for loan losses, see the "Provision for Loan Losses" section elsewhere within this Management's Discussion and Analysis of Financial Condition and Results of Operations and note 5 to the Company's consolidated financial statements.

Goodwill. Acquisitions accounted for under the purchase method of accounting require that assets acquired and liabilities assumed be recorded at their fair value which is an estimate determined by the use of internal or other valuation techniques. These valuation estimates result in goodwill and other intangible assets with goodwill representing the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Goodwill is subject to an annual impairment test and is evaluated using various fair value techniques. See note 7 to the Company's consolidated financial statements for further information.

Overview

Net income for the year ended December 31, 2006 was \$1,940,000 or \$0.99 per diluted share compared to net income of \$4,481,000 or \$2.32 per diluted share for the year ended December 31, 2005. The decreases in net income and net income per diluted share for the year ended December 31, 2006 were primarily due to after tax securities gains of \$3,308,000 taken in the first quarter of 2005 and the increase of \$325,000 after taxes in the provision for loan losses in the year 2006 compared to the year 2005. Partially offsetting these factors was an increase in net interest income of \$245,000 after taxes and an after tax charge of \$235,000 recorded in the first quarter of 2005 for severance expenses related to the retirement of the Company's former Chairman and Chief Executive Officer.

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Other factors were decreased incentive expense, employee benefit expense, marketing expense, professional fees and other noninterest expense items. Partially offsetting these factors were increased net occupancy expense and data processing expense.

Net income for the year ended December 31, 2005 was \$4,481,000 or \$2.32 per diluted share compared to a loss of (\$1,036,000) or (\$0.69) per diluted share for the twelve months ended December 31, 2004. The Company changed its fiscal year from September 30 to December 31, effective December 31, 2004. Accordingly, results of operations and related statistical information set forth in this Management's Discussion and Analysis of Financial Condition and Results of Operations for the twelve months ended December 31, 2004 is unaudited and is derived by taking the (audited) twelve months ended September 30, 2004 amount and adding the (audited) three months ended December 31, 2004 amount and subtracting the (unaudited) three months ended December 31, 2003 amount. The increases in net income and net income per diluted share for the year ended December 31, 2005 were primarily due to after tax securities gains of \$3,308,000 taken in the first quarter of 2005 which was previously mentioned and the significance of the Company's July 2004 merger with Independence Bancorp (the "Merger") to the Company's operations including an after tax charge of approximately \$526,000 recorded in the second quarter of 2004 in connection with the termination of a data processing contract. Other factors which contributed to the increase were a decrease of \$560,000, after taxes, in the provision for loan losses taken in the twelve months ended December 31, 2005 compared to the same period in 2004, an after tax charge of \$158,000 relating to the Bank's termination of its pension plan in the third quarter of 2004, a \$356,000 goodwill writeoff recorded in the third quarter of 2004 in regards to the Citizens disposal and certain merger-related expenses also taken in the third quarter of 2004. Partially offsetting these factors was the after tax charge of \$235,000 recorded in the first quarter 2005 for severance expenses related to the retirement of the Company's former Chairman and CEO which was previously mentioned.

Results of Operations

Net Interest Income

Net interest income is the most significant component of the Company's revenues. Net interest income is the difference between interest income on interest-earning assets (primarily loans and investment securities) and interest expense on interest-bearing liabilities (deposits and borrowed funds). Net interest income depends on the volume and rate earned on interest-earning assets and the volume and rate paid on interest-bearing liabilities.

Net interest income was \$10.6 million for the year ended December 31, 2006, an increase of \$0.3 million or 4% from \$10.3 million for the year ended December 31, 2005. Net interest spread and net interest margin were 2.98% and 3.40%, respectively, for the year ended December 31, 2006, compared to 3.14% and 3.44% for the year ended December 31, 2005. The decrease in net interest spread and net interest margin for the year 2006 compared to the year 2005 was primarily due to the reversal of \$57,000 of interest income on a \$2.6 million loan which was placed on nonaccrual in August 2006 and a faster increase in interest rates on interest-bearing liabilities, including the effect of the increasing rate on the \$4.1 million of variable rate subordinated debentures, compared to the rates on interest-earning assets. Partially offsetting these factors were increases in the volume of net earning assets. Changes in volume resulted in an increase in net interest income of \$0.7 million for the year of 2006 compared to the year 2005, and changes in interest rates and the mix resulted in a decrease in net interest income of \$0.4 million for the year 2006 versus the year 2005.

Net interest income was \$10.3 million for the year ended December 31, 2005, an increase of \$4.1 million or 67% from \$6.2 million for the twelve months ended December 31, 2004. Net interest spread and net interest margin were 3.14% and 3.44%, respectively, for the year ended December 31, 2005, compared to 3.07% and 3.30% for the twelve months ended December 31, 2004. The increase in the net interest margin was due to an increase in the volume of net interest bearing

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assets, primarily resulting from the Merger and due to loan growth since the Merger. Changes in volume resulted in an increase in net interest income in 2005 of \$4.4 million and changes in interest rates and the mix resulted in a decrease in net interest income of \$0.3 million versus the comparable periods in 2004.

For a detailed analysis of interest income and interest expense, see "Average Balance Sheets" and "Rate/Volume Analysis" below.

Average Balance Sheets

The following table set fort