

First Internet Bancorp  
Form 10-Q  
May 15, 2013

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

**FORM 10-Q**

(Mark One)

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

For the Quarterly Period Ended March 31, 2013

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

For the Transition Period From \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number **001-35750**

**First Internet Bancorp**  
(Exact Name of  
Registrant as Specified in  
Its Charter)

**Indiana** **20-3489991**  
(State or Other Jurisdiction of (I.R.S. Employer  
Incorporation or Organization) Identification No.)

**8888 Keystone Crossing, Suite 1700** **46240**  
**Indianapolis, Indiana**  
(Address of Principal Executive Offices) (Zip Code)

**(317) 532-7900**  
(Registrant's Telephone Number, Including Area Code)

(Former Name, Former Address and Former Fiscal Year,  
if Changed Since Last Report)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).

Large Accelerated Filer

Accelerated Filer

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

Smaller Reporting  
Company

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

As of May 10, 2013, the registrant had 1,876,782 shares of common stock issued and outstanding.

### **Cautionary Note Regarding Forward-Looking Statements**

This Quarterly Report on Form 10-Q contains certain “forward-looking statements” within the meaning of the federal securities laws. These statements are not historical facts, rather statements based on First Internet Bancorp’s (“we,” “our,” “us” or the “Company”) current expectations regarding its business strategies, intended results and future performance. Forward-looking statements are generally preceded by terms such as “expects,” “believes,” “anticipates,” “intends” and similar expressions. Such statements are subject to certain risks and uncertainties including changes in economic conditions in our market area, changes in policies by regulatory agencies, the outcome of litigation, fluctuations in interest rates and real estate property values in our market area, demand for loans and deposits in the Company’s market area, changes in the quality or composition of our loan portfolio, changes in accounting principles, laws and regulations, and competition that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. Additional factors that may affect our results include those discussed in our most recent Annual Report on Form 10-K under the heading “Risk Factors” and in other reports filed with the Securities and Exchange Commission. The Company cautions readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. The factors listed above could affect the Company’s financial performance and could cause the Company’s actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements.

Except as required by law, the Company does not undertake, and specifically disclaims any obligation, to publicly release the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

(i)

**PART I**

**ITEM 1. FINANCIAL STATEMENTS.**

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## First Internet Bancorp

Condensed Consolidated Balance Sheets  
(Dollar Amounts in Thousands except shares)

|  | March 31,<br>2013<br>(Unaudited) | December 31,<br>2012 |
|--|----------------------------------|----------------------|
| Assets   |                                  |                      |
| Cash and due from banks  | \$ 1,427                         | \$ 2,881             |
| Interest-bearing demand deposits   | 32,979                           | 29,632               |
| Total cash and cash equivalents  | 34,406                           | 32,513               |
| Interest-bearing time deposits   | 1,500                            | —                    |
| Securities available for sale - at fair value (amortized cost of \$161,649 and \$153,896)                | 164,275                          | 156,693              |
| Loans held for sale  | 61,596                           | 63,234               |
| Loans receivable - net of allowance for loan losses of \$5,748 and \$5,833                               | 352,616                          | 352,328              |
| Accrued interest receivable  | 2,137                            | 2,196                |
| Federal Home Loan Bank of Indianapolis stock   | 2,943                            | 2,943                |
| Cash surrender value of life insurance   | 11,636                           | 11,539               |
| Premises and equipment, net  | 4,848                            | 793                  |
| Goodwill   | 4,687                            | 4,687                |
| Other real estate owned  | 4,208                            | 3,666                |
| Other assets   | 5,984                            | 5,775                |
| Total assets   | \$ 650,836                       | \$ 636,367           |
| Liabilities and Shareholders' Equity   |                                  |                      |
| Liabilities  |                                  |                      |
| Non-interest bearing deposits  | \$ 16,046                        | \$ 13,187            |
| Interest-bearing deposits  | 530,621                          | 517,504              |
| Total deposits   | 546,667                          | 530,691              |
| Advances from Federal Home Loan Bank   | 25,713                           | 40,686               |
| Accrued interest payable   | 91                               | 120                  |
| Accrued expenses and other liabilities   | 15,722                           | 3,520                |
| Total liabilities  | 588,193                          | 575,017              |
| Commitments and Contingencies  |                                  |                      |
| Shareholders' Equity   |                                  |                      |
| Preferred stock, no par value; 4,913,779 shares authorized; issued and outstanding - none                | —                                | —                    |
| Voting common stock, no par value; 45,000,000 shares authorized; 1,876,782 shares issued and outstanding | 41,537                           | 41,508               |
| Nonvoting common stock, no par value; 86,221 shares authorized; issued and outstanding - none            | —                                | —                    |
| Retained earnings  | 19,399                           | 18,024               |
| Accumulated other comprehensive income (net of income taxes of \$919 and \$979)                          | 1,707                            | 1,818                |
| Total shareholders' equity   | 62,643                           | 61,350               |
| Total liabilities and shareholders' equity   | \$ 650,836                       | \$ 636,367           |

See Notes to Condensed Consolidated Financial Statements

## First Internet Bancorp

Condensed Consolidated Statements of Income – Unaudited  
(Dollar Amounts in Thousands except shares and per share data)

|  | Three Months Ended March 31, |          |
|--|------------------------------|----------|
|  | 2013                         | 2012     |
| Interest Income  |                              |          |
| Loans  | \$ 4,967                     | \$ 4,728 |
| Securities – taxable   | 484                          | 942      |
| Securities – non-taxable   | 303                          | 421      |
| Total interest income  | 5,754                        | 6,091    |
| Interest Expense   |                              |          |
| Deposits   | 1,628                        | 1,821    |
| Other borrowed funds   | 308                          | 338      |
| Total interest expense   | 1,936                        | 2,159    |
| Net Interest Income  | 3,818                        | 3,932    |
| Provision for Loan Losses  | 134                          | 570      |
| Net Interest Income After Provision for Loan Losses              | 3,684                        | 3,362    |
| Noninterest Income   |                              |          |
| Service charges and fees   | 234                          | 265      |
| Gain on loans sold   | 3,011                        | 1,750    |
| Other-than-temporary impairment                                  |                              |          |
| Total loss related to other than temporarily impaired securities | (979                         | ) —      |
| Portion of loss recognized in other comprehensive income (loss)  | 945                          | —        |
| Other-than-temporary impairment loss recognized in net income    | (34                          | ) —      |
| Gain (loss) on sale of securities                                | (185                         | ) 40     |
| Loss on asset disposals  | (79                          | ) (110   |
| Other  | 198                          | 93       |
| Total noninterest income   | 3,145                        | 2,038    |
| Noninterest Expense  |                              |          |
| Salaries and employee benefits                                   | 2,379                        | 1,991    |
| Marketing, advertising and promotion                             | 372                          | 391      |
| Professional services  | 653                          | 328      |
| Data processing  | 214                          | 230      |
| Loan expenses  | 80                           | 185      |
| Net occupancy expenses   | 401                          | 412      |
| Deposit insurance premium  | 112                          | 98       |
| Other  | 435                          | 247      |
| Total noninterest expense  | 4,646                        | 3,882    |
| Income Before Income Taxes                                       | 2,183                        | 1,518    |
| Income Tax Provision   | 695                          | 372      |
| Net Income   | \$ 1,488                     | \$ 1,146 |
| Income Per Share of Common Stock                                 |                              |          |
| Basic  | \$ 0.77                      | \$ 0.60  |
| Diluted  | 0.77                         | 0.60     |

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|  |           |           |
|--|-----------|-----------|
| Weighted-Average Number of Common Shares Outstanding |           |           |
| Basic  | 1,924,148 | 1,909,723 |
| Diluted  | 1,924,148 | 1,909,723 |
| Dividends Declared Per Share                         | \$ 0.06   | \$ 0.00   |

See Notes to Condensed Consolidated Financial Statements



First Internet Bancorp

Condensed Consolidated Statements of Comprehensive Income – Unaudited  
(Dollar Amounts in Thousands)

|   | Three Months Ended<br>March 31, |          |
|---|---------------------------------|----------|
|   | 2013                            | 2012     |
| Net income  | \$ 1,488                        | \$ 1,146 |
| Other comprehensive income (loss)   |                                 |          |
| Net unrealized holding gains on securities available for sale   | 589                             | 449      |
| Reclassification adjustment for (gains) losses realized   | 185                             | (40 )    |
| Net unrealized holding losses on securities available for sale for which an other-than-temporary impairment has been recognized in income | (979 )                          | —        |
| Reclassification adjustment for other-than-temporary impairment loss recognized in income   | 34                              | —        |
| Other comprehensive income (loss) before tax  | (171 )                          | 409      |
| Income tax (provision) benefit  | 60                              | (145 )   |
| Other comprehensive income (loss) - net of tax  | (111 )                          | 264      |
| Comprehensive income  | \$ 1,377                        | \$ 1,410 |

See Notes to Condensed Consolidated Financial Statements

First Internet Bancorp

Consolidated Statements of Shareholders' Equity - Unaudited

Three Months Ended March 31, 2013

(Dollar Amounts in Thousands except per share data)

|   | Voting and<br>Nonvoting<br>Common<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Income | Retained<br>Earnings | Total<br>Shareholders'<br>Equity |
|---|--|---|----------------------|----------------------------------|
| Balance, January 1, 2013                    | \$ 41,508                                  | \$ 1,818  | \$ 18,024            | \$ 61,350                        |
| Net income                                  |  |   | 1,488                | 1,488                            |
| Other comprehensive loss                    |  | (111 )  |                      | (111 )                           |
| Cash dividends declared (\$0.06 per share)  |  |   | (113 )               | (113 )                           |
| Issuance of directors deferred stock rights | 29   |   |                      | 29                               |
| Balance, March 31, 2013                     | \$ 41,537                                  | \$ 1,707  | \$ 19,399            | \$ 62,643                        |

## First Internet Bancorp

Condensed Consolidated Statements of Cash Flows – Unaudited  
(Dollar Amounts in Thousands)

|   | Three Months Ended March 31, |           |
|---|------------------------------|-----------|
|   | 2013                         | 2012      |
| <b>Operating Activities</b>   |                              |           |
| Net income  | \$ 1,488                     | \$ 1,146  |
| Adjustments to reconcile net income to net cash from operating activities |                              |           |
| Depreciation  | 91                           | 71        |
| Amortization  | 794                          | 354       |
| Loss from real estate owned   | —                            | 21        |
| Increase in cash surrender value of life insurance                        | (97)                         | (90)      |
| Provision for loan losses   | 134                          | 570       |
| Stock compensation expense  | 29                           | 15        |
| Loss on other-than-temporary impairment of security                       | 34                           | —         |
| Loss (Gain) from sale of available-for-sale securities                    | 185                          | (40)      |
| Loans originated for sale   | (236,800)                    | (149,009) |
| Proceeds from sale of loans   | 241,449                      | 173,686   |
| Gain on loans sold  | (3,011)                      | (1,750)   |
| Changes in assets and liabilities   |                              |           |
| Accrued interest receivable   | 59                           | (119)     |
| Other assets  | (132)                        | 1,143     |
| Accrued expenses and other liabilities                                    | 12,171                       | 238       |
| Net cash used in operating activities                                     | 16,394                       | 26,236    |
| <b>Investing Activities</b>   |                              |           |
| Net change in loans   | (422)                        | 1,696     |
| Net change in interest bearing time deposits                              | (1,500)                      | —         |
| Loans purchased   | —                            | (9,737)   |
| Life insurance purchased  | —                            | (3,000)   |
| Proceeds from liquidation of real estate owned                            | —                            | 29        |
| Maturities of securities available for sale                               | 13,657                       | 6,580     |
| Proceeds from sale of securities available for sale                       | 41,834                       | 2,082     |
| Purchase of securities available for sale                                 | (64,231)                     | (33,033)  |
| Purchase of premise and equipment   | (4,815)                      | (223)     |
| Net cash used in investing activities                                     | (15,477)                     | (35,606)  |
| <b>Financing Activities</b>   |                              |           |
| Net increase in deposits  | 15,976                       | 24,708    |
| Repayment of FHLB advances  | (15,000)                     | —         |
| Net cash provided by financing activities                                 | 976                          | 24,708    |
| Net Increase in Cash and Cash Equivalents                                 | 1,893                        | 15,338    |
| Cash and Cash Equivalents, Beginning of Period                            | 32,513                       | 34,778    |
| Cash and Cash Equivalents, End of Period                                  | \$ 34,406                    | \$ 50,116 |
| <b>Supplemental Disclosures of Cash Flows Information</b>                 |                              |           |

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|  |          |          |
|--|----------|----------|
| Cash paid during the period for interest | \$ 1,965 | \$ 2,177 |
| Cash paid during the period for taxes    | 50       | —        |
| Loans transferred to real estate owned   | —        | —        |

See Notes to Condensed Consolidated Financial Statements

First Internet Bancorp

Notes to Condensed Consolidated Financial Statements – Unaudited  
**(Dollar Amounts in Thousands except shares and per share data)**

Note 1:

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information or footnotes necessary for a complete presentation of financial condition, results of operations, or cash flows in accordance with U.S. generally accepted accounting principles (“GAAP”). In our opinion, all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation have been included. The results of operations for the three months ended March 31, 2013 are not necessarily indicative of the results expected for the year ending December 31, 2013 or any other period. The March 31, 2013 condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the First Internet Bancorp Annual Report on Form 10-K for the year ended December 31, 2012.

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

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

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

Certain reclassifications have been made to the 2012 financial statements to conform to the 2013 financial statement presentation. These reclassifications had no effect on net income.

## Note 2:

## Earnings Per Share

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

The following is a reconciliation of the weighted-average common shares for the basic and diluted earnings per share computations for the three months ended March 31, 2013 and 2012:

|  | Three Months Ended<br>March 31, |           |
|--|---------------------------------|-----------|
|  | 2013                            | 2012      |
| Basic earnings per share   |                                 |           |
| Weighted-average common shares   | 1,924,148                       | 1,909,723 |
| Diluted earnings per share   |                                 |           |
| Weighted-average common shares   | 1,924,148                       | 1,909,723 |
| Dilutive effect of stock compensation  | —                               | —         |
| Dilutive effect of stock options   | —                               | —         |
| Weighted-average common and incremental shares   | 1,924,148                       | 1,909,723 |
| Number of stock options excluded from the calculation of earnings per share as the options' exercise prices were greater than the average market price of the Company's common stock | —                               | 90,000    |

## First Internet Bancorp

Notes to Condensed Consolidated Financial Statements – Unaudited  
(Dollar Amounts in Thousands except per share data)

## Note 3:

## Securities

Securities at March 31, 2013 and December 31, 2012 are as follows:

|  | <b>March 31, 2013</b>     |                        |                              |                       |
|--|---------------------------|------------------------|------------------------------|-----------------------|
|  | <b>Amortized<br/>Cost</b> | <b>Gross<br/>Gains</b> | <b>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> |
| Securities available for sale  |                           |                        |                              |                       |
| U.S. government-sponsored enterprises  | \$49,495                  | \$918                  | \$(28 )                      | \$50,385              |
| Municipals   | 37,671                    | 2,261                  | (76 )                        | 39,856                |
| Mortgage-backed and asset-backed securities – government-sponsored enterprises | 47,957                    | 1,475                  | (34 )                        | 49,398                |
| Mortgage-backed and asset-backed securities – private labeled                  | 2,300                     | 13                     | (114 )                       | 2,199                 |
| Other securities   | 24,226                    | 138                    | (1,927 )                     | 22,437                |
| Total available for sale   | \$161,649                 | \$4,805                | \$(2,179 )                   | \$164,275             |
|  |                           |                        |                              |                       |
|  | <b>December 31, 2012</b>  |                        |                              |                       |
|  | <b>Amortized<br/>Cost</b> | <b>Gross<br/>Gains</b> | <b>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> |
| Securities available for sale  |                           |                        |                              |                       |
| U.S. government-sponsored enterprises  | \$18,666                  | \$953                  | \$(1 )                       | \$19,618              |
| Municipals   | 39,999                    | 2,685                  | (144 )                       | 42,540                |
| Mortgage-backed and asset-backed securities – government-sponsored enterprises | 75,782                    | 1,884                  | (177 )                       | 77,489                |
| Mortgage-backed and asset-backed securities – private labeled                  | 2,696                     | 17                     | (260 )                       | 2,453                 |
| Other securities   | 16,753                    | 105                    | (2,265 )                     | 14,593                |
| Total available for sale   | \$153,896                 | \$5,644                | \$(2,847 )                   | \$156,693             |

The carrying value of securities at March 31, 2013 is shown below by their contractual maturity date. Actual maturities will differ because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

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|  | Available for Sale<br>Amortized Fair |           |
|--|--------------------------------------|-----------|
|  | Cost                                 | Value     |
| Within one year  | \$2,056                              | \$2,101   |
| One to five years  | 26,213                               | 26,343    |
| Five to ten years  | 30,813                               | 31,279    |
| After ten years  | 52,310                               | 52,955    |
|  | 111,392                              | 112,678   |
| Mortgage-backed and asset-backed securities – government-sponsored enterprises | 47,957                               | 49,398    |
| Mortgage-backed and asset-backed securities – private labeled                  | 2,300                                | 2,199     |
| Totals   | \$161,649                            | \$164,275 |

Gross gains of \$102 and \$40, and gross losses of \$287 and \$0 resulting from sales of available-for-sale securities were realized for March 31, 2013 and 2012, respectively.



First Internet Bancorp

Notes to Condensed Consolidated Financial Statements – Unaudited  
(Dollar Amounts in Thousands except per share data)

Certain investments in debt securities are reported in the condensed consolidated financial statements at an amount less than their historical cost. Total fair value of these investments at March 31, 2013 and December 31, 2012 was \$31,079 and \$41,986, which is approximately 19% and 27%, respectively, of the Company’s available-for-sale investment portfolio. These declines primarily resulted from fluctuations in market interest rates after purchase.

Except as discussed below, management believes the declines in fair value for these securities are temporary.

Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other-than-temporary impairment (“OTTI”) is identified.

The following tables show the Company’s investments’ gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at March 31, 2013 and December 31, 2012:

|  | March 31, 2013      |                   |                     |                   |            |                   |
|--|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
|  | Less Than 12 Months |                   | 12 Months or Longer |                   | Total      |                   |
|  | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |
| Securities available for sale:   |                     |                   |                     |                   |            |                   |
| U.S. government-sponsored enterprises  | \$ 11,443           | \$ (28 )          | \$ 22               | \$ —              | \$ 11,465  | \$ (28 )          |
| Municipals   | 1,046               | (68 )             | 1,068               | (8 )              | 2,114      | (76 )             |
| Mortgage-backed and asset-backed securities - government-sponsored enterprises | 4,962               | (34 )             | —                   | —                 | 4,962      | (34 )             |
| Mortgage-backed and asset-backed securities – private labeled                  | —                   | —                 | 1,405               | (114 )            | 1,405      | (114 )            |
| Other securities   | 7,984               | (41 )             | 3,149               | (1,886 )          | 11,133     | (1,927 )          |
|  | \$ 25,435           | \$ (171 )         | \$ 5,644            | \$ (2,008 )       | \$ 31,079  | \$ (2,179 )       |

December 31, 2012

12 Months or Longer Total

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|   | Less Than 12<br>Months |                      |               |                      |               |                      |
|---|------------------------|----------------------|---------------|----------------------|---------------|----------------------|
|   | Fair<br>Value          | Unrealized<br>Losses | Fair<br>Value | Unrealized<br>Losses | Fair<br>Value | Unrealized<br>Losses |
| Securities available for sale:  |                        |                      |               |                      |               |                      |
| U.S. government-sponsored enterprises   | \$—                    | \$ —                 | \$ 119        | \$ (1 )              | \$ 119        | \$ (1 )              |
| Municipals  | 470                    | (4 )                 | 2,618         | (140 )               | 3,088         | (144 )               |
| Mortgage-backed and asset-backed securities -<br>government-sponsored enterprises | 28,505                 | (177 )               | —             | —                    | 28,505        | (177 )               |
| Mortgage-backed and asset-backed securities –<br>private labeled                  | —                      | —                    | 1,504         | (260 )               | 1,504         | (260 )               |
| Other securities  | 5,947                  | (53 )                | 2,823         | (2,212 )             | 8,770         | (2,265 )             |
|   | \$34,922               | \$ (234 )            | \$ 7,064      | \$ (2,613 )          | \$ 41,986     | \$ (2,847 )          |

Municipals

The unrealized losses on the Company's investments in municipal securities were caused by interest rate changes. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Company does not intend to sell the investments and it is unlikely the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other than temporarily impaired at March 31, 2013.

First Internet Bancorp

Notes to Condensed Consolidated Financial Statements – Unaudited  
(Dollar Amounts in Thousands except per share data)

Mortgage-Backed Securities

The unrealized losses on the Company's investment in mortgage-backed securities were caused by interest rate changes. The Company expects to recover the amortized cost basis over the term of the securities. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is unlikely the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other than temporarily impaired at March 31, 2013.

Other Securities

The Company's unrealized loss on investments in other securities is primarily made up of two investments. The first investment is a \$2,000 par investment in I-PreTSL I B-2 pooled trust security. The unrealized loss was primarily caused by a sector downgrade by several industry analysts. The Company currently expects to recover the entire amortized cost basis of the investment. The determination of no credit loss was calculated by comparing expected discounted cash flows based on performance indicators of the underlying assets in the security to the carrying value of the investment. Because the Company does not intend to sell the investment and it is unlikely the Company will be required to sell the investment before recovery of its amortized cost basis, which may be maturity, it does not consider the remainder of the investment to be other than temporarily impaired at March 31, 2013. The second investment is discussed in the next section.

Other-Than-Temporary Impairment

The Company routinely conducts periodic reviews to identify and evaluate investment securities to determine whether an OTTI has occurred. For certain investments, economic models are used to determine whether an OTTI has occurred on these securities.

An OTTI has been recognized on a \$2,000 par investment in ALESCO IV Series B2 pooled trust security. The unrealized loss was primarily caused by (a) a decrease in performance and (b) a sector downgrade by several industry analysts. The Company currently expects ALESCO IV to settle the security at a price less than the contractual amount of the investment (that is, the Company expects to recover less than the entire amortized cost basis of the security). The Company has recognized a loss equal to the credit loss, establishing a new, lower amortized cost basis. The credit loss was calculated by comparing expected discounted cash flows based on performance indicators of the underlying assets in the security to the carrying value of the investment. Because the Company does not intend to sell the investment and it is unlikely the Company will be required to sell the investment before recovery of its new, lower amortized cost basis, which may be maturity, it does not consider the remainder of the investment in ALESCO IV to be other than temporarily impaired at March 31, 2013.

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

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

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The credit losses recognized in earnings during the three months ended March 31, 2013 and 2012 were as follows:

|   | Three Months Ended March 31, |      |
|---|------------------------------|------|
|   | 2013                         | 2012 |
| ALESCO IV Series B2   | \$ —                         | \$ — |
| I-PreTSL I B-2  | —                            | —    |
| Mortgage-backed and asset-backed securities – private labeled | 34                           | —    |
|   | \$ 34                        | \$ — |

Credit Losses Recognized on Investments

Certain debt securities have experienced fair value deterioration due to credit losses, as well as due to other market factors, but are not otherwise other than temporarily impaired.

The following table provides information about debt securities for which only a credit loss was recognized in income and other losses are recorded in other comprehensive loss.

|   | Accumulated Credit Losses |        |
|---|---------------------------|--------|
| Credit losses on debt securities held   |                           |        |
| January 1, 2013   | \$                        | 1,737  |
| Realized losses related to other-than-temporary impairments                         |                           | (266 ) |
| Additions related to other-than-temporary losses not previously recognized          |                           | 31     |
| Additions related to increases in previously recognized other-than-temporary losses |                           | 3      |
| March 31, 2013  | \$                        | 1,505  |

|   |    | <b>Accumulated Credit<br/>Losses</b> |
|---|----|--------------------------------------|
| Credit losses on debt securities held   |    |                                      |
| January 1, 2012   | \$ | 1,835                                |
| Realized losses related to other-than-temporary impairments                         |    | —                                    |
| Additions related to other-than-temporary losses not previously recognized          |    | —                                    |
| Additions related to increases in previously recognized other-than-temporary losses |    | —                                    |
| March 31, 2012  | \$ | 1,835                                |

Amounts reclassified from accumulated other comprehensive income and the affected line items in the statements of income during the three months ended March 31, 2013 and 2012, were as follows:

|   | Amounts<br>Reclassified<br>from<br>Accumulated<br>Other<br>Comprehensive<br>Income for the<br>Three Months<br>Ended March<br>31, |       | <b>Affected Line Item in the Statements of</b>                |
|---|--|-------|---|
|   | <b>2013</b>  | 2012  | <b>Income</b>   |
| Securities available for sale   |  |       |   |
| Gain (loss) realized in earnings                                      | \$ (185 )  | \$ 40 | Gain (loss) on sale of securities                             |
| OTTI losses recognized in earnings                                    | (34 )  | —     | Other-than-temporary impairment loss recognized in net income |
| Total reclassified amount before tax                                  | (219 )   | 40    | Income Before Income Taxes                                    |
| Tax (expense) benefit   | 77   | (14 ) | Income Tax Provision  |
| Total reclassifications out of Accumulated Other Comprehensive Income | \$ (142 )  | \$ 26 | Net Income  |

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## Note 4:

## Loans Receivable

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

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

Categories of loans include:

|   | March 31, 2013 | December 31, 2012 |
|---|----------------|-------------------|
| Real estate loans   |                |                   |
| Residential   | \$ 124,290     | \$ 128,815        |
| Commercial  | 89,347         | 84,918            |
| Total real estate loans   | 213,637        | 213,733           |
| Commercial loans  | 19,744         | 14,271            |
| Consumer loans  | 121,500        | 126,486           |
| Total loans   | 354,881        | 354,490           |
| Deferred loan origination costs and premiums and discounts on purchased loans | 3,483          | 3,671             |
| Allowance for loan losses   | (5,748 )       | (5,833 )          |
| Total net loans   | \$ 352,616     | \$ 352,328        |

The risk characteristics of each loan portfolio segment are as follows:

**Commercial Real Estate:** These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts, and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company's commercial real estate portfolio are diverse in terms of property type and geographic location. Management monitors and evaluates commercial real estate loans based on property financial performance, collateral value and other risk grade criteria. As a general rule, the Company avoids financing special use projects or properties outside of its designated market areas unless other underwriting factors are present to help mitigate risk. In addition, management tracks the level of owner-occupied commercial real estate loans versus nonowner-occupied loans.

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

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



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Allowance for Loan Losses Methodology

Company policy is designed to ensure that an adequate allowance for loan losses (“ALLL”) is maintained. The portfolio is segmented by loan type. The required ALLL for types of performing homogeneous loans which do not have a specific reserve is determined by applying a factor based on historical losses averaged over the past 12 months. Management believes the historical loss experience methodology is appropriate in the current economic environment, as it captures loss rates that are comparable to the current period being analyzed. Management adds qualitative factors for observable trends, changes in internal practices, changes in delinquencies and impairments, and, finally, external factors. Observable factors include changes in the composition and size of portfolios, as well as loan terms or concentration levels. We evaluate the impact of internal changes such as management and staff experience levels or modification to loan review processes. Delinquency trends are scrutinized for both volume and severity of past due, nonaccrual, classified or graded loans as well as any changes in the value of underlying collateral. Finally, we consider the effect of other external factors such as national, regional and local economic and business conditions, as well as competitive, legal and regulatory requirements. All criticized, classified and impaired loans are evaluated for impairment by applying at least one of three methodologies: present value of future cash flows; fair value of collateral less cost to sell; or the loan’s observable market price. All troubled debt restructurings (“TDR”) are considered impaired loans. Loans evaluated for impairment are removed from other pools to prevent double-counting.

Provision for Loan Losses

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

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

Policy for Charging Off Loans

The Company's policy is to charge off a loan at any point in time when it no longer can be considered a bankable asset, meaning collectable within the parameters of policy. A secured loan is generally charged off to the estimated fair value of the collateral no later than when it is 120 days past due as to principal or interest. An unsecured loan generally is charged off no later than when it is 180 days past due as to principal or interest. All charge-offs are approved by the Chief Credit Officer.

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The following tables present the balance in the ALLL and the recorded investment in loans based on portfolio segment and impairment method as of March 31, 2013, December 31, 2012 and March 31, 2012:

|                                       | March 31, 2013                |                           |            |            |            |
|---------------------------------------|-------------------------------|---------------------------|------------|------------|------------|
|                                       | Residential<br>Real<br>Estate | Commercial<br>Real Estate | Commercial | Consumer   | Total      |
| Allowance for loan losses:            |                               |                           |            |            |            |
| Balance, beginning of year            | \$ 1,149                      | \$ 3,107                  | \$ 371     | \$ 1,206   | \$ 5,833   |
| Provision charged to expense          | (81 )                         | (25 )                     | 95         | 145        | 134        |
| Losses charged off                    | (54 )                         | —                         | —          | (236 )     | (290 )     |
| Recoveries                            | 8                             | —                         | —          | 63         | 71         |
| Balance, end of year                  | 1,022                         | 3,082                     | 466        | 1,178      | 5,748      |
| Ending balance:                       |                               |                           |            |            |            |
| individually evaluated for impairment | 11                            | 680                       | —          | 64         | 755        |
| Ending balance:                       |                               |                           |            |            |            |
| collectively evaluated for impairment | \$ 1,011                      | \$ 2,402                  | \$ 466     | \$ 1,114   | \$ 4,993   |
| Loans:                                |                               |                           |            |            |            |
| Ending balance                        | \$ 124,290                    | \$ 89,347                 | \$ 19,744  | \$ 121,500 | \$ 354,881 |
| Ending balance:                       |                               |                           |            |            |            |
| individually evaluated for impairment | 2,272                         | 2,465                     | —          | 476        | 5,213      |
| Ending balance:                       |                               |                           |            |            |            |
| collectively evaluated for impairment | \$ 122,018                    | \$ 86,882                 | \$ 19,744  | \$ 121,024 | \$ 349,668 |

|                                       | March 31, 2012                |                           |            |          |          |
|---------------------------------------|-------------------------------|---------------------------|------------|----------|----------|
|                                       | Residential<br>Real<br>Estate | Commercial<br>Real Estate | Commercial | Consumer | Total    |
| Allowance for loan losses:            |                               |                           |            |          |          |
| Balance, beginning of year            | \$ 1,099                      | \$ 2,485                  | \$ 333     | \$ 1,739 | \$ 5,656 |
| Provision charged to expense          | 181                           | 79                        | 97         | 213      | 570      |
| Losses charged off                    | (129 )                        | —                         | —          | (450 )   | (579 )   |
| Recoveries                            | 9                             | —                         | —          | 132      | 141      |
| Balance, end of year                  | 1,160                         | 2,564                     | 430        | 1,634    | 5,788    |
| Ending balance:                       |                               |                           |            |          |          |
| individually evaluated for impairment | 350                           | 1,328                     | —          | 15       | 1,693    |
| Ending balance:                       |                               |                           |            |          |          |
| collectively evaluated for impairment | \$ 810                        | \$ 1,236                  | \$ 430     | \$ 1,619 | \$ 4,095 |



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|  | December 31, 2012             |                           |            |            |            |
|--|-------------------------------|---------------------------|------------|------------|------------|
|  | Residential<br>Real<br>Estate | Commercial<br>Real Estate | Commercial | Consumer   | Total      |
| Loans:   |                               |                           |            |            |            |
| Ending balance   | \$ 128,815                    | \$ 84,918                 | \$ 14,271  | \$ 126,486 | \$ 354,490 |
| Ending balance:<br>individually evaluated for impairment | 2,482                         | 2,467                     | —          | 474        | 5,423      |
| Ending balance:<br>collectively evaluated for impairment | \$ 126,333                    | \$ 82,451                 | \$ 14,271  | \$ 126,012 | \$ 349,067 |

The Company utilizes a risk grading matrix to assign a risk grade to each of its commercial loans. Loans are graded on a scale of 1 to 8. A description of the general characteristics of the 8 risk grades is as follows:

Grades 1 & 2 - These grades are assigned to loans with very high credit quality borrowers of investment or near investment grade or where the loan is primarily secured by cash or conservatively margined high quality marketable securities. These borrowers are generally publicly traded, have significant capital strength, possess investment grade public debt ratings, demonstrate low leverage, exhibit stable earnings and growth and have ready access to various financing alternatives.

Grades 3 & 4 - Loans assigned these grades include loans to borrowers possessing solid credit quality with acceptable risk. Borrowers in these grades are differentiated from higher grades on the basis of size (capital and/or revenue), leverage, asset quality, stability of the industry or specific market area and quality/coverage of collateral. These borrowers generally have a history of consistent earnings and reasonable leverage.

Grade 5 - This grade includes “pass grade” loans to borrowers which require special monitoring because of deteriorating financial results, declining credit ratings, decreasing cash flow, increasing leverage, marginal collateral coverage or industry stress that has resulted or may result in a changing overall risk profile.

Grade 6 - This grade is for “Special Mention” loans in accordance with regulatory guidelines. This grade is intended to include loans to borrowers whose credit quality has clearly deteriorated and where risk of further decline is possible unless active measures are taken to correct the situation. Weaknesses are considered potential at this state and are not yet fully defined.

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Grade 7 - This grade includes “Substandard” loans in accordance with regulatory guidelines. Loans categorized in this grade possess a well-defined credit weakness, and the likelihood of repayment from the primary source is uncertain. Significant financial deterioration has occurred, and very close attention is warranted to ensure the full repayment without loss. Collateral coverage may be marginal, and the accrual of interest has been suspended.

Grade 8 - This grade includes “Doubtful” loans in accordance with regulatory guidelines. Such loans have been placed on nonaccrual status and may be heavily dependent upon collateral possessing a value that is difficult to determine or based upon some near-term event which lacks clear certainty. These loans have all of the weaknesses of those classified as Substandard; however, based on existing conditions, these weaknesses make full collection of the principal balance highly improbable.

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Nonaccrual Loans

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

The following tables present the credit risk profile of the Company's loan portfolio based on rating category and payment activity as of March 31, 2013 and December 31, 2012:

|                   | March 31, 2013 |            |
|-------------------|----------------|------------|
|                   | Commercial     |            |
|                   | Real Estate    | Commercial |
| Rating:           |                |            |
| 1-5 Pass          | \$85,253       | \$ 19,361  |
| 6 Special Mention | 1,629          | 383        |
| 7 Substandard     | 2,465          | —          |
| 8 Doubtful        | —              | —          |
| Total             | \$89,347       | \$ 19,744  |

  

|                            | March 31, 2013 |           |
|----------------------------|----------------|-----------|
|                            | Residential    |           |
|                            | Real Estate    | Consumer  |
| Performing                 | \$123,101      | \$121,323 |
| Nonperforming (nonaccrual) | 1,189          | 177       |
| Total                      | \$124,290      | \$121,500 |

  

|  | December 31, 2012 |            |
|--|-------------------|------------|
|  | Commercial        |            |
|  | Real Estate       | Commercial |

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|                   | Estate    |           |
|-------------------|-----------|-----------|
| Rating:           |           |           |
| 1-5 Pass          | \$ 80,830 | \$ 13,860 |
| 6 Special Mention | 1,621     | 411       |
| 7 Substandard     | 2,467     | —         |
| 8 Doubtful        | —         | —         |
| Total             | \$ 84,918 | \$ 14,271 |

|                            | December 31, 2012 |            |
|----------------------------|-------------------|------------|
|                            | Residential       |            |
|                            | Real              | Consumer   |
|                            | Estate            |            |
| Performing                 | \$ 127,426        | \$ 126,331 |
| Nonperforming (nonaccrual) | 1,389             | 155        |
| Total                      | \$ 128,815        | \$ 126,486 |



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The following tables present the Company's loan portfolio aging analysis as of March 31, 2013 and December 31, 2012:

|                   | March 31, 2013               |                           |                                | Total<br>Past Due | Current   | Total<br>Loans<br>Receivable | Nonaccrual<br>Loans | Total Loans<br>90 Days or<br>More Past Due<br>and Accruing |
|-------------------|------------------------------|---------------------------|--------------------------------|-------------------|-----------|------------------------------|---------------------|--|
|                   | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past Due | 90 Days<br>or More<br>Past Due |                   |           |                              |                     |  |
| Real estate loans |                              |                           |                                |                   |           |                              |                     |  |
| Residential       | \$485                        | \$ 185                    | \$ 1,056                       | \$ 1,726          | \$122,564 | \$ 124,290                   | \$ 1,189            | \$ —   |
| Commercial        | —                            | —                         | 2,362                          | 2,362             | 86,985    | 89,347                       | 2,362               | —  |
| Commercial        | —                            | —                         | —                              | —                 | 19,744    | 19,744                       | —                   | —  |
| Consumer          | 676                          | 83                        | 129                            | 888               | 120,612   | 121,500                      | 177                 | 44   |
| Total             | \$1,161                      | \$ 268                    | \$ 3,547                       | \$ 4,976          | \$349,905 | \$ 354,881                   | \$ 3,728            | \$ 44  |

|                   | December 31, 2012            |                           |                                | Total<br>Past Due | Current   | Total<br>Loans<br>Receivable | Nonaccrual<br>Loans | Total Loans<br>90 Days or<br>More Past Due<br>and Accruing |
|-------------------|------------------------------|---------------------------|--------------------------------|-------------------|-----------|------------------------------|---------------------|--|
|                   | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past Due | 90 Days<br>or More<br>Past Due |                   |           |                              |                     |  |
| Real estate loans |                              |                           |                                |                   |           |                              |                     |  |
| Residential       | \$130                        | \$ 5                      | \$ 1,555                       | \$ 1,690          | \$127,125 | \$ 128,815                   | \$ 1,389            | \$ 450   |
| Commercial        | —                            | —                         | 2,362                          | 2,362             | 82,556    | 84,918                       | 2,362               | —  |
| Commercial        | —                            | —                         | —                              | —                 | 14,271    | 14,271                       | —                   | —  |
| Consumer          | 1,025                        | 148                       | 122                            | 1,295             | 125,191   | 126,486                      | 155                 | 21   |
| Total             | \$1,155                      | \$ 153                    | \$ 4,039                       | \$ 5,347          | \$349,143 | \$ 354,490                   | \$ 3,906            | \$ 471   |

## Impaired Loans

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

accrual of interest on impaired and nonaccrual loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due.

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

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The following tables present the Company's impaired loans as of March 31, 2013, December 31, 2012 and March 31, 2012:

|  | March 31, 2013 |           |           |          |          |
|--|----------------|-----------|-----------|----------|----------|
|  | Recorded       | Unpaid    | Specific  | Average  | Interest |
|  | Balance        | Principal | Allowance | Balance  | Income   |
|  |                | Balance   |           |          |          |
| Loans without a specific valuation allowance |                |           |           |          |          |
| Residential real estate loans                | \$2,244        | \$ 2,604  | \$ —      | \$ 2,145 | \$ 7     |
| Commercial real estate loans                 | —              | —         | —         | —        | —        |
| Commercial loans                             | —              | —         | —         | —        | —        |
| Consumer loans                               | 350            | 582       | —         | 365      | —        |
| Total  | 2,594          | 3,186     | —         | 2,510    | 7        |
| Loans with a specific valuation allowance    |                |           |           |          |          |
| Residential real estate loans                | 28             | 35        | 11        | 232      | —        |
| Commercial real estate loans                 | 2,465          | 2,924     | 680       | 2,466    | 1        |
| Commercial loans                             | —              | —         | —         | —        | —        |
| Consumer loans                               | 126            | 193       | 64        | 110      | —        |
| Total  | 2,619          | 3,152     | 755       | 2,808    | 1        |
| Total impaired loans                         |                |           |           |          |          |
| Residential real estate loans                | 2,272          | 2,639     | 11        | 2,377    | 7        |
| Commercial real estate loans                 | 2,465          | 2,924     | 680       | 2,466    | 1        |
| Commercial loans                             | —              | —         | —         | —        | —        |
| Consumer loans                               | 476            | 775       | 64        | 475      | —        |
| Total  | \$5,213        | \$ 6,338  | \$ 755    | \$ 5,318 | \$ 8     |

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|  | December 31, 2012   |                                | March 31, 2012        |                    |                    |
|--|---------------------|--------------------------------|-----------------------|--------------------|--------------------|
|  | Recorded<br>Balance | Unpaid<br>Principal<br>Balance | Specific<br>Allowance | Average<br>Balance | Interest<br>Income |
| Loans without a specific valuation allowance |                     |                                |                       |                    |                    |
| Residential real estate loans                | \$2,047             | \$ 2,357                       | \$ —                  | \$ 1,112           | \$ —               |
| Commercial real estate loans                 | —                   | —                              | —                     | —                  | —                  |
| Commercial loans                             | —                   | —                              | —                     | —                  | —                  |
| Consumer loans                               | 380                 | 577                            | —                     | 361                | —                  |
| Total  | 2,427               | 2,934                          | —                     | 1,473              | —                  |
| Loans with a specific valuation allowance    |                     |                                |                       |                    |                    |
| Residential real estate loans                | 435                 | 442                            | 206                   | 645                | 5                  |
| Commercial real estate loans                 | 2,467               | 2,925                          | 682                   | 7,634              | 2                  |
| Commercial loans                             | —                   | —                              | —                     | —                  | —                  |
| Consumer loans                               | 94                  | 206                            | 54                    | 88                 | —                  |
| Total  | 2,996               | 3,573                          | 942                   | 8,367              | 7                  |
| Total impaired loans                         |                     |                                |                       |                    |                    |
| Residential real estate loans                | 2,482               | 2,799                          | 206                   | 1,757              | 5                  |
| Commercial real estate loans                 | 2,467               | 2,925                          | 682                   | 7,634              | 2                  |
| Commercial loans                             | —                   | —                              | —                     | —                  | —                  |
| Consumer loans                               | 474                 | 783                            | 54                    | 449                | —                  |
| Total  | \$5,423             | \$ 6,507                       | \$ 942                | \$ 9,840           | \$ 7               |

## Troubled Debt Restructurings (TDR)

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

When loans are modified in a TDR, any possible impairment similar to other impaired loans is evaluated based on the present value of expected future cash flows, discounted at the contractual interest rate of the original loan agreement, or use the current fair value of the collateral, less selling costs for collateral dependent loans. If it is determined that the value of the modified loan is less than the recorded balance of the loan, impairment is recognized through a

specific allowance or charge-off to the allowance. In periods subsequent to modification, all TDRs, including those that have payment defaults, are evaluated for possible impairment, and impairment is recognized through the allowance.

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(Dollar Amounts in Thousands except per share data)

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

Loans classified as a TDR during the three months ended March 31, 2013 consisted of two consumer loans with a recorded balance of \$2 before and after the modification. There were no loans classified as a TDR during the three months ended March 31, 2012. The 2013 modifications consisted solely of maturity date concessions. Payment extensions have proven to be successful in optimizing the overall collectability of the loan by increasing the period of time that the borrower is able to make required payments to the Company.

There were no TDR loans which had payment defaults during the three months ended March 31, 2013 and 2012. Default occurs when a loan is 90 days or more past due or transferred to nonaccrual within 12 months of restructuring.

## Note 5:

## Premises and Equipment

Premises and equipment at March 31, 2013 and December 31, 2012 consisted of the following:

|                               | March 31, 2013 | December 31, 2012 |
|-------------------------------|----------------|-------------------|
| Land                          | \$ 2,500       | \$ —              |
| Building and improvements     | 1,583          | —                 |
| Furniture and equipment       | 3,448          | 3,521             |
| Less accumulated depreciation | (2,683)        | (2,728)           |
|                               | \$ 4,848       | \$ 793            |

The \$1,583 cost basis of the building is being depreciated on a straight-line basis over 39 years.

Note 6:

Goodwill

The change in the carrying amount of goodwill for the periods ended March 31, 2013 and December 31, 2012 were:

|                                       |         |
|---------------------------------------|---------|
| Balance as of January 1, 2012         | \$4,687 |
| Changes in goodwill during the year   | —       |
| Balance as of December 31, 2012       | 4,687   |
| Changes in goodwill during the period | —       |
| Balance as of March 31, 2013          | \$4,687 |

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(Dollar Amounts in Thousands except per share data)

Note 7:

Benefit Plans

Employment Agreements

The Company has entered into employment agreements with certain officers that provide for the continuation of salary and certain benefits for a specified period of time under certain conditions. Under the terms of the agreements, these payments could occur in the event of a change in control of the Company, as defined, along with other specific conditions.

Stock Options

The Company has a qualified stock option plan for Directors and key employees of the Company (“Stock Option Plan”) and has reserved 400,000 shares of common stock that may be issued pursuant to the Stock Option Plan. The option exercise price per share is the fair value of a share on the date of grant, and the stock options become exercisable in a series of three equal and successive annual installments, with the first one-third vesting at the end of one year measured from the grant date of the option. Each option grant expires within ten years of the grant date. The options are nontransferable and are forfeited upon termination of employment. There are no options outstanding as of March 31, 2013.

Directors Deferred Stock Plan

The Company has adopted a stock compensation plan for members of the Board of Directors (Directors Deferred Stock Plan). The Company has reserved 120,000 shares of common stock that may be issued pursuant to the Directors Deferred Stock Plan. The plan provides directors the option to elect to receive up to 100% of their annual retainer in either common stock or deferred stock rights. Monthly meeting fees are paid in cash. The deferred stock right is payable to the director on the basis of one common share for each deferred stock right. Director compensation totaled \$46 and \$27 for the three months ended March 31, 2013 and 2012, respectively, of which \$30 and \$15 for the three months ended March 31, 2013 and 2012, respectively, were paid in either common stock or deferred stock rights. The common stock and deferred stock rights are granted on January 1 at fair value and vest from January 1 until December



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31. The Company recognizes compensation expense ratably over the vesting period based upon the fair value of the stock on the grant date.

The following is an analysis of deferred stock rights and common stock related to the Directors Deferred Stock Plan for the three months ended March 31, 2013:

|                                  | Three months ended March 31, 2013 |                  |
|----------------------------------|-----------------------------------|------------------|
|                                  | Deferred<br>Rights                | Common<br>Shares |
| Outstanding, beginning of period | 46,876                            |                  |
| Granted                          | 5,646                             |                  |
| Exercised                        | —                                 |                  |
| Outstanding, end of period       | 52,522                            |                  |

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Note 8: Fair Value of Financial Instruments

Accounting Standards Codification Topic 820, *Fair Value Measurements*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Topic 820 also specifies a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

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

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

**Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

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

Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid mutual funds. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows.

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Level 2 securities include U.S. government-sponsored enterprises, mortgage and asset-backed securities and obligations of state, municipals and certain corporate securities. Matrix pricing is a mathematical technique widely used in the banking industry to value investment securities without relying exclusively on quoted prices for specific investment securities but rather relying on the investment securities' relationship to other benchmark quoted investment securities.

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

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## Notes to Condensed Consolidated Financial Statements – Unaudited

(Dollar Amounts in Thousands except per share data)

The following tables present the fair value measurements of securities available for sale recognized in the accompanying condensed consolidated balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at March 31, 2013 and December 31, 2012:

|  | Fair Value | March 31, 2013<br>Fair Value Measurements Using                |   |   |
|--|------------|--|---|---|
|  |            | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| U.S. government-sponsored enterprises  | \$50,385   | \$ —   | \$ 50,385                                     | \$ —                                      |
| Municipals   | 39,856     | —  | 39,856  | —   |
| Mortgage-backed and asset-backed securities - government-sponsored enterprises | 49,398     | —  | 49,398  | —   |
| Mortgage-backed and asset-backed securities - private labeled                  | 2,199      | —  | 2,199   | —   |
| Other securities   | 22,437     | 1,542  | 19,727  | 1,168                                     |
|  | \$164,275  | \$ 1,542   | \$ 161,565                                    | \$ 1,168                                  |

  

|                                       | Fair Value | December 31, 2012<br>Fair Value Measurements Using             |   |   |
|---------------------------------------|------------|--|---|---|
|                                       |            | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| U.S. government-sponsored enterprises | \$19,618   | \$ —   | \$ 19,618                                     | \$ —                                      |

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|   |            |          |            |        |
|---|------------|----------|------------|--------|
| Municipals  | 42,540     | —        | 42,540     | —      |
| Mortgage-backed and asset-backed securities -<br>government-sponsored enterprises | 77,489     | —        | 77,489     | —      |
| Mortgage-backed and asset-backed securities - private labeled                     | 2,453      | —        | 2,453      | —      |
| Other securities  | 14,593     | 1,553    | 12,200     | 840    |
|   | \$ 156,693 | \$ 1,553 | \$ 154,300 | \$ 840 |

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Notes to Condensed Consolidated Financial Statements – Unaudited

(Dollar Amounts in Thousands except per share data)

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

|  | Securities<br>Available for Sale |
|--|----------------------------------|
| Balance, January 1, 2012   | \$ 470                           |
| Total realized and unrealized gains and losses<br>Included in net income | —                                |
| Included in other comprehensive loss                                     | 55                               |
| Balance, March 31, 2012  | \$ 525                           |
| Balance, January 1, 2013   | \$ 840                           |
| Total realized and unrealized gains and losses<br>Included in net income | —                                |
| Included in other comprehensive loss                                     | 328                              |
| Balance, March 31, 2013  | \$ 1,168                         |

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

Impaired Loans (Collateral Dependent)

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

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

Impaired loans that are collateral dependent are classified within Level 3 of the fair value hierarchy when impairment is determined using the fair value method.

The following tables present the fair value measurements of impaired loans recognized in the accompanying condensed consolidated balance sheets measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fell at March 31, 2013 and December 31, 2012:

|                | March 31, 2013                |   |   |       |
|----------------|-------------------------------|---|---|-------|
|                | Fair Value Measurements Using |   |   |       |
|                | Quoted                        |   |   |       |
|                | Prices                        |   |   |       |
|                | in                            |   |   |       |
|                | Active                        |   |   |       |
|                | Markets                       |   |   |       |
|                | for                           |   |   |       |
|                | Identical                     |   |   |       |
|                | Assets                        |   |   |       |
|                | (Level                        |   |   |       |
|                | 1)                            |   |   |       |
|                | Fair Value                    | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |       |
| Impaired loans | \$ 89                         | \$ —  | \$ —                                      | \$ 89 |

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Notes to Condensed Consolidated Financial Statements – Unaudited

(Dollar Amounts in Thousands except per share data)

|                | December 31, 2012<br>Fair Value Measurements Using  |   |  |          |
|----------------|---|---|--|----------|
|                | Quoted<br>Prices<br>in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |          |
| Impaired loans | \$ 1,481  | \$ —  | \$ —   | \$ 1,481 |

Unobservable (Level 3) Inputs

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

|  | Fair Value at<br>March 31,<br>2013 | Valuation<br>Technique          | Unobservable<br>Inputs   | Range   |
|--|------------------------------------|---------------------------------|--|---|
| Other securities                       | \$ 1,168                           | Discounted cash flow            | Discount margin<br>Cumulative default %<br>Loss given default %<br>Cumulative prepayment % | 6.5% - 14%<br>2.7% -<br>100%<br>85% - 100%<br>0% - 100% |
| Collateral dependent impaired<br>loans | \$ 89                              | Market comparable<br>properties | Marketability discount   | 35%   |
|  | Fair Value at<br>December 31,      | Valuation<br>Technique          | Unobservable<br>Inputs   | Range   |



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2012

|                                     |          |                              |                         |                |
|-------------------------------------|----------|------------------------------|-------------------------|----------------|
| Other securities                    | \$ 840   | Discounted cash flow         | Discount margin         | 7% -<br>14.25% |
|                                     |          |                              | Cumulative default %    | 2.2% -<br>100% |
|                                     |          |                              | Loss given default %    | 85% - 100%     |
|                                     |          |                              | Cumulative prepayment % | 0% - 100%      |
| Collateral dependent impaired loans | \$ 1,481 | Market comparable properties | Marketability discount  | 12%            |

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

Cash and Cash Equivalents

For these instruments, the carrying amount is a reasonable estimate of fair value.

Loans Held For Sale

The fair value of these financial instruments approximates carrying value.

Loans Receivable

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

Accrued Interest Receivable

The fair value of these financial instruments approximates carrying value.

Federal Home Loan Bank Stock

The carrying amount approximates fair value.

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Notes to Condensed Consolidated Financial Statements – Unaudited

(Dollar Amounts in Thousands except per share data)

Deposits

The fair value of noninterest-bearing demand deposits and savings and NOW accounts is the amount payable as of the reporting date. The fair value of fixed maturity certificates of deposit is estimated using rates currently offered for deposits of similar remaining maturities.

FHLB Advances

The fair value of fixed rate advances is estimated using rates currently offered for similar remaining maturities.

Accrued Interest Payable

The fair value of these financial instruments approximates carrying value.

Commitments

The fair value of commitments to extend credit are based on fees currently charged to enter into similar agreements with similar maturities and interest rates. The Company determined that the fair value of commitments was zero based on the contractual value of outstanding commitments at March 31, 2013 and December 31, 2012.

The following schedule includes the carrying value and estimated fair value of all financial assets and liabilities at March 31, 2013 and December 31, 2012:

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March 31, 2013

Fair Value Measurements Using

|                                | Carrying<br>Amount | Quoted Prices<br>In Active<br>Market for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|--------------------------------|--------------------|--|---|--|
| Cash and cash equivalents      | \$34,406           | \$ 34,406  | \$ —  | \$ —   |
| Interest bearing time deposits | 1,500              | 1,500  | —   | —  |
| Loans held for sale            | 61,596             | —  | 61,596  | —  |
| Loans receivable - net         | 352,616            | —  | —   | 353,563  |
| Accrued interest receivable    | 2,137              | 2,137  | —   | —  |
| FHLB stock                     | 2,943              | 2,943  | —   | —  |
| Deposits                       | 546,667            | 315,007  | —   | 237,656  |
| FHLB advances                  | 25,713             | —  | 27,860  | —  |
| Accrued interest payable       | 91                 | 91   | —   | —  |

December 31, 2012

Fair Value Measurements Using

|                             | Carrying<br>Amount | Quoted Prices<br>In Active<br>Market for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|-----------------------------|--------------------|--|---|--|
| Cash and cash equivalents   | \$32,513           | \$ 32,513  | \$ —  | \$ —   |
| Loans held for sale         | 63,234             | —  | 63,234  | —  |
| Loans receivable - net      | 352,328            | —  | —   | 351,194  |
| Accrued interest receivable | 2,196              | 2,196  | —   | —  |
| FHLB stock                  | 2,943              | 2,943  | —   | —  |
| Deposits                    | 530,691            | 300,818  | —   | 236,375  |
| FHLB advances               | 40,686             | —  | 42,986  | —  |
| Accrued interest payable    | 120                | 120  | —   | —  |

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(Dollar Amounts in Thousands except per share data)

Note 9: Future Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2013-02 to improve the transparency of reporting reclassifications out of accumulated other comprehensive income. Other comprehensive income includes gains and losses that are initially excluded from net income for an accounting period. Those gains and losses are later reclassified out of accumulated other comprehensive income into net income. The amendments in the Update do not change the current requirements for reporting net income or other comprehensive income in financial statements. All of the information required within this Update is already required to be disclosed elsewhere in the financial statements under GAAP.

The new amendments will require an organization to:

Present (either on the face of the statement where net income is presented or in the notes) the effects on the line items of net income of significant amounts reclassified out of accumulated other comprehensive income—but only if the item reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period.

Cross-reference to other disclosures currently required under GAAP for other reclassification items (that are not required under GAAP) to be reclassified directly to net income in their entirety in the same reporting period. This would be the case when a portion of the amount reclassified out of accumulated other comprehensive income is initially transferred to a balance sheet account instead of directly to income or expense.

The amendments are effective for reporting periods beginning after December 15, 2012. The Company has adopted the methodologies prescribed by this ASU, and the ASU did not have a material effect on its financial position or results of operations.

In January 2013, the FASB issued ASU 2013-01, which clarifies the scope of transactions that are subject to the disclosures about offsetting. The Update clarifies that ordinary trade receivables and receivables are not in the scope of ASU 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities. Specifically, Update 2011-11 applies only to derivatives, repurchase agreements and reverse purchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with specific criteria contained in

FASB Accounting Standards Codification® or subject to a master netting arrangement or similar agreement. Issued in December 2011, Update 2011-11 was the result of a joint project with the International Accounting Standards Board. Its objective was to improve transparency and comparability between GAAP and International Financial Reporting Standards by requiring enhanced disclosures about financial instruments and derivative instruments that are either (1) offset on the statement of financial position or (2) subject to an enforceable master netting arrangement or similar agreement. The Board undertook this clarification project in response to concerns expressed by U.S. stakeholders about the standard's broad definition of financial instruments. After the standard was finalized, companies realized that many contracts have standard commercial provisions that would equate to a master netting arrangement, significantly increasing the cost of compliance.

On February 28, 2013, FASB issued ASU 2013-04, which provides guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this Update is fixed at the reporting date, except for obligations addressed within existing guidance in GAAP. The amendments in this Update are effective for fiscal years beginning after December 31, 2013. Early adoption is permitted. The Company will adopt the methodologies prescribed by this ASU by the date required, and does not anticipate that the ASU will have a material effect on its financial position or results of operations.

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

**Management's Discussion and Analysis of Financial Condition and Results of Operations**

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

**Overview**

First Internet Bancorp (the "Company") is the bank holding company for First Internet Bank of Indiana (the "Bank"), a nationwide provider of innovative online banking products and services to approximately 40,000 customers. First Internet Bancorp's common stock is listed on the NASDAQ Capital Market.

The Bank is an Indiana chartered bank and was the first state-chartered, FDIC-insured Internet bank. With no branch offices, the Bank has grown retail and commercial customers organically, with lending and deposit products and services that are scalable for our nationwide platform. In recent years, the Bank has been able to capitalize on the significant demand for residential mortgage refinancing, maintaining high credit quality while offering short periods to close. Commercial lending and treasury management services are primarily based in Central Indiana; however, our credit tenant lease financing is nationwide. While maintaining sufficient liquidity, we seek to minimize our cash and cash equivalents by deploying excess cash into diversified, higher yielding assets.

**Results of Operations**

**Comparison of the Three Months Ended March 31, 2013 and March 31, 2012**

During the three months ended March 31, 2013, we had net income of \$1.49 million compared to net income of \$1.15 million for the three months ended March 31, 2012. Net income attributable to common shareholders was \$0.77 per

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diluted share for the three months ended March 31, 2013 compared to \$0.60 per diluted share for the 2012 period. On March 18, 2013, the Board of Directors declared a cash dividend of \$0.06 per common share.

Other key comparisons between our operating results for the three months ended March 31, 2013 and 2012 are:

Net interest income experienced a \$114,000 decrease in the 2013 period despite the 6.4% increase in average earning assets as interest rates continued to decline due the economy and competition. Average loans increased 12.4% at March 31, 2013, offsetting the 29 basis point reduction in rates during the 2013 period. The lower rate environment also drove prepayments in our mortgage-backed securities portfolio resulting in accelerated premium amortization and calls on our agency securities. Management rebalanced the securities portfolio in March 2013 to mitigate this volatility. Total interest expense declined to \$1.94 million for the 2013 period compared with \$2.16 million for the prior year period as we allowed higher rate deposits to roll off the books.

Non-interest income increased \$1.14 million during the three months ended March 31, 2013 as compared to the prior year period. Despite an overall slowdown in the residential refinancing marketplace, the Bank was able to generate a 72% increase in gains on loans sold or \$3.01 million compared to \$1.75 million for the three months ended March 31, 2013 and 2012, respectively. The 2013 period included a \$185,000 loss related to rebalancing the mortgage-backed securities portfolio which is not expected to recur.

Non-interest expense was \$4.65 million during the 2013 period as compared to \$3.88 million for the prior year period as the Bank hired additional employees to support its growth. The three months ended March 31, 2013 included \$193,000 in expenses that are not expected to recur related to listing the Company's stock on NASDAQ Capital Markets.



## Net Interest Income

Net interest income for the three months ended March 31, 2013 totaled \$3.82 million, a 2.9% decrease from the 2012 period. The decrease was primarily driven by decline in yield on our investment securities. At December 31, 2012, mortgage-backed securities were 50% of the total available for sale portfolio with a significant portion purchased at a premium. Accelerated prepayments attributable to the ongoing low rate environment resulted in premium amortization of \$840,000 during the three months ended March 31, 2013 compared to \$406,000 for the prior year period. Similarly, agency calls reduced interest and dividend income by \$100,000 on a portion of our investment portfolio. Interest income on loans increased 5% during the three months ended March 31, 2013 as average loans outstanding grew 12.4% as compared to the prior year period. The loan growth came from commercial real estate, commercial and industrial and single family mortgage loans held for sale. The increase in interest income from loan growth was somewhat offset by a 29 basis point decline in yield, reflecting the lower rate environment.

Total interest expense declined to \$1.94 million for the 2013 period compared with \$2.16 million for the prior year period as deposits increased but at an overall lower cost. Interest expense on deposits decreased 25 basis points from the prior year period as customers shifted from time deposits to money market accounts. We have demonstrated the ability to retain deposits without paying the highest direct bank rates. In the three months ended March 31, 2013, \$15.00 million in FHLB advances matured which reduced costs for the period and will reduce the costs of FHLB advances in the remainder of 2013.

## Average Balance Sheets, Net Interest Earnings

For the periods presented, the following table provides the total dollar amount of interest income from average interest-earning assets and the resulting yields. It also highlights the interest expense on average interest-bearing liabilities, expressed both in dollars and rates, and the net interest margin. The table does not reflect any effect of income taxes. Balances are based on the average of daily balances. Non-accrual loans are included in average loan balances.

*Average Balance Sheets*

(dollars in thousands)

|  | Three Months ended March 31,<br>2013 |                              |            | 2012               |                              |            |        |   |
|--|--------------------------------------|------------------------------|------------|--------------------|------------------------------|------------|--------|---|
|  | Average<br>Balance                   | Interest<br>and<br>Dividends | Yield/Cost | Average<br>Balance | Interest<br>and<br>Dividends | Yield/Cost |        |   |
| Assets:  |                                      |                              |            |                    |                              |            |        |   |
| Interest-earning assets:   |                                      |                              |            |                    |                              |            |        |   |
| Loans  | \$424,028                            | \$ 4,967                     | 4.75       | %                  | \$377,411                    | \$ 4,728   | 5.04   | % |
| Investment securities – taxable  | 139,117                              | 459                          | 1.34       | %                  | 147,671                      | 916        | 2.49   | % |
| Investment securities – non-taxable  | 41,269                               | 303                          | 2.98       | %                  | 43,194                       | 421        | 3.92   | % |
| FHLB stock   | 2,943                                | 25                           | 3.45       | %                  | 2,943                        | 26         | 3.55   | % |
| Total interest-earning assets  | 607,535                              | 5,754                        | 3.84       | %                  | 571,219                      | 6,091      | 4.29   | % |
| Noninterest-earning assets   | 24,182                               |                              |            |                    | 21,454                       |            |        |   |
| Total assets   | \$631,539                            |                              |            |                    | \$592,673                    |            |        |   |
| Liabilities and equity:  |                                      |                              |            |                    |                              |            |        |   |
| Interest-bearing liabilities   |                                      |                              |            |                    |                              |            |        |   |
| Regular savings accounts   | \$13,372                             | 19                           | 0.58       | %                  | \$8,402                      | 13         | 0.62   | % |
| Interest-bearing demand deposits   | 68,540                               | 93                           | 0.55       | %                  | 60,648                       | 91         | 0.60   | % |
| Money market accounts  | 204,543                              | 379                          | 0.75       | %                  | 172,032                      | 352        | 0.82   | % |
| Certificates and brokered deposits   | 230,850                              | 1,137                        | 2.00       | %                  | 237,469                      | 1,365      | 2.31   | % |
| Total interest-bearing deposits  | 517,305                              | 1,628                        | 1.28       | %                  | 478,551                      | 1,821      | 1.53   | % |
| FHLB advances  | 32,084                               | 308                          | 3.89       | %                  | 40,582                       | 338        | 3.35   | % |
| Total interest-bearing liabilities   | 549,389                              | 1,936                        | 1.43       | %                  | 519,133                      | 2,159      | 1.67   | % |
| Noninterest-bearing liabilities  | 16,466                               |                              |            |                    | 14,518                       |            |        |   |
| Other non-interest bearing liabilities                                     | 3,982                                |                              |            |                    | 2,583                        |            |        |   |
| Total liabilities  | 569,820                              |                              |            |                    | 536,234                      |            |        |   |
| Stockholders' equity   | 61,702                               |                              |            |                    | 56,439                       |            |        |   |
| Total liabilities and equity   | \$631,539                            |                              |            |                    | \$592,673                    |            |        |   |
| Net interest income  |                                      | \$ 3,818                     |            |                    |                              | \$ 3,932   |        |   |
| Interest rate spread   |                                      |                              | 2.41       | %                  |                              |            | 2.62   | % |
| Net interest margin  |                                      |                              | 2.55       | %                  |                              |            | 2.77   | % |
| Average interest-earning assets to average<br>interest-bearing liabilities |                                      |                              | 110.55     | %                  |                              |            | 110.03 | % |

*Rate/Volume Analysis*

(dollars in thousands)

The following table sets forth certain information regarding changes in our interest income and interest expense for the periods indicated. For each category of earning assets and interest bearing liabilities, information is provided on changes attributable to (i) changes in volume (change in average volume multiplied by old rate); and (ii) changes in rates (change in rate multiplied by old average volume). Changes in rate/volume (change in rate multiplied by the change in volume) have been allocated to the changes due to volume and rate in proportion to the absolute value of the changes due to volume and rate prior to the allocation.

|  | Rate/Volume Analysis of<br>Net Interest Income<br>Three Months ended March 31 2013 vs. 2012<br>Due to Changes in |             |           |
|--|--|-------------|-----------|
|  | Volume   | Rate        | Net       |
| Interest income                            |  |             |           |
| Loans receivable                           | \$ 1,649   | \$ (1,410 ) | \$ 239    |
| Investment securities – taxable            | (72 )  | (385 )      | (457 )    |
| Investment securities – non-taxable        | (18 )  | (100 )      | (118 )    |
| FHLB stock                                 | -  | (1 )        | (1 )      |
| Total                                      | 1,559  | (1,896 )    | (337 )    |
| Interest expense                           |  |             |           |
| Deposits                                   | 200  | (393 )      | (193 )    |
| FHLB advances                              | (265 )   | 235         | (30 )     |
| Total                                      | (65 )  | (158 )      | (223 )    |
| Increase (decrease) in net interest income | \$ 1,624   | \$ (1,738 ) | \$ (114 ) |

Provision for loan losses decreased by \$436,000 during the three months ended March 31, 2013, from the three months ended March 31, 2012 as the primary quantitative driver, historical loss experiences, of the estimates we make to determine the provision improved. In determining the provision, management also evaluates qualitative factors such as the improvement to our internal processes for collection and review resulting from the addition of our senior credit officer. The decrease in the provision is supported by the general trends noted in our respective portfolios. Gains on loans sold increased in the 2013 period by \$1.26 million, or 72.1%, compared to the prior year period, as we continued to originate a significant volume of single family mortgage loans, meeting consumer refinancing demand due to the low rate environment. Our volumes continued to increase significantly from the prior year and were slightly ahead of the three months ended December 31, 2012. Management has developed a purchase loan origination program to offset the impact of potential declines in consumer refinancing demand in anticipation of an eventual shift in the residential mortgage market when rates eventually rise.

A \$185,000 loss on the sale of securities was incurred in the three months ended March 31, 2013 as we sold negative yielding mortgage-backed securities and reinvested the proceeds in a manner management believes will be accretive to future earnings and will stabilize cash flows.

Other noninterest income increased by \$105,000 during the three months ended March 31, 2013 compared to the prior year period, primarily due to \$99,000 of rental income recognized in the 2013 period on other real estate owned.

Salaries and employee benefits increased \$388,000, or 19.5%, during the three months ended March 31, 2013, reflecting the addition of 29 full time employees since March 31, 2012. We have fully staffed our commercial & industrial team, added two officers and filled key operational and marketing positions while also increasing the number of residential mortgage staff to address increased origination volumes.

As a result of the Company's stock being listed on NASDAQ, professional service expenses for the three months ended March 31, 2013 included \$117,000 which are not expected to recur in future periods. Our effective income tax rates (income tax provision divided by net income before income tax) for the three months ended March 31, 2013 and 2012 were 31.8% and 24.5% respectively. The increase in tax rates is the result of more taxable investment income from the prior year as well as NASDAQ listing expenses which are not deductible for tax purposes in 2013.

### ***Financial Condition***

### **Investment securities**

## Edgar Filing: First Internet Bancorp - Form 10-Q

Investment securities totaled \$164.28 million at March 31, 2013 compared to \$156.69 million at December 31, 2012. During the three months ended March 31, 2013, we sold \$39.01 million in mortgage-backed securities and purchased \$52.59 million of U.S. government/agency debt, collateralized mortgage obligations and corporate securities to rebalance the securities portfolio with investments having shorter durations and lower prepayment risk which should improve yields on the portfolio. Amounts for securities purchased in March to be settled in April of \$10.0 million are included in accrued expenses and liabilities. All investments are available for sale and recorded at fair value.

The following table summarizes the book value and approximate fair value and distribution of our investment securities as of the dates indicated.

(dollars in thousands)

|   | March 31, 2013 |                        | December 31, 2012 |                        |
|---|----------------|------------------------|-------------------|------------------------|
|   | Amortized Cost | Approximate Fair Value | Amortized Cost    | Approximate Fair Value |
| Securities available for sale:  |                |                        |                   |                        |
| U.S. government-sponsored enterprises   | \$49,495       | \$ 50,385              | \$18,666          | \$ 19,618              |
| Municipals  | 37,671         | 39,856                 | 39,999            | 42,540                 |
| <u>Mortgage- and asset-backed securities – government-sponsored enterprises</u> | 47,957         | 49,398                 | 75,782            | 77,489                 |
| <u>Mortgage- and asset-backed securities – private labeled</u>                  | 2,300          | 2,199                  | 2,696             | 2,453                  |
| Other securities  | 24,226         | 22,437                 | 16,753            | 14,593                 |
| Total securities available for sale   | \$161,649      | \$ 164,275             | \$153,896         | \$ 156,693             |

At March 31, 2013, the portfolio included two trust preferred securities which are Collateralized Debt Obligations (“CDO”) backed by pools of debt securities issued by financial institutions: ALESCO IV and I-PreTSL I B-2 notes. During the third quarter of 2009, after analysis of the expected future cash flows and the timing of resumed interest payments, the Company determined that placing the ALESCO CDO on non-accrual status was the most prudent course of action. The Company stopped all accrual of interest and never capitalized any “payment in kind” (“PIK”) interest payments to the principal balance of the security. The Company intends to keep this security on non-accrual status until the scheduled interest payments resume on a regular basis and any previously recorded PIK has been paid. The PIK status of this security, among other factors, indicates potential OTTI and accordingly, we utilized an independent third party for the valuation of the CDOs as of March 31, 2013. Based on this valuation and our review of the assumptions and methodologies used, we believe the amortized costs recorded for our CDO investments accurately reflects the position of these securities at March 31, 2013.

## Loans

Net loans at March 31, 2013 maintained December 31, 2012 levels. Commercial lending grew consistent with our diversification strategy. Most notably, commercial & industrial loans increased 38% from December 31, 2012 as our experienced team completed its first full year of operations. Credit tenant leasing grew 14.7% during the quarter ended March 31, 2013. The growth was offset by slight reduction in consumer loans.

### *Loan Portfolio Analysis*

(dollars in thousands)

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|  | March 31, 2013 |          |  | December 31, 2012 |          |  |
|--|----------------|----------|--|-------------------|----------|--|
| Real estate loans:                             |                |          |  |                   |          |  |
| Residential                                    | \$ 124,290     | 35.02 %  |  | \$ 128,815        | 36.34 %  |  |
| Commercial – Credit tenant lease               | 32,438         | 9.14 %   |  | 28,264            | 7.97 %   |  |
| Commercial – Other                             | 56,909         | 16.04 %  |  | 56,654            | 15.98 %  |  |
| Total real estate loans                        | 213,637        | 60.20 %  |  | 213,733           | 60.29 %  |  |
| Commercial loans                               | 19,744         | 5.57 %   |  | 14,271            | 4.03 %   |  |
| Consumer loans – Trailers                      | 76,875         | 21.66 %  |  | 79,625            | 22.46 %  |  |
| Consumer loans – Recreational vehicle          | 40,149         | 11.31 %  |  | 42,087            | 11.87 %  |  |
| Consumer loans – Other                         | 4,476          | 1.26 %   |  | 4,774             | 1.35 %   |  |
|  | 354,881        | 100.00 % |  | 354,490           | 100.00 % |  |
| Less:  |                |          |  |                   |          |  |
| Net deferred loan fees, premiums and discounts | 3,483          |          |  | 3,671             |          |  |
| Allowance for losses                           | (5,748 )       |          |  | (5,833 )          |          |  |
| Total loans                                    | \$352,616      |          |  | \$352,328         |          |  |

*Asset Quality and Allowance for Loan Loss*

Non-performing loans are comprised of loans past due 90 days or more on nonaccrual status and other nonaccrual loans. Non-performing assets include non-performing loans plus other real estate owned and other assets which are primarily repossessed vehicles. At March 31, 2013, our non-performing loans totaled \$3.77 million, or 1.06%, of total loans compared to 2.28% at March 31, 2012. At March 31, 2013, our total non-performing assets totaled \$10.21 million, or 1.57%, of total assets compared to 2.28% at March 31, 2012.

| (dollars in thousands)                        | March 31,<br>2013 | December 31,<br>2012 |      |   |
|---|-------------------|----------------------|------|---|
| Non-accrual loans                             |                   |                      |      |   |
| Real estate loans:                            |                   |                      |      |   |
| Residential                                   | \$ 1,189          | \$ 1,389             |      |   |
| Commercial                                    | 2,362             | 2,362                |      |   |
| Total real estate loans                       | 3,551             | 3,751                |      |   |
| Commercial loans                              | —                 | —                    |      |   |
| Consumer loans                                | 177               | 155                  |      |   |
| Total non-accrual loans                       | 3,728             | 3,906                |      |   |
| Accruing loans past due 90 days or more:      |                   |                      |      |   |
| Real estate loans:                            |                   |                      |      |   |
| Residential                                   | —                 | 450                  |      |   |
| Commercial                                    | —                 | —                    |      |   |
| Total real estate loans                       | —                 | 450                  |      |   |
| Commercial loans                              | —                 | —                    |      |   |
| Consumer loans                                | 44                | 21                   |      |   |
| Total accruing loans past due 90 days or more | 44                | 471                  |      |   |
| Total non-performing loans                    | 3,772             | 4,377                |      |   |
| Other real estate owned:                      |                   |                      |      |   |
| Residential                                   | 265               | 265                  |      |   |
| Commercial                                    | 3,943             | 3,401                |      |   |
| Other   | —                 | —                    |      |   |
| Total other real estate owned                 | 4,208             | 3,666                |      |   |
| Other non-performing assets                   | 2,227             | 2,253                |      |   |
| Total non-performing assets                   | \$ 10,207         | \$ 10,296            |      |   |
| Total non-performing loans to total loans     | 1.06              | %                    | 1.23 | % |
| Total non-performing assets to total assets   | 1.57              | %                    | 1.62 | % |



*Troubled Debt Restructurings*

| (dollars in thousands)                     | March 31,<br>2013 | December 31,<br>2012 |
|--|-------------------|----------------------|
| Troubled debt restructurings – non-accrual | \$ 1,037          | \$ 1,065             |
| Troubled debt restructurings – performing  | 882               | 905                  |
| Total troubled debt restructurings         | \$ 1,919          | \$ 1,970             |

Total non-performing assets decreased from \$10.3 million at December 31, 2012 to \$10.2 million at March 31, 2013. Total non-performing loans decreased by \$615,000, or 13.8%, from December 31, 2012 to March 31, 2013 reflecting a significant decline in delinquencies. We have six properties in other real estate owned at March 31, 2013. One property consists of two buildings which are residential units on a college campus. We have invested \$541,000 in improvements in collaboration with the university during the period so that the properties can be occupied in the fall semester.

## Premises and Equipment

We do not have branches and primarily lease all office space and equipment. In the three months ended March 31, 2013, we acquired an office building with approximately 52,000 square feet of office space and related real estate located at 11201 USA Parkway, Fishers, Indiana (the "Property") from an unaffiliated third party for an aggregate consideration of approximately \$4.00 million. The Company acquired the Property for the current and future operations of the Bank. The Bank intends to use the Property for some of its administrative operations and not as a branch or loan or deposit production office. The \$4.06 million increase in premises and equipment, net as of March 31, 2013, reflects this acquisition.

## Deposits

(dollars in thousands)

|                               | March 31, 2013 |        |   | December 31, 2012 |        |   |
|-------------------------------|----------------|--------|---|-------------------|--------|---|
| Regular savings accounts      | \$14,911       | 2.73   | % | \$11,583          | 2.18   | % |
| Non-interest bearing          | 16,046         | 2.94   | % | 13,187            | 2.49   | % |
| Interest-bearing              | 75,217         | 13.76  | % | 73,660            | 13.88  | % |
| Money market accounts         | 208,833        | 38.20  | % | 202,388           | 38.14  | % |
| Certificates of deposit       | 213,317        | 39.02  | % | 211,542           | 39.86  | % |
| Brokered deposits             | 18,490         | 3.38   | % | 18,490            | 3.48   | % |
| Premiums on brokered deposits | (147 )         | -0.03  | % | (159 )            | -0.03  | % |
| Total                         | \$546,667      | 100.00 | % | \$530,691         | 100.00 | % |

Total deposits grew to \$546.7 million at the end of the first quarter, compared with \$530.7 million at December 31, 2012. Non-interest bearing demand deposit accounts grew to \$16.1 million compared with \$13.2 million at the end of 2012, reflecting more relationship banking business with commercial customers. In the last year, First Internet Bank added online banking and treasury management services to complement its commercial lending services in order to attract not only loans, but expanded commercial banking relationships. As we grow this part of our business, we expect the fee-based services will contribute to non-interest income and help to reduce our cost of funds.

While we are focused on building non-interest bearing deposits, our independence from a traditional bricks and mortar branch structure permits us to offer competitive rates for interest-bearing accounts, as needed, in order to fund loan growth. Deposit interest expense in first quarter 2013 declined to \$1.63 million compared with \$1.82 million in the last quarter of 2012, reflecting ongoing efforts to re-price interest-bearing accounts as appropriate in the continued low-interest rate environment, and reduced use of higher-cost wholesale funding sources. The ability to grow core deposits to fund lending activity continues to drive a declining use of Federal Home Loan Bank borrowings.

## Shareholders' Equity

Shareholders' equity increased \$1.29 million to \$62.64 million at March 31, 2013 compared to \$61.35 million at December 31, 2012. This was the result of net income for the three months ended March 31, 2013 of \$1.49 million offset by an unrealized loss in other comprehensive loss before tax of \$171,000 and \$113,000 in dividends declared on common stock.

At March 31, 2013, the Company and the Bank exceeded all applicable regulatory capital minimum requirements, and the Bank was considered "well-capitalized" under applicable regulations. We believe our capital resources are sufficient to meet our current and expected needs, including any cash dividends we may pay. However, if we continue to experience significant growth, we may require additional capital resources.

(dollars in thousands)

|  | Actual   |        | Minimum<br>Capital<br>Requirement |       | Minimum to be<br>Well Capitalized<br>Under Prompt<br>Corrective Actions |        |
|--|----------|--------|-----------------------------------|-------|---|--------|
|  | Amount   | Ratio  | Amount                            | Ratio | Amount  | Ratio  |
| As of March 31, 2013:                    |          |        |                                   |       |   |        |
| Total capital (to risk-weighted assets)  |          |        |                                   |       |   |        |
| Consolidated                             | \$62,016 | 10.1 % | \$49,197                          | 8.0 % | N/A   | N/A    |
| Bank                                     | 61,424   | 10.0 % | 49,135                            | 8.0 % | 61,419  | 10.0 % |
| Tier 1 capital (to risk-weighted assets) |          |        |                                   |       |   |        |
| Consolidated                             | 56,249   | 9.2 %  | 24,598                            | 4.0 % | N/A   | N/A    |
| Bank                                     | 55,657   | 9.1 %  | 24,568                            | 4.0 % | 36,851  | 6.0 %  |
| Tier 1 capital (to average assets)       |          |        |                                   |       |   |        |
| Consolidated                             | 56,249   | 9.0 %  | 24,961                            | 4.0 % | N/A   | N/A    |
| Bank                                     | 55,657   | 8.9 %  | 24,946                            | 4.0 % | 31,183  | 5.0 %  |

### Liquidity and Capital Resources

The Company's primary source of funds is dividends from the Bank, the declaration of which is subject to regulatory limits. On March 18, 2013, the Company's Board of Directors declared a cash dividend for the first quarter of 2013 of \$0.06 per share of common stock payable April 15, 2013 to shareholders of record on April 1, 2013. We expect to continue to pay dividends on a quarterly basis; however, the declaration and amount of future dividends will be determined by the Board of Directors on the basis of our financial condition, earnings, regulatory constraints and other factors. At March 31, 2013, the Company, on an unconsolidated basis, had \$353,000 in cash generally available for its cash needs.

At March 31, 2013, we had \$198.68 million in cash and investment securities available for sale and \$61.60 million in loans held for sale that were generally available for our cash needs compared to \$189.21 million and \$63.23 million at December 31, 2012, respectively. At March 31, 2013, we had the ability to borrow an additional \$28.46 million in FHLB advances and correspondent bank fed funds line of credit draws. Management is evaluating options to expand our borrowing capacity.

At March 31, 2013, approved outstanding loan commitments, including unused lines of credit, amounted to \$37.04 million compared to \$33.60 million at December 31, 2012. Certificates of deposit scheduled to mature in one year or less at March 31, 2013, totaled \$72.10 million; however, due to our competitive rates, we believe that a majority of maturing deposits will remain with the Bank.

***Critical Accounting Policies and Estimates***

There have been no material changes in our critical accounting policies from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2012.

***Future Accounting Pronouncements***

Refer to Note 9 of the condensed consolidated financial statements.

***Off-Balance Sheet Arrangements***

We do not have any off-balance sheet arrangements.

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

Not applicable.

**ITEM 4. CONTROLS AND PROCEDURES.**

*Evaluation of Disclosure Controls and Procedures*

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

We performed an evaluation under the supervision and with the participation of our management, including our principal executive and principal financial officers, to assess the effectiveness of the design and operation of our disclosure controls and procedures under the Exchange Act. Based on that evaluation, our management, including our principal executive and principal financial officers, concluded that our disclosure controls and procedures were effective as of March 31, 2013.

*Changes in Internal Control Over Financial Reporting*

There has been no change in our internal control over financial reporting during the quarter ended March 31, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II**

**ITEM 1. LEGAL PROCEEDINGS.**

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

**ITEM 1A. RISK FACTORS.**

There have been no material changes from the risk factors previously disclosed in Part I, Item 1A, of our Annual Report on Form 10-K for the year ended December 31, 2012.

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

During the first quarter of 2013, we issued 5,646 deferred stock rights to our non-employee directors under our Directors' Deferred Stock Plan. None of the foregoing transactions involved any underwriters, underwriting discounts or commissions, or any public offering, and we believe the transactions were exempt from the registration requirements of the Securities Act of 1933, as amended, in reliance on Section 4(a)(2) thereof, as transactions by an issuer not involving a public offering.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES.**

None.

**ITEM 4. MINE SAFETY DISCLOSURES.**

None.

**ITEM 5. OTHER INFORMATION.**

None.

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**ITEM 6. EXHIBITS.**

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

| <b>Exhibit No.</b> | <b>Description</b>   |
|--------------------|--|
| 3.1                | Articles of Incorporation of First Internet Bancorp (incorporated by reference to Exhibit 3.1 to registration statement on Form 10 filed November 30, 2012)  |
| 3.2                | Amended and Restated Bylaws of First Internet Bancorp, as amended March 18, 2013 (incorporated by reference to Exhibit 3.2 to annual report on Form 10-K for the year ended December 31, 2012)   |
| 10.1               | Amended and Restated Employment Agreement, dated March 28, 2013 and effective March 1, 2013, by and between First Internet Bank of Indiana, First Internet Bancorp and David B. Becker (incorporated by reference to Exhibit 10.4 to annual report on Form 10-K for the year ended December 31, 2012)* |
| 10.2               | Change in Control Termination Benefits Agreement, dated January 14, 2013, by and between First Internet Bancorp and Kay Whitaker (incorporated by reference to Exhibit 10.6 to annual report on Form 10-K for the year ended December 31, 2012)*   |
| 10.3               | Contract for Purchase of Property, dated January 30, 2013, between First Internet Bancorp and LHRET Ascension SV, LLC (incorporated by reference to Exhibit 10.10 to annual report on Form 10-K for the year ended December 31, 2012)  |
| 10.4               | Offer and Contract for Purchase of Real Estate, accepted February 5, 2013, between First Internet Bancorp and St. Vincent Hospital and Health Care Center, Inc. (incorporated by reference to Exhibit 10.11 to annual report on Form 10-K for the year ended December 31, 2012)                        |
| 10.5               | Loan Agreement, dated as of March 6, 2013, by First Internet Bancorp and First Internet Bank of Indiana (incorporated by reference to Exhibit 10.1 to current report on Form 8-K filed March 11, 2013)   |
| 10.6               | Office Lease, dated as of March 6, 2013, by and between First Internet Bancorp and First Internet Bank of Indiana (incorporated by reference to Exhibit 10.2 to Current Report on Form 8-K filed March 11, 2013)   |
| 31.1               | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer  |
| 31.2               | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer  |
| 32.1               | Section 1350 Certifications  |

\* Management contract, compensatory plan or arrangement required to be filed as an exhibit.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized

FIRST INTERNET BANCORP

Date: May 15, 2013 By/s/ David B. Becker  
David B. Becker,

*Chief Executive Officer, President and Chairman*

Date: May 15, 2013 By/s/ Kay E. Whitaker  
Kay E. Whitaker,

*Senior Vice President-Finance,*

*Chief Financial Officer and Secretary*

*(Principal Financial Officer)*

**EXHIBIT INDEX**

| <b>Exhibit No.</b> | <b>Description</b>   | <b>Method of Filing</b>   |
|--------------------|--|---------------------------|
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| 31.1               | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer  | Filed Electronically      |
| 31.2               | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer  | Filed Electronically      |
| 32.1               | Section 1350 Certifications  | Filed Electronically      |