

FIRST CAPITAL INC
Form 10-Q
November 12, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 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 September 30, 2014

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 No. 0-25023

First Capital, Inc.

(Exact name of registrant as specified in its charter)

Indiana	35-2056949
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

220 Federal Drive NW, Corydon, Indiana 47112
(Address of principal executive offices) (Zip Code)

Registrant's telephone number including area code 1-812-738-2198

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes

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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a small reporting company. See definition of "accelerated filer," "large accelerated filer" and "smaller reporting company"

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in Rule 12b-2 of the Exchange Act.

(Check one): Large Accelerated Filer Accelerated Filer
 Non-accelerated Filer Smaller Reporting Company X

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 2,740,502 shares of common stock were outstanding as of October 31, 2014.

FIRST CAPITAL, INC.

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Signatures

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PART I - FINANCIAL INFORMATION
 FIRST CAPITAL, INC. AND SUBSIDIARIES
 CONSOLIDATED BALANCE SHEETS
 (Unaudited)

	September 30, 2014	December 31, 2013
	(In thousands)	
ASSETS		
Cash and due from banks	\$9,918	\$ 10,058
Interest bearing deposits with banks	3,822	467
Federal funds sold	6,423	611
Total cash and cash equivalents	20,163	11,136
Interest-bearing time deposits	6,635	4,425
Securities available for sale, at fair value	100,491	108,762
Securities-held to maturity	7	9
Loans, net	302,275	288,506
Loans held for sale	1,039	1,611
Federal Home Loan Bank stock, at cost	2,820	2,820
Foreclosed real estate	58	466
Premises and equipment	10,334	10,347
Accrued interest receivable	1,607	1,716
Cash value of life insurance	6,123	6,332
Goodwill	5,386	5,386
Other assets	3,354	2,868
Total Assets	\$460,292	\$ 444,384
LIABILITIES		
Deposits:		
Noninterest-bearing	\$71,998	\$ 56,436
Interest-bearing	329,051	317,394
Total deposits	401,049	373,830
Retail repurchase agreements	0	9,310
Advances from Federal Home Loan Bank	0	5,500
Accrued interest payable	154	192
Accrued expenses and other liabilities	2,799	2,213
Total liabilities	404,002	391,045
EQUITY		
Preferred stock of \$.01 par value per share Authorized 1,000,000 shares; none issued	0	0
Common stock of \$.01 par value per share Authorized 5,000,000 shares; issued 3,164,416 shares; outstanding 2,740,502 shares (2,784,088 in 2013)	32	32
Additional paid-in capital	24,313	24,313
Retained earnings-substantially restricted	39,550	36,947
Accumulated other comprehensive income (loss)	540	(720)

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Less treasury stock, at cost - 423,914 shares (380,328 shares in 2013)	(8,253)	(7,345)
Total First Capital, Inc. stockholders' equity	56,182	53,227
Noncontrolling interest in subsidiary	108	112
Total equity	56,290	53,339
Total Liabilities and Equity	\$460,292	\$ 444,384

See accompanying notes to consolidated financial statements.

PART I - FINANCIAL INFORMATION
 FIRST CAPITAL, INC. AND SUBSIDIARY
 CONSOLIDATED STATEMENTS OF INCOME
 (Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
(In thousands, except per share data)				
INTEREST INCOME				
Loans, including fees	\$ 4,057	\$ 4,011	\$ 11,931	\$ 11,860
Securities:				
Taxable	289	307	909	970
Tax-exempt	249	287	813	821
Federal Home Loan Bank dividends	27	25	92	74
Federal funds sold and interest bearing deposits with banks	24	19	66	54
Total interest income	4,646	4,649	13,811	13,779
INTEREST EXPENSE				
Deposits	278	355	858	1,145
Retail repurchase agreements	0	7	12	22
Advances from Federal Home Loan Bank	2	46	5	139
Total interest expense	280	408	875	1,306
Net interest income	4,366	4,241	12,936	12,473
Provision for loan losses	75	100	190	575
Net interest income after provision for loan losses	4,291	4,141	12,746	11,898
NONINTEREST INCOME				
Service charges on deposit accounts	816	823	2,361	2,327
Commission income	237	102	435	297
Gain on sale of securities	0	8	54	29
Gain on sale of mortgage loans	180	194	499	675
Mortgage brokerage fees	15	20	29	37
Increase in cash surrender value of life insurance	35	38	112	122
Other income	155	26	214	74
Total noninterest income	1,438	1,211	3,704	3,561
NONINTEREST EXPENSE				
Compensation and benefits	1,957	1,757	5,628	5,232
Occupancy and equipment	298	281	910	880
Data processing	404	373	1,168	1,084
Professional fees	138	164	436	534
Advertising	82	80	215	189
Other operating expenses	712	615	1,882	1,979
Total noninterest expense	3,591	3,270	10,239	9,898
Income before income taxes	2,138	2,082	6,211	5,561
Income tax expense	611	653	1,862	1,721
Net Income	1,527	1,429	4,349	3,840
Less: net income attributable to noncontrolling interest in subsidiary	3	3	10	10
Net Income Attributable to First Capital, Inc.	\$ 1,524	\$ 1,426	\$ 4,339	\$ 3,830

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Earnings per common share attributable to First
Capital, Inc.

Basic	\$ 0.56	\$ 0.51	\$ 1.57	\$ 1.38
Diluted	\$ 0.56	\$ 0.51	\$ 1.57	\$ 1.38
Dividends per share	\$ 0.21	\$ 0.20	\$ 0.63	\$ 0.60

See accompanying notes to consolidated financial statements.

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PART I - FINANCIAL INFORMATION
 FIRST CAPITAL, INC. AND SUBSIDIARY
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Net Income	\$1,527	\$1,429	\$ 4,349	\$ 3,840
OTHER COMPREHENSIVE INCOME (LOSS)				
Unrealized gains (losses) on securities available for sale:				
Unrealized holding gains (losses) arising during the period	257	(781)	2,130	(3,605)
Income tax (expense) benefit	(101)	309	(837)	1,428
Net of tax amount	156	(472)	1,293	(2,177)
Less: reclassification adjustment for realized gains included in net income				
	0	(7)	(54)	(29)
Income tax expense	0	3	21	11
Net of tax amount	0	(4)	(33)	(18)
Other Comprehensive Income (Loss), net of tax	156	(476)	1,260	(2,195)
Comprehensive Income	1,683	953	5,609	1,645
Less: comprehensive income attributable to the noncontrolling interest in subsidiary	3	3	10	10
Comprehensive Income Attributable to First Capital, Inc.	\$1,680	\$950	\$ 5,599	\$ 1,635

See accompanying notes to consolidated financial statements.

PART I - FINANCIAL INFORMATION
 FIRST CAPITAL, INC. AND SUBSIDIARY
 CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
 (Unaudited)

(In thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Noncontrolling Interest	Total
Balances at January 1, 2013	\$ 32	\$24,313	\$ 34,101	\$ 1,704	\$ (7,326)	\$ 112	\$52,936
Net income	0	0	3,830	0	0	10	3,840
Other comprehensive loss	0	0	0	(2,195)	0	0	(2,195)
Cash dividends	0	0	(1,670)	0	0	(14)	(1,684)
Purchase of treasury shares	0	0	0	0	(10)	0	(10)
Balances at September 30, 2013	\$ 32	\$24,313	\$ 36,261	\$ (491)	\$ (7,336)	\$ 108	\$52,887
Balances at January 1, 2014	\$ 32	\$24,313	\$ 36,947	\$ (720)	\$ (7,345)	\$ 112	\$53,339
Net income	0	0	4,339	0	0	10	4,349
Other comprehensive income	0	0	0	1,260	0	0	1,260
Cash dividends	0	0	(1,736)	0	0	(14)	(1,750)
Purchase of treasury shares	0	0	0	0	(908)	0	(908)
Balances at September 30, 2014	\$ 32	\$24,313	\$ 39,550	\$ 540	\$ (8,253)	\$ 108	\$56,290

See accompanying notes to consolidated financial statements.

PART I - FINANCIAL INFORMATION
FIRST CAPITAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended September 30,	
	2014	2013
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 4,349	\$ 3,840
Adjustments to reconcile net income to net cash and cash equivalents provided by operating activities:		
Amortization of premiums and accretion of discounts on securities, net	530	712
Depreciation and amortization expense	527	533
Deferred income taxes	(116)	87
Increase in cash value of life insurance	(112)	(122)
Gain on life insurance	(129)	0
Gain on sale of securities	(54)	(29)
Provision for loan losses	190	575
Proceeds from sales of loans	20,596	32,090
Loans originated for sale	(19,525)	(28,506)
Gain on sale of loans	(499)	(675)
Decrease in accrued interest receivable	109	82
Decrease in accrued interest payable	(38)	(65)
Net change in other assets/liabilities	(64)	722
Net Cash Provided By Operating Activities	5,764	9,244
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment in interest-bearing time deposits	(2,210)	(820)
Purchase of securities available for sale	(20,657)	(23,460)
Proceeds from maturities of securities available for sale	16,655	19,047
Proceeds from sales of securities available for sale	5,669	517
Principal collected on mortgage-backed obligations	8,120	10,446
Net increase in loans receivable	(13,962)	(9,473)
Proceeds from sale of foreclosed real estate	411	299
Purchase of premises and equipment	(514)	(238)
Net Cash Used In Investing Activities	(6,488)	(3,682)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in deposits	27,219	(7,336)
Net decrease in advances from Federal Home Loan Bank	(5,500)	(100)
Net decrease in retail repurchase agreements	(9,310)	(3,655)
Purchase of treasury stock	(908)	(10)
Dividends paid	(1,750)	(1,684)
Net Cash Provided By (Used In) Financing Activities	9,751	(12,785)
Net Increase (Decrease) in Cash and Cash Equivalents	9,027	(7,223)
Cash and cash equivalents at beginning of period	11,136	21,811

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Cash and Cash Equivalents at End of Period	\$ 20,163	\$ 14,588
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See accompanying notes to consolidated financial statements.

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Presentation of Interim Information

First Capital, Inc. (“Company”) is the savings and loan holding company for First Harrison Bank (“Bank”). The information presented in this report relates primarily to the Bank's operations. First Harrison Investments, Inc. and First Harrison Holdings, Inc. are wholly-owned Nevada corporate subsidiaries of the Bank that jointly own First Harrison, LLC, a Nevada limited liability corporation that holds and manages an investment portfolio. First Harrison REIT, Inc. (“REIT”) was incorporated as a wholly-owned subsidiary of First Harrison Holdings, Inc. to hold a portion of the Bank’s real estate mortgage loan portfolio. On January 21, 2009, the REIT issued 105 shares of 12.5% redeemable cumulative preferred stock with an aggregate liquidation value of \$105,000 in a private placement offering in order to satisfy certain ownership requirements to qualify as a real estate investment trust. At September 30, 2014, this noncontrolling interest represented 0.2% ownership of the REIT. On September 23, 2014, the Company formed FHB Risk Mitigation Services, Inc. (“Captive”). The Captive is a wholly-owned insurance subsidiary of the Company that will provide property and casualty insurance coverage to the Company, the Bank and all subsidiaries and reinsurance to five other third party insurance captives for which insurance may not be currently available or economically feasible in today’s insurance marketplace.

In the opinion of management, the unaudited consolidated financial statements include all adjustments considered necessary to present fairly the financial position as of September 30, 2014, and the results of operations for the three months and nine months ended September 30, 2014 and 2013 and the cash flows for the nine months ended September 30, 2014. All of these adjustments are of a normal, recurring nature. Such adjustments are the only adjustments included in the unaudited consolidated financial statements. Interim results are not necessarily indicative of results for a full year or any other period.

The accompanying unaudited consolidated financial statements and notes have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial statements and are presented as permitted by the instructions to Form 10-Q. Accordingly, they do not contain certain information included in the Company’s annual audited consolidated financial statements and related footnotes for the year ended December 31, 2013 included in the Company’s Annual Report on Form 10-K.

The unaudited consolidated financial statements include the accounts of the Company and its subsidiaries. All material intercompany balances and transactions have been eliminated in consolidation.

FIRST CAPITAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

2. Investment Securities

Debt and equity securities have been classified in the consolidated balance sheets according to management's intent. Investment securities at September 30, 2014 and December 31, 2013 are summarized as follows:

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2014				
Securities available for sale:				
Agency mortgage-backed securities	\$ 30,408	\$ 173	\$ 160	\$ 30,421
Agency CMO	15,813	108	205	15,716
Other debt securities:				
Agency notes and bonds	22,555	35	162	22,428
Municipal obligations	30,884	1,172	135	31,921
Subtotal - debt securities	99,660	1,488	662	100,486
Mutual funds	5	0	0	5
Total securities available for sale	\$ 99,665	\$ 1,488	\$ 662	\$ 100,491
Securities held to maturity:				
Agency mortgage-backed securities	\$ 7	\$ 0	\$ 0	\$ 7
Total securities held to maturity	\$ 7	\$ 0	\$ 0	\$ 7
December 31, 2013				
Securities available for sale:				
Agency mortgage-backed securities	\$ 18,408	\$ 205	\$ 244	\$ 18,369
Agency CMO	20,486	96	341	20,241
Other debt securities:				
Agency notes and bonds	31,594	49	729	30,914
Municipal obligations	36,200	778	938	36,040
Subtotal - debt securities	106,688	1,128	2,252	105,564
Mutual funds	3,238	0	40	3,198
Total securities available for sale	\$ 109,926	\$ 1,128	\$ 2,292	\$ 108,762
Securities held to maturity:				
Agency mortgage-backed securities	\$ 9	\$ 0	\$ 0	\$ 9
Total securities held to maturity	\$ 9	\$ 0	\$ 0	\$ 9

FIRST CAPITAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(2 – continued)

Agency notes and bonds, agency mortgage-backed securities and agency collateralized mortgage obligations (CMO) include securities issued by the Government National Mortgage Association (GNMA), a U.S. government agency, and the Federal National Mortgage Association (FNMA), the Federal Home Loan Mortgage Corporation (FHLMC) and the Federal Home Loan Bank (FHLB), which are government-sponsored enterprises.

The amortized cost and fair value of debt securities as of September 30, 2014, by contractual maturity, are shown below. Expected maturities of mortgage-backed securities may differ from contractual maturities because the mortgages underlying the obligations may be prepaid without penalty.

	Securities Available for Sale		Securities Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
(In thousands)				
Due in one year or less	\$ 120	\$ 122	\$ 0	\$ 0
Due after one year through five years	13,653	13,782	0	0
Due after five years through ten years	23,602	23,945		
Due after ten years	16,064	16,500	0	0
	53,439	54,349	0	0
Mortgage-backed securities and CMO	46,221	46,137	7	7
	\$ 99,660	\$ 100,486	\$ 7	\$ 7

Information pertaining to investment securities available for sale with gross unrealized losses at September 30, 2014, aggregated by investment category and the length of time that individual investment securities have been in a continuous position, follows:

	Number of Investment Positions	Fair Value	Gross Unrealized Losses
(Dollars in thousands)			
Continuous loss position less than twelve months:			
Agency notes and bonds	5	\$ 2,013	\$ 4
Agency CMO	2	1,620	8
Agency mortgage-backed securities	20	15,653	75
Municipal obligations	2	323	1
Total less than twelve months	29	19,609	88
Continuous loss position more than twelve months:			
Agency notes and bonds	10	11,473	158

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Agency CMO	10	8,187	197
Agency mortgage-backed securities	7	6,192	85
Municipal obligations	16	7,300	134
Total more than twelve months	43	33,152	574
Total securities available for sale	72	\$ 52,761	\$ 662

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FIRST CAPITAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(2 – continued)

Management evaluates securities for other-than-temporary impairment at least quarterly, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recover in fair value.

At September 30, 2014, the 72 U.S. government agency debt securities, including agency notes and bonds, mortgage-backed securities and CMO, and municipal obligations in a loss position had depreciated approximately 1.3% from the amortized cost basis. All of the U.S. government agency securities and municipal obligations are issued by U.S. government agencies, government-sponsored enterprises and municipal governments, or are secured by first mortgage loans and municipal project revenues. These unrealized losses related principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government, its agencies or other governments, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. As the Company has the ability to hold the debt securities until maturity, or the foreseeable future if classified as available for sale, no declines are deemed to be other-than-temporary.

During the nine months ended September 30, 2014, the Company realized gross gains on sales of available for sale municipal securities and U.S. government agency mortgage-backed securities of \$66,000 and \$5,000, respectively and a loss of \$17,000 on the sale of mutual funds. During the three months ended September 30, 2014, the Company realized gross gains on sales of available for sale municipal securities and U.S. government agency mortgage-backed securities of \$12,000 and \$5,000, respectively and a loss of \$17,000 on the sale of mutual funds. During the nine months ended September 30, 2013, the Company realized gross gains on sales of available for sale municipal securities and U.S. government agency debt securities of \$21,000 and \$8,000, respectively. The Company realized gross gains on sales of available for sale U.S. government agency debt securities of \$8,000 during the three months ended September 30, 2013.

In June 2014, the Company acquired an additional 31,750 shares of common stock in another financial institution, in addition to the 100,000 shares acquired in December 2013, representing approximately 9% of the outstanding common stock of the entity, for a total investment of \$711,000. The investment is accounted for using the cost method of accounting and is included in other assets in the consolidated balance sheet.

3. Loans and Allowance for Loan Losses

The Company's loan and allowance for loan loss policies are as follows:

Loans are stated at unpaid principal balances, less net deferred loan fees and the allowance for loan losses. The Company grants real estate mortgage, commercial business and consumer loans. A substantial portion of the loan portfolio is represented by mortgage loans to customers in southern Indiana. The ability of the Company's customers to honor their loan agreements is dependent upon the real estate and general economic conditions in this area.

FIRST CAPITAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(3 – continued)

Loan origination and commitment fees, as well as certain direct costs of underwriting and closing loans, are deferred and amortized as a yield adjustment to interest income over the lives of the related loans using the interest method. Amortization of net deferred loan fees is discontinued when a loan is placed on nonaccrual status.

The recognition of income on a loan is discontinued and previously accrued interest is reversed, when interest or principal payments become ninety (90) days past due unless, in the opinion of management, the outstanding interest remains collectible. Past due status is determined based on contractual terms. Generally, by applying the cash receipts method, interest income is subsequently recognized only as received until the loan is returned to accrual status. The cash receipts method is used when the likelihood of further loss on the loan is remote. Otherwise, the Company applies the cost recovery method and applies all payments as a reduction of the unpaid principal balance until the loan qualifies for return to accrual status. Interest income on impaired loans is recognized using the cost recovery method, unless the likelihood of further loss on the loan is remote.

A loan is restored to accrual status when all principal and interest payments are brought current and the borrower has demonstrated the ability to make future payments of principal and interest as scheduled, which generally requires that the borrower demonstrate a period of performance of at least six consecutive months.

For portfolio segments other than consumer loans, the Company's practice is to charge-off any loan or portion of a loan when the loan is determined by management to be uncollectible due to the borrower's failure to meet repayment terms, the borrower's deteriorating or deteriorated financial condition, the depreciation of the underlying collateral, the loan's classification as a loss by regulatory examiners, or for other reasons. A partial charge-off is recorded on a loan when the uncollectibility of a portion of the loan has been confirmed, such as when a loan is discharged in bankruptcy, the collateral is liquidated, a loan is restructured at a reduced principal balance, or other identifiable events that lead management to determine the full principal balance of the loan will not be repaid. A specific reserve is recognized as a component of the allowance for estimated losses on loans individually evaluated for impairment. Partial charge-offs on nonperforming and impaired loans are included in the Company's historical loss experience used to estimate the general component of the allowance for loan losses as discussed below. Specific reserves are not considered charge-offs in management's analysis of the allowance for loan losses because they are estimates and the outcome of the loan relationship is undetermined. At September 30, 2014, the Company had 12 loans on which partial charge-offs of \$480,000 had been recorded.

Consumer loans not secured by real estate are typically charged off at 90 days past due, or earlier if deemed uncollectible, unless the loans are in the process of collection. Overdrafts are charged off after 45 days past due. Charge-offs are typically recorded on loans secured by real estate when the property is foreclosed upon.

The allowance for loan losses reflects management's judgment of probable loan losses inherent in the loan portfolio at the balance sheet date. Additions to the allowance for loan losses are made by the provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

FIRST CAPITAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(3 – continued)

The Company uses a disciplined process and methodology to evaluate the allowance for loan losses on at least a quarterly basis that is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific and general components. The specific component relates to loans that are individually evaluated for impairment or loans otherwise classified as doubtful, substandard, or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan.

The general component covers non-classified loans and classified loans that are found, upon individual evaluation, to not be impaired. Such loans are pooled by segment and losses are modeled using annualized historical loss experience adjusted for qualitative factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company over the most recent twelve calendar quarters unless the historical loss experience is not considered indicative of the level of risk in the remaining balance of a particular portfolio segment, in which case an adjustment is determined by management. The Company's historical loss experience is then adjusted by an overall loss factor weighting adjustment based on a qualitative analysis prepared by management and reviewed on a quarterly basis. The overall loss factor considers changes in underwriting standards, economic conditions, changes and trends in past due and classified loans and other internal and external factors.

Management also applies additional loss factor multiples to loans classified as watch, special mention and substandard that are not individually evaluated for impairment. The loss factor multiples for classified loans are based on management's assessment of historical trends regarding losses experienced on classified loans in prior periods. See below for additional discussion of the overall loss factor and loss factor multiples for classified loans as of September 30, 2014 and December 31, 2013, as well as a discussion of changes in management's allowance for loan losses methodology from 2013 to 2014.

Management exercises significant judgment in evaluating the relevant historical loss experience and the qualitative factors. Management also monitors the differences between estimated and actual incurred loan losses for loans considered impaired in order to evaluate the effectiveness of the estimation process and make any changes in the methodology as necessary.

Management utilizes the following portfolio segments in its analysis of the allowance for loan losses: residential real estate, land, construction, commercial real estate, commercial business, home equity and second mortgage, and other consumer loans. Additional discussion of the portfolio segments and the risks associated with each segment can be found in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

FIRST CAPITAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Values for collateral dependent loans are generally based on appraisals obtained from independent licensed real estate appraisers, with adjustments applied for estimated costs to sell the property, costs to complete unfinished or repair damaged property and other factors. New appraisals are generally obtained for all significant properties when a loan is identified as impaired, and a property is considered significant if the value of the property is estimated to exceed \$200,000. Subsequent appraisals are obtained as needed or if management believes there has been a significant change in the market value of the property. In instances where it is not deemed necessary to obtain a new appraisal, management bases its impairment and allowance for loan loss analysis on the original appraisal with adjustments for current conditions based on management's assessment of market factors and management's inspection of the property.

Loans at September 30, 2014 and December 31, 2013 consisted of the following:

(In thousands)	September 30, 2014	December 31, 2013
Real estate mortgage loans:		
Residential	\$ 103,955	\$ 107,029
Land	10,459	10,309
Residential construction	15,948	14,423
Commercial real estate	79,991	76,496
Commercial real estate construction	1,118	1,715
Commercial business loans	29,687	21,956
Consumer loans:		
Home equity and second mortgage loans	36,656	34,815
Automobile loans	25,520	23,983
Loans secured by savings accounts	1,026	1,138
Unsecured loans	3,416	3,541
Other consumer loans	4,818	4,824
Gross loans	312,594	300,229
Less undisbursed portion of loans in process	(5,723)	(7,142)
Principal loan balance	306,871	293,087

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Deferred loan origination fees, net	459	341
Allowance for loan losses	(5,055)	(4,922)
Loans, net	\$ 302,275	\$ 288,506

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FIRST CAPITAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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The following table provides the components of the Company’s recorded investment in loans at September 30, 2014:

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity & 2nd Mtg	Other Consumer	Total
	(In thousands)							
Recorded Investment in Loans:								
Principal loan balance	\$103,955	\$10,459	\$11,343	\$79,991	\$29,687	\$36,656	\$34,780	\$306,871
Accrued interest receivable	365	50	27	198	91	127	147	1,005
Net deferred loan origination fees and costs	63	3	(2)	(32)	(7)	434	0	459
Recorded investment in loans	\$104,383	\$10,512	\$11,368	\$80,157	\$29,771	\$37,217	\$34,927	\$308,335
Recorded Investment in Loans as Evaluated for Impairment:								
Individually evaluated for impairment	\$1,297	\$107	\$0	\$1,709	\$1,864	\$170	\$0	\$5,147
Collectively evaluated for impairment	103,086	10,405	11,368	78,448	27,907	37,047	34,927	303,188
Acquired with deteriorated credit quality	0	0	0	0	0	0	0	0
Ending balance	\$104,383	\$10,512	\$11,368	\$80,157	\$29,771	\$37,217	\$34,927	\$308,335

FIRST CAPITAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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The following table provides the components of the Company's recorded investment in loans at December 31, 2013:

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity & 2nd Mtg	Other Consumer	Total
	(In thousands)							
Recorded Investment in Loans:								
Principal loan balance	\$107,029	\$10,309	\$ 8,996	\$ 76,496	\$ 21,956	\$ 34,815	\$ 33,486	\$293,087
Accrued interest receivable	427	49	22	202	56	126	168	1,050
Net deferred loan origination fees and costs	52	2	0	(32)	(9)	328	0	341
Recorded investment in loans	\$107,508	\$10,360	\$ 9,018	\$ 76,666	\$ 22,003	\$ 35,269	\$ 33,654	\$294,478
Recorded Investment in Loans as Evaluated for Impairment:								
Individually evaluated for impairment	\$2,040	\$120	\$ 0	\$ 2,586	\$ 1,898	\$ 276	\$ 0	\$6,920
Collectively evaluated for impairment	105,468	10,240	9,018	74,080	20,105	34,993	33,654	287,558
Acquired with deteriorated credit quality	0	0	0	0	0	0	0	0
Ending balance	\$107,508	\$10,360	\$ 9,018	\$ 76,666	\$ 22,003	\$ 35,269	\$ 33,654	\$294,478

FIRST CAPITAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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An analysis of the allowance for loan losses as of September 30, 2014 is as follows:

	Residential			Commercial		Home Equity	Other	Total
	Real	Land	Construction	Real Estate	Commercial	&	Consumer	
	Estate				Business	2nd Mtg		
	(In thousands)							
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	\$53	\$0	\$ 0	\$ 13	\$ 1,226	\$ 16	\$ 0	\$1,308
Collectively evaluated for impairment	772	156	77	1,248	221	929	344	3,747
Acquired with deteriorated credit quality	0	0	0	0	0	0	0	0
Ending balance	\$825	\$156	\$ 77	\$ 1,261	\$ 1,447	\$ 945	\$ 344	\$5,055

An analysis of the allowance for loan losses as of December 31, 2013 is as follows:

	Residential			Commercial		Home Equity	Other	Total
	Real	Land	Construction	Real Estate	Commercial	&	Consumer	
	Estate				Business	2nd Mtg		
	(In thousands)							
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	\$112	\$0	\$ 0	\$ 145	\$ 1,259	\$ 13	\$ 0	\$1,529
Collectively evaluated for impairment	699	152	63	1,139	187	864	289	3,393
Acquired with deteriorated credit quality	0	0	0	0	0	0	0	0
Ending balance	\$811	\$152	\$ 63	\$ 1,284	\$ 1,446	\$ 877	\$ 289	\$4,922

FIRST CAPITAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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An analysis of the changes in the allowance for loan losses for the three months and nine months ended September 30, 2014 is as follows:

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity & 2nd Mtg	Other Consumer	Total
	(In thousands)							
Allowance for loan losses:								
Changes in Allowance for Loan Losses for the three-months ended September 30, 2014								
Beginning balance	\$843	\$153	\$78	\$1,280	\$1,444	\$932	\$336	\$5,066
Provisions for loan losses	36	3	(1)	(19)	(5)	1	60	75
Charge-offs	(56)	0	0	0	0	0	(84)	(140)
Recoveries	2	0	0	0	8	12	32	54
Ending balance	\$825	\$156	\$77	\$1,261	\$1,447	\$945	\$344	\$5,055
Changes in Allowance for Loan Losses for the nine-months ended September 30, 2014								
Beginning balance	\$811	\$152	\$63	\$1,284	\$1,446	\$877	\$289	\$4,922
Provisions for loan losses	148	4	14	(23)	(12)	(69)	128	190
Charge-offs	(140)	0	0	0	0	(54)	(172)	(366)
Recoveries	6	0	0	0	13	191	99	309
Ending balance	\$825	\$156	\$77	\$1,261	\$1,447	\$945	\$344	\$5,055

FIRST CAPITAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(3 – continued)

An analysis of the changes in the allowance for loan losses for the three months and nine months ended September 30, 2013 is as follows:

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity & 2nd Mtg	Other Consumer	Total
	(In thousands)							
Allowance for loan losses:								
Changes in Allowance for Loan Losses for the three-months ended September 30, 2013								
Beginning balance	\$905	\$73	\$60	\$1,291	\$1,260	\$894	\$352	\$4,835
Provisions for loan losses	(26)	(3)	(10)	(52)	210	(13)	(6)	100
Charge-offs	0	0	0	(1)	0	(24)	(89)	(114)
Recoveries	15	0	0	3	4	8	53	83
Ending balance	\$894	\$70	\$50	\$1,241	\$1,474	\$865	\$310	\$4,904
Changes in Allowance for Loan Losses for the nine-months ended September 30, 2013								
Beginning balance	\$922	\$71	\$0	\$1,310	\$1,223	\$919	\$291	\$4,736
Provisions for loan losses	211	1	50	3	196	(37)	151	575
Charge-offs	(298)	(2)	0	(89)	0	(59)	(260)	(708)
Recoveries	59	0	0	17	55	42	128	301
Ending balance	\$894	\$70	\$50	\$1,241	\$1,474	\$865	\$310	\$4,904

FIRST CAPITAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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At September 30, 2014 and December 31, 2013, for each loan portfolio segment, management applied an overall qualitative factor of 1.18 to the Company's historical loss factors. The overall qualitative factor is derived from management's analysis of changes and trends in the following qualitative factors:

Underwriting Standards – Management reviews the findings of periodic internal audit loan reviews, independent outsourced loan reviews and loan reviews performed by the banking regulators to evaluate the risk associated with changes in underwriting standards. At September 30, 2014 and December 31, 2013, management assessed the risk associated with this component as neutral, requiring no adjustment to the historical loss factors.

Economic Conditions – Management analyzes trends in housing and unemployment data in the Harrison, Floyd, Washington and Clark counties of Indiana, the Company's primary market area, to evaluate the risk associated with economic conditions. Due to a decrease in new home construction and an increase in unemployment in the Company's primary market area, management assigned a risk factor of 1.20 for this component at September 30, 2014 and December 31, 2013.

Past Due Loans – Management analyzes trends in past due loans for the Company to evaluate the risk associated with delinquent loans. In general, past due loan ratios have remained at elevated levels compared to historical amounts since 2007, and management assigned a risk factor of 1.20 for this component at September 30, 2014 and December 31, 2013.

Other Internal and External Factors – This component includes management's consideration of other qualitative factors such as loan portfolio composition. The Company has focused on the origination of commercial business and real estate loans in an effort to convert the Company's balance sheet from that of a traditional thrift institution to a commercial bank. In addition, the Company has increased its investment in mortgage loans in which it does not hold a first lien position. Commercial loans and second mortgage loans generally entail greater credit risk than residential mortgage loans secured by a first lien. As a result of changes in the loan portfolio composition and other factors, management assigned a risk factor of 1.30 at September 30, 2014 and December 31, 2013.

Each of the four factors above was assigned an equal weight to arrive at an average for the overall qualitative factor of 1.18 at September 30, 2014 and December 31, 2013. The effect of the overall qualitative factor was to increase the estimated allowance for loan losses by \$455,000 and \$471,000 at September 30, 2014 and December 31, 2013, respectively.

Management also adjusts the historical loss factors for loans classified as watch, special mention and substandard that are not individually evaluated for impairment. The adjustments consider the increased likelihood of loss on classified loans based on the Company's separate historical experience for classified loans. The effect of the adjustments for classified loans was to increase the estimated allowance for loan losses by \$487,000 and \$521,000 at September 30, 2014 and December 31, 2013, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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The following table summarizes the Company's impaired loans as of September 30, 2014 and for the three months and nine months ended September 30, 2014:

	At September 30, 2014			Three Months Ended September 30, 2014			Nine Months Ended September 30, 2014		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Interest - Cash Method	Average Recorded Investment	Interest Income Recognized	Interest - Cash Method
(In thousands)									
Loans with no related allowance recorded:									
Residential	\$ 1,042	\$ 1,325	\$ 0	\$ 1,113	\$ 8	\$ 9	\$ 1,331	\$ 25	\$ 31
Land	107	126	0	110	0	0	116	0	0
Construction	0	0	0	0	0	0	65	0	0
Commercial real estate	1,666	1,698	0	1,713	19	18	1,588	53	58
Commercial business	188	209	0	188	0	0	142	0	0
Home equity/2nd mortgage	74	88	0	85	0	0	167	2	1
Other consumer	0	0	0	0	0	0	0	0	0
	3,077	3,446	0	3,209	27	27	3,409	80	90
Loans with an allowance recorded:									
Residential	255	299	53	259	0	0	394	0	0
Land	0	0	0	0	0	0	2	0	0
Construction	0	0	0	0	0	0	0	0	0
Commercial real estate	43	66	13	477	0	0	809	0	0
Commercial business	1,676	1,909	1,226	1,676	0	0	1,709	0	0
Home equity/2nd mortgage	96	96	16	48	0	0	38	0	0
	0	0	0	0	0	0	0	0	0

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Other consumer									
	2,070	2,370	1,308	2,460	0	0	2,952	0	0
Total:									
Residential	1,297	1,624	53	1,372	8	9	1,725	25	31
Land	107	126	0	110	0	0	118	0	0
Construction	0	0	0	0	0	0	65	0	0
Commercial real estate	1,709	1,764	13	2,190	19	18	2,397	53	58
Commercial business	1,864	2,118	1,226	1,864	0	0	1,851	0	0
Home equity/2nd mortgage	170	184	16	133	0	0	205	2	1
Other consumer	0	0	0	0	0	0	0	0	0
	\$5,147	\$ 5,816	\$ 1,308	\$ 5,669	\$ 27	\$ 27	\$ 6,361	\$ 80	\$ 90

FIRST CAPITAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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The following table summarizes the Company's impaired loans for the three months and nine months ended September 30, 2013:

	Three Months Ended September 30, 2013			Nine Months Ended September 30, 2013		
	Average Recorded Investment	Interest Income Recognized	Interest Recognized - Cash Method	Average Recorded Investment	Interest Income Recognized	Interest Recognized - Cash Method
Loans with no related allowance recorded:						
Residential	\$ 1,041	\$ 4	\$ 2	\$ 1,219	\$ 8	\$ 3
Land	125	0	0	125	0	0
Construction	102	0	0	217	0	0
Commercial real estate	138	0	0	471	0	0
Commercial business	0	0	0	0	0	0
Home equity/2nd mortgage	161	2	2	141	3	3
Other consumer	0	0	0	0	0	0
	1,567	6	4	2,173	11	6
Loans with an allowance recorded:						
Residential	560	0	0	668	1	0
Land	0	0	0	2	0	0
Construction	0	0	0	0	0	0
Commercial real estate	977	0	0	1,147	0	0
Commercial business	1,872	0	0	1,824	4	3
Home equity/2nd mortgage	55	0	0	54	1	0
Other consumer	0	0	0	0	0	0
	3,464	0	0	3,695	6	3
Total:						
Residential	1,601	4	2	1,887	9	3
Land	125	0	0	127	0	0
Construction	102	0	0	217	0	0
Commercial real estate	1,115	0	0	1,618	0	0
Commercial business	1,872	0	0	1,824	4	3
Home equity/2nd mortgage	216	2	2	195	4	3
Other consumer	0	0	0	0	0	0