HORIZON BANCORP /IN/
Form 10-Q
August 11, 2014
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HORIZON BANCORP

FORM 10-Q

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2014

Commission file number 0-10792

HORIZON BANCORP

(Exact name of registrant as specified in its charter)

Indiana	**35-1562417**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
515 Franklin Square, Michigan City, Indiana	**46360**
(Address of principal executive offices)	**(Zip Code)**

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

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

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

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

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 9,210,786 shares of Common Stock, no par value, at August 11, 2014.

HORIZON BANCORP

FORM 10-Q

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PART 1 FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

HORIZON BANCORP AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(Dollar Amounts in Thousands)

	June 30 2014 (Unaudited)	December 31 2013
Assets		
Cash and due from banks	**$ 50,804**	$ 31,721
Investment securities, available for sale	**364,418**	508,591
Investment securities, held to maturity (fair value of $175,494 and $9,910)	**173,200**	9,910
Loans held for sale	**7,286**	3,281
Loans, net of allowance for loan losses of $15,660 and $15,992	**1,305,834**	1,052,836
Premises and equipment, net	**50,853**	46,194
Federal Reserve and Federal Home Loan Bank stock	**16,326**	14,184
Goodwill	**28,034**	19,748
Other intangible assets	**4,422**	3,288
Interest receivable	**8,280**	7,501
Cash value life insurance	**38,860**	36,190
Other assets	**24,934**	24,832
Total assets	**$ 2,073,251**	$ 1,758,276
Liabilities		
Deposits		
Non-interest bearing	**$ 270,023**	$ 231,096
Interest bearing	**1,229,080**	1,060,424
Total deposits	**1,499,103**	1,291,520
Borrowings	**340,201**	256,296
Subordinated debentures	**32,564**	32,486
Interest payable	**508**	506
Other liabilities	**13,539**	12,948
Total liabilities	**1,885,915**	1,593,756
Commitments and contingent liabilities		
Stockholders Equity		
Preferred stock, Authorized, 1,000,000 shares Series B shares $.01 par value, $1,000 liquidation value Issued 12,500 shares	**12,500**	12,500

Common stock, no par value Authorized, 22,500,000 shares Issued, 9,274,416 and 8,706,971 shares Outstanding, 9,201,786 and 8,630,966 shares		
Additional paid-in capital	**45,438**	32,496
Retained earnings	**127,154**	121,253
Accumulated other comprehensive income (loss)	**2,244**	(1,729)
Total stockholders equity	**187,336**	164,520
Total liabilities and stockholders equity	**$ 2,073,251**	$ 1,758,276

See notes to condensed consolidated financial statements

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HORIZON BANCORP AND SUBSIDIARIES

Condensed Consolidated Statements of Income

(Dollar Amounts in Thousands, Except Per Share Data)

	Three Months Ended June 30		Six Months Ended June 30	
	2014 (Unaudited)	**2013 (Unaudited)**	**2014 (Unaudited)**	**2013 (Unaudited)**
Interest Income				
Loans receivable	**$ 16,631**	$ 16,906	**$ 29,585**	$ 33,346
Investment securities				
Taxable	**2,395**	2,047	**4,785**	4,069
Tax exempt	**1,096**	1,024	**2,219**	1,991
Total interest income	**20,122**	19,977	**36,589**	39,406
Interest Expense				
Deposits	**1,355**	1,445	**2,632**	2,925
Borrowed funds	**1,478**	1,456	**2,900**	2,904
Subordinated debentures	**501**	501	**997**	992
Total interest expense	**3,334**	3,402	**6,529**	6,821
Net Interest Income	**16,788**	16,575	**30,060**	32,585
Provision for loan losses	**339**	729	**339**	2,813
Net Interest Income after Provision for Loan Losses	**16,449**	15,846	**29,721**	29,772
Non-interest Income				
Service charges on deposit accounts	**1,038**	988	**1,961**	1,901
Wire transfer fees	**145**	203	**257**	393
Interchange fees	**1,254**	1,060	**2,213**	1,926
Fiduciary activities	**1,199**	1,047	**2,247**	2,187
Gain on sale of investment securities (includes $0 for the three and six months ended June 30, 2014 and $0 for the three months ended and $368 for the six months ended June 30, 2013, related to accumulated other comprehensive earnings reclassifications)				368
Gain on sale of mortgage loans	**2,537**	2,807	**3,948**	5,913
Mortgage servicing income net of impairment	**233**	302	**440**	465
Increase in cash value of bank owned life insurance	**252**	257	**485**	509
Other income	**(31)**	185	**598**	647

Total non-interest income		**6,627**		6,849		**12,149**		14,309
Non-interest Expense								
Salaries and employee benefits		**8,293**		7,721		**15,776**		15,225
Net occupancy expenses		**1,360**		1,295		**2,784**		2,606
Data processing		**937**		818		**1,807**		1,418
Professional fees		**419**		454		**1,027**		953
Outside services and consultants		**1,298**		486		**1,959**		1,198
Loan expense		**1,272**		1,402		**2,287**		2,516
FDIC insurance expense		**285**		268		**541**		551
Other losses		**95**		163		**133**		91
Other expense		**2,449**		2,188		**4,608**		4,216
Total non-interest expense		**16,408**		14,795		**30,922**		28,774
Income Before Income Tax		**6,668**		7,900		**10,948**		15,307
Income tax expense (includes $0 for the three and six months ended June 30, 2014 and $0 for the three months ended and $129 for the six months ended June 30, 2013, related to income tax expense from reclassification items)		**1,890**		2,235		**2,753**		4,331
Net Income		**4,778**		5,665		**8,195**		10,976
Preferred stock dividend and discount accretion		**(32)**		(96)		**(63)**		(242)
Net Income Available to Common Shareholders	**$**	**4,746**	$	5,569	**$**	**8,132**	$	10,734
Basic Earnings Per Share	**$**	**0.52**	$	0.65	**$**	**0.91**	$	1.25
Diluted Earnings Per Share		**0.50**		0.62		**0.88**		1.20

See notes to condensed consolidated financial statements

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HORIZON BANCORP AND SUBSIDIARIES

Condensed Consolidated Statements of Comprehensive Income (Loss)

(Dollar Amounts in Thousands)

	Three Months Ended June 30		Six Months Ended June 30	
	2014 (Unaudited)	2013 (Unaudited)	2014 (Unaudited)	2013 (Unaudited)
Net Income	**$ 4,778**	$ 5,665	**$ 8,195**	$ 10,976
Other Comprehensive Income (Loss)				
Change in fair value of derivative instruments:				
Change in fair value of derivative instruments for the period	**(317)**	1,582	**(542)**	2,020
Income tax effect	**111**	(554)	**190**	(707)
Changes from derivative instruments	**(206)**	1,028	**(352)**	1,313
Change in securities available-for-sale:				
Unrealized appreciation (depreciation) for the period on available-for-sale securities	**2,336**	(12,168)	**6,762**	(14,607)
Unrealized appreciation (depreciation) for the period on held-to-maturity (1)	**(108)**		**(108)**	
Reclassification adjustment for securities gains realized in income				368
Income tax effect	**(779)**	4,259	**(2,329)**	4,984
Unrealized gains (losses) on available-for-sale securities	**1,449**	(7,909)	**4,325**	(9,255)
Other Comprehensive Income (Loss), Net of Tax	**1,243**	(6,881)	**3,973**	(7,942)
Comprehensive Income (Loss)	**$ 6,021**	**$ (1,216)**	**$ 12,168**	$ 3,034

(1) The amortization of the unrealized holding gains in accumulated other comprehensive income at the date of the transfer partially offsets the accretion of the difference between the par value and the fair value of the investment securities at the date of the transfer.

See notes to condensed consolidated financial statements

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HORIZON BANCORP AND SUBSIDIARIES

Condensed Consolidated Statement of Stockholders Equity

(Unaudited)

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

	Preferred Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balances, January 1, 2014	**$ 12,500**	**$ 32,496**	**$ 121,253**	**$ (1,729)**	**$ 164,520**
Net income			8,195		8,195
Other comprehensive income, net of tax				3,973	3,973
Amortization of unearned compensation		166			166
Stock option expense		87			87
Stock issued from acquisition		12,689			12,689
Cash dividends on preferred stock (1.00%)			(63)		(63)
Cash dividends on common stock ($.24 per share)			(2,231)		(2,231)
Balances, June 30, 2014	**$ 12,500**	**$ 45,438**	**$ 127,154**	**$ 2,244**	**$ 187,336**

See notes to condensed consolidated financial statements

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HORIZON BANCORP AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(Dollar Amounts in Thousands)

	Six Months Ended June 30	
	2014 (Unaudited)	**2013 (Unaudited)**
Operating Activities		
Net income	**$ 8,195**	$ 10,976
Items not requiring (providing) cash		
Provision for loan losses	**339**	2,813
Depreciation and amortization	**1,805**	1,686
Share based compensation	**87**	16
Mortgage servicing rights recovery	**(38)**	(135)
Premium amortization on securities available for sale, net	**1,132**	1,540
Gain on sale of investment securities		(368)
Gain on sale of mortgage loans	**(3,948)**	(5,913)
Proceeds from sales of loans	**93,991**	202,947
Loans originated for sale	**(94,048)**	(198,000)
Change in cash value of life insurance	**(485)**	(509)
Gain on sale of other real estate owned	**(173)**	(277)
Net change in		
Interest receivable	**(432)**	(33)
Interest payable	**(50)**	371
Other assets	**702**	7,101
Other liabilities	**(1,190)**	(983)
Net cash provided by operating activities	**5,887**	21,232
Investing Activities		
Purchases of securities available for sale	**(52,484)**	(97,983)
Proceeds from sales, maturities, calls, and principal repayments of securities available for sale	**35,828**	82,920
Purchase of securities held to maturity	**(4,839)**	(9,910)
Proceeds from maturities of securities held to maturity	**7,900**	
Purchase of Federal Reserve Bank stock	**(6)**	(851)
Net change in loans	**(130,424)**	67,621
Proceeds on the sale of OREO and repossessed assets	**2,095**	2,053
Purchases of premises and equipment	**(3,326)**	(2,356)
Acquisition of SCB	**7,925**	
Purchase of Mortgage Company	**(736)**	
Net cash provided by (used in) by investing activities	**(138,067)**	41,494

Financing Activities		
Net change in		
Deposits	**86,564**	3,103
Borrowings	**66,993**	(62,849)
Dividends paid on common shares	**(2,231)**	(1,738)
Dividends paid on preferred shares	**(63)**	(242)
Net cash provided by (used in) financing activities	**151,263**	(61,726)
Net Change in Cash and Cash Equivalents	**19,083**	1,000
Cash and Cash Equivalents, Beginning of Period	**31,721**	30,735
Cash and Cash Equivalents, End of Period	**$ 50,804**	$ 31,735
Additional Supplemental Information		
Interest paid	**$ 6,527**	$ 6,450
Income taxes paid	**600**	3,100
Transfer of loans to other real estate owned	**1,999**	1,381
Transfer of available-for -sale securities to held-to-maturity	**167,047**	
The Company purchased all of the capital stock of Summit for $18,896. In conjunction with the acquisition, liabilities were assumed as follows:		
Fair value of assets acquired	**158,585**	
Cash paid to retire Summit debt	**6,207**	
Cash paid for the capital stock	**1,029**	
Liabilities assumed	**138,660**	

See notes to condensed consolidated financial statements

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HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Note 1 Accounting Policies

The accompanying unaudited condensed consolidated financial statements include the accounts of Horizon Bancorp (Horizon or the Company) and its wholly-owned subsidiaries, including Horizon Bank, N.A. (Bank). All inter-company balances and transactions have been eliminated. The results of operations for the periods ended June 30, 2014 are not necessarily indicative of the operating results for the full year of 2014. The accompanying unaudited condensed consolidated financial statements reflect all adjustments that are, in the opinion of Horizon s management, necessary to fairly present the financial position, results of operations and cash flows of Horizon for the periods presented. Those adjustments consist only of normal recurring adjustments.

Certain information and note disclosures normally included in Horizon s annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in Horizon s Annual Report on Form 10-K for 2013 filed with the Securities and Exchange Commission on February 28, 2014. The condensed consolidated balance sheet of Horizon as of December 31, 2013 has been derived from the audited balance sheet as of that date.

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

	Three months ended June 30		Six months ended June 30	
	2014 (Unaudited)	**2013 (Unaudited)**	**2014 (Unaudited)**	**2013 (Unaudited)**
Basic earnings per share				
Net income	**$ 4,778**	$ 5,665	**$ 8,195**	$ 10,976
Less: Preferred stock dividends and accretion of discount	**32**	96	**63**	242
Net income available to common shareholders	**$ 4,746**	$ 5,569	**$ 8,132**	$ 10,734
Weighted average common shares outstanding	**9,182,986**	8,617,466	**8,908,492**	8,617,466
Basic earnings per share	**$ 0.52**	$ 0.65	**$ 0.91**	$ 1.25
Diluted earnings per share				

Net income available to common shareholders	**$ 4,746**	$ 5,569	**$ 8,132**	$ 10,734
Weighted average common shares outstanding	**9,182,986**	8,617,466	**8,908,492**	8,617,466
Effect of dilutive securities:				
Warrants	**303,399**	287,815	**308,060**	290,550
Restricted stock	**38,003**	35,263	**38,717**	35,411
Stock options	**36,551**	33,559	**38,154**	33,981
Weighted average shares outstanding	**9,560,939**	8,974,103	**9,293,423**	8,977,408
Diluted earnings per share	**$ 0.50**	$ 0.62	**$ 0.88**	$ 1.20

At June 30, 2014 and 2013, there were 42,683 and 46,760 shares, respectively, which were not included in the computation of diluted earnings per share because they were non-dilutive.

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Notes to Condensed Consolidated Financial Statements

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Horizon has share-based employee compensation plans, which are described in the notes to the financial statements included in the December 31, 2013 Annual Report on Form 10-K.

Reclassifications

Certain reclassifications have been made to the 2013 condensed consolidated financial statements to be comparable to 2014. These reclassifications had no effect on net income.

Note 2 Acquisition

On April 3, 2014 Horizon closed its acquisition of SCB Bancorp, Inc. (Summit) and Horizon Bank N.A. s acquisition of Summit Community Bank, through mergers effective as of that date. Under the final terms of the acquisition, the exchange ratio was 0.4904 shares of Horizon s common stock and $5.15 in cash for each share of Summit common stock outstanding. Summit shares outstanding at the closing were 1,164,442, and the shares of Horizon common stock issued to Summit shareholders totaled 570,820. Horizon s stock price was $22.23 per share at the close of business on April 3, 2014. Based upon these numbers, the total value of the consideration for the acquisition was $18.9 million (not including the retirement of Summit debt). For the six months ended June 30, 2014, the Company had approximately $1.2 million is costs related to the acquisition. These expenses are classified in the other expense section of the income statement and primarily located in the salaries and employee benefits, professional services and other expense line items. As a result of the acquisition, the Company will have an opportunity to increase its deposit base and reduce transaction costs. The Company also expects to reduce cost through economies of scale.

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

ASSETS		**LIABILITIES**	
Cash and due from banks	$ 15,161	Deposits	
		Non-interest bearing	$ 27,274
Commercial	70,441	NOW accounts	16,332
Residential mortgage	43,448	Savings and money market	35,045
Consumer	10,192	Certificates of deposits	42,368
Total loans	124,081	Total deposits	121,019
Premises and equipment, net	2,548	Borrowings	16,990

FRB and FHLB stock	2,136	Interest payable	52
Goodwill	8,286	Other liabilities	599
Core deposit intangible	822		
Interest receivable	347		
Cash value life insurance	2,185		
Other assets	3,019		
Total assets purchased	$ 158,585	Total liabilities assumed	$ 138,660
Common shares issued	$ 12,689		
Cash paid	6,207		
Retirement of Holding Company Debt	1,029		
Total estimated purchase price	$ 19,925		

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HORIZON BANCORP AND SUBSIDIARIES

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Of the total estimated purchase price of $19.9 million, $822,000 has been allocated to core deposit intangible. Additionally, $8.3 million has been allocated to goodwill and $4.4 million of the purchase price is deductible and was assigned to the business assets. The core deposit intangible will be amortized over seven years on a straight line basis.

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

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

The Company acquired the $130.5 million loan portfolio at a fair value discount of $6.4 million. The performing portion of the portfolio, $106.2 million, had an estimated fair value of $104.6 million. The excess of expected cash flows above the fair value of the performing portion of loans will be accreted to interest income over the remaining lives of the loans in accordance with ASC 310-20.

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

The following table details the acquired loans that are accounted for in accordance with ASC 310-30 as of April 3, 2014.

Contractually required principal and interest at acquisition	$ 14,460
Contractual cash flows not expected to be collected (nonaccretable differences)	3,077
Expected cash flows at acquisition	11,383
Interest component of expected cash flows (accretable discount)	1,758
Fair value of acquired loans accounted for under ASC 310-30	$ 9,625

Pro-forma statements were not presented due to the materiality of the transaction.

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HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Note 3 Securities

The fair value of securities is as follows:

June 30, 2014	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
U.S. Treasury and federal agencies	$ 35,737	$ 137	$ (342)	$ 35,532
State and municipal	47,691	1,778	(88)	49,381
Federal agency collateralized mortgage obligations	115,503	1,159	(1,420)	115,242
Federal agency mortgage-backed pools	158,907	4,367	(687)	162,587
Private labeled mortgage-backed pools	892	28		920
Corporate notes	738	18		756
Total available for sale investment securities	$ 359,468	$ 7,487	$ (2,537)	$ 364,418
Held to maturity				
U.S. Treasury and federal agencies	$ 9,764	$ 79	$	$ 9,843
State and municipal	136,131	1,816	(19)	137,928
Federal agency collateralized mortgage obligations	4,360	5	(1)	4,364
Federal agency mortgage-backed pools	22,945	414		23,359
Total held to maturity investment securities	$ 173,200	$ 2,314	$ (20)	$ 175,494

December 31, 2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
U.S. Treasury and federal agencies	$ 43,808	$ 133	$ (807)	$ 43,134
State and municipal	176,670	4,405	(3,177)	177,898
Federal agency collateralized mortgage obligations	116,047	1,242	(2,583)	114,706
Federal agency mortgage-backed pools	170,006	3,172	(2,284)	170,894
Private labeled mortgage-backed pools	1,188	38		1,226
Corporate notes	708	25		733

Total available for sale investment securities	$ 508,427	$ 9,015	$ (8,851)	$ 508,591
Held to maturity, State and Municipal	$ 9,910	$	$	$ 9,910

Based on evaluation of available evidence, including recent changes in market interest rates, credit rating information, and information obtained from regulatory filings, management believes the declines in fair value for these securities are temporary. While these securities are held in the available for sale portfolio and held-to-maturity, Horizon intends, and has the ability, to hold them until the earlier of a recovery in fair value or maturity.

Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other-than-temporary impairment is identified. At June 30, 2014, no individual investment security had an unrealized loss that was determined to be other-than-temporary.

The unrealized losses on the Company s investments in securities of state and municipal governmental agencies, U.S. Treasury and federal agencies, and federal agency mortgage-backed pools were caused by interest rate volatility and not a decline in credit quality. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. The Company expects to recover the amortized cost basis over the term of the securities. Because the Company does not intend to sell the investments and it is not likely that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be at maturity, the Company did not consider those investments to be other-than-temporarily impaired at June 30, 2014.

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HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

The Company elected to transfer 319 available-for-sale (AFS) securities with an aggregate fair value of $167.1 million to a classification of held-to-maturity (HTM) on April 1, 2014. In accordance with FASB ASC 320-10-55-24, the transfer from AFS to HTM must be recorded at the fair value of the AFS securities at the time of transfer. The net unrealized holding gain of $1.3 million, net of tax, at the date of transfer was retained in accumulated other comprehensive income (loss), with the associated pre-tax amount retained in the carrying value of the HTM securities. Such amounts will be amortized to comprehensive income over the remaining life of the securities. The fair value of the transferred AFS securities became the book value of the HTM securities at April 1, 2014, with no unrealized gain or loss at this date. Future reporting periods, with potential changes in market value for these securities, would likely record an unrealized gain or loss for disclosure purposes.

The amortized cost and fair value of securities available for sale and held to maturity at June 30, 2014 and December 31, 2013, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	June 30, 2014		December 31, 2013	
	Amortized Cost	**Fair Value**	**Amortized Cost**	**Fair Value**
Available for sale				
Within one year	$ 4,738	$ 4,778	$ 3,643	$ 3,663
One to five years	45,331	45,937	49,198	49,627
Five to ten years	28,584	29,278	106,225	107,424
After ten years	5,513	5,676	62,120	61,051
	84,166	85,669	221,186	221,765
Federal agency collateralized mortgage obligations	115,503	115,242	116,047	114,706
Federal agency mortgage-backed pools	158,907	162,587	170,006	170,894
Private labeled mortgage-backed pools	892	920	1,188	1,226
Total available for sale investment securities	$ 359,468	$ 364,418	$ 508,427	$ 508,591
Held to maturity				
Within one year	$ 5,951	$ 5,951	$ 9,910	$ 9,910
One to five years	383	384		
Five to ten years	89,024	90,139		
After ten years	50,537	51,297		

	145,895	147,771	9,910	9,910
Federal agency collateralized mortgage obligations	4,360	4,364		
Federal agency mortgage-backed pools	22,945	23,359		
Total held to maturity investment securities	$ 173,200	$ 175,494	$ 9,910	$ 9,910

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The following table shows the gross unrealized losses and the fair value of the Company s investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position.

June 30, 2014	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or More Fair Value	12 Months or More Unrealized Losses	Total Fair Value	Total Unrealized Losses
U.S. Treasury and federal agencies	$ 3,064	$ (20)	$ 23,661	$ (322)	$ 26,725	$ (342)
State and municipal	4,826	(27)	4,405	(80)	9,231	(107)
Federal agency collateralized mortgage obligations	12,989	(35)	42,578	(1,386)	55,567	(1,421)
Federal agency mortgage-backed pools			35,378	(687)	35,378	(687)
Total temporarily impaired securities	$ 20,879	$ (82)	$ 106,022	$ (2,475)	$ 126,901	$ (2,557)

December 31, 2013	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or More Fair Value	12 Months or More Unrealized Losses	Total Fair Value	Total Unrealized Losses
U.S. Treasury and federal agencies	$ 32,099	$ (807)	$	$	$ 32,099	$ (807)
State and municipal	57,078	(2,993)	3,206	(184)	60,284	(3,177)
Federal agency collateralized mortgage obligations	64,445	(2,121)	8,601	(462)	73,046	(2,583)
Federal agency mortgage-backed pools	87,919	(2,284)			87,919	(2,284)
Total temporarily impaired securities	$ 241,541	$ (8,205)	$ 11,807	$ (646)	$ 253,348	$ (8,851)

	Three months ended June 30 2014	Three months ended June 30 2013	Six months ended June 30 2014	Six months ended June 30 2013
Sales of securities available for sale (Unaudited)				
Proceeds	**$**	**$**	**$**	$ 23,485
Gross gains				376
Gross losses				(8)

Note 4 Loans

	June 30 2014	December 31 2013
Commercial		
Working capital and equipment	**$ 276,180**	$ 241,569
Real estate, including agriculture	**347,051**	245,313
Tax exempt	**4,670**	2,898
Other	**20,301**	15,409
Total	**648,202**	505,189
Real estate		
1 4 family	**231,230**	181,393
Other	**4,293**	4,565
Total	**235,523**	185,958
Consumer		
Auto	**142,464**	139,915
Recreation	**5,677**	4,839
Real estate/home improvement	**34,084**	30,729
Home equity	**106,517**	96,924
Unsecured	**4,126**	3,825
Other	**4,005**	3,293
Total	**296,873**	279,525
Mortgage warehouse	**140,896**	98,156
Total loans	**1,321,494**	1,068,828
Allowance for loan losses	**(15,660)**	(15,992)
Loans, net	**$ 1,305,834**	$ 1,052,836

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Commercial

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

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

Real Estate and Consumer

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

Mortgage Warehousing

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

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

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

June 30, 2014	Loan Balance	Interest Due	Deferred Fees / (Costs)	Recorded Investment
Owner occupied real estate	$ 206,000	$ 332	$ 642	$ 206,974
Non owner occupied real estate	294,681	345	542	295,568
Residential spec homes	835	1		836
Development & spec land loans	24,188	81	33	24,302
Commercial and industrial	121,192	830	89	122,111
Total commercial	646,896	1,589	1,306	649,791
Residential mortgage	225,819	872	636	227,327
Residential construction	9,068	17		9,085
Mortgage warehouse	140,896	480		141,376
Total real estate	375,783	1,369	636	377,788
Direct installment	34,106	110	(335)	33,881
Direct installment purchased	256			256
Indirect installment	132,053	287		132,340
Home equity	130,734	567	59	131,360
Total consumer	297,149	964	(276)	297,837
Total loans	1,319,828	3,922	1,666	1,325,416
Allowance for loan losses	(15,660)			(15,660)
Net loans	$ 1,304,168	$ 3,922	$ 1,666	$ 1,309,756

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December 31, 2013	Loan Balance	Interest Due	Deferred Fees / (Costs)	Recorded Investment
Owner occupied real estate	$ 156,262	$ 257	$ 207	$ 156,726
Non owner occupied real estate	224,713	105	299	225,117
Residential spec homes	400			400
Development & spec land loans	21,289	62	42	21,393
Commercial and industrial	101,920	737	57	102,714
Total commercial	504,584	1,161	605	506,350
Residential mortgage	176,068	578	382	177,028
Residential construction	9,508	14		9,522
Mortgage warehouse	98,156	480		98,636
Total real estate	283,732	1,072	382	285,186
Direct installment	29,983	104	(281)	29,806
Direct installment purchased	294			294
Indirect installment	131,384	320		131,704
Home equity	117,958	529	187	118,674
Total consumer	279,619	953	(94)	280,478
Total loans	1,067,935	3,186	893	1,072,014
Allowance for loan losses	(15,992)			(15,992)
Net loans	$ 1,051,943	$ 3,186	$ 893	$ 1,056,022

Note 5 Accounting for Certain Loans Acquired in a Transfer

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

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

Management estimated the cash flows expected to be collected at acquisition using our internal risk models, which incorporate the estimate of current key assumptions, such as default rates, severity and prepayment speeds.

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The carrying amount of those loans is included in the balance sheet amounts of loans receivable are as follows:

	June 30 2014 Heartland	June 30 2014 Summit	June 30 2014 Total
Commercial	19,801	73,026	$ 92,827
Real estate	10,659	26,075	36,734
Consumer	9,304	9,580	18,884
Outstanding balance	$ 39,764	$ 108,681	$ 148,445
Carrying amount, net of allowance of $494			$ 147,951

	December 31 2013 Heartland	December 31 2013 Summit	December 31 2013 Total
Commercial	$ 37,048	$	$ 37,048
Real estate	11,761		11,761
Consumer	11,485		11,485
Outstanding balance	$ 60,294	$	$ 60,294
Carrying amount, net of allowance of $389			$ 59,905

Accretable yield, or income expected to be collected for the six months ended June 30, is as follows:

	Heartland	Summit	2014
Balance at January 1	$ 3,185	$ 494	$ 3,185
Additions		1,758	1,758
Accretion	(288)		(288)
Reclassification from nonaccreatable difference			
Disposals	(95)		(95)
Balance at June 30	$ 2,802	$ 1,758	$ 4,560

	Heartland	Summit	2013
Balance at January 1	$ 6,111	$	$ 6,111
Additions			
Accretion	(451)		(451)
Reclassification from nonaccreatable difference			
Disposals	(696)		(696)
Balance at June 30	$ 4,964	$	$ 4,964

During the three and six months ended June 30, 2014, the Company increased the allowance for loan losses by a charge to the income statement by $339,000 and $339,000, respectively and for the three and six months ended June 30, 2013, $100,000 and $1.5 million, respectively. No allowances for loan losses were reversed for the three or six months ended June 30, 2014 or 2013.

Note 6 Allowance for Loan Losses

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

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	Three Months Ended June 30		Six Months Ended June 30	
	2014 (Unaudited)	2013 (Unaudited)	2014 (Unaudited)	2013 (Unaudited)
Balance at beginning of the period	$ 16,102	$ 19,565	$ 15,992	$ 18,270
Loans charged-off:				
Commercial				
Owner occupied real estate		6		138
Non owner occupied real estate		45	22	191
Residential development				
Development & Spec Land Loans	166		173	
Commercial and industrial	127	774	127	913
Total commercial	293	825	322	1,242
Real estate				
Residential mortgage	172	416	194	559
Residential construction				
Mortgage warehouse				
Total real estate	172	416	194	559
Consumer				
Direct Installment	44	88	77	195
Direct Installment Purchased				
Indirect Installment	341	271	568	624
Home Equity	247	201	431	639
Total consumer	632	560	1,076	1,458
Total loans charged-off	1,097	1,801	1,592	3,259
Recoveries of loans previously charged-off:				
Commercial				
Owner occupied real estate	2	14	6	46
Non owner occupied real estate	74	1	75	3
Residential development				
Development & Spec Land Loans				
Commercial and industrial	32	111	417	147
Total commercial	108	126	498	196
Real estate				

Residential mortgage	3	5	7	8
Residential construction				
Mortgage warehouse				
Total real estate	3	5	7	8
Consumer				
Direct Installment	21	54	39	448
Direct Installment Purchased				
Indirect Installment	147	202	266	372
Home Equity	37		111	32
Total consumer	205	256	416	852
Total loan recoveries	316	387	921	1,056
Net loans charged-off (recovered)	781	1,414	671	2,203
Provision charged to operating expense				
Commercial	(93)	(940)	119	802
Real estate	(383)	675	(987)	986
Consumer	815	994	1,207	1,025
Total provision charged to operating expense	339	729	339	2,813
Balance at the end of the period	$ 15,660	$ 18,880	$ 15,660	$ 18,880

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

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

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

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

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

June 30, 2014	Commercial	Real Estate	Mortgage Warehousing	Consumer	Total
Allowance For Loan Losses					
Ending allowance balance attributable to loans:					
Individually evaluated for impairment	$ 1,135	$	$	$	$ 1,135
Collectively evaluated for impairment	5,329	2,367	1,559	4,776	14,031
Loans acquired with deteriorated credit quality	494				494
Total ending allowance balance	$ 6,958	$ 2,367	$ 1,559	$ 4,776	$ 15,660
Loans:					
Individually evaluated for impairment	$ 7,715	$	$	$	$ 7,715
Collectively evaluated for impairment	641,485	236,412	141,376	297,837	1,317,110
Loans acquired with deteriorated credit quality	591				591
Total ending loans balance	$ 649,791	$ 236,412	$ 141,376	$ 297,837	$ 1,325,416

December 31, 2013	Commercial	Real Estate	Mortgage Warehousing	Consumer	Total
Allowance For Loan Losses					

Ending allowance balance attributable to loans:					
Individually evaluated for impairment	$ 1,312	$	$	$	$ 1,312
Collectively evaluated for impairment	4,963	3,462	1,638	4,228	14,291
Loans acquired with deteriorated credit quality	389				389
Total ending allowance balance	$ 6,664	$ 3,462	$ 1,638	$ 4,228	$ 15,992
Loans:					
Individually evaluated for impairment	$ 7,448	$	$	$	$ 7,448
Collectively evaluated for impairment	489,547	186,526	98,636	279,448	1,054,157
Loans acquired with deteriorated credit quality	9,355	24		1,030	10,409
Total ending loans balance	$ 506,350	$ 186,550	$ 98,636	$ 280,478	$ 1,072,014

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Note 7 Non-performing Loans and Impaired Loans

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

June 30, 2014	Non-accrual	Loans Past Due Over 90 Days Still Accruing	Non-Performing TDRs	Performing TDRs	Total Non-Performing Loans
Commercial					
Owner occupied real estate	$ 1,578	$	$ 46	$ 755	$ 2,379
Non owner occupied real estate	2,299		406	1,172	3,877
Residential development					
Development & Spec Land Loans	49				49
Commercial and industrial	782	17	1,139		1,938
Total commercial	4,708	17	1,591	1,927	8,243
Real estate					
Residential mortgage	2,830	2	1,077	2,489	6,398
Residential construction			274		274
Mortgage warehouse					
Total real estate	2,830	2	1,351	2,489	6,672
Consumer					
Direct Installment	371				371
Direct Installment Purchased					
Indirect Installment	537	23			560
Home Equity	1,398		236	1,198	2,832
Total Consumer	2,306	23	236	1,198	3,763
Total	$ 9,844	$ 42	$ 3,178	$ 5,614	$ 18,678

December 31, 2013	Non-accrual	Loans Past Due Over 90 Days Still	Non-Performing TDRs	Performing TDRs	Total Non-Performing

		Accruing			Loans
Commercial					
Owner occupied real estate	$ 293	$	$ 222	$ 778	$ 1,293
Non owner occupied real estate	2,289	45	1,117	518	3,969
Residential development					
Development & Spec Land Loans	182				182
Commercial and industrial	1,250		777		2,027
Total commercial	4,014	45	2,116	1,296	7,471
Real estate					
Residential mortgage	2,459	2	719	2,686	5,866
Residential construction			280		280
Mortgage warehouse					
Total real estate	2,459	2	999	2,686	6,146
Consumer					
Direct Installment	202				202
Direct Installment Purchased					
Indirect Installment	531	2			533
Home Equity	2,542		311	1,072	3,925
Total Consumer	3,275	2	311	1,072	4,660
Total	$ 9,748	$ 49	$ 3,426	$ 5,054	$ 18,277

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Included in the $9.8 million of non-accrual loans and the $3.2 million of non-performing TDR s at June 30, 2014 were $1.2 million and $482,000, respectively, of loans acquired for which accretable yield was recognized.

From time to time, the Bank obtains information that may lead management to believe that the collection of payments may be doubtful on a particular loan. In recognition of this, it is management s policy to convert the loan from an earning asset to a non-accruing loan. The entire balance of a loan is considered delinquent if the minimum payment contractually required to be made is not received by the specified due date. Further, it is management s policy to place a loan on a non-accrual status when the payment is delinquent in excess of 90 days or the loan has had the accrual of interest discontinued by management. The officer responsible for the loan and the Chief Credit Officer or the senior collection officer must review all loans placed on non-accrual status. Subsequent payments on non-accrual loans are recorded as a reduction of principal, and interest income is recorded only after principal recovery is reasonably assured. Nonaccrual loans are returned to accrual status when, in the opinion of management, the financial position of the borrower indicates there is no longer any reasonable doubt as to the timely collection of interest or principal in accordance with the loan terms. The Company requires a period of satisfactory performance of not less than six months before returning a nonaccrual loan to accrual status.

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

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

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

The Company s TDRs are considered impaired loans and included in the allowance methodology using the guidance for impaired loans. At June 30, 2014, the type of concessions the Company has made on restructured loans has been temporary rate reductions and/or reductions in monthly payments and there have been no restructured loans with modified recorded balances. Any modification to a loan that is a concession and is not in the normal course of lending is considered a restructured loan. A restructured loan is returned to accruing status after six consecutive payments but is still reported as TDR unless the loan bears interest at a market rate. As of June 30, 2014, the Company had $8.8 million in TDRs and $5.6 million were performing according to the restructured terms and no TDR s were returned to accrual status during the first six months of 2014. There was $1.5 million of specific reserves allocated to TDRs at June 30, 2014 based on the discounted cash flows.

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Loans transferred and classified as troubled debt restructuring during the three and six months ended June 30, 2014 and 2013, segregated by class, are shown in the table below.

	Three Months Ending June 30, 2014		Three Months Ending June 30, 2013		Six Months Ending June 30, 2014		Six Months Ending June 30, 2013	
	Number of Defaults	Unpaid Principal Balance	Number of Defaults	Unpaid Principal Balance	Number of Defaults	Unpaid Principal Balance	Number of Defaults	Unpaid Principal Balance
Commercial								
Owner occupied real estate		$		$		$		$
Non owner occupied real estate								
Residential development								
Development & Spec Land Loans								
Commercial and industrial					2	371		
Total commercial					2	371		
Real estate								
Residential mortgage	1	226	2	368	1	226	5	758
Residential construction								
Mortgage warehouse								
Total real estate	1	226	2	368	1	226	5	758
Consumer								
Direct Installment								
Direct Installment Purchased								
Indirect Installment								
Home Equity	1	51	1	997	2	196	1	997
Total Consumer	1	51	1	997	2	196	1	997
Total	2	$ 277	3	$ 1,365	5	$ 793	6	$ 1,755

Troubled debt restructured loans which had payment defaults during the three and six months ended June 30, 2014 and 2013, segregated by class, are shown in the table below. Default occurs when a loan is 90 days or more past due or has been transferred to nonaccrual.

	Three Months Ending June 30, 2014		Three Months Ending June 30, 2013		Six Months Ending June 30, 2014		Six Months Ending June 30, 2013	
	Number of Defaults	Unpaid Principal Balance	Number of Defaults	Unpaid Principal Balance	Number of Defaults	Unpaid Principal Balance	Number of Defaults	Unpaid Principal Balance
Commercial								
Owner occupied real estate		$		$		$		$
Non owner occupied real estate								
Residential development								
Development & Spec Land Loans								
Commercial and industrial					2	371		
Total commercial					2	371		
Real estate								
Residential mortgage	1	223			2	377	3	239
Residential construction								
Mortgage warehouse								
Total real estate	1	223			2	377	3	239
Consumer								
Direct Installment								
Direct Installment Purchased								
Indirect Installment								
Home Equity	1	51	1	997	2	196	1	997
Total Consumer	1	51	1	997	2	196	1	997
Total	2	$ 274	1	$ 997	6	$ 944	4	$ 1,236

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

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

				Three Months Ending		Six Months Ending	
June 30, 2014	**Unpaid Principal Balance**	**Recorded Investment**	**Allowance For Loan Loss Allocated**	**Average Balance in Impaired Loans**	**Cash/ Accrual Interest Income Recognized**	**Average Balance in Impaired Loans**	**Cash/ Accrual Interest Income Recognized**
With no recorded allowance							
Commercial							
Owner occupied real estate	$ 2,121	$ 2,124	$	$ 1,885	$ 40	$ 1,432	$ 51
Non owner occupied real estate	3,244	3,246		3,270	93	3,283	98
Residential development							
Development & Spec Land Loans							
Commercial and industrial	283	283		441		466	
Total commercial	5,648	5,653		5,596	133	5,181	149
With an allowance recorded							
Commercial							
Owner occupied real estate							
Non owner occupied real estate	340	340	170	342		347	
Residential development							
Development & Spec Land Loans							
Commercial and industrial	1,722	1,722	965	1,710		1,570	2
Total commercial	2,062	2,062	1,135	2,052		1,917	2
Total	$ 7,710	$ 7,715	$ 1,135	$ 7,648	$ 133	$ 7,098	$ 151

				Three Months Ending		Six Months Ending	
June 30, 2013	**Unpaid Principal Balance**	**Recorded Investment**	**Allowance For Loan Loss Allocated**	**Average Balance in Impaired Loans**	**Cash/ Accrual Interest Income Recognized**	**Average Balance in Impaired Loans**	**Cash/ Accrual Interest Income Recognized**

With no recorded allowance							
Commercial							
Owner occupied real estate	$ 1,142	$ 1,146	$	$ 1,750	$ 13	$ 1,785	$ 27
Non owner occupied real estate	2,579	2,584		2,710	12	2,439	23
Residential development							
Development & Spec Land Loans	60	60		64		45	
Commercial and industrial	906	922		1,595	3	1,478	3
Total commercial	4,687	4,712		6,119	28	5,747	53
With an allowance recorded							
Commercial							
Owner occupied real estate	172	172	30	216		222	
Non owner occupied real estate	1,795	1,795	1,097	1,799		1,809	
Residential development							
Development & Spec Land Loans	673	673	425	702		706	
Commercial and industrial	2,063	2,075	846	2,072	20	1,433	20
Total commercial	4,703	4,715	2,398	4,789	20	4,170	20
Total	$ 9,390	$ 9,427	$ 2,398	$ 10,908	$ 48	$ 9,917	$ 73

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

June 30, 2014	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial						
Owner occupied real estate	$ 90	$ 60	$	$ 150	$ 205,850	$ 206,000
Non owner occupied real estate	819			819	293,862	294,681
Residential development					835	835
Development & Spec Land Loans					24,188	24,188
Commercial and industrial	384	6	17	407	120,785	121,192
Total commercial	1,293	66	17	1,376	645,520	646,896
Real estate						
Residential mortgage	30	270	2	302	225,517	225,819
Residential construction					9,068	9,068
Mortgage warehouse					140,896	140,896
Total real estate	30	270	2	302	375,481	375,783
Consumer						
Direct Installment	85	15		100	34,006	34,106
Direct Installment Purchased					256	256
Indirect Installment	807	154	23	984	131,069	132,053
Home Equity	711	240		951	129,783	130,734
Total consumer	1,603	409	23	2,035	295,114	297,149
Total	$ 2,926	$ 745	$ 42	$ 3,713	$ 1,316,115	$ 1,319,828
Percentage of total loans	0.22%	0.06%	0.00%	0.28%	99.72%	

December 31, 2013	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total

Commercial						
Owner occupied real estate	$ 341	$	$	$ 341	$ 155,921	$ 156,262
Non owner occupied real estate	424		45	469	224,244	224,713
Residential development					400	400
Development & Spec Land Loans					21,289	21,289
Commercial and industrial					101,920	101,920
Total commercial	765		45	810	503,774	504,584
Real estate						
Residential mortgage	445	87	2	534	175,534	176,068
Residential construction					9,508	9,508
Mortgage warehouse					98,156	98,156
Total real estate	445	87	2	534	283,198	283,732
Consumer						
Direct Installment	120	24		144	29,839	29,983
Direct Installment Purchased					294	294
Indirect Installment	1,011	175	2	1,188	130,196	131,384
Home Equity	767	58		825	117,133	117,958
Total consumer	1,898	257	2	2,157	277,462	279,619
Total	$ 3,108	$ 344	$ 49	$ 3,501	$ 1,064,434	$ 1,067,935
Percentage of total loans	0.29%	0.03%	0.00%	0.33%	99.67%	

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

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

For new and renewed commercial loans, the Bank s Credit Department, which acts independently of the loan officer, assigns the credit quality grade to the loan. Loan grades for loans with an aggregate credit exposure that exceeds the authorities in the respective markets (ranging from $1,000,000 to $2,500,000) are validated by the Loan Committee, which is chaired by the Chief Credit Officer (CCO).

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

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

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

For residential real estate and consumer loans, Horizon uses a grading system based on delinquency. Loans that are 90 days or more past due, on non-accrual, or are classified as a TDR are graded Substandard. After being 90 days delinquent a loan is charged off unless it is well secured and in the process of collection. If the latter case exists, the loan is placed on non-accrual. Occasionally a mortgage loan may be graded as Special Mention. When this situation arises, it is because the characteristics of the loan and the borrower fit the definition of a Risk Grade 5 described below, which is normally used for grading commercial loans. Loans not graded Substandard are considered Pass.

Horizon Bank employs a nine-grade rating system to determine the credit quality of commercial loans. The first five grades represent acceptable quality, and the last four grades mirror the criticized and classified grades used by the bank regulatory agencies (special mention, substandard, doubtful, and loss). The loan grade definitions are detailed below.

Risk Grade 1: Excellent (Pass)

Loans secured by liquid collateral, such as certificates of deposit, reputable bank letters of credit, or other cash equivalents; loans that are guaranteed or otherwise backed by the full faith and credit of the United States government or an agency thereof, such as the Small Business Administration; or loans to any publicly held company with a current long-term debt rating of A or better.

Risk Grade 2: Good (Pass)

Loans to businesses that have strong financial statements containing an unqualified opinion from a CPA firm and at least three consecutive years of profits; loans supported by unaudited financial statements containing strong balance sheets, five consecutive years of profits, a five-year satisfactory relationship with the Bank, and key balance sheet and income statement trends that are either stable or positive; loans secured by publicly traded marketable securities where there is no impediment to liquidation; loans to individuals backed by liquid personal assets and unblemished credit history; or loans to publicly held companies with current long-term debt ratings of Baa or better.

Risk Grade 3: Satisfactory (Pass)

Loans supported by financial statements (audited or unaudited) that indicate average or slightly below average risk and having some deficiency or vulnerability to changing economic conditions; loans with some weakness but offsetting features of other support are readily available; loans that are meeting the terms of repayment, but which may be susceptible to deterioration if adverse factors are encountered. Loans may be graded Satisfactory when there is no recent information on which to base a current risk evaluation and the following conditions apply:

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

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

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

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

Risk Grade 4 Satisfactory/Monitored:

Loans in this category are considered to be of acceptable credit quality, but contain greater credit risk than Satisfactory loans. Borrower displays acceptable liquidity, leverage, and earnings performance within the Bank s minimum underwriting guidelines. The level of risk is acceptable but conditioned on the proper level of loan officer supervision. Loans that normally fall into this grade include acquisition, construction and development loans and income producing properties that have not reached stabilization.

Risk Grade 4W Management Watch:

Loans in this category are considered to be of acceptable quality, but with above normal risk. Borrower displays potential indicators of weakness in the primary source of repayment resulting in a higher reliance on secondary sources of repayment. Balance sheet may exhibit weak liquidity and/or high leverage. There is inconsistent earnings performance without the ability to sustain adverse economic conditions. Borrower may be operating in a declining industry or the property type, as for a commercial real estate loan, may be high risk or in decline. These loans require an increased level of loan officer supervision and monitoring to assure that any deterioration is addressed in a timely fashion.

Risk Grade 5: Special Mention

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

Risk Grade 6: Substandard

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

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

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

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

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

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

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

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

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

The lender is seriously contemplating foreclosure or legal action due to the apparent deterioration in the loan.

There is a significant deterioration in market conditions to which the borrower is highly vulnerable.

Risk Grade 7: Doubtful

One or more of the following characteristics may be present in loans classified Doubtful:

Loans have all of the weaknesses of those classified as Substandard. However, based on existing conditions, these weaknesses make full collection of principal highly improbable.

The primary source of repayment is gone, and there is considerable doubt as to the quality of the secondary source of repayment.

The possibility of loss is high but because of certain important pending factors which may strengthen the loan, loss classification is deferred until the exact status of repayment is known.

Risk Grade 8: Loss

Loans are considered uncollectible and of such little value that continuing to carry them as assets is not feasible. Loans will be classified Loss when it is neither practical nor desirable to defer writing off or reserving all or a portion of a basically worthless asset, even though partial recovery may be possible at some time in the future.

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

The following table presents loans by credit grades.

June 30, 2014	Pass	Special Mention	Substandard	Doubtful	Total
Commercial					
Owner occupied real estate	$ 194,208	$ 2,728	$ 9,064	$	$ 206,000
Non owner occupied real estate	273,976	9,516	11,189		294,681
Residential development	835				835
Development & Spec Land Loans	22,941	85	1,162		24,188
Commercial and industrial	115,769	1,778	3,645		121,192
Total commercial	607,729	14,107	25,060		646,896
Real estate					
Residential mortgage	219,421		6,398		225,819
Residential construction	8,794		274		9,068
Mortgage warehouse	140,896				140,896
Total real estate	369,111		6,672		375,783
Consumer					
Direct Installment	33,735		371		34,106
Direct Installment Purchased	256				256
Indirect Installment	131,493		560		132,053
Home Equity	127,902		2,832		130,734
Total Consumer	293,386		3,763		297,149
Total	$ 1,270,226	$ 14,107	$ 35,495	$	$ 1,319,828
Percentage of total loans	96.24%	1.07%	2.69%	0.00%	

December 31, 2013	Pass	Special Mention	Substandard	Doubtful	Total
Commercial					
Owner occupied real estate	$ 146,085	$ 2,231	$ 7,946	$	$ 156,262
Non owner occupied real estate	208,625	5,047	11,041		224,713

Residential development	400				400
Development & Spec Land Loans	19,858	91	1,340		21,289
Commercial and industrial	91,852	6,492	3,576		101,920
Total commercial	466,820	13,861	23,903		504,584
Real estate					
Residential mortgage	170,202		5,866		176,068
Residential construction	9,228		280		9,508
Mortgage warehouse	98,156				98,156
Total real estate	277,586		6,146		283,732
Consumer					
Direct Installment	29,781		202		29,983
Direct Installment Purchased	294				294
Indirect Installment	130,851		533		131,384
Home Equity	114,033		3,925		117,958
Total Consumer	274,959		4,660		279,619
Total	$ 1,019,365	$ 13,861	$ 34,709	$	$ 1,067,935
Percentage of total loans	95.45%	1.30%	3.25%	0.00%	

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Note 8 Derivative Financial Instruments

Cash Flow Hedges

As a strategy to maintain acceptable levels of exposure to the risk of changes in future cash flow due to interest rate fluctuations, the Company entered into interest rate swap agreements for a portion of its floating rate debt. The agreements provide for the Company to receive interest from the counterparty at three month LIBOR and to pay interest to the counterparty at a weighted average fixed rate of 6.14% on a notional amount of $30.5 million at June 30, 2014 and December 31, 2013. Under the agreements, the Company pays or receives the net interest amount monthly, with the monthly settlements included in interest expense.

Management has designated the interest rate swap agreement as a cash flow hedging instrument. For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings. At June 30, 2014 the Company s cash flow hedge was effective and is not expected to have a significant impact on the Company s net income over the next 12 months.

Fair Value Hedges

Fair value hedges are intended to reduce the interest rate risk associated with the underlying hedged item. The Company enters into fixed rate loan agreements as part of its lending policy. To mitigate the risk of changes in fair value based on fluctuations in interest rates, the Company has entered into interest rate swap agreements on individual loans, converting the fixed rate loans to a variable rate. For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative as well as the offsetting gain or loss on the hedged item attributable to the hedged risk are recognized in current earnings. At June 30, 2014, the Company s fair value hedges were effective and are not expected to have a significant impact on the Company s net income over the next 12 months.

The change in fair value of both the hedge instruments and the underlying loan agreements are recorded as gains or losses in interest income. The fair value hedges are considered to be highly effective and any hedge ineffectiveness was deemed not material. The notional amounts of the loan agreements being hedged were $108.2 million at June 30, 2014 and $95.3 million at December 31, 2013.

Other Derivative Instruments

The Company enters into non-hedging derivatives in the form of mortgage loan forward sale commitments with investors and commitments to originate mortgage loans as part of its mortgage banking business. At June 30, 2014, the Company s fair value of these derivatives were recorded and over the next 12 months are not expected to have a significant impact on the Company s net income.

The change in fair value of both the forward sale commitments and commitments to originate mortgage loans were recorded and the net gains or losses included in the Company s gain on sale of loans.

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The following tables summarize the fair value of derivative financial instruments utilized by Horizon:

	Asset Derivative June 30, 2014		Liability Derivatives June 30, 2014	
Derivatives designated as hedging instruments (Unaudited)	**Balance Sheet Location**	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Interest rate contracts	Loans	$	Other liabilities	$ 698
Interest rate contracts	Other Assets	698	Other liabilities	3,367
Total derivatives designated as hedging instruments		698		4,065
Derivatives not designated as hedging instruments				
Mortgage loan contracts	Other assets	641	Other liabilities	
Total derivatives not designated as hedging instruments		641		
Total derivatives		$ 1,339		$ 4,065

	Asset Derivative December 31, 2013		Liability Derivatives December 31, 2013	
Derivatives designated as hedging instruments (Unaudited)	**Balance Sheet Location**	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Interest rate contracts	Loans	7	Other liabilities	$ (53)
Interest rate contracts	Other Assets	(60)	Other liabilities	2,826
Total derivatives designated as hedging instruments		(53)		2,773
Derivatives not designated as hedging instruments				
Mortgage loan contracts	Other assets	212	Other liabilities	22
Total derivatives not designated as hedging instruments		212		22

Total derivatives	$ 159	$ 2,795

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

	Comprehensive Income on Derivative (Effective Portion) Three Months Ended June 30		**Comprehensive Income on Derivative (Effective Portion) Six Months Ended June 30**	
Derivative in cash flow hedging relationship	**2014 (Unaudited)**	**2013 (Unaudited)**	**2014 (Unaudited)**	**2013 (Unaudited)**
Interest rate contracts	$ (206)	$ 1,028	$ (352)	$ 1,313

FASB Accounting Standards Codification (ASC) Topic 820-10-20 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Topic 820-10-55 establishes a fair value hierarchy that emphasizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value.

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Derivative in fair value hedging relationship	Location of gain (loss) recognized on derivative	Amount of Gain (Loss) Recognized on Derivative Three Months Ended June 30		Amount of Gain (Loss) Recognized on Derivative Six Months Ended June 30	
		2014 (Unaudited)	2013 (Unaudited)	2014 (Unaudited)	2013 (Unaudited)
Interest rate contracts	Interest income - loans	$ 544	$ (1,444)	$ 751	$ (1,846)
Interest rate contracts	Interest income - loans	(544)	1,444	(751)	1,846
Total		$	$	$	$

Derivative not designated as hedging relationship	Location of gain (loss) recognized on derivative	Amount of Gain (Loss) Recognized on Derivative Three Months Ended June 30		Amount of Gain (Loss) Recognized on Derivative Six Months Ended June 30	
		2014 (Unaudited)	2013 (Unaudited)	2014 (Unaudited)	2013 (Unaudited)
Mortgage contracts	Other income - gain on sale of loans	$ 210	$ (396)	$ 450	$ (408)

Note 9 Disclosures about Fair Value of Assets and Liabilities

The Fair Value Measurements topic of the FASB ASC defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. There are three levels of inputs that may be used to measure fair value:

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

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

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

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying condensed consolidated financial statements, as well as the general classification of such instruments pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the period ended June 30, 2014. For assets classified within Level 3 of the fair value hierarchy, the process used to develop the reported fair value is described below.

Available for sale securities

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

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Hedged loans

Certain fixed rate loans have been converted to variable rate loans by entering into interest rate swap agreements. The fair value of those fixed rate loans is based on discounting the estimated cash flows using interest rates determined by the respective interest rate swap agreement. Loans are classified within Level 2 of the valuation hierarchy based on the unobservable inputs used.

Interest rate swap agreements

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

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

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2014				
Available-for-sale securities				
U.S. Treasury and federal agencies	$ 35,532	$	$ 35,532	$
State and municipal	49,381		49,381	
Federal agency collateralized mortgage obligations	115,242		115,242	
Federal agency mortgage-backed pools	162,587		162,587	
Private labeled mortgage-backed pools	920		920	
Corporate notes	756		756	
Total available-for-sale securities	364,418		364,418	
Hedged loans	108,194		108,194	
Forward sale commitments	641		641	
Interest rate swap agreements	(4,065)		(4,065)	

Commitments to originate loans				
December 31, 2013				
Available-for-sale securities				
U.S. Treasury and federal agencies	$ 43,134	$	$ 43,134	$
State and municipal	177,898		177,898	
Federal agency collateralized mortgage obligations	114,706		114,706	
Federal agency mortgage-backed pools	170,894		170,894	
Private labeled mortgage-backed pools	1,226		1,226	
Corporate notes	733		733	
Total available-for-sale securities	508,591		508,591	
Hedged loans	95,372		95,372	
Forward sale commitments	212		212	
Interest rate swap agreements	(2,773)		(2,773)	
Commitments to originate loans	(22)		(22)	

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Realized gains and losses included in net income for the periods are reported in the condensed consolidated statements of income as follows:

Non Interest Income Total gains and losses from:	Three Months Ended June 30 2014 (Unaudited)	Three Months Ended June 30 2013 (Unaudited)	Six Months Ended June 30 2014 (Unaudited)	Six Months Ended June 30 2013 (Unaudited)
Hedged loans	$ 544	$ (1,444)	$ 751	$ (1,846)
Fair value interest rate swap agreements	(544)	1,444	(751)	1,846
Derivative loan commitments	210	(396)	450	(408)
	$ 210	$ (396)	$ 450	$ (408)

Certain other assets are measured at fair value on a nonrecurring basis in the ordinary course of business and are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2014				
Impaired loans	$ 6,575	$	$	$ 6,575
Mortgage servicing rights	7,313			7,313
December 31, 2013				
Impaired loans	$ 6,114	$	$	$ 6,114
Mortgage servicing rights	7,039			7,039

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

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

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

Mortgage Servicing Rights (MSRs): MSRs do not trade in an active market with readily observable prices. Accordingly, the fair value of these assets is classified as Level 3. The Company determines the fair value of MSRs using an income approach model based upon the Company s month-end interest rate curve and prepayment assumptions. The model utilizes assumptions to estimate future net servicing income cash flows, including estimates of time decay, payoffs and changes in valuation inputs and assumptions. The Company reviews the valuation assumptions against this market data for reasonableness and adjusts the assumptions if deemed appropriate. The carrying amount of the MSR s fair value increased by $38,000 during the first six months of 2014 and increased by $135,000 during the first six months of 2013.

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

	Fair Value at June 30, 2014	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Impaired loans	$ 6,575	Collateral based measurement	Discount to reflect current market conditions and ultimate collectability	10% - 15% (12%)
Mortgage servicing rights	$ 7,313	Discounted cashflows	Discount rate, Constant prepayment rate, Probably of default	10% - 15% (12%), 4% - 7% (4.6%), 1% - 10% (4.5%)

	Fair Value at December 31, 2013	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Impaired loans	$ 6,114	Collateral based measurement	Discount to reflect current market conditions and ultimate collectability	10% - 15% (12%)
Mortgage servicing rights	$ 7,039	Discounted cashflows	Discount rate, Constant prepayment rate, Probably of default	10% - 15% (12%), 4% - 7% (4.6%), 1% - 10% (4.5%)

Note 10 Fair Value of Financial Instruments

The estimated fair value amounts of the Company s financial instruments were determined using available market information, current pricing information applicable to Horizon and various valuation methodologies. Where market quotations were not available, considerable management judgment was involved in the determination of estimated fair values. Therefore, the estimated fair value of financial instruments shown below may not be representative of the amounts at which they could be exchanged in a current or future transaction. Due to the inherent uncertainties of expected cash flows of financial instruments, the use of alternate valuation assumptions and methods could have a significant effect on the estimated fair value amounts.

The estimated fair values of financial instruments, as shown below, are not intended to reflect the estimated liquidation or market value of Horizon taken as a whole. The disclosed fair value estimates are limited to Horizon s significant financial instruments at June 30, 2014 and December 31, 2013. These include financial instruments recognized as assets and liabilities on the condensed consolidated balance sheet as well as certain off-balance sheet financial instruments. The estimated fair values shown below do not include any valuation of assets and liabilities, which are not financial instruments as defined by the FASB ASC fair value hierarchy.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Cash and Due from Banks The carrying amounts approximate fair value.

Held-to-Maturity Securities For debt securities held to maturity, fair values are based on quoted market prices or dealer quotes. For those securities where a quoted market price is not available, carrying amount is a reasonable estimate of fair value based upon comparison with similar securities.

Loans Held for Sale The carrying amounts approximate fair value.

Net Loans The fair value of portfolio loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. The carrying amounts of loans held for sale approximate fair value.

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FHLB and FRB Stock Fair value of FHLB and FRB stock is based on the price at which it may be resold to the FHLB and FRB.

Interest Receivable/Payable The carrying amounts approximate fair value.

Deposits The fair value of demand deposits, savings accounts, interest-bearing checking accounts and money market deposits is the amount payable on demand at the reporting date. The fair value of fixed maturity certificates of deposit is estimated by discounting the future cash flows using rates currently offered for deposits of similar remaining maturity.

Borrowings Rates currently available to Horizon for debt with similar terms and remaining maturities are used to estimate fair values of existing borrowings.

Subordinated Debentures Rates currently available for debentures with similar terms and remaining maturities are used to estimate fair values of existing debentures.

Commitments to Extend Credit and Standby Letters of Credit The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. Due to the short-term nature of these agreements, carrying amounts approximate fair value.

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

	June 30, 2014			
	Carrying Amount	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Assets				
Cash and due from banks	$ 50,804	$ 50,804	$	$
Investment securities, held to maturity	173,200			173,200

Loans held for sale	7,286			7,286
Loans excluding loan level hedges, net	1,197,640			1,217,773
Stock in FHLB and FRB	16,326		16,326	
Interest receivable	8,280		8,280	
Liabilities				
Non-interest bearing deposits	$ 270,023	$ 270,023	$	$
Interest-bearing deposits	1,229,080		1,167,153	
Borrowings	340,201		342,639	
Subordinated debentures	32,564		32,622	
Interest payable	508		508	

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	December 31, 2013			
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash and due from banks	$ 31,721	$ 31,721	$	$
Investment securities, held to maturity	9,910			9,910
Loans held for sale	3,281			3,281
Loans excluding loan level hedges, net	957,464			975,910
Stock in FHLB and FRB	14,184		14,184	
Interest receivable	7,501		7,501	
Liabilities				
Non-interest bearing deposits	$ 231,096	$ 231,096	$	$
Interest-bearing deposits	1,060,424		1,002,980	
Borrowings	256,296		257,093	
Subordinated debentures	32,486		32,528	
Interest payable	506		506	

Note 11 Accumulated Other Comprehensive Income (Loss)

The components accumulated other comprehensive income (loss) included in capital are as follows:

	June 30 2014	December 31 2013
Unrealized gain on securities available for sale	$ 4,949	$ 164
Unamortized gain on securities held to maturity, previously transferred from AFS	1,871	
Unrealized loss on derivative instruments	(3,367)	(2,826)
Tax effect	(1,209)	933
Total accumulated other comprehensive income (loss)	$ 2,244	$ (1,729)

Note 12 Future Accounting Matters

Accounting Standards Update No. 2014-08- Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity In April 2014, FASB issued ASU 2014-08. This update seeks to better define the groups of assets which qualify for discontinued operations, in order to ease the burden and cost for preparers and stakeholders. This issue changed the criteria for reporting discontinued operations and related reporting requirements, including the provision for disclosures about the disposal of and individually significant component of an entity that does not qualify for discontinued operations presentation.

The amendments in this Update are effective for fiscal years beginning after December 15, 2014. Early adoption is permitted only for disposals or classifications as held for sale. The Company will adopt the methodologies prescribed by this ASU by the date required, and does not anticipate that the ASU will have a material effect on its financial position or results of operations.

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Accounting Standards Update No. 2014-09- Revenue from Contracts with Customers In May 2014, FASB, in joint cooperation with IASB, issued ASU 2014-09. The topic of Revenue Recognition had become broad, with several other regulatory agencies issuing standards which lacked cohesion. The new guidance establishes a common framework and reduces the number of requirements to which an entity must consider in recognizing revenue and yet provides improved disclosures to assist stakeholders reviewing financial statements.

The amendments in this Update are effective for annual reporting periods beginning after December 15, 2016. Early adoption is not permitted. The Company will adopt the methodologies prescribed by this ASU by the date required, and does not anticipate that the ASU will have a material effect on its financial position or results of operations.

Accounting Standards Update No. 2014-11- Transfers and Servicing In June 2014, FASB, issued ASU 2014-11. This update addresses the concerns of stakeholders by changing the accounting practices surrounding repurchase agreements. The new guidance changes the accounting for repurchase-to-maturity transactions and linked repurchase financings to secured borrowing accounting, which is consistent with the accounting for other repurchase agreements.

The amendments in this Update are effective for annual reporting periods beginning after December 15, 2014. Early adoption is prohibited. The Company will adopt the methodologies prescribed by this ASU by the date required, and does not anticipate that the ASU will have a material effect on its financial position or results of operations.

Accounting Standards Update No. 2014-12- Compensation Stock Compensation In June 2014, FASB, issued ASU 2014-12. This update defines the accounting treatment for share-based payments and resolves the diverse accounting treatment of those awards in practice. The new requirement mandates that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. Compensation cost will now be recognized in the period in which it becomes likely that the performance target will be met.

The amendments in this Update are effective for annual reporting periods beginning after December 15, 2015. Early adoption is permitted. The Company will adopt the methodologies prescribed by this ASU by the date required, and does not anticipate that the ASU will have a material effect on its financial position or results of operations.

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

Forward Looking Statements

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, with respect to Horizon Bancorp (Horizon or the Company) and Horizon Bank, N.A. (the Bank). Horizon intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Reform Act of 1995, and is including this statement for the purposes of these safe harbor provisions. Statements in this report should be considered in conjunction with the other information available about Horizon, including the information in the other filings we make with the Securities and Exchange Commission. The forward-looking statements are based on management s expectations and are subject to a number of risks and uncertainties. We have tried, wherever possible, to identify such statements by using words such as anticipate, expect, estimate, project, intend, plan, believe, could, will and similar expressions in connection with any discussi operating or financial performance. Although management believes that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from those expressed or implied in such statements.

Actual results may differ materially, adversely or positively, from the expectations of the Company that are expressed or implied by any forward-looking statement. Risks, uncertainties, and factors that could cause the Company s actual results to vary materially from those expressed or implied by any forward-looking statement include but are not limited to:

changes in general economic conditions and their impact on Horizon and its customers, including the slowing or failure of economic recovery

changes in the level and volatility of interest rates, spreads on earning assets and interest-bearing liabilities, and interest rate sensitivity;

estimates of fair value of certain of Horizon s assets and liabilities;

volatility and disruption in financial markets;

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

unavailability of sources of liquidity;

potential risk of environmental liability related to lending activities;

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

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

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

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

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

rapid technological developments and changes;

inability to contain costs and expenses;

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

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

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The foregoing list of important factors is not exclusive, and you are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this document or, in the case of documents incorporated by reference, the dates of those documents. We do not undertake to update any forward-looking statements, whether written or oral, that may be made from time to time by or on behalf of us. For a detailed discussion of the risks and uncertainties that may cause our actual results or performance to differ materially from the results or performance expressed or implied by forward-looking statements, see Risk Factors in Item 1A of Part I of our 2013 Annual Report on Form 10-K and in the subsequent reports we file with the SEC.

Overview

Horizon is a registered bank holding company incorporated in Indiana and headquartered in Michigan City, Indiana. Horizon provides a broad range of banking services in Northwestern and Central Indiana and Southwestern and South Central Michigan through its bank subsidiary. Horizon operates as a single segment, which is commercial banking. Horizon s common stock is traded on the NASDAQ Global Market under the symbol HBNC. The Bank was chartered as a national banking association in 1873 and has operated continuously since that time. The Bank is a full-service commercial bank offering commercial and retail banking services, corporate and individual trust and agency services, and other services incident to banking.

On November 12, 2013, Horizon entered into an Agreement and Plan of Merger (the Merger Agreement) providing for Horizon s acquisition of SCB Bancorp, Inc., a Michigan corporation (Summit). Pursuant to the Merger Agreement, Summit would merge with and into Horizon, with Horizon surviving the merger (the Merger), and Summit Community Bank, a Michigan-chartered commercial bank and wholly owned subsidiary of SCB Bancorp, Inc., would merge with and into a wholly owned subsidiary of Horizon, Horizon Bank, N.A. (Horizon Bank), with Horizon Bank as the surviving bank.

On April 3, 2014 Horizon completed the acquisition of Summit and Horizon Bank s acquisition of Summit Community Bank, through mergers effective April 3, 2014. Under the terms of the acquisition, the exchange ratio was 0.4904 shares of Horizon common stock and $5.15 in cash for each outstanding share of Summit common stock. Summit shares outstanding at the closing were 1,164,442, and the shares of Horizon s common stock issued to Summit shareholders totaled 570,820. Horizon s stock price was $22.23 per share at the close of business on April 3, 2014. Based upon these numbers, the total value of the consideration for the acquisition was $18.9 million (not including the retirement of Summit debt).

Following are some highlights of Horizon s financial performance through the second quarter of 2014:

Assets passed the $2.0 billion threshold reaching $2.1 billion as of June 30, 2014.

The quarterly dividend was increased from 11 cents to 13 cents per share on July 18, 2014.

Total loans increased $222.7 million during the quarter and $256.7 million during the first six months of 2014 to $1.3 billion as of June 30, 2014.

Commercial loans increased $119.6 million during the quarter and $143.0 million during the first six months of 2014 to $648.2 million as of June 30, 2014.

Second quarter 2014 net income was $4.8 million or $.50 diluted earnings per share, an increase of $1.4 million over the previous quarter.

Net income for the first six months of 2014 was $8.2 million or $.88 diluted earnings per share.

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Net Interest Margin, excluding the impact of acquisitions (core net interest margin), was 3.52% for the second quarter of 2014 compared to 3.38% in the previous quarter.

Return on average assets was 0.98% for the second quarter of 2014 and 0.89% for the first six months of 2014.

Return on average common equity was 11.95% for the second quarter of 2014 and 10.40% for the first six months of 2014.

Non-performing loans to total loans as of June 30, 2014 were 1.41% compared to 1.70% as of December 31, 2013 and 2.27% as of June 30, 2013.

Critical Accounting Policies

The notes to the consolidated financial statements included in Item 8 of the Company s Annual Report on Form 10-K for 2013 contain a summary of the Company s significant accounting policies. Certain of these policies are important to the portrayal of the Company s financial condition, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Management has identified as critical accounting policies the allowance for loan losses, intangible assets, mortgage servicing rights, hedge accounting and valuation measurements.

Allowance for Loan Losses

An allowance for loan losses is maintained to absorb probable incurred loan losses inherent in the loan portfolio. The determination of the allowance for loan losses is a critical accounting policy that involves management s ongoing quarterly assessments of the probable incurred losses inherent in the loan portfolio. The identification of loans that have probable incurred losses is subjective; therefore, a general reserve is maintained to cover all probable losses within the entire loan portfolio. Horizon utilizes a loan grading system that helps identify, monitor and address asset quality problems in an adequate and timely manner. Each quarter, various factors affecting the quality of the loan portfolio are reviewed. Large credits are reviewed on an individual basis for loss potential. Other loans are reviewed as a group based upon previous trends of loss experience. Horizon also reviews the current and anticipated economic conditions of its lending market as well as transaction risk to determine the effect they may have on the loss experience of the loan portfolio.

Goodwill and Intangible Assets

Management believes that the accounting for goodwill and other intangible assets also involves a higher degree of judgment than most other significant accounting policies. FASB ASC 350-10 establishes standards for the amortization of acquired intangible assets and impairment assessment of goodwill. At June 30, 2014, Horizon had core deposit intangibles of $4.4 million subject to amortization and $28.0 million of goodwill, which is not subject to amortization. Goodwill arising from business combinations represents the value attributable to unidentifiable intangible assets in the business acquired. Horizon s goodwill relates to the value inherent in the banking industry and that value is dependent upon the ability of Horizon to provide quality, cost effective banking services in a competitive marketplace. The goodwill value is supported by revenue that is in part driven by the volume of business transacted. A decrease in earnings resulting from a decline in the customer base or the inability to deliver cost effective services over sustained periods can lead to impairment of goodwill that could adversely affect earnings in future periods. FASB ASC 350-10 requires an annual evaluation of goodwill for impairment. The evaluation of goodwill for impairment requires the use of estimates and assumptions. Market price at the close of business on June 30, 2014 was $21.84 per share compared to a book value of $19.00 per common share. Horizon reported record earnings for the fourteenth consecutive year in 2013.

Horizon has concluded that, based on its own internal evaluation, the recorded value of goodwill is not impaired.

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Mortgage Servicing Rights

Servicing assets are recognized as separate assets when rights are acquired through purchase or through the sale of financial assets on a servicing-retained basis. Capitalized servicing rights are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated regularly for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying servicing rights by predominant characteristics, such as interest rates, original loan terms and whether the loans are fixed or adjustable rate mortgages. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. When the book value of an individual stratum exceeds its fair value, an impairment reserve is recognized so that each individual stratum is carried at the lower of its amortized book value or fair value. In periods of falling market interest rates, accelerated loan prepayment can adversely affect the fair value of these mortgage-servicing rights relative to their book value. In the event that the fair value of these assets was to increase in the future, Horizon can recognize the increased fair value to the extent of the impairment allowance but cannot recognize an asset in excess of its amortized book value. Future changes in management s assessment of the impairment of these servicing assets, as a result of changes in observable market data relating to market interest rates, loan prepayment speeds, and other factors, could impact Horizon s financial condition and results of operations either positively or negatively.

Generally, when market interest rates decline and other factors favorable to prepayments occur, there is a corresponding increase in prepayments as customers refinance existing mortgages under more favorable interest rate terms. When a mortgage loan is prepaid, the anticipated cash flows associated with servicing that loan are terminated, resulting in a reduction of the fair value of the capitalized mortgage servicing rights. To the extent that actual borrower prepayments do not react as anticipated by the prepayment model (i.e., the historical data observed in the model does not correspond to actual market activity), it is possible that the prepayment model could fail to accurately predict mortgage prepayments and could result in significant earnings volatility. To estimate prepayment speeds, Horizon utilizes a third-party prepayment model, which is based upon statistically derived data linked to certain key principal indicators involving historical borrower prepayment activity associated with mortgage loans in the secondary market, current market interest rates and other factors, including Horizon s own historical prepayment experience. For purposes of model valuation, estimates are made for each product type within the mortgage servicing rights portfolio on a monthly basis. In addition, on a quarterly basis Horizon engages a third party to independently test the value of its servicing asset.

Derivative Instruments

As part of the Company s asset/liability management program, Horizon utilizes, from time-to-time, interest rate floors, caps or swaps to reduce the Company s sensitivity to interest rate fluctuations. These are derivative instruments, which are recorded as assets or liabilities in the consolidated balance sheets at fair value. Changes in the fair values of derivatives are reported in the consolidated income statements or other comprehensive income (OCI) depending on the use of the derivative and whether the instrument qualifies for hedge accounting. The key criterion for the hedge accounting is that the hedged relationship must be highly effective in achieving offsetting changes in those cash flows that are attributable to the hedged risk, both at inception of the hedge and on an ongoing basis.

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

Valuation Measurements

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

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Financial Condition

On June 30, 2014, Horizon s total assets were $2.1 billion, an increase of approximately $315.0 million compared to December 31, 2013. The increase was primarily due to the growth in net loans of $253.0 million.

Investment securities were comprised of the following as of:

	June 30, 2014		December 31, 2013	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for sale				
U.S. Treasury and federal agencies	$ 35,737	$ 35,532	$ 43,808	$ 43,134
State and municipal	47,691	49,381	176,670	177,898
Federal agency collateralized mortgage obligations	115,503	115,242	116,047	114,706
Federal agency mortgage-backed pools	158,907	162,587	170,006	170,894
Private labeled mortgage-backed pools	892	920	1,188	1,226
Corporate notes	738	756	708	733
Total available for sale investment securities	$ 359,468	$ 364,418	$ 508,427	$ 508,591
Held to maturity				
U.S. Treasury and federal agencies	$ 9,764	$ 9,843	$	$
State and municipal	136,131	137,928	9,910	9,910
Federal agency collateralized mortgage obligations	4,360	4,364		
Federal agency mortgage-backed pools	22,945	23,359		
Total held to maturity investment securities	$ 173,200	$ 175,494	$ 9,910	$ 9,910

Total investment securities increased by approximately $19.1 million at June 30, 2014 compared to December 31, 2013 due to excess liquidity. In the second quarter of 2014, Horizon reclassified securities with a book value of $165.1 million and a net unrealized gain of $2.0 million from available for sale to held to maturity. At the time of reclassification, the fair value of the securities of $167.1 million was reclassified as held to maturity. This reclassification was made due to Horizon s intent and ability to hold these securities to maturity. Investments classified as held to maturity are subsequently measured at amortized cost on the balance sheet.

Net loans increased $253.0 million since December 31, 2013 to $1.3 billion as of June 30, 2014. This increase was the result of an increase in commercial loans of $143.0 million, mortgage warehouse loans of $42.7 million, residential mortgage loans of $49.6 million and consumer loans of $17.3 million. On April 3, 2014, as part of the Summit acquisition, Horizon acquired $124.0 million in loans. These loans consisted of $70.4 million in commercial, $43.4 million of residential mortgage and $10.2 million of consumer. The growth in total loans during the second quarter of 2014 is the direct result of increased calling efforts to increase Horizon s market share within the Company s footprint, organic market expansion and the Summit acquisition.

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The following are the loan balances by type as of:

	June 30 2014	December 31 2013	Amount Change	Acquired Summit Loans	Excluding Acquired Loans Amount Change	Percent Change	Annualized Percent Change
Commercial loans	$ 648,202	$ 505,189	$ 143,013	$ (70,441)	$ 72,572	14.4%	29.0%
Mortgage warehouse loans	140,896	98,156	42,740		42,740	43.5%	87.8%
Residential mortgage loans	235,523	185,958	49,565	(43,448)	6,117	3.3%	6.6%
Consumer loans	296,873	279,525	17,348	(10,192)	7,156	2.6%	5.2%
Held for sale loans	7,286	3,281	4,005		4,005	122.1%	246.2%
Total loans	1,328,780	1,072,109	256,671	(124,081)	132,590	12.4%	24.9%

Total deposits increased $207.6 million since December 31, 2013. This increase was the result of organic growth of $86.4 million and deposits acquired in the Summit acquisition of $121.2 million. Non-interest bearing deposit accounts increased by $38.9 million, interest bearing transaction accounts increased by $139.1 million and time deposits increased by $29.6 million due to increased calling and marketing efforts and market expansion as well as the Summit acquisition.

The Company s borrowings increased $83.9 million from December 31, 2013 as net loan growth of $253.0 million outpaced deposit growth of $207.6 million during the six months ended June 30, 2014, thereby increasing the Company s reliance on borrowings to fund loan growth during the quarter. At June 30, 2014, the Company had $110.0 million in short-term funds borrowed compared to $41.0 million at December 31, 2013. The Company s current balance sheet strategy is to utilize a reasonable level of short-term borrowings during extended low rate environments in addition to what is needed for the fluctuations in mortgage warehouse lending.

Stockholders equity totaled $187.3 million at June 30, 2014 compared to $164.5 million at December 31, 2013. The increase in stockholders equity during the period was the result of the generation of net income, an increase in accumulated other comprehensive income and common stock issued in the Summit acquisition, net of dividends declared. At June 30, 2014, the ratio of average stockholders equity to average assets was 8.79% compared to 9.46% for December 31, 2013. Book value per common share at June 30, 2014 increased to $19.00 compared to $17.64 at December 31, 2013.

Results of Operations

Overview

Consolidated net income for the three-month period ended June 30, 2014 was $4.8 million, a decrease of 15.7% from the $5.7 million for the same period in 2013. Earnings per common share for the three months ended June 30, 2014 were $0.52 basic and $0.50 diluted, compared to $0.65 basic and $0.62 diluted for the same three-month period in 2013. Diluted earnings per share decreased by $.12 compared to the same three-month period in 2013 due to lower non-interest income from a decline in gain on sale of mortgage loans and an increase in non-interest expenses primarily due to an increase in salaries from company growth and transaction expenses related to the Summit acquisition. Additionally, the decrease in diluted earnings per share reflects the shares issued to Summit shareholders as part of the transaction.

Consolidated net income for the six-month period ended June 30, 2014 was $8.2 million, a decrease of 25.3% from $11.0 million for the same period in 2013. Earnings per common share for the six months ended June 30, 2014 were $0.91 basic and $0.88 diluted, compared to $1.25 basic and $1.20 diluted for the same six-month period in 2013. Diluted earnings per share decreased by $.32 compared to the same six-month period in 2013 due primarily to lower non-interest income from a decline in gain on sale of mortgage loans and an increase in non-interest expenses primarily due to an increase in salaries and employee benefits from company growth and transaction expenses related to the Summit acquisition. Additionally, the decrease in diluted earnings per share reflects the shares issued to Summit shareholders as part of the transaction.

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Net Interest Income

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

Net interest income during the three months ended June 30, 2014 was $16.8 million, an increase of $213,000 from the $16.6 million earned during the same period in 2013. Yields on the Company s interest-earning assets decreased by 54 basis points to 4.51% for the three months ending June 30, 2014 from 5.05% for the three months ended June 30, 2013. Interest income increased $145,000 from $20.0 million for the three months ended June 30, 2013 to $20.1 million for the same period in 2014. This increase was primarily due to an increase in interest earning assets offset by lower yields on loans and a decrease in interest income from acquisition-related purchase accounting adjustments from $2.4 million for the second quarter of 2013 to $1.2 million for the same period of 2014.

Rates paid on interest-bearing liabilities decreased by 13 basis points for the three months ended June 30, 2014 compared to the same period in 2013 due to the continued low interest rate environment. Interest expense decreased $68,000 from $3.4 million for the three months ended June 30, 2013 to $3.3 million for the same period in 2014. This decrease was due lower rates being paid on the Company s interest bearing liabilities. The net interest margin decreased 43 basis points from 4.21% for the three months ended June 30, 2013 to 3.78% for the same period in 2014. The decrease in the margin for the three months ended June 30, 2014 compared to the same period in 2013 was due to the decrease of approximately $1.1 million of interest income from acquisition-related purchase accounting adjustments as well as a reduction in the yield on interest-earning assets. Excluding the interest income recognized from the acquisition-related purchase accounting adjustments, the margin would have been 3.52% for the three-month period ending June 30, 2014 compared to 3.61% for the same period in 2013.

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

	Three Months Ended June 30, 2014			Three Months Ended June 30, 2013		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
ASSETS						
Interest-earning assets						
Federal funds sold .	$ 9,062	$ 5	0.22%	$ 5,690	$ 3	0.21%
Interest-earning deposits	7,987	4	0.20%	10,289	5	0.19%
Investment securities - taxable	403,910	2,386	2.37%	369,382	2,039	2.21%
Investment securities - non-taxable (1)	145,591	1,096	4.25%	131,474	1,024	4.53%
Loans receivable (2)(3)	1,266,026	16,631	5.27%	1,109,345	16,906	6.12%
Total interest-earning assets (1)	1,832,576	20,122	4.51%	1,626,180	19,977	5.05%
Noninterest-earning assets						
Cash and due from banks	28,106			23,544		
Allowance for loan losses	(15,808)			(19,572)		
Other assets	129,608			133,658		
	$ 1,974,482			$ 1,763,810		
LIABILITIES AND SHAREHOLDERS EQUITY						
Interest-bearing liabilities						
Interest-bearing deposits	$ 1,229,025	$ 1,355	0.44%	$ 1,091,285	$ 1,445	0.53%
Borrowings	273,968	1,478	2.16%	240,681	1,456	2.43%
Subordinated debentures	32,541	501	6.18%	32,172	501	6.25%
Total interest-bearing liabilities	1,535,534	3,334	0.87%	1,364,138	3,402	1.00%
Noninterest-bearing liabilities						
Demand deposits	253,093			218,433		
Accrued interest payable and other liabilities	12,245			16,492		
Shareholders equity	173,610			164,747		

	$ 1,974,482		$ 1,763,810	
Net interest income/spread	$ 16,788	3.63%	$ 16,575	4.05%
Net interest income as a percent of average interest earning assets (1)		3.78%		4.21%

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

Net interest income during the six months ended June 30, 2014 was $30.1 million, a decrease of $2.5 million from the $32.6 million earned during the same period in 2013. Yields on the Company s interest-earning assets decreased by 63 basis points to 4.39% for the six months ended June 30, 2014 from 5.02% for the same period in 2013. Interest income decreased $2.8 million from $39.4 million for the six months ended June 30, 2013 to $36.6 million for the same period in 2014. This decrease was primarily due to lower yields on loans and a decrease in interest income from acquisition-related purchase accounting adjustments from $4.2 million for the first six months of 2013 to $1.6 million for the same period of 2014.

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Rates paid on interest-bearing liabilities decreased by 8 basis points for the six months ended June 30, 2014 compared to the same period in 2013 due to the continued low interest rate environment. Interest expense decreased $292,000 from $6.8 million for the six months ended June 30, 2013 to $6.5 million for the same period of 2014. This decrease was due to lower rates being paid on the Company s interest bearing liabilities partially offset with a higher volume of interest bearing liabilities. The net interest margin decreased 55 basis points from 4.17% for the six months ended June 30, 2013 to 3.62% for the same period in 2014. The decrease in the margin for the six months ended June 30, 2014 compared to the same period in 2013 was due to the decrease of approximately $2.6 million of interest income from acquisition-related purchase accounting adjustments as well as a reduction in the yield on interest-earning assets. Excluding the interest income recognized from the acquisition-related purchase accounting adjustments, the margin would have been 3.43% for the six months ending June 30, 2014 compared to 3.66% for the same period in 2013.

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

	Six Months Ended June 30, 2014			Six Months Ended June 30, 2013		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
ASSETS						
Interest-earning assets						
Federal funds sold	$ 7,842	$ 9	0.23%	$ 9,171	$ 10	0.22%
Interest-earning deposits	6,855	7	0.21%	8,920	9	0.20%
Investment securities - taxable	395,406	4,769	2.43%	372,394	4,050	2.19%
Investment securities - non-taxable (1)	146,709	2,219	4.07%	126,758	1,991	4.95%
Loans receivable (2)(3)	1,159,127	29,585	5.15%	1,113,770	33,346	6.05%
Total interest-earning assets (1)	1,715,939	36,589	4.39%	1,631,013	39,406	5.02%
Noninterest-earning assets						
Cash and due from banks	26,507			23,780		
Allowance for loan losses	(15,987)			(19,124)		
Other assets	133,408			134,689		
	$ 1,859,867			$ 1,770,358		

LIABILITIES AND SHAREHOLDERS EQUITY

Interest-bearing liabilities						
Interest-bearing deposits	$ 1,154,682	$ 2,632	0.46%	$ 1,102,991	$ 2,925	0.53%
Borrowings	250,761	2,900	2.33%	242,364	2,904	2.42%
Subordinated debentures	32,522	997	6.18%	32,265	992	6.20%
Total interest-bearing liabilities	1,437,965	6,529	0.92%	1,377,620	6,821	1.00%
Noninterest-bearing liabilities						
Demand deposits	238,579			211,568		
Accrued interest payable and other liabilities	12,191			17,384		
Shareholders equity	171,132			163,786		
	$ 1,859,867			$ 1,770,358		
Net interest income/spread		$ 30,060	3.47%		$ 32,585	4.02%
Net interest income as a percent of average interest earning assets (1)			3.62%			4.17%

(4) Securities balances represent daily average balances for the fair value of securities. The average rate is calculated based on the daily average balance for the amortized cost of securities. Interest rate is presented on a tax equivalent basis.

(5) Includes loan fees and late fees. The inclusion of these fees does not have a material effect on the average interest rate.

(6) Non-accruing loans for the purpose of the computations above are included in the daily average loan amounts outstanding. Loan totals are shown net of unearned income and deferred loans fees.

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Provision for Loan Losses

Horizon assesses the adequacy of its Allowance for Loan and Lease Losses (ALLL) by regularly reviewing the performance of its loan portfolios. During the three-month period ended June 30, 2014, a provision of $339,000 was required to adequately fund the ALLL compared to a provision of $729,000 for the same period of 2013. Commercial loan net charge-offs during the three months ended June 30, 2014 were $185,000, residential mortgage loan net charge-offs were $169,000, and consumer loan net charge-offs were $426,000. The lower provision for loan losses in the second quarter of 2014 compared to the same period of 2013 was due to the continued improvement of nonperforming and substandard loans. The ALLL balance at June 30, 2014 was $15.7 million or 1.18% of total loans. This compares to an ALLL balance of $16.0 million at December 31, 2013 or 1.49% of total loans and $18.9 million at June 30, 2013 or 1.67% of total loans. The decrease in the ratio at June 30, 2014 compared to December 31, 2013 was primarily due to an increase in total loans of $256.7 million. The decrease in the ratio at June 30, 2014 compared to June 30, 2013 was due to a decrease in the allowance for loan and lease losses of $3.2 million due to the continued improvement of non-performing and substandard loan and an increase in total loans of $196.4 million.

For the six-month period ended June 30, 2014, the provision for loan losses totaled $339,000 compared to $2.8 million in the same period of 2013. The lower provision for loan losses in the first six months of 2014 compared to the same period of 2013 was due to the continued improvement of non-performing and substandard loans.

No assurance can be given that Horizon will not, in any particular period, sustain loan losses that are significant in relation to the amount reserved, or that subsequent evaluations of the loan portfolio, in light of factors then prevailing, including economic conditions and management s ongoing quarterly assessments of the portfolio, will not require increases in the allowance for loan losses. Horizon considers the allowance for loan losses to be appropriate to cover probable incurred losses in the loan portfolio as of June 30, 2014.

Non-performing loans totaled $18.7 million on June 30, 2014, up from $18.3 million on December 31, 2013 and down from $25.6 million on June 30, 2013. Compared to December 31, 2013, non-performing commercial loans and real estate loans increased by $772,000 and $527,000, respectively, partially offset by a decrease of $898,000 in non-performing consumer loans.

At June 30, 2014, loans acquired in the Summit acquisition represented $859,000 in non-performing, $2.9 million in substandard and $463,000 in delinquent loans. At June 30, 2014, loans acquired in the Heartland acquisition represented $3.2 million in non-performing, $7.8 million in substandard and $306,000 in delinquent loans, which compares to $4.5 million in non-performing, $10.3 million in substandard and $323,000 in delinquent loans at December 31, 2013.

Other Real Estate Owned (OREO) totaled $1.2 million on June 30, 2014, down from $2.1 million on December 31, 2013 and up from $1.1 million on June 30, 2013.

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Non-interest Income

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

	Three Months Ended June 30, 2014	June 30, 2013	Amount Change	Percent Change
Non-interest Income				
Service charges on deposit accounts	**$ 1,038**	$ 988	$ 50	5.1%
Wire transfer fees	**145**	203	(58)	-28.6%
Interchange fees	**1,254**	1,060	194	18.3%
Fiduciary activities	**1,199**	1,047	152	14.5%
Gain on sale of mortgage loans	**2,537**	2,807	(270)	-9.6%
Mortgage servicing net of impairment	**233**	302	(69)	-22.8%
Increase in cash surrender value of bank owned life insurance	**252**	257	(5)	-1.9%
Other income	**(31)**	185	(216)	-116.8%
Total non-interest income	**$ 6,627**	$ 6,849	$ (222)	-3.2%

Total non-interest income was $222,000 lower in the second quarter of 2014 compared to the same period of 2013. Interchange fees increased by $194,000 in the second quarter of 2014 compared to the same period of 2013, primarily due to an increase in volume. Fiduciary activity fees increased $152,000 in the second quarter of 2014 compared to the same period of 2013, primarily due to customer and market value growth. Residential mortgage loan activity during the second quarter of 2014 generated $2.5 million of income from the gain on sale of mortgage loans, down $270,000 from the same period in 2013. The reduction in the gain on sale of mortgages loans was due to the decrease in total origination volume of $40.3 million for the second quarter of 2014 compared to the same period in 2013, partially offset by an increase in the percentage earned on the sale of these loans. Loans originated for sale during the second quarter of 2014 totaled $58.1 million compared to $98.3 million for the same period in 2013. Other income decreased by $216,000 from $185,000 for the second quarter of 2013 to negative $31,000 for the second quarter of 2014 due primarily to the liquidation of an asset that resulted in a net loss.

	Six Months Ended June 30, 2014	June 30, 2013	Amount Change	Percent Change

Non-interest Income				
Service charges on deposit accounts	**$ 1,961**	$ 1,901	$ 60	3.2%
Wire transfer fees	**257**	393	(136)	-34.6%
Interchange fees	**2,213**	1,926	287	14.9%
Fiduciary activities	**2,247**	2,187	60	2.7%
Gain on sale of securities		368	(368)	NM
Gain on sale of mortgage loans	**3,948**	5,913	(1,965)	-33.2%
Mortgage servicing net of impairment	**440**	465	(25)	-5.4%
Increase in cash surrender value of bank owned life insurance	**485**	509	(24)	-4.7%
Other income	**598**	647	(49)	-7.6%
Total non-interest income	**$ 12,149**	$ 14,309	$ (2,160)	-15.1%

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Total non-interest income was $2.2 million lower in the first six months of 2014 compared to the same period of 2013. Wire transfer fees were $136,000 lower during the first six months of 2014 compared to the same period in 2013 primarily due to a decrease in volume. Interchange fees were $287,000 higher during the first six months of 2014 compared to the same period in 2013 primarily due to an increase in volume. Gain on sale of securities were $368,000 lower during the first half of 2014 as Horizon incurred a gain on the sale of securities of $368,000 during the first half of 2013 as the result of an analysis that determined market conditions provided the opportunity to add gains to capital without negatively impacting long-term earnings. Residential mortgage loan activity during the first six months of 2014 generated $3.9 million of income from the gain on sale of mortgage loans, down $2.0 million from the same period in 2013. This decrease was due to a decrease in volume, partially offset by an increase in the percentage earned on the sale of these loans. Loans originated for sale during the first half of 2014 were $94.0 million compared to $198.0 million for the same period in 2013.

Non-interest Expense

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

	Three Months Ended			
	June 30 2014	**June 30 2013**	**Amount Change**	**Percent Change**
Non-interest expense				
Salaries	**$ 6,002**	$ 5,282	$ 720	13.6%
Commission and bonuses	**1,009**	1,100	(91)	-8.3%
Employee benefits	**1,282**	1,339	(57)	-4.3%
Net occupancy expenses	**1,360**	1,295	65	5.0%
Data processing	**937**	818	119	14.5%
Professional fees	**419**	454	(35)	-7.7%
Outside services and consultants	**1,298**	486	812	167.1%
Loan expense	**1,272**	1,402	(130)	-9.3%
FDIC deposit insurance	**285**	268	17	6.3%
Other losses	**95**	163	(68)	-41.7%
Other expense	**2,449**	2,188	261	11.9%
Total non-interest expense	**$ 16,408**	$ 14,795	$ 1,613	10.9%

Total non-interest expenses were $1.6 million higher in the second quarter of 2014 compared to the same period of 2013. Salaries increased $720,000 compared to the same quarter in 2013 primarily due to changes in annual merit pay and a larger employee base. Data processing expense increased during the quarter by $119,000 compared to the same period in 2013 due to $99,000 in one-time fees associated with the Summit acquisition. Outside services and consultants increased by $812,000 compared to the same period of 2013 due to $729,000 in one-time fees associated with the Summit acquisition. The decrease of $130,000 in loan expense during the second quarter of 2014 compared to the prior year was related to a decrease in loan origination costs, indirect dealer fees and collection and workout costs. Other expenses increased $261,000 in the second quarter of 2014 compared to the same period in 2013 primarily due to the Company s growth and expansion efforts.

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	Six Months Ended			
	June 30 2014	**June 30 2013**	**Amount Change**	**Percent Change**
Non-interest expense				
Salaries	**$ 11,358**	$ 10,461	$ 897	8.6%
Commission and bonuses	**1,489**	2,139	(650)	-30.4%
Employee benefits	**2,929**	2,625	304	11.6%
Net occupancy expenses	**2,784**	2,606	178	6.8%
Data processing	**1,807**	1,418	389	27.4%
Professional fees	**1,027**	953	74	7.8%
Outside services and consultants	**1,959**	1,198	761	63.5%
Loan expense	**2,287**	2,516	(229)	-9.1%
FDIC deposit insurance	**541**	551	(10)	-1.8%
Other losses	**133**	91	42	46.2%
Other expense	**4,608**	4,216	392	9.3%
Total non-interest expense	**$ 30,922**	$ 28,774	$ 2,148	7.5%

Total non-interest expenses were $2.1 million higher in the first six months of 2014 compared to the same period of 2013. Salaries and employee benefits increased $1.2 million compared to the same period in 2013 primarily due to changes in annual merit pay, a larger employee base and increased employee benefits costs. Commission and bonuses decreased $650,000 compared to the same period of 2013 primarily due to lower commissions earned due to a decrease in mortgage loans originated. Net occupancy expenses increased $178,000 compared to the same period in 2013 primarily due to the Summit acquisition and Horizon s investment in growth markets. Data processing expense increased $389,000 compared to the same period in 2013 due to growth in services and $196,000 in one-time fees associated with the Summit acquisition. Outside services and consultants increased by $761,000 compared to the same period of 2013 due to growth $898,000 in fees associated with the Summit acquisition which occurred during the first six months of 2014. The decrease of $229,000 in loan expense during the first six months of 2014 compared to the prior year was related to a decrease in loan origination costs, indirect dealer fees and collection and workout costs. Other expenses increased $392,000 in the first half of 2014 compared to the same period in 2013 primarily due to the Company s growth and expansion efforts.

Income Taxes

Income tax expense for the second quarter of 2014 was $1.9 million compared to $2.2 million for same period of 2013. The effective tax rate for the second quarter of 2014 was 28.3% compared to 28.3% in the same period of 2013.

Income tax expense for the six months ended June 30, 2014 was $2.8 million compared to $4.3 million for same period of 2013. The effective tax rate for the first six months of 2014 was 25.1% compared to 28.3% in the same period of 2013. The decrease in the effective tax rate is primarily due to lower net income during the six months ended June 30, 2014 compared to the same period of 2013.

Liquidity

The Bank maintains a stable base of core deposits provided by long-standing relationships with individuals and local businesses. These deposits are the principal source of liquidity for Horizon. Other sources of liquidity for Horizon include earnings, loan repayment, investment security sales and maturities, proceeds from the sale of residential mortgage loans, and borrowing relationships with correspondent banks, including the FHLB. During the six months ended June 30, 2014, cash and cash equivalents increased by approximately $19.1 million. At June 30, 2014, in addition to liquidity available from the normal operating, funding, and investing activities of Horizon, the Bank had approximately $268.9 million in unused credit lines with various money center banks, including the FHLB and the FRB Discount Window compared to $311.8 million at December 31, 2013 and $346.5 million at June 30, 2013.

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Capital Resources

The capital resources of Horizon and the Bank exceeded regulatory capital ratios for well capitalized banks at June 30, 2014. Stockholders equity totaled $187.3 million as of June 30, 2014, compared to $164.5 million as of December 31, 2013. For the three months ended June 30, 2014, the ratio of average stockholders equity to average assets was 8.79% compared to 9.46% for the three months ended December 31, 2013. The increase in stockholders equity during the period was the result of the generation of net income, an increase in accumulated other comprehensive income and common stock issued in the Summit acquisition, net of dividends declared.

The Company currently intends to continue its participation in the Small Business Lending Fund, pursuant to which it issued preferred stock to the US Treasury, since the growth in the Company s small business lending has reduced the dividend cost. For the three months ending June 30, 2014, the dividend cost was approximately $31,000, or 1.0% annualized. For each of the remaining two quarters of 2014, the dividend cost will be approximately $31,000 or 1.0% annualized. The Company plans to reserve cash for the ability to redeem this preferred stock if and when the cost of this capital exceeds other forms of capital, subject to regulatory approval.

Horizon declared common stock dividends in the amount of $0.24 per share during the first six months of 2014 compared to $0.20 per share for the same period of 2013. The dividend payout ratio (dividends as a percent of basic earnings per share) was 26.3% and 16.1% for the first six months of 2014 and 2013, respectively. For additional information regarding dividends, see Horizon s Annual Report on Form 10-K for 2013.

Basel III

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

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

Use of Non-GAAP Financial Measures

Certain information set forth in this document refers to a financial measure determined by methods other than in accordance with GAAP. Specifically, we have included a non-GAAP financial measure of the net interest margin excluding the impact of acquisitions. Horizon believes that this non-GAAP financial measure is helpful to investors and provides a greater understanding of our business without giving effect to the purchase accounting impacts of acquisitions, although this measure is not necessarily comparable to similar measures that may be presented by other companies and it should not be considered in isolation or as a substitute for the related GAAP measure.

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Non-GAAP Reconciliation of Net Interest Margin

(Dollar Amounts in Millions, Unaudited)

	Three Months Ended			Six Months Ended	
	June 30, 2014	March 31, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Net Interest Margin As Reported					
Net interest income	$ 16.8	$ 13.3	$ 16.6	$ 30.1	$ 32.6
Average interest-earning assets	1,832.6	1,598.3	1,626.2	1,715.9	1,631.0
Net interest income as a percent of average interest earning assets	3.78%	3.48%	4.21%	3.62%	4.17%
Impact of Acquisitions					
Interest income from acquisition-related purchase accounting adjustments	$ (1.2)	$ (0.4)	$ (2.4)	$ (1.6)	$ (4.1)
Net Interest Margin Excluding Impact of Acquisitions					
Net interest income	$ 15.6	$ 12.9	$ 14.2	$ 28.5	$ 28.4
Average interest-earning assets	1,832.6	1,598.3	1,626.2	1,715.9	1,631.0
Net interest income as a percent of average interest earning assets	3.52%	3.38%	3.61%	3.43%	3.66%

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Quantitative and Qualitative Disclosures About Market Risk

For the Three and Six Months Ended June 30, 2014

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We refer you to Horizon s 2013 Annual Report on Form 10-K for analysis of its interest rate sensitivity. Horizon believes there have been no significant changes in its interest rate sensitivity since it was reported in its 2013 Annual Report on Form 10-K.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation Of Disclosure Controls And Procedures

Based on an evaluation of disclosure controls and procedures as of June 30, 2014, Horizon s Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of Horizon s disclosure controls (as defined in Exchange Act Rule 13a-15(e) of the Securities Exchange Act of 1934 (the Exchange Act)). Based on such evaluation, such officers have concluded that, as of the evaluation date, Horizon s disclosure controls and procedures are effective to ensure that the information required to be disclosed by Horizon in the reports it files under the Exchange Act is recorded, processed, summarized and reported within the time specified in Securities and Exchange Commission rules and forms and are designed to ensure that information required to be disclosed in those reports is accumulated and communicated to management as appropriate to allow timely decisions regarding disclosure.

Changes In Internal Control Over Financial Reporting

Horizon s management, including its Chief Executive Officer and Chief Financial Officer, also have concluded that during the fiscal quarter ended June 30, 2014, there have been no changes in Horizon s internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, Horizon s internal control over financial reporting.

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HORIZON BANCORP AND SUBSIDIARIES

Part II Other Information

For the Three and Six Months Ended June 30, 2014

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

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

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

Not Applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable

ITEM 5. OTHER INFORMATION

Not Applicable

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HORIZON BANCORP AND SUBSIDIARIES

Part II Other Information

For the Three and Six Months Ended June 30, 2014

ITEM 6. EXHIBITS

(a) Exhibits

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

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SIGNATURES

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

	HORIZON BANCORP
Dated: August 11, 2014	/s/ Craig M. Dwight Craig M. Dwight
	Chief Executive Officer
Dated: August 11, 2014	/s/ Mark E. Secor Mark E. Secor
	Chief Financial Officer

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INDEX TO EXHIBITS

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