

HORIZON BANCORP /IN/
Form 10-Q
May 06, 2016
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United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

HORIZON BANCORP

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2016

Commission file number 0-10792

HORIZON BANCORP

(Exact name of registrant as specified in its charter)

Indiana
(State or other jurisdiction of

35-1562417
(I.R.S. Employer

incorporation or organization)

Identification No.)

515 Franklin Square,

Michigan City, Indiana
(Address of principal executive offices)

46360
(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 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 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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 11,983,313 shares of Common Stock, no par value, at May 6, 2016.

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HORIZON BANCORP

FORM 10-Q

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Table of Contents**PART 1 FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****HORIZON BANCORP AND SUBSIDIARIES****Condensed Consolidated Balance Sheets**

(Dollar Amounts in Thousands)

	March 31 2016 (Unaudited)	December 31 2015
Assets		
Cash and due from banks	\$ 47,612	\$ 48,650
Investment securities, available for sale	462,476	444,982
Investment securities, held to maturity (fair value of \$188,093 and \$193,703)	180,291	187,629
Loans held for sale	3,168	7,917
Loans, net of allowance for loan losses of \$14,236 and \$14,534	1,705,836	1,734,597
Premises and equipment, net	60,190	60,798
Federal Reserve and Federal Home Loan Bank stock	13,823	13,823
Goodwill	49,600	49,600
Other intangible assets	7,095	7,371
Interest receivable	10,476	10,535
Cash value of life insurance	54,849	54,504
Other assets	32,502	31,995
Total assets	\$ 2,627,918	\$ 2,652,401
Liabilities		
Deposits		
Non-interest bearing	\$ 343,025	\$ 335,955
Interest bearing	1,535,454	1,544,198
Total deposits	1,878,479	1,880,153
Borrowings	430,507	449,347
Subordinated debentures	32,836	32,797
Interest payable	580	507
Other liabilities	24,099	22,765
Total liabilities	2,366,501	2,385,569
Commitments and contingent liabilities		
Stockholders Equity		
Preferred stock, Authorized, 1,000,000 shares Series B shares \$.01 par value, \$1,000 liquidation value Issued 0 and 12,500 shares		12,500

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Common stock, no par value Authorized, 22,500,000 shares Issued, 12,008,497 and 11,995,324 shares Outstanding, 11,983,313 and 11,939,887 shares

Additional paid-in capital	106,500	106,370
Retained earnings	152,219	148,685
Accumulated other comprehensive income (loss)	2,698	(723)
Total stockholders' equity	261,417	266,832
Total liabilities and stockholders' equity	\$ 2,627,918	\$ 2,652,401

See notes to condensed consolidated financial statements

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Condensed Consolidated Statements of Income**

(Dollar Amounts in Thousands, Except Per Share Data)

	Three Months Ended March 31	
	2016	2015
	(Unaudited)	(Unaudited)
Interest Income		
Loans receivable	\$ 19,747	\$ 16,862
Investment securities		
Taxable	2,544	2,154
Tax exempt	1,237	1,077
Total interest income	23,528	20,093
Interest Expense		
Deposits	1,491	1,232
Borrowed funds	1,759	1,479
Subordinated debentures	504	496
Total interest expense	3,754	3,207
Net Interest Income	19,774	16,886
Provision for loan losses	532	614
Net Interest Income after Provision for Loan Losses	19,242	16,272
Non-interest Income		
Service charges on deposit accounts	1,238	999
Wire transfer fees	121	151
Interchange fees	1,458	1,102
Fiduciary activities	1,635	1,297
Gain on sale of investment securities (includes \$108 and \$124 for the three months ended March 31, 2016 and 2015, respectively, related to accumulated other comprehensive earnings reclassifications)	108	124
Gain on sale of mortgage loans	2,114	2,379
Mortgage servicing income net of impairment	447	179
Increase in cash value of bank owned life insurance	345	258
Death benefit on bank owned life insurance		145
Other income	398	432
Total non-interest income	7,864	7,066

Non-interest Expense		
Salaries and employee benefits	10,065	8,504
Net occupancy expenses	1,936	1,551
Data processing	1,105	923
Professional fees	831	527
Outside services and consultants	1,099	626
Loan expense	1,195	1,257
FDIC insurance expense	405	337
Other losses	267	(45)
Other expense	2,844	2,388
Total non-interest expense	19,747	16,068
Income Before Income Tax	7,359	7,270
Income tax expense (includes \$38 and \$43 for the three months ended March 31, 2016 and 2015, respectively, related to income tax expense from reclassification items)	1,978	1,912
Net Income	5,381	5,358
Preferred stock dividend	(42)	(31)
Net Income Available to Common Shareholders	\$ 5,339	\$ 5,327
Basic Earnings Per Share	\$ 0.45	\$ 0.58
Diluted Earnings Per Share	0.44	0.55

See notes to condensed consolidated financial statements

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Condensed Consolidated Statements of Comprehensive Income**

(Dollar Amounts in Thousands)

	Three Months Ended March 31	
	2016	2015
	(Unaudited)	(Unaudited)
Net Income	\$ 5,381	\$ 5,358
Other Comprehensive Income (Loss)		
Change in fair value of derivative instruments:		
Change in fair value of derivative instruments for the period	(562)	(329)
Income tax effect	197	115
Changes from derivative instruments	(365)	(214)
Change in securities:		
Unrealized appreciation for the period on AFS securities	5,946	1,714
Amortization from transfer of securities from available-for-sale to held-to-maturity securities	(229)	(114)
Reclassification adjustment for securities gains realized in income	108	124
Income tax effect	(2,039)	(604)
Unrealized gains on securities	3,786	1,120
Other Comprehensive Income, Net of Tax	3,421	906
Comprehensive Income	\$ 8,802	\$ 6,264

See notes to condensed consolidated financial statements

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Condensed Consolidated Statement of Stockholders' Equity****(Unaudited)**

(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, 2016	\$ 12,500	\$ 106,370	\$ 148,685	\$ (723)	\$ 266,832
Net income			5,381		5,381
Other comprehensive loss, net of tax				3,421	3,421
Redemption of preferred stock	(12,500)				(12,500)
Amortization of unearned compensation		62			62
Stock option expense		68			68
Cash dividends on preferred stock (1.00%)			(42)		(42)
Cash dividends on common stock (\$.15 per share)			(1,805)		(1,805)
Balances, March 31, 2016	\$	\$ 106,500	\$ 152,219	\$ 2,698	\$ 261,417

See notes to condensed consolidated financial statements

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Condensed Consolidated Statements of Cash Flows**

(Dollar Amounts in Thousands)

	Three Months Ended March 31	
	2016	2015
	(Unaudited)	(Unaudited)
Operating Activities		
Net income	\$ 5,381	\$ 5,358
Items not requiring (providing) cash		
Provision for loan losses	532	614
Depreciation and amortization	1,183	956
Share based compensation	68	59
Mortgage servicing rights net (recovery) impairment	1	414
Premium amortization on securities available for sale, net	1,187	476
Gain on sale of investment securities	(108)	(124)
Gain on sale of mortgage loans	(2,114)	(2,379)
Proceeds from sales of loans	62,022	71,211
Loans originated for sale	(55,162)	(68,918)
Change in cash value of life insurance	(345)	(258)
Gain on sale of other real estate owned	(100)	(263)
Net change in		
Interest receivable	59	(185)
Interest payable	73	7
Other assets	(1,730)	5,503
Other liabilities	(1,532)	(1,287)
Net cash provided by operating activities	9,415	11,184
Investing Activities		
Purchases of securities available for sale	(33,716)	(30,406)
Proceeds from sales, maturities, calls, and principal repayments of securities available for sale	26,663	25,260
Purchases of securities held to maturity	(8,677)	
Proceeds from maturities of securities held to maturity	10,319	735
Net change in loans	29,354	(81,515)
Proceeds on the sale of OREO and repossessed assets	663	1,414
Change in premises and equipment, net	(237)	(2,168)
Net cash provided by (used in) investing activities	24,369	(86,680)
Financing Activities		
Net change in		
Deposits	(1,674)	(17,224)

Borrowings	(18,801)	89,255
Redemption of preferred stock	(12,500)	
Dividends paid on common shares	(1,805)	(1,304)
Dividends paid on preferred shares	(42)	(31)
Net cash (used in) provided by financing activities	(34,822)	70,696
Net Change in Cash and Cash Equivalents	(1,038)	(4,800)
Cash and Cash Equivalents, Beginning of Period	48,650	43,476
Cash and Cash Equivalents, End of Period	\$ 47,612	\$ 38,676
Additional Supplemental Information		
Interest paid	\$ 3,681	\$ 3,199
Income taxes paid	1,250	
Transfer of loans to other real estate owned	1,379	(772)
See notes to condensed consolidated financial statements		

Table of Contents**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 March 31, 2016 and March 31, 2015 are not necessarily indicative of the operating results for the full year of 2016 or 2015. 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 2015 filed with the Securities and Exchange Commission on February 29, 2016. The condensed consolidated balance sheet of Horizon as of December 31, 2015 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	
	March 31	
	2016	2015
	(Unaudited)	(Unaudited)
Basic earnings per share		
Net income	\$ 5,381	\$ 5,358
Less: Preferred stock dividends	42	31
Net income available to common shareholders	\$ 5,339	\$ 5,327
Weighted average common shares outstanding	11,949,416	9,216,011
Basic earnings per share	\$ 0.45	\$ 0.58
Diluted earnings per share		
Net income available to common shareholders	\$ 5,339	\$ 5,327
Weighted average common shares outstanding	11,949,416	9,216,011
Effect of dilutive securities:		
Warrants		321,652

Restricted stock	21,033	30,510
Stock options	38,035	41,333
Weighted average shares outstanding	12,008,484	9,609,506
Diluted earnings per share	\$ 0.44	\$ 0.55

There were zero dilutive shares for the three months ended March 31, 2016 and 62,445 shares for the three months ended March 31, 2015 which were not included in the computation of diluted earnings per share because they were non-dilutive.

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements**

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

Horizon has share-based employee compensation plans, which are described in the notes to the financial statements included in the December 31, 2015 Annual Report on Form 10-K.

Reclassifications

Certain reclassifications have been made to the 2015 condensed consolidated financial statements to be comparable to 2016. These reclassifications had no effect on net income.

Note 2 Acquisitions

On July 1, 2015, Horizon completed the acquisition of Peoples Bancorp, an Indiana corporation (Peoples) and Horizon Bank N.A.'s acquisition of Peoples Federal Savings Bank of DeKalb County (Peoples FSB), through mergers effective July 1, 2015. Under the terms of the acquisition, the exchange ratio was 0.95 shares of Horizon common stock (the Exchange Ratio) and \$9.75 in cash for each outstanding share of Peoples common stock. Peoples shareholders owning fewer than 100 shares of common stock received \$33.14 in cash for each common share. Peoples shares outstanding at the closing were 2,311,858, and the shares of Horizon common stock issued to Peoples shareholders totaled 2,192,202. Horizon's stock price was \$25.32 per share at the close of business on July 1, 2015. Based upon these numbers, the total value of the consideration for the acquisition was \$78.1 million. The Company had approximately \$4.9 million in costs related to the acquisition as of December 31, 2015. These expenses were 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 Peoples 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 final purchase price for the Peoples acquisition is allocated as follows:

ASSETS

Cash and due from banks	\$ 205,054
Investment securities, held to maturity	2,038
Commercial	67,435
Residential mortgage	137,331
Consumer	19,593
Total loans	224,359

Premises and equipment, net	5,524
FRB and FHLB stock	2,743
Goodwill	21,424
Core deposit intangible	4,394
Interest receivable	1,279
Cash value of life insurance	13,898
Other assets	4,364

Total assets purchased	\$ 485,077
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Common shares issued	\$ 55,506
Cash paid	22,641

Total estimated purchase price	\$ 78,147
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LIABILITIES

Deposits	
Non-interest bearing	\$ 28,251
NOW accounts	65,771
Savings and money market	125,176
Certificates of deposits	131,889

Total deposits	351,087
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Borrowings	48,884
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Interest payable	21
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Other liabilities	6,938
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Total liabilities assumed	\$ 406,930
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(Table Dollar Amounts in Thousands, Except Per Share Data)

Of the total purchase price of \$78.1 million, \$4.4 million has been allocated to core deposit intangible. Additionally, \$21.0 million has been allocated to goodwill and none of the purchase price is deductible. The core deposit intangible will be amortized over seven years on a straight line basis.

The Company acquired the \$228.6 million loan portfolio at a fair value discount of \$4.8 million. The performing portion of the portfolio, \$223.4 million, had an estimated fair value of \$220.0 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.

The Company acquired certain 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.

The 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 non-accrual 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.

Loans with 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 July 1, 2015.

Contractually required principal and interest at acquisition	\$ 5,730
Contractual cash flows not expected to be collected (nonaccretable differences)	715
Expected cash flows at acquisition	5,015
Interest component of expected cash flows (accretable discount)	647
Fair value of acquired loans accounted for under ASC 310-30	\$ 4,368

The results of operations of Peoples and Peoples FSB have been included in the Company's consolidated financial statements since the acquisition dates. The following schedule includes pro forma results for the periods ended March 31, 2016 and 2015 as if the Peoples and Peoples FSB acquisitions had occurred as of the beginning of the comparable prior reporting period.

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

	Three Months Ended	
	March 31,	March 31,
	2016	2015
Summary of Operations:		
Net Interest Income	\$ 19,774	\$ 19,865
Provision for Loan Losses	532	644
Net Interest Income after Provision for Loan Losses	19,242	19,221
Non-interest Income	7,864	7,966
Non-Interest Expense	19,747	19,270
Income before Income Taxes	7,359	7,917
Income Tax Expense	1,978	1,939
Net Income	5,381	5,978
Net Income Available to Common Shareholders	\$ 5,339	\$ 5,984
Basic Earnings Per Share	\$ 0.45	\$ 0.52
Diluted Earnings Per Share	\$ 0.44	\$ 0.51

The pro forma information includes adjustments for interest income on loans, amortization of intangibles arising from the transaction, interest expense on deposits acquired, premises expense for the banking centers acquired and the related income tax effects. The pro forma information for the three months ended March 31, 2015 includes \$657,000, net of tax, of operating revenue from Peoples and approximately \$95,000, net of tax, of non-recurring expenses directly attributable to the Peoples acquisition.

The pro forma financial information is presented for information purposes only and is not indicative of the results of operations that actually would have been achieved had the acquisition consummated as of that time, nor is it intended to be a projection of future results.

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

Note 3 Securities

The fair value of securities is as follows:

March 31, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
U.S. Treasury and federal agencies	\$ 15,412	\$ 60	\$ (2)	\$ 15,470
State and municipal	69,204	1,840	(2)	71,042
Federal agency collateralized mortgage obligations	155,687	1,836	(210)	157,313
Federal agency mortgage-backed pools	215,167	3,648	(239)	218,576
Corporate notes	32	43		75
Total available for sale investment securities	\$ 455,502	\$ 7,427	\$ (453)	\$ 462,476
Held to maturity				
State and municipal	\$ 145,520	\$ 6,753	\$ (188)	\$ 152,085
Federal agency collateralized mortgage obligations	8,731	136		8,867
Federal agency mortgage-backed pools	26,040	1,149	(48)	27,141
Total held to maturity investment securities	\$ 180,291	\$ 8,038	\$ (236)	\$ 188,093
December 31, 2015				
Available for sale				
U.S. Treasury and federal agencies	\$ 5,940	\$ 3	\$ (17)	\$ 5,926
State and municipal	73,829	1,299	(33)	75,095
Federal agency collateralized mortgage obligations	157,291	567	(1,655)	156,203
Federal agency mortgage-backed pools	206,970	2,080	(1,346)	207,704
Corporate notes	32	22		54
Total available for sale investment securities	\$ 444,062	\$ 3,971	\$ (3,051)	\$ 444,982

Held to maturity

U.S. Treasury and federal agencies	\$ 5,859	\$ 93	\$	\$ 5,952
State and municipal	146,331	5,375	(253)	151,453
Federal agency collateralized mortgage obligations	9,051	27	(124)	8,954
Federal agency mortgage-backed pools	26,388	1,141	(185)	27,344
Total held to maturity investment securities	\$ 187,629	\$ 6,636	\$ (562)	\$ 193,703

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 March 31, 2016, 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, federal agency collateralized mortgage obligations, 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 March 31, 2016.

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements**

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

The amortized cost and fair value of securities available for sale and held to maturity at March 31, 2016 and December 31, 2015, 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.

	March 31, 2016		December 31, 2015	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for sale				
Within one year	\$ 6,786	\$ 6,816	\$ 7,192	\$ 7,232
One to five years	46,633	47,547	38,197	38,894
Five to ten years	15,505	16,047	16,807	17,152
After ten years	15,724	16,178	17,605	17,797
	84,648	86,588	79,801	81,075
Federal agency collateralized mortgage obligations	155,687	157,313	157,291	156,203
Federal agency mortgage-backed pools	215,167	218,575	206,970	207,704
Total available for sale investment securities	\$ 455,502	\$ 462,476	\$ 444,062	\$ 444,982
Held to maturity				
Within one year	\$	\$	\$	\$
One to five years	15,360	16,126	17,815	18,403
Five to ten years	98,023	102,861	106,167	110,026
After ten years	32,137	33,098	28,208	28,976
	145,520	152,085	152,190	157,405
Federal agency collateralized mortgage obligations	8,731	8,867	9,051	8,954
Federal agency mortgage-backed pools	26,040	27,141	26,388	27,344
Total held to maturity investment securities	\$ 180,291	\$ 188,093	\$ 187,629	\$ 193,703

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.

	Less than 12 Months	12 Months or More	Total
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March 31, 2016	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and federal agencies	\$ 1,998	\$ (2)	\$	\$	\$ 1,998	\$ (2)
State and municipal	1,931	(186)	1,812	(4)	3,743	(190)
Federal agency collateralized mortgage obligations	6,684	(54)	24,739	(156)	31,423	(210)
Federal agency mortgage-backed pools	29,691	(239)	3,833	(48)	33,524	(287)
Total temporarily impaired securities	\$ 40,304	\$ (481)	\$ 30,384	\$ (208)	\$ 70,688	\$ (689)

December 31, 2015	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and federal agencies	\$ 5,468	\$ (17)	\$	\$	\$ 5,468	\$ (17)
State and municipal	17,353	(280)	446	(6)	17,799	(286)
Federal agency collateralized mortgage obligations	89,459	(1,123)	25,428	(655)	114,887	(1,779)
Federal agency mortgage-backed pools	113,244	(1,212)	16,506	(319)	129,750	(1,531)
Total temporarily impaired securities	\$ 225,524	\$ (2,632)	\$ 42,380	\$ (980)	\$ 267,904	\$ (3,613)

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements**

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

	Three Months Ended March 31	
	2016	2015
Sales of securities available for sale (Unaudited)		
Proceeds	\$ 7,297	\$ 13,332
Gross gains	108	147
Gross losses		(23)

Note 4 Loans

	March 31 2016	December 31 2015
Commercial		
Working capital and equipment	\$ 381,425	\$ 381,245
Real estate, including agriculture	381,256	391,668
Tax exempt	9,072	8,674
Other	26,001	23,408
Total	797,754	804,995
Real estate		
1-4 family	438,391	433,015
Other	4,415	4,129
Total	442,806	437,144
Consumer		
Auto	164,600	168,397
Recreation	5,021	5,365
Real estate/home improvement	49,114	47,015
Home equity	125,556	127,113
Unsecured	3,836	4,120
Other	11,509	10,290
Total	359,636	362,300
Mortgage warehouse	119,876	144,692
Total loans	1,720,072	1,749,131
Allowance for loan losses	(14,236)	(14,534)

Loans, net	\$ 1,705,836	\$ 1,734,597
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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, the general economy or fluctuations in interest rates. The

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HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

properties securing the Company's commercial real estate portfolio are diverse in terms of property type, and are monitored for concentrations of credit. Management 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 and the related mortgagee are underwritten by Horizon to the end investor guidelines and 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 reacquires the loan under its option within the agreement. Due to the reacquire 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 reacquire from Horizon its 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 reacquire 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 reacquire its loan on an individual mortgage, Horizon would be able to exercise its rights under the agreement.

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements**

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

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

March 31, 2016	Loan Balance	Interest Due	Deferred Fees / (Costs)	Recorded Investment
Owner occupied real estate	\$ 264,899	\$ 611	\$ 1,205	\$ 266,715
Non owner occupied real estate	324,824	336	506	325,666
Residential spec homes	7,011	12	17	7,040
Development & spec land loans	19,961	46	18	20,025
Commercial and industrial	179,006	1,101	307	180,414
Total commercial	795,701	2,106	2,053	799,860
Residential mortgage	421,422	1,283	2,364	425,069
Residential construction	19,020	34		19,054
Mortgage warehouse	119,876	480		120,356
Total real estate	560,318	1,797	2,364	564,479
Direct installment	56,767	160	(360)	56,567
Direct installment purchased	140			140
Indirect installment	147,574	304		147,878
Home equity	156,160	621	(645)	156,136
Total consumer	360,641	1,085	(1,005)	360,721
Total loans	1,716,660	4,988	3,412	1,725,060
Allowance for loan losses	(14,236)			(14,236)
Net loans	\$ 1,702,424	\$ 4,988	\$ 3,412	\$ 1,710,824

December 31, 2015	Loan Balance	Interest Due	Deferred Fees / (Costs)	Recorded Investment
Owner occupied real estate	\$ 268,281	\$ 613	\$ 1,328	\$ 270,222
Non owner occupied real estate	326,399	306	497	327,202
Residential spec homes	5,018	9	17	5,044
Development & spec land loans	18,183	33	26	18,242
Commercial and industrial	184,911	1,246	335	186,492

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Total commercial	802,792	2,207	2,203	807,202
Residential mortgage	414,924	1,275	2,470	418,669
Residential construction	19,751	34		19,785
Mortgage warehouse	144,692	480		145,172
Total real estate	579,367	1,789	2,470	583,626
Direct installment	54,341	168	(359)	54,150
Direct installment purchased	153			153
Indirect installment	151,523	323		151,846
Home equity	157,164	628	(522)	157,270
Total consumer	363,181	1,119	(881)	363,419
Total loans	1,745,340	5,115	3,792	1,754,247
Allowance for loan losses	(14,534)			(14,534)
Net loans	\$ 1,730,806	\$ 5,115	\$ 3,792	\$ 1,739,713

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements**

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

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 non-accrual 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 carrying amounts of those loans included in the balance sheet amounts of loans receivable are as follows:

	March 31 2016 Heartland	March 31 2016 Summit	March 31 2016 Peoples	March 31 2016 Total
Commercial	\$ 1,282	\$ 5,494	\$ 962	\$ 7,738
Real estate	676	1,199	289	2,164
Consumer	1	9		10
Outstanding balance	\$ 1,959	\$ 6,702	\$ 1,251	\$ 9,912
Carrying amount, net of allowance of \$0				\$ 9,912

	December 31 2015 Heartland	December 31 2015 Summit	December 31 2015 Peoples	December 31 2015 Total
Commercial	\$ 1,633	\$ 5,567	\$ 1,061	\$ 8,261
Real estate	693	1,216	179	2,088
Consumer	6	35		41
Outstanding balance	\$ 2,332	\$ 6,818	\$ 1,240	\$ 10,390

Carrying amount, net of allowance of \$63	\$ 10,327
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Accretable yield, or income expected to be collected for the three months ended March 31, is as follows:

	Three Months Ended March 31, 2016			
	Heartland	Summit	Peoples	Total
Balance at January 1	\$ 795	\$ 708	\$ 555	\$ 2,058
Additions				
Accretion	(36)	(55)	(42)	(133)
Reclassification from nonaccretable difference				
Disposals	(10)	(4)	(30)	(44)
Balance at March 31	\$ 749	\$ 649	\$ 483	\$ 1,881

	Three Months Ended March 31, 2015			
	Heartland	Summit	Peoples	Total
Balance at January 1	\$ 2,400	\$ 1,268	\$	\$ 3,668
Additions				
Accretion	(107)	(99)		(206)
Reclassification from nonaccretable difference				
Disposals	(88)	(49)		(137)
Balance at March 31	\$ 2,205	\$ 1,120	\$	\$ 3,325

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements**

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

During the three months ended March 31, 2016 and 2015, the Company decreased the allowance for loan losses on purchased loans by a recovery to the income statement of \$63,000 and \$105,000, respectively.

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.

	Three Months Ended	
	March 31	
	2016	2015
	(Unaudited)	(Unaudited)
Balance at beginning of the period	\$ 14,534	\$ 16,501
Loans charged-off:		
Commercial		
Owner occupied real estate	147	
Non owner occupied real estate	299	16
Residential development		
Development & Spec Land Loans		
Commercial and industrial	39	
Total commercial	485	16
Real estate		
Residential mortgage	115	22
Residential construction		
Mortgage warehouse		
Total real estate	115	22
Consumer		
Direct Installment	58	59
Direct Installment Purchased		
Indirect Installment	276	369
Home Equity	175	200
Total consumer	509	628

Total loans charged-off	1,109	666
Recoveries of loans previously charged-off:		
Commercial		
Owner occupied real estate	25	8
Non owner occupied real estate	23	
Residential development	2	
Development & Spec Land Loans		
Commercial and industrial	32	19
Total commercial	82	27
Real estate		
Residential mortgage	32	2
Residential construction		
Mortgage warehouse		
Total real estate	32	2
Consumer		
Direct Installment	16	29
Direct Installment Purchased		
Indirect Installment	94	101
Home Equity	55	26
Total consumer	165	156
Total loan recoveries	279	185
Net loans charged-off (recovered)	830	481
Provision charged to operating expense		
Commercial	(332)	(45)
Real estate	(592)	933
Consumer	1,456	(274)
Total provision charged to operating expense	532	614
Balance at the end of the period	\$ 14,236	\$ 16,634

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements**

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

Certain loans are individually evaluated for impairment, and the Company's general practice is to proactively charge down impaired loans to the fair value, which is the appraised value less estimated selling costs, 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.

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:

March 31, 2016	Mortgage				Total
	Commercial	Real Estate	Warehousing	Consumer	
Allowance For Loan Losses					
Ending allowance balance attributable to loans:					
Individually evaluated for impairment	\$ 900	\$	\$	\$	\$ 900
Collectively evaluated for impairment	5,560	1,794	1,014	4,968	13,336
Loans acquired with deteriorated credit quality					

Total ending allowance balance	\$ 6,460	\$ 1,794	\$ 1,014	\$ 4,968	\$ 14,236
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Loans:

Individually evaluated for impairment	\$ 5,788	\$	\$	\$	\$ 5,788
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Collectively evaluated for impairment	794,072	444,123	120,356	360,721	1,719,272
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Loans acquired with deteriorated credit quality					
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Total ending loans balance	\$ 799,860	\$ 444,123	\$ 120,356	\$ 360,721	\$ 1,725,060
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December 31, 2015	Commercial	Real Estate	Mortgage Warehousing	Consumer	Total
Allowance For Loan Losses					
Ending allowance balance attributable to loans:					
Individually evaluated for impairment	\$ 202	\$	\$	\$	\$ 202
Collectively evaluated for impairment	6,739	2,476	1,007	3,856	14,078
Loans acquired with deteriorated credit quality	254				254
Total ending allowance balance	\$ 7,195	\$ 2,476	\$ 1,007	\$ 3,856	\$ 14,534

Loans:

Individually evaluated for impairment	\$ 7,019	\$	\$	\$	\$ 7,019
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Collectively evaluated for impairment	798,454	438,454	145,172	363,419	1,745,499
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Loans acquired with deteriorated credit quality	1,729				1,729
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Total ending loans balance	\$ 807,202	\$ 438,454	\$ 145,172	\$ 363,419	\$ 1,754,247
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(Table Dollar Amounts in Thousands, Except Per Share Data)

Note 7 Non-performing Loans and Impaired Loans

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

		Loans Past Due Over 90 Days Still Accruing		Non- Performing TDRs	Performing TDRs	Total Non- Performing Loans
March 31, 2016	Non-accrual					
Commercial						
Owner occupied real estate	\$ 1,089	\$	\$	\$	\$	\$ 1,089
Non owner occupied real estate	2,934			1,615	60	4,609
Residential development						
Development & Spec Land Loans						
Commercial and industrial	76					76
Total commercial	4,099			1,615	60	5,774
Real estate						
Residential mortgage	3,950	1		815	962	5,728
Residential construction				246		246
Mortgage warehouse						
Total real estate	3,950	1		1,061	962	5,974
Consumer						
Direct Installment	496					496
Direct Installment Purchased						
Indirect Installment	739					739
Home Equity	1,611			181	209	2,001
Total Consumer	2,846			181	209	3,236
Total	\$ 10,895	\$ 1		\$ 2,857	\$ 1,231	\$ 14,984

December 31, 2015	Non-accrual	Loans Past Due	Non- Performing TDRs	Performing TDRs	Total Non- Performing Loans
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**Over 90
Days
Still
Accruing**

Commercial					
Owner occupied real estate	\$ 1,749	\$	\$	\$	\$ 1,749
Non owner occupied real estate	3,034		1,915	60	5,009
Residential development					
Development & Spec Land Loans	71				71
Commercial and industrial	176				176
Total commercial	5,030		1,915	60	7,005
Real estate					
Residential mortgage	4,354	1	824	808	5,987
Residential construction			250		250
Mortgage warehouse					
Total real estate	4,354	1	1,074	808	6,237
Consumer					
Direct Installment	541				541
Direct Installment Purchased					
Indirect Installment	601	27			628
Home Equity	1,736		183	350	2,269
Total Consumer	2,878	27	183	350	3,438
Total	\$ 12,262	\$ 28	\$ 3,172	\$ 1,218	\$ 16,680

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HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

Included in the \$10.9 million of non-accrual loans and the \$2.9 million of non-performing TDRs at March 31, 2016 were \$2.4 million and \$95,000, 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 Operations 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. Non-accrual 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 non-accrual 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 March 31, 2016, 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 three consecutive payments but is still reported as TDR unless the loan bears interest at a market rate. As of March 31, 2016, the Company had \$4.1 million in TDRs and \$1.2 million were performing according to the restructured terms and zero TDRs were returned to accrual status during the first three months of 2016. There was \$140,000 of specific reserves allocated to TDRs at March 31, 2016 based on the discounted cash flows or when appropriate the fair value of the collateral.

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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:

	Unpaid Principal Balance	Recorded Investment	Allowance For Loan Loss Allocated	Three Months Ending Average Balance in Impaired Loans	Cash/Accrual Interest Income Recognized
March 31, 2016					
With no recorded allowance					
Commercial					
Owner occupied real estate	\$ 1,089	\$ 1,089	\$	\$ 1,106	\$
Non owner occupied real estate	1,851	1,856		2,063	1
Residential development					
Development & Spec Land Loans					
Commercial and industrial	76	76		330	
Total commercial	3,016	3,021		3,499	1
With an allowance recorded					
Commercial					
Owner occupied real estate					
Non owner occupied real estate	2,757	2,767	900	2,767	
Residential development					
Development & Spec Land Loans					
Commercial and industrial					
Total commercial	2,757	2,767	900	2,767	
Total	\$ 5,773	\$ 5,788	\$ 900	\$ 6,266	\$ 1

	Unpaid Principal Balance	Recorded Investment	Allowance For Loan Loss Allocated	Three Months Ending Average Balance in Impaired Loans	Cash/Accrual Interest Income Recognized
March 31, 2015					
With no recorded allowance					
Commercial					
Owner occupied real estate	\$ 1,076	\$ 1,077	\$	\$ 1,329	\$ 2

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Non owner occupied real estate	3,907	3,912		4,534	6
Residential development					
Development & Spec Land Loans					
Commercial and industrial	609	609		649	
Total commercial	5,592	5,598		6,512	8
With an allowance recorded					
Commercial					
Owner occupied real estate	417	417	165	419	
Non owner occupied real estate	1,590	1,590	184	1,590	
Residential development					
Development & Spec Land Loans					
Commercial and industrial	942	942	680	949	
Total commercial	2,949	2,949	1,029	2,958	
Total	\$ 8,541	\$ 8,547	\$ 1,029	\$ 9,470	\$ 8

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements**

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

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

March 31, 2016	Greater than 90			Total Past Due	Loans Not Past Due		Total
	30 - 59 Days Past Due	60 - 89 Days Past Due	Days Past Due		Past Due	Due	
Commercial							
Owner occupied real estate	\$ 161	\$ 158	\$	\$ 319	\$ 264,580	\$ 264,899	
Non owner occupied real estate					324,824	324,824	
Residential development					7,011	7,011	
Development & Spec Land Loans					19,961	19,961	
Commercial and industrial		20		20	178,986	179,006	
Total commercial	161	178		339	795,362	795,701	
Real estate							
Residential mortgage	498		1	499	420,923	421,422	
Residential construction					19,020	19,020	
Mortgage warehouse					119,876	119,876	
Total real estate	498		1	499	559,819	560,318	
Consumer							
Direct Installment	51	9		60	56,707	56,767	
Direct Installment Purchased					140	140	
Indirect Installment	412	150		562	147,012	147,574	
Home Equity	672	17		689	155,471	156,160	
Total consumer	1,135	176		1,311	359,330	360,641	
Total	\$ 1,794	\$ 354	\$ 1	\$ 2,149	\$ 1,714,511	\$ 1,716,660	
Percentage of total loans	0.10%	0.02%	0.00%	0.13%	99.87%		

December 31, 2015	Greater than 90			Total Past Due	Loans Not Past Due		Total
	30 - 59 Days Past Due	60 - 89 Days Past Due	Days Past Due		Past Due	Due	
Commercial							
Owner occupied real estate	\$ 481	\$ 18	\$	\$ 499	\$ 267,782	\$ 268,281	

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Non owner occupied real estate	49		49	326,350	326,399
Residential development				5,018	5,018
Development & Spec Land Loans				18,183	18,183
Commercial and industrial	32		32	184,879	184,911
Total commercial	562	18	580	802,212	802,792
Real estate					
Residential mortgage	1,121	344	1	1,466	413,458
Residential construction				19,751	19,751
Mortgage warehouse				144,692	144,692
Total real estate	1,121	344	1	1,466	577,901
Consumer					
Direct Installment	106	10		116	54,225
Direct Installment Purchased					153
Indirect Installment	1,186	268	27	1,481	150,042
Home Equity	1,193	203		1,396	155,768
Total consumer	2,485	481	27	2,993	360,188
Total	\$ 4,168	\$ 843	\$ 28	\$ 5,039	\$ 1,740,301

Percentage of total loans 0.24% 0.05% 0.00% 0.29% 99.71%

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.

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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).

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.

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Loans may be graded Satisfactory when there is no recent information on which to base a current risk evaluation and the following conditions apply:

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.

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

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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The following table presents loans by credit grades.

March 31, 2016	Pass	Special Mention	Substandard	Doubtful	Total
Commercial					
Owner occupied real estate	\$ 253,513	\$ 6,118	\$ 5,268	\$	\$ 264,899
Non owner occupied real estate	317,121	2,709	4,994		324,824
Residential development	7,011				7,011
Development & Spec Land Loans	19,961				19,961
Commercial and industrial	172,960	1,997	4,049		179,006
Total commercial	770,566	10,824	14,311		795,701
Real estate					
Residential mortgage	415,694		5,728		421,422
Residential construction	18,774		246		19,020
Mortgage warehouse	119,876				119,876
Total real estate	554,344		5,974		560,318
Consumer					
Direct Installment	56,271		496		56,767
Direct Installment Purchased	140				140
Indirect Installment	146,835		739		147,574
Home Equity	154,159		2,001		156,160
Total Consumer	357,405		3,236		360,641
Total	\$ 1,682,315	\$ 10,824	\$ 23,521	\$	\$ 1,716,660
Percentage of total loans	98.00%	0.63%	1.37%	0.00%	

December 31, 2015	Pass	Special Mention	Substandard	Doubtful	Total
Commercial					
Owner occupied real estate	\$ 257,181	\$ 4,954	\$ 6,146	\$	\$ 268,281
Non owner occupied real estate	320,216	585	5,598		326,399
Residential development	5,018				5,018
Development & Spec Land Loans	18,112		71		18,183

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Commercial and industrial	180,581	693	3,637	184,911
Total commercial	781,108	6,232	15,452	802,792
Real estate				
Residential mortgage	408,937		5,987	414,924
Residential construction	19,501		250	19,751
Mortgage warehouse	144,692			144,692
Total real estate	573,130		6,237	579,367
Consumer				
Direct Installment	53,800		541	54,341
Direct Installment Purchased	153			153
Indirect Installment	150,895		628	151,523
Home Equity	154,895		2,269	157,164
Total Consumer	359,743		3,438	363,181
Total	\$ 1,713,981	\$ 6,232	\$ 25,127	\$ 1,745,340
Percentage of total loans	98.20%	0.36%	1.44%	0.00%

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Note 8 Repurchase Agreements

The Company transfers various securities to customers in exchange for cash at the end of each business day and agrees to acquire the securities at the end of the next business day for the cash exchanged plus interest. The process is repeated at the end of each business day until the agreement is terminated. The securities underlying the agreement remained under the Bank's control.

The following table shows repurchase agreements accounted for as secured borrowings (in thousands):

	Remaining Contractual Maturity of the Agreements						Total
	Overnight and Continuous	Up to one year	One to three years	Three to five years	Five to ten years	Beyond ten years	
Repurchase Agreements and repurchase-to-maturity transactions							
Repurchase Agreements	\$ 55,768	\$	\$ 85,000	\$ 10,000	\$	\$	\$ 150,768
Securities lending transactions							
U.S. Treasury and federal agencies	\$ 4,024	\$	\$	\$	\$	\$	\$ 4,024
Federal agency collateralized mortgage obligations	\$ 47,004		467	192	22,365	32,006	102,034
Federal agency mortgage-backed pools	\$ 13,650		140	1,490	20,277	29,403	64,960
Total	64,678		607	1,682	42,642	61,409	171,018
Total borrowings	\$ (8,910)	\$	\$ 84,393	\$ 8,318	\$ (42,642)	\$ (61,409)	\$ (20,250)

Note 9 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 March 31, 2016 and December 31, 2015. 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 March 31, 2016, 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 March 31, 2016, 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.

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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 \$115.1 million at March 31, 2016 and \$117.3 million at December 31, 2015.

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 March 31, 2016, 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.

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

	Asset Derivatives March 31, 2016		Liability Derivatives March 31, 2016	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments (Unaudited)				
Interest rate contracts	Loans	\$	Other liabilities	\$ 4,283
Interest rate contracts	Other Assets	4,283	Other liabilities	3,702
Total derivatives designated as hedging instruments		4,283		7,985
Derivatives not designated as hedging instruments				
Mortgage loan contracts	Other assets	644	Other liabilities	
Total derivatives not designated as hedging instruments		644		
Total derivatives		\$ 4,927		\$ 7,985

	Asset Derivatives December 31, 2015	Liability Derivatives December 31, 2015
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	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments (Unaudited)				
Interest rate contracts	Loans	\$	Other liabilities	\$ 1,782
Interest rate contracts	Other Assets	1,782	Other liabilities	3,141
Total derivatives designated as hedging instruments		1,782		4,923
Derivatives not designated as hedging instruments				
Mortgage loan contracts	Other assets	642	Other liabilities	
Total derivatives not designated as hedging instruments		642		
Total derivatives		\$ 2,424		\$ 4,923

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The effect of the derivative instruments on the condensed consolidated statement of income for the three-month periods ending March 31 is as follows:

Comprehensive Income on Derivative

Derivative in cash flow hedging relationship	(Effective Portion) Three Months Ended March 31	
	2016 (Unaudited)	2015 (Unaudited)
Interest rate contracts	\$ (365)	\$ (214)

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.

Derivative in fair value hedging relationship	Location of gain (loss) recognized on derivative	Amount of Gain (Loss) Recognized on Derivative Three Months Ended March 31	
		2016 (Unaudited)	2015 (Unaudited)
Interest rate contracts	Interest income - loans	\$ 1,478	\$ 719
Interest rate contracts	Interest income - loans	(1,478)	(719)
Total		\$	\$

Derivative not designated as hedging relationship	Location of gain (loss) recognized on derivative	Amount of Gain (Loss) Recognized on Derivative Three Months Ended March 31	
		2016 (Unaudited)	2015 (Unaudited)
Mortgage contracts	Other income - gain on sale of loans	\$ 2	\$ 189

Note 10 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 March 31, 2016. For assets classified within Level 3 of the fair value hierarchy, the process used to develop the reported fair value is described below.

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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.

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.

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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)
March 31, 2016				
Available-for-sale securities				
U.S. Treasury and federal agencies	\$ 15,470	\$	\$ 15,470	\$
State and municipal	71,042		71,042	
Federal agency collateralized mortgage obligations	157,313		157,313	
Federal agency mortgage-backed pools	218,576		218,576	
Corporate notes	75		75	
Total available-for-sale securities	462,476		462,476	
Hedged loans	110,837		110,837	
Forward sale commitments	644		644	
Interest rate swap agreements	(7,985)		(7,985)	
Commitments to originate loans				
December 31, 2015				
Available-for-sale securities				
U.S. Treasury and federal agencies	\$ 5,926	\$	\$ 5,926	\$
State and municipal	75,095		75,095	
Federal agency collateralized mortgage obligations	156,203		156,203	
Federal agency mortgage-backed pools	207,704		207,704	
Corporate notes	54		54	
Total available-for-sale securities	444,982		444,982	
Hedged loans	115,472		115,472	
Forward sale commitments	642		642	

Interest rate swap agreements	(4,923)	(4,923)
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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	Three Months Ended March 31	
	2016	2015
Total gains and losses from:	(Unaudited)	(Unaudited)
Hedged loans	\$ 1,478	\$ 719
Fair value interest rate swap agreements	(1,478)	(719)
Derivative loan commitments	2	189
	\$ 2	\$ 189

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):

Quoted Prices in

	Fair Value	Active Markets		
		for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
March 31, 2016				
Impaired loans	\$ 4,873	\$	\$	\$ 4,873
Mortgage servicing rights	9,093			9,093
December 31, 2015				
Impaired loans	\$ 6,803	\$	\$	\$ 6,803
Mortgage servicing rights	8,874			8,874

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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 MSRs' fair value due to impairment decreased by \$1,000 during the first three months of 2016 and decreased by \$76,000 during the first three months of 2015.

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 March 31, 2016	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Impaired loans	\$ 4,873	Collateral based measurement	Discount to reflect current market conditions and ultimate collectability	10% - 15% (12%)
Mortgage servicing rights	\$ 9,093	Discounted cashflows	Discount rate, Constant prepayment rate, Probability of default	4% - 7% (4.6%), 1% - 10% (4.5%)
	Fair Value at December 31, 2015	Valuation Technique	Unobservable Inputs	Range (Weighted Average)

Impaired loans			Discount to reflect current market conditions and ultimate collectability	10% - 15% (12%)
	\$ 6,803	Collateral based measurement		
Mortgage servicing rights			Discount rate, Constant prepayment rate, Probability of default	10% - 15% (12%), 4% - 7% (4.6%), 1% - 10% (4.5%)
	\$ 8,874	Discounted cashflows		

Note 11 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.

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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 March 31, 2016 and December 31, 2015. 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.

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.

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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).

	Carrying Amount	March 31, 2016		
		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	\$ 47,612	\$ 47,612	\$	\$
Investment securities, held to maturity	180,291		188,093	
Loans held for sale	3,168			3,168
Loans excluding loan level hedges, net	1,594,999			1,584,414
Stock in FHLB and FRB	13,823		13,823	
Interest receivable	10,476		10,476	
Liabilities				
Non-interest bearing deposits	\$ 343,025	\$ 343,025	\$	\$
Interest-bearing deposits	1,535,454		1,483,711	
Borrowings	430,507		426,966	
Subordinated debentures	32,836		33,003	
Interest payable	580		580	
December 31, 2015				
	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	\$ 48,650	\$ 48,650	\$	\$
Investment securities, held to maturity	187,629		193,703	
Loans held for sale	7,917			7,917

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Loans excluding loan level hedges, net	1,619,125		1,703,506
Stock in FHLB and FRB	13,823		13,823
Interest receivable	10,535		10,535
Liabilities			
Non-interest bearing deposits	\$ 335,955	\$ 335,955	\$
Interest-bearing deposits	1,544,198		1,461,314
Borrowings	449,347		441,547
Subordinated debentures	32,797		32,996
Interest payable	507		507

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Note 12 Accumulated Other Comprehensive Income

	March 31 2016	December 31 2015
Unrealized gain on securities available for sale	\$ 6,973	\$ 920
Unamortized gain on securities held to maturity, previously transferred from AFS	879	1,109
Unrealized loss on derivative instruments	(3,702)	(3,142)
Tax effect	(1,452)	390
Total accumulated other comprehensive income (loss)	\$ 2,698	\$ (723)

Note 13 Regulatory Capital

Horizon and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies and are assigned to a capital category. Failure to meet the minimum regulatory capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators, which if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective actions, the Bank must meet specific capital guidelines involving quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined), or leverage ratio. For March 31, 2016, Basel III rules require the Bank to maintain minimum amounts and ratios of common equity Tier I capital (as defined in the regulation) to risk-weighted assets (as defined). Additionally, under Basel III rules, the decision was made to opt-out of including accumulated other comprehensive income in regulatory capital

To be categorized as well capitalized, the Bank must maintain minimum Total risk-based, Tier I risk-based, common equity Tier I risk-based (March 31, 2016) and Tier I leverage ratios as set forth in the table below. As of March 31, 2016 and December 31, 2015, the Bank met all capital adequacy requirements to be considered well capitalized. There have been no conditions or events since the end of the first quarter of 2016 that management believes have changed the Bank's classification as well capitalized. There is no threshold for well-capitalized status for bank holding companies.

Horizon and the Bank's actual and required capital ratios as of March 31, 2016 and December 31, 2015 were as follows:

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	Actual		Required For Capital Adequacy Purposes		Well Capitalized Under Prompt ¹ Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of March 31, 2016						
Total capital ¹ (to risk-weighted assets)						
Consolidated	\$ 251,434	13.57%	\$ 159,902	8.63%	N/A	N/A
Bank	242,478	13.10%	159,739	8.63%	\$ 185,098	10.00%
Tier 1 capital ¹ (to risk-weighted assets)						
Consolidated	203,797	12.80%	105,560	6.63%	N/A	N/A
Bank	228,242	12.33%	122,729	6.63%	148,089	8.00%
Common equity tier 1 capital ¹ (to risk-weighted assets)						
Consolidated	203,797	11.00%	95,044	5.13%	N/A	N/A
Bank	228,242	12.33%	94,962	5.13%	120,322	6.50%
Tier 1 capital ¹ (to average assets)						
Consolidated	237,198	9.32%	101,802	4.00%	N/A	N/A
Bank	228,242	8.98%	101,667	4.00%	127,084	5.00%
As of December 31, 2015						
Total capital ¹ (to risk-weighted assets)						
Consolidated	\$ 264,452	13.99%	\$ 151,223	8.00%	N/A	N/A
Bank	237,348	12.57%	151,057	8.00%	\$ 188,821	10.00%
Tier 1 capital ¹ (to risk-weighted assets)						
Consolidated	249,918	13.22%	113,427	6.00%	N/A	N/A
Bank	222,814	11.80%	113,295	6.00%	151,060	8.00%
Common equity tier 1 capital ¹ (to risk-weighted assets)						
Consolidated	204,350	10.81%	85,067	4.50%	N/A	N/A
Bank	222,814	11.80%	84,971	4.50%	122,737	6.50%
Tier 1 capital ¹ (to average assets)						
Consolidated	249,918	9.82%	101,800	4.00%	N/A	N/A
Bank	222,814	8.77%	101,626	4.00%	127,032	5.00%

¹ As defined by regulatory agencies**Note 14 Preferred Stock Redemption**

On February 1, 2016, Horizon Bancorp (Horizon) completed the redemption (the Redemption) of all 12,500 outstanding shares of Senior Non-Cumulative Perpetual Preferred Stock, Series B (the SBLF Preferred Stock) which were held by the U.S. Department of Treasury and issued pursuant to its Small Business Lending Fund (SBLF). The SBLF Preferred Stock was redeemed at its liquidation value of \$1,000 per share, plus accrued dividends, for a total Redemption price of \$12,510,416.67. Horizon funded the Redemption using cash on hand without borrowing and without a special dividend from its wholly owned banking subsidiary, Horizon Bank, N.A. Following the Redemption, Horizon does not have any shares of its Senior Non-Cumulative Perpetual Preferred Stock, Series B outstanding. The Redemption terminates Horizon s participation in the SBLF.

Note 15 Business Combinations

On February 4, 2016, Horizon entered into an Agreement and Plan of Merger (the Merger Agreement) providing for Horizon s acquisition of Kosciusko Financial, Inc., an Indiana corporation (Kosciusko). Pursuant to the Merger Agreement, Kosciusko would merge with and into Horizon, with Horizon surviving the merger (the Merger), and Farmers State Bank, a state chartered bank and wholly-owned subsidiary of Kosciusko, would merge with and into a wholly-owned subsidiary of Horizon, Horizon Bank, N.A. (Horizon Bank), with Horizon Bank as the surviving bank.

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The boards of directors of each of Horizon and Kosciusko have approved the Merger and the Merger Agreement. The regulatory approvals have been received. Subject to the approval of the Merger by Kosciusko shareholders and other closing conditions, the parties anticipate completing the Merger during the second quarter of 2016.

In connection with the Merger, shareholders of Kosciusko will have the option to receive \$81.75 per share in cash or 3.0122 shares of Horizon common stock for each share of Kosciusko's common stock or a combination thereof, provided the overall shares exchanged consist of 65% stock and 35% cash. Based upon the February 3, 2016, closing price of \$23.99 per share of Horizon common stock, the transaction has an implied valuation of approximately \$22.5 million.

Subject to certain terms and conditions, the board of directors of Kosciusko has agreed to recommend the approval and adoption of the Merger Agreement to the Kosciusko shareholders and will solicit proxies voting in favor of the Merger from Kosciusko's shareholders.

The Merger Agreement also provides for certain termination rights for both Horizon and Kosciusko, and further provides that upon termination of the Merger Agreement under certain circumstances, Kosciusko will be obligated to pay Horizon a termination fee.

As of December 31, 2015, Kosciusko reported total assets of approximately \$148.2 million, total deposits of approximately \$122.8 million and total loans of approximately \$106.1 million.

On March 10, 2016, Horizon entered into an Agreement and Plan of Merger (the "Merger Agreement") providing for Horizon's acquisition of LaPorte Bancorp, Inc. ("LaPorte Bancorp"). Pursuant to the Merger Agreement, LaPorte Bancorp would merge with and into Horizon, with Horizon surviving the merger (the "Merger"), and The LaPorte Savings Bank, a state chartered bank and wholly-owned subsidiary of LaPorte Bancorp, would merge with and into a wholly-owned subsidiary of Horizon, Horizon Bank, N.A. ("Horizon Bank"), with Horizon Bank as the surviving bank.

The boards of directors of each of Horizon and LaPorte Bancorp have approved the Merger and the Merger Agreement. Subject to the approval of the Merger by LaPorte Bancorp shareholders, regulatory approvals and other closing conditions, the parties anticipate completing the Merger during the third quarter of 2016.

In connection with the Merger, shareholders of LaPorte Bancorp will have the option to receive \$17.50 per share in cash or 0.629 shares of Horizon common stock for each share of LaPorte Bancorp's common stock or a combination thereof, provided the overall shares exchanged consist of 65% stock and 35% cash. Based upon the March 9, 2016, closing price of \$24.21 per share of Horizon common stock, the transaction has an implied valuation of approximately \$94.1 million.

Subject to certain terms and conditions, the board of directors of LaPorte Bancorp has agreed to recommend the approval and adoption of the Merger Agreement to the LaPorte Bancorp shareholders and will solicit proxies voting in favor of the Merger from LaPorte Bancorp's shareholders.

The Merger Agreement also provides for certain termination rights for both Horizon and LaPorte Bancorp, and further provides that upon termination of the Merger Agreement under certain circumstances, LaPorte Bancorp will be obligated to pay Horizon a termination fee.

As of December 31, 2015, LaPorte Bancorp reported total assets of approximately \$543.2 million, total deposits of approximately \$391.0 million and total loans of approximately \$348.5 million.

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Note 16 Future Accounting Matters

In June 2014, the FASB issued **ASU No. 2014-12 Compensation Stock Compensation (Topic 718) Accounting for Share Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period**. This ASU requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. ASU 2014-12 became effective for interim and annual periods beginning after December 15, 2015 and did not have a significant impact on the Company's financial condition or results of operations.

In January 2016, the FASB issued **ASU No. 2016-01 Financial Instruments Overall (Subtopic 825-10) Recognition and Measurement of Financial Assets and Financial Liabilities**. This ASU is intended to improve the recognition and measurement of financial instruments by requiring equity investments to be measured at fair value with changes in fair value recognized in net income; requiring public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; requiring separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements; eliminating the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured and amortized at cost on the balance sheet; and requiring a reporting organization to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. ASU 2016-01 is effective for interim and annual reporting periods beginning after December 15, 2017. The amendments should be applied through a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values (including disclosure requirements) should be applied prospectively to equity investments that exist as of the date of adoption. The Company will be evaluating the impact of adopting this ASU.

In February 2016, the FASB issued **ASU No. 2016-02 Leases (Topic 842)**. This ASU requires lessees and lessors to classify leases as either capital leases or operating leases. The ASU also requires lessees to recognize assets and liabilities for all leases with the exception of short term leases. There are new disclosure requirements for these leases which will provide users of financial statements with information to understand the amount, timing and uncertainty of cash flows arising from leases. ASU 2016-02 will become effective for fiscal years beginning after December 31, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company will be evaluating the impact of adopting this ASU.

In March 2016, the FASB issued **ASU No. 2016-05 Derivatives and Hedging (Topic 815)**. This ASU applies to all reporting entities for which there is a change in the counterparty to a derivative instrument that has been designated as a hedging instrument under Topic 815. The ASU clarifies that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument under Topic 815 does not, in and of itself, require dedesignation of that hedging relationship provided that all other hedge accounting criteria as identified in Topic 815 continue to be met. ASU 2016-05 will become effective for fiscal years beginning after December 15, 2016, including interim

periods within those fiscal years. Early adoption is permitted. The Company will be evaluating the impact of adopting this ASU.

In March 2016, the FASB issued **ASU No. 2016-09 Compensation Stock Compensation (Topic 718) Improvements to Employee Share-Based Payment Accounting**. This ASU requires all income tax effects of awards to be recognized in the income statement when the awards vest or are settled. It also allows an employer to repurchase more of an employee's shares than it can today for tax withholding purposes without triggering liability accounting and to make a policy election for forfeitures as they occur. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted. The Company will be evaluating the impact of adopting this ASU.

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Note 17 General Litigation

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

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Management's Discussion and Analysis of Financial Condition

And 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 discussion of 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:

economic conditions and their impact on Horizon and its customers;

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

rising interest rates and their impact on mortgage loan volumes and the outflow of deposits;

loss of key Horizon personnel;

increases in disintermediation, as new technologies allow consumers to complete financial transactions without the assistance of banks;

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;

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 new Basel III capital rules;

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;

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the risks presented by cyber terrorism and data security breaches;

containing costs and expenses;

the slowing or failure of economic recovery;

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.

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 2015 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 Northern and Central Indiana and Southwestern and 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 Select 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 July 1, 2015, Horizon completed the acquisition of Peoples Bancorp, an Indiana corporation ("Peoples") and Horizon Bank's acquisition of Peoples Federal Savings Bank of DeKalb County, a federally-chartered stock savings bank and wholly owned subsidiary of Peoples, through mergers effective July 1, 2015. Under the terms of the acquisition, the exchange ratio was 0.95 shares of Horizon common stock (the "Exchange Ratio") and \$9.75 in cash for

each outstanding share of Peoples common stock. Peoples shareholders owning fewer than 100 shares of common stock received \$33.14 in cash for each common share. Peoples shares outstanding at the closing were 2,311,858, and the shares of Horizon common stock issued to Peoples shareholders totaled 2,192,202. Horizon's stock price was \$25.32 per share at the close of business on July 1, 2015. Based upon these numbers, the total value of the consideration for the acquisition was \$78.1 million.

On April 3, 2014, Horizon completed the acquisition of SCB Bancorp, Inc., a Michigan corporation (Summit) and Horizon Bank's acquisition of Summit Community Bank, a Michigan-chartered commercial bank and wholly owned subsidiary of Summit, 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 first quarter of 2016:

Net income for the first quarter of 2016 was \$5.4 million or \$.44 diluted earnings per share compared to \$5.4 million or \$.55 diluted earnings per share in the same period of 2015.

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Excluding merger expenses, gain on sale of investment securities, the death benefit on bank owned life insurance and acquisition-related purchase accounting adjustments, net income for the first quarter of 2016 increase to \$5.4 million or an increase of 18.7% compared to the same period of 2015.

Net interest income for the first quarter of 2016 increased \$2.9 million or 17.1% compared to the same period in 2015.

Non-interest income for the first quarter of 2016 increased \$798,000 or 11.3% compared to the same period in 2015.

Net interest margin, excluding the impact of acquisitions (core net interest margin), was 3.36% for the first quarter of 2016 compared to 3.38% in the prior quarter and 3.47% for the same period in 2015.

Non-performing loans to total loans was .87% as of March 31, 2016 compared to .95% as of December 31, 2015 and 1.52% as of March 31, 2015.

Horizon's tangible book value per share rose to \$17.08 at March 31, 2016, compared to \$16.53 at December 31, 2015 and \$16.80 at March 31, 2015.

On February 5, 2016, Horizon announced the pending acquisition of Kosciusko Financial, Inc. (Kosciusko) and its wholly-owned subsidiary, Farmers State Bank, headquartered in Mentone, Indiana.

On March 10, 2016, Horizon announced the pending acquisition of LaPorte Bancorp, Inc. (LaPorte Bancorp) and its wholly-owned subsidiary, The LaPorte Savings Bank, headquartered in La Porte, Indiana.

Horizon paid off the \$12.5 million in funds received through the Small Business Lending Fund with cash from the holding company on February 1, 2016.

Horizon Bank's capital ratios, including Tier 1 Capital to Average Assets of 9.03% and Total Capital to Risk Weighted Assets of 13.31% as of March 31, 2016, continue to be well above the regulatory standards for well-capitalized banks.

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 2015 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.

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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 March 31, 2016, Horizon had core deposit intangibles of \$7.1 million subject to amortization and \$49.6 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 March 31, 2016 was \$24.72 per share compared to a book value of \$21.82 per common share.

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

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.

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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.

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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On March 31, 2016, Horizon's total assets were \$2.6 billion, a decrease of approximately \$24.5 million compared to December 31, 2015. The decrease was primarily in net loans of \$28.8 million offset partially by an increase in investment securities of \$10.2 million.

Investment securities were comprised of the following as of (dollars in thousands):

	March 31, 2016		December 31, 2015	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for sale				
U.S. Treasury and federal agencies	\$ 15,412	\$ 15,470	\$ 5,940	\$ 5,926
State and municipal	69,204	71,042	73,829	75,095
Federal agency collateralized mortgage obligations	155,687	157,313	157,291	156,203
Federal agency mortgage-backed pools	215,167	218,576	206,970	207,704
Corporate notes	32	75	32	54
Total available for sale investment securities	\$ 455,502	\$ 462,476	\$ 444,062	\$ 444,982
Held to maturity				
U.S. Treasury and federal agencies	\$	\$	\$ 5,859	\$ 5,952
State and municipal	145,520	152,085	146,331	151,453
Federal agency collateralized mortgage obligations	8,731	8,867	9,051	8,954
Federal agency mortgage-backed pools	26,040	27,141	26,388	27,344
Total held to maturity investment securities	\$ 180,291	\$ 188,093	\$ 187,629	\$ 193,703

Total investment securities increased by approximately \$10.2 million at March 31, 2016 compared to December 31, 2015 primarily due to the investing of cash.

Total loans decreased \$33.8 million since December 31, 2015 to \$1.7 billion as of March 31, 2016. This decrease was the result of a decrease in commercial loans of \$7.2 million, mortgage warehouse loans of \$24.8 million and consumer loans of \$2.7 million offset by an increase in residential mortgage loans of \$5.7 million. The decrease in commercial loans was primarily attributed to loan payoffs, seasonal pay downs on agricultural lines of credit and annual agricultural term loan payments. The decrease in mortgage warehouse loans was due to seasonality and changes in

mortgage compliance that slowed production volume during the quarter.

Total deposits decreased \$1.7 million since December 31, 2015 to \$1.9 billion as of March 31, 2016. Non-interest bearing deposit accounts increased by \$7.1 million, interest-bearing transaction accounts decreased by \$59.0 million and time deposits increased by \$50.2 million during the three months ended March 31, 2016.

The Company's borrowings decreased \$18.8 million from December 31, 2015. At March 31, 2016, the Company had \$192.0 million in short-term funds borrowed compared to \$206.0 million at December 31, 2015. 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 municipal deposits and mortgage warehouse lending.

Stockholders' equity totaled \$261.4 million at March 31, 2016 compared to \$266.8 million at December 31, 2015. The decrease in stockholders' equity during the period was the result of the redemption of \$12.5 million of preferred stock and dividends declared, net of the generation of net income. At March 31, 2016, the ratio of average stockholders' equity to average assets was 10.16% compared to 10.32% for December 31, 2015. Book value per common share at March 31, 2016 increased to \$21.82 compared to \$21.30 at December 31, 2015.

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Results of Operations

Overview

Consolidated net income for the three-month period ended March 31, 2016 was \$5.4 million compared to \$5.4 million for the same period in 2015. Earnings per common share for the three months ended March 31, 2016 were \$0.45 basic and \$0.44 diluted, compared to \$0.58 basic and \$0.55 diluted for the same three-month period in the previous year. Compared to the previous year net interest income increased by \$2.9 million, non-interest income increased by \$798,000 and non-interest expenses increased by \$3.7 million. Non-interest expenses increased primarily due to an increase in salaries and employee benefits and expenses related to outside services and consultants. The decrease in earnings per share from the previous year reflects an increase in diluted shares primarily due to the Peoples acquisition. Excluding acquisition-related expenses and purchase accounting adjustments, gain on sale of investment securities and the death benefit on bank owned life insurance, net income for the first quarter of 2016 was \$5.4 million or \$.45 diluted earnings per share compared to \$4.6 million or \$.47 diluted earnings per share in the same period of 2015.

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-month period ended March 31, 2016 was \$19.8 million, an increase of \$2.9 million from the \$16.9 million earned during the same period in 2015. Yields on the Company's interest-earning assets decreased by 30 basis points to 4.09% for the three months ending March 31, 2016 from 4.39% for the three months ended March 31, 2015. Interest income increased \$3.5 million from \$20.1 million for the three months ended March 31, 2015 to \$23.6 million for the same period in 2016. This increase was due to an increase in interest-earning assets, partially offset by lower yields on loans and investment securities and a decrease in interest income from acquisition-related purchase accounting adjustments from \$438,000 for the three months ending March 31, 2015 to \$402,000 for the same period of 2016.

Rates paid on interest-bearing liabilities decreased by 6 basis points for the three-month period ended March 31, 2016 compared to the same period in 2015 due to the continued low interest rate environment and shift in mix on

interest-bearing liabilities. Interest expense increased \$547,000 compared to the three-month period ended March 31, 2015 to \$3.8 million for the same period in 2016. This increase was due to higher average balances of interest-bearing deposits and borrowings, partially offset by lower rates paid on interest-bearing deposits and borrowings. The net interest margin decreased 25 basis points from 3.70% for the three-month period ended March 31, 2015 to 3.45% for the same period in 2016. The decrease in the margin for the three-month period ended March 31, 2016 compared to the same period in 2015 was due to a reduction in the yield on interest-earning assets and a decrease of approximately \$536,000 of interest income from acquisition-related purchase accounting adjustments. Excluding the interest income recognized from the acquisition-related purchase accounting adjustments, the margin would have been 3.36% for the three-month period ending March 31, 2016 compared to 3.47% for the same period in 2015.

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The following are the average balance sheets for the three months ending (dollars in thousands):

	Three Months Ended March 31, 2016			Three Months Ended March 31, 2015		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
ASSETS						
Interest-earning assets						
Federal funds sold	\$ 2,424	\$ 1	0.17%	\$ 4,804	\$ 2	0.17%
Interest-earning deposits	20,810	49	0.95%	10,772	3	0.11%
Investment securities - taxable	463,544	2,494	2.16%	360,554	2,149	2.42%
Investment securities - non-taxable (1)	182,275	1,237	3.79%	140,748	1,077	4.31%
Loans receivable (2)(3)	1,698,197	19,747	4.69%	1,382,992	16,862	4.96%
Total interest-earning assets (1)	2,367,250	23,528	4.09%	1,899,870	20,093	4.39%
Non-interest-earning assets						
Cash and due from banks	32,925			28,994		
Allowance for loan losses	(14,508)			(16,489)		
Other assets	214,604			157,553		
	\$ 2,600,271			\$ 2,069,928		
LIABILITIES AND SHAREHOLDERS EQUITY						
Interest-bearing liabilities						
Interest-bearing deposits	\$ 1,534,833	\$ 1,491	0.39%	\$ 1,215,862	\$ 1,232	0.41%
Borrowings	406,679	1,759	1.74%	337,430	1,479	1.78%
Subordinated debentures	32,813	504	6.18%	32,657	496	6.16%
Total interest-bearing liabilities	1,974,325	3,754	0.76%	1,585,949	3,207	0.82%
Non-interest-bearing liabilities						
Demand deposits	339,141			271,158		
Accrued interest payable and other liabilities	22,521			14,989		
Stockholders' equity	264,284			197,832		
	\$ 2,600,271			\$ 2,069,928		

Net interest income/spread	\$ 19,774	3.32%	\$ 16,886	3.57%
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Net interest income as a percent of average interest earning assets (1)		3.45%		3.70%
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- (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.

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 portfolio. During the three-month period ended March 31, 2016, a provision of \$532,000 was required to adequately fund the ALLL compared to \$614,000 for the same period of 2015. Commercial loan net charge-offs during the three-month period ended March 31, 2016 were \$403,000, residential mortgage loan net charge-offs were \$83,000 and consumer loan net charge-offs were \$344,000. The lower provision for loan losses in the first quarter of 2016 compared to the same period of 2015 was due to the improvement of non-performing and substandard loans. The ALLL balance at March 31, 2016 was \$14.2 million or 0.83% of total loans. This compares to an ALLL balance of \$14.5 million at December 31, 2015 or 0.83% of total loans. The ratio was unchanged from December 31, 2015 as the decrease in the ALLL was offset by a decrease in total loans outstanding during the three months ended March 31, 2016.

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Horizon's loan loss reserve ratio, excluding loans with credit-related purchase accounting adjustments, stood at 0.98% as of March 31, 2016. The table below illustrates Horizon's loan loss reserve ratio composition as of March 31, 2016.

Non- GAAP Allowance for Loan and Lease Loss Detail**As of March 31, 2016**

(Dollars in Thousands, Unaudited)

	Horizon Legacy	Heartland	Summit	Peoples	Total
Pre-discount loan balance	\$ 1,454,494	\$ 20,784	\$ 73,204	\$ 179,696	\$ 1,728,178
Allowance for loan losses (ALLL)	14,236				14,236
Loan discount	N/A	1,345	2,861	3,900	8,106
ALLL+loan discount	14,236	1,345	2,861	3,900	22,342
Loans, net	\$ 1,440,258	\$ 19,439	\$ 70,343	\$ 175,796	\$ 1,705,836
ALLL/ pre-discount loan balance	0.98%	0.00%	0.00%	0.00%	0.82%
Loan discount/ pre-discount loan balance	N/A	6.47%	3.91%	2.17%	0.47%
ALLL+loan discount/ pre-discount loan balance	0.98%	6.47%	3.91%	2.17%	1.29%

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 March 31, 2016.

Non-performing loans totaled \$15.0 million as of March 31, 2016, down from \$16.7 million on December 31, 2015. Compared to December 31, 2015, non-performing commercial, real estate and consumer loans decreased by \$1.2 million, \$264,000 and \$201,000, respectively.

At March 31, 2016, loans acquired represented \$3.0 million in non-performing, \$4.5 million in substandard and \$0 in 90 day delinquent loans.

Other Real Estate Owned (OREO) totaled \$3.8 million on March 31, 2016 compared to \$3.2 million on December 31, 2015 and \$749,000 on March 31, 2015.

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The following is a summary of changes in non-interest income (table dollar amounts in thousands):

	Three Months Ended		2015 - 2016	
	March 31 2016	March 31 2015	Amount Change	Percent Change
Non-interest Income				
Service charges on deposit accounts	\$ 1,238	\$ 999	\$ 239	23.9%
Wire transfer fees	121	151	(30)	-19.9%
Interchange fees	1,458	1,102	356	32.3%
Fiduciary activities	1,635	1,297	338	26.1%
Gain on sale of investment securities	108	124	(16)	-12.9%
Gain on sale of mortgage loans	2,114	2,379	(265)	-11.1%
Mortgage servicing net of impairment	447	179	268	149.7%
Increase in cash surrender value of bank owned life insurance	345	258	87	33.7%
Death benefit on officer life insurance		145	(145)	100.0%
Other income	398	432	(34)	-7.9%
Total non-interest income	\$ 7,864	\$ 7,066	\$ 798	11.3%

Total non-interest income was \$798,000 higher in the first three months of 2016 compared to the same period of 2015. Service charges on deposit accounts increased \$239,000, interchange fees increased by \$356,000 and fiduciary activities increased \$338,000, primarily due to overall company growth and increased volume. Residential mortgage loan activity during the first three months of 2016 generated \$2.1 million of income from the gain on sale of mortgage loans, down \$265,000 from the same period in 2015. The decrease in the gain on sale of mortgage loans was due to a decrease in total loans sold of \$13.7 million from \$68.9 million in the first three months of 2015 to \$55.2 million in the same period of 2016, partially offset by an increase in the percentage earned on the sale of these loans from 3.18% in the first three months of 2015 to 3.83% in the same period of 2016. Mortgage servicing net of impairment increased by \$268,000 during the first three months of 2016 compared to the same period of 2015 primarily due to a larger portfolio of mortgage loans serviced. The Company also recognized a \$145,000 death benefit on officer life insurance during the first three months of 2015 that was not realized in the same period of 2016.

Non-interest Expense

The following is a summary of changes in non-interest expense (table dollar amounts in thousands):

	Three Months Ended		Amount Change	Percent Change
	March 31 2016	March 31 2015		
Non-interest expense				
Salaries	\$ 6,886	\$ 5,633	\$ 1,253	22.2%
Commission and bonuses	1,075	1,167	(92)	-7.9%
Employee benefits	2,104	1,704	400	23.5%
Net occupancy expenses	1,936	1,551	385	24.8%
Data processing	1,105	923	182	19.7%
Professional fees	831	527	304	57.7%
Outside services and consultants	1,099	626	473	75.6%
Loan expense	1,195	1,257	(62)	-4.9%
FDIC deposit insurance	405	337	68	20.2%
Other losses	267	(45)	312	-693.3%
Other expense	2,844	2,388	456	19.1%
Total non-interest expense	\$ 19,747	\$ 16,068	\$ 3,679	22.9%

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Total non-interest expenses were \$3.7 million higher in the first three months of 2016 compared to the same period of 2015. Salaries increased by \$1.3 million and employee benefits increased by \$400,000 due to a larger employee base. Net occupancy expense increased \$385,000 due to Horizon's investment in growth markets and the Peoples acquisition. Data processing expenses increased \$182,000, professional fees increased by \$304,000 and other expenses increased by \$456,000 primarily due to company growth. Outside services and consultants expense increased by \$473,000 due to the one-time fees associated with the pending Kosciusko and LaPorte Bancorp acquisitions. One-time non-interest expense related to the pending acquisitions totaled \$639,000 in the first three months of 2016. Other losses increased by \$312,000 due to increased losses related to debit card fraud as well as a recovery that was received in the first quarter of 2015.

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 three months ended March 31, 2016, cash and cash equivalents decreased by approximately \$1.0 million. At March 31, 2016, in addition to liquidity available from the normal operating, funding, and investing activities of Horizon, the Bank had approximately \$257.5 million in unused credit lines with various money center banks, including the FHLB and the FRB Discount Window compared to \$253.2 million at December 31, 2015 and \$252.9 million at March 31, 2015.

Capital Resources

The capital resources of Horizon and the Bank exceeded regulatory capital ratios for well capitalized banks at March 31, 2016. Stockholders' equity totaled \$261.4 million as of March 31, 2016, compared to \$266.8 million as of December 31, 2015. For the three months ended March 31, 2016, the ratio of average stockholders' equity to average assets was 10.16% compared to 10.32% for the three months ended December 31, 2015. The decrease in stockholders' equity during the period was due to the payoff of \$12.5 million in funds received through the Small Business Lending Fund with cash from the holding company on February 1, 2016, which was partially offset through the generation of net income, net of dividends declared.

On February 1, 2016, the Company paid off the \$12.5 million in funds received through the Small Business Lending Fund with cash from the holding company, thereby ending its participation in the program, pursuant to which it issued preferred stock to the US Treasury. The funds were paid off due to an increase in the dividend cost that would have gone in effect at the end of February 2016. For the three months ending March 31, 2016, the dividend cost was \$42,000 or 1.0% annualized and included the acceleration of interest due to the payoff.

Horizon declared common stock dividends in the amount of \$0.15 per share during the first three months of 2016 compared to \$0.14 per share for the same period of 2015. The dividend payout ratio (dividends as a percent of basic earnings per share) was 33.6% and 24.2% for the first three months of 2016 and 2015, respectively. For additional information regarding dividends, see Horizon's Annual Report on Form 10-K for 2015.

Use of Non-GAAP Financial Measures

Certain information set forth in this quarterly report on Form 10-Q refers to financial measures determined by methods other than in accordance with GAAP. Specifically, we have included non-GAAP financial measures of the net interest margin and the allowance for loan and lease losses excluding the impact of

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acquisition-related purchase accounting adjustments and net income and diluted earnings per share excluding the impact of one-time costs related to acquisitions, acquisition-related purchase accounting adjustments and other events that are considered to be non-recurring. Horizon believes that these non-GAAP financial measures are helpful to investors and provide a greater understanding of our business without giving effect to the purchase accounting impacts and one-time costs of acquisitions and non-core items, although these measures are not necessarily comparable to similar measures that may be presented by other companies and should not be considered in isolation or as a substitute for the related GAAP measure.

Non-GAAP Reconciliation of Net Interest Margin

(Dollar in Thousands)

	Three Months Ended		
	March 31	December 31	March 31
	2016	2015	2015
	(Unaudited)		(Unaudited)
<u>Net Interest Margin As Reported</u>			
Net interest income	\$ 19,774	\$ 20,222	\$ 16,886
Average interest-earning assets	2,367,250	2,369,301	1,899,870
Net interest income as a percent of average interest-earning assets (Net Interest Margin)	3.45%	3.50%	3.70%
<u>Impact of Acquisitions</u>			
Interest income from acquisition-related purchase accounting adjustments	\$ (547)	\$ (695)	\$ (1,083)
<u>Excluding Impact of Acquisitions</u>			
Net interest income	\$ 19,227	\$ 19,527	\$ 15,803
Average interest-earning assets	2,367,250	2,369,301	1,899,870
Core Net Interest Margin	3.36%	3.38%	3.47%

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Non-GAAP Reconciliation of Net Income and Diluted Earnings per Share

(Dollar in Thousands Except per Share Data, Unaudited)

	Three Months Ended March 31	
	2016	2015
<u>Non-GAAP Reconciliation of Net Income</u>		
Net income as reported	\$ 5,381	\$ 5,358
Merger expenses	639	146
Tax effect	(165)	(51)