

HORIZON BANCORP /IN/  
Form 10-Q  
November 13, 2006

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**HORIZON BANCORP**  
**SECURITIES AND EXCHANGE COMMISSION**  
**450 5th Street N.W.**  
**Washington, D.C. 20549**  
**FORM 10-Q**  
**QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF**  
**THE SECURITIES EXCHANGE ACT OF 1934**  
**For the quarterly period ended September 30, 2006**  
**Commission file number 0-10792**  
**HORIZON BANCORP**  
(Exact name of registrant as specified in its charter)

**Indiana**

**35-1562417**

(State or other jurisdiction of incorporation or  
organization)

(I.R. S. Employer Identification No.)

**515 Franklin Square, Michigan City, Indiana**

**46360**

(Address of principal executive offices)

(Zip Code)

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

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the 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:

3,238,682 at November 8, 2006

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**Horizon Bancorp and Subsidiaries**  
**Condensed Consolidated Balance Sheets**  
(Dollar Amounts in Thousands)

	September 30, 2006 (Unaudited)	December 31, 2005
<b>Assets</b>		
Cash and due from banks	\$ 21,673	\$ 39,163
Interest-bearing demand deposits	104	87
Cash and cash equivalents	21,777	39,250
Interest-bearing deposits	128	15,735
Investment securities, available for sale	239,869	275,177
Loans held for sale	6,169	2,440
Loans, net of allowance for loan losses of \$8,810 and \$8,368	820,381	724,366
Premises and equipment	22,891	21,425
Federal Reserve and Federal Home Loan Bank stock	12,457	12,983
Goodwill	5,787	5,787
Other intangible assets	2,503	2,780
Interest receivable	5,655	5,813
Other assets	21,572	22,119
Total assets	\$1,159,189	\$1,127,875
<b>Liabilities</b>		
Deposits		
Noninterest bearing	\$ 90,205	\$ 148,127
Interest bearing	724,981	707,439
Total deposits	815,186	855,566
Short-term borrowings	120,579	50,024
Long-term borrowings	128,969	133,609
Subordinated debentures	27,837	27,837
Interest payable	1,904	1,663
Other liabilities	5,224	5,646
Total liabilities	1,099,699	1,074,345
<b>Stockholders Equity</b>		
Preferred stock, no par value Authorized, 1,000,000 shares No shares issued	1,110	1,092

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Common stock, \$.2222 stated value Authorized, 22,500,000 shares Issued, 4,995,906 and 4,852,751 shares		
Additional paid-in capital	<b>25,135</b>	24,552
Retained earnings	<b>52,417</b>	48,523
Restricted stock, unearned compensation		(760)
Accumulated other comprehensive loss	<b>(2,020)</b>	(2,853)
Less treasury stock, at cost, 1,759,424 and 1,755,158 shares	<b>(17,152)</b>	(17,024)
Total stockholders' equity	<b>59,490</b>	53,530
 Total liabilities and stockholders' equity	 <b>\$1,159,189</b>	 \$1,127,875

See notes to condensed consolidated financial statements

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**Horizon Bancorp and Subsidiaries**  
**Condensed Consolidated Statements of Income**  
(Dollar Amounts in Thousands, Except Per Share Data)

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30</b>		<b>September 30</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	<b>(Unaudited)</b>	<b>(Unaudited)</b>	<b>(Unaudited)</b>	<b>(Unaudited)</b>
<b>Interest Income</b>				
Loans receivable	<b>\$15,010</b>	\$12,662	<b>\$ 41,612</b>	\$ 31,716
Investment securities				
Taxable	<b>1,870</b>	2,469	<b>6,096</b>	7,295
Tax exempt	<b>878</b>	610	<b>2,363</b>	1,760
Total interest income	<b>17,758</b>	15,741	<b>50,071</b>	40,771
<b>Interest Expense</b>				
Deposits	<b>7,003</b>	4,375	<b>18,273</b>	11,348
Federal funds purchased and short-term borrowings	<b>594</b>	578	<b>1,584</b>	1,405
Long-term borrowings	<b>1,766</b>	1,465	<b>5,113</b>	4,362
Subordinated debentures	<b>583</b>	415	<b>1,643</b>	1,076
Total interest expense	<b>9,946</b>	7,193	<b>26,613</b>	18,191
<b>Net Interest Income</b>	<b>7,812</b>	8,548	<b>23,458</b>	22,580
Provision for loan losses	<b>120</b>	360	<b>725</b>	1,071
<b>Net Interest Income after Provision for Loan Losses</b>	<b>7,692</b>	8,188	<b>22,733</b>	21,509
<b>Other Income</b>				
Service charges on deposit accounts	<b>833</b>	766	<b>2,297</b>	1,887
Wire transfer fees	<b>101</b>	120	<b>290</b>	326
Fiduciary activities	<b>758</b>	645	<b>2,231</b>	1,964
Commission income from insurance agency	<b>-0-</b>	-0-	<b>-0-</b>	46
Gain on sale of loans	<b>459</b>	474	<b>1,087</b>	1,341
Gain on sale of mortgage servicing rights	<b>656</b>	-0-	<b>656</b>	-0-
Increase in cash surrender value of Bank owned life insurance	<b>122</b>	125	<b>348</b>	361
Loss on sale of securities	<b>(515)</b>	-0-	<b>(764)</b>	-0-
Other income	<b>448</b>	373	<b>1127</b>	1,329
Total other income	<b>2,862</b>	2,503	<b>7,272</b>	7,254

**Other Expenses**

Salaries and employee benefits	<b>4,228</b>	4,221	<b>12,524</b>	12,471
Net occupancy expenses	<b>577</b>	605	<b>1,756</b>	1,612
Data processing and equipment expenses	<b>725</b>	704	<b>2,024</b>	1,736
Other expenses	<b>2,322</b>	2,258	<b>6,487</b>	5,920
Total other expenses	<b>7,852</b>	7,788	<b>22,791</b>	21,739

**Income Before Income Tax**

Income tax expense	<b>734</b>	875	<b>1,963</b>	2,013
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Net Income	<b>\$ 1,968</b>	\$ 2,028	<b>\$ 5,251</b>	\$ 5,011
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**Basic Earnings Per Share**

<b>\$ .62</b>	\$ .66	<b>\$ 1.66</b>	\$ 1.64
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**Diluted Earnings Per Share**

<b>\$ .61</b>	\$ .64	<b>\$ 1.64</b>	\$ 1.59
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**Horizon Bancorp and Subsidiaries**  
**Consolidated Statement of Stockholders' Equity**  
**(Unaudited)**

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

	Common Stock	Additional Paid-in Capital	Comprehensive Income	Retained Earnings	Restricted Stock, Unearned Compensation	Accumulated Other Comprehensive Loss	Treasury Stock	Total
<b>Balances, December 31, 2005</b>	\$ 1,092	\$ 24,552		\$ 48,523	\$ (760)	\$ (2,853)	\$ (17,024)	\$ 53,530
Net income			\$ 5,251	5,251				5,251
Other comprehensive income, net of tax, unrealized gains on securities			833			833		833
Comprehensive income			\$ 6,084					
Reclassification of restricted stock, unearned compensation to paid-in capital upon adoption of SFAS 123 (R)		(760)			760			
Amortization of unearned compensation		159						159
Exercise of stock options	18	695						713
Tax benefit related to stock options		460						460
Stock option expense		29						29
Purchase treasury stock							(128)	(128)
Cash dividends (\$ .42 per share)				(1,357)				(1,357)



**Balances,  
September 30,  
2006**

\$ 1,110	\$	25,135		\$ 52,417	\$	0	\$	(2,020)	\$	(17,152)	\$ 59,490
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See notes to condensed consolidated financial statements.

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**Horizon Bancorp and Subsidiaries**  
**Condensed Consolidated Statements of Cash Flows**  
(Dollar Amounts in Thousands)

	<b>Nine Months Ended September 30</b>	
	<b>2006 (Unaudited)</b>	<b>2005 (Unaudited)</b>
<b>Operating Activities</b>		
Net income	\$ 5,251	\$ 5,011
Items not requiring (providing) cash		
Provision for loan losses	725	1,071
Depreciation and amortization	1,841	1,633
Share based compensation	29	
Federal Home Loan Bank stock dividend		(251)
Mortgage servicing rights (recovery) impairment	(40)	(141)
Deferred income tax	967	293
Investment securities amortization, net	193	205
Loss on sale of securities	764	
Gain on sale of mortgage servicing rights	(656)	
Gain on sale of loans	(1,087)	(1,341)
Proceeds from sales of loans	80,225	73,032
Loans originated for sale	(82,867)	(73,323)
(Gain) loss on sale of other real estate owned	4	(45)
Loss on sale of fixed assets	11	7
Increase in cash surrender value of life insurance	(348)	(361)
Net change in:		
Interest receivable	158	(461)
Interest payable	241	563
Other assets	(1,142)	(481)
Other liabilities	(489)	(1,134)
Net cash provided by operating activities	3,780	4,273
<b>Investing Activities</b>		
Net change in deposits	15,607	4,702
Purchases of securities available for sale	(77,796)	(35,111)
Proceeds from sales, maturities, calls, and principal repayments of securities available for sale	113,431	54,144
Net change in loans	(97,144)	(63,386)
Purchase Federal Reserve Bank stock	(31)	
Proceeds from sale of mortgage servicing rights	1,273	
Proceeds from sale of Federal Home Loan Bank stock	557	
Proceeds from sale of fixed assets	1	116
Recoveries on loans previously charged-off	471	342
Proceeds from sale of other real estate owned	25	484
Purchases of premises and equipment	(2,899)	(865)

Acquisition, net of cash		(2,901)
Net cash used in investing activities	<b>(46,505)</b>	(42,475)
<b>Financing Activities</b>		
Net change in		
Deposits	<b>(40,380)</b>	55,731
Short-term borrowings	<b>70,555</b>	(12,058)
Proceeds from long-term borrowings		72,000
Repayment of long-term borrowings	<b>(4,640)</b>	(76,079)
Proceeds from issuance of stock	<b>742</b>	1,564
Purchase of treasury stock	<b>(128)</b>	(651)
Tax benefit of options exercised	<b>460</b>	451
Dividends paid	<b>(1,357)</b>	(1,221)
Net cash provided by financing activities	<b>25,252</b>	39,737
<b>Net Change in Cash and Cash Equivalents</b>	<b>(17,473)</b>	1,535
<b>Cash and Cash Equivalents, Beginning of Period</b>	<b>39,250</b>	18,254
<b>Cash and Cash Equivalents, End of Period</b>	<b>\$ 21,777</b>	\$ 19,789
<b>Additional Cash Flows Information</b>		
Interest paid	<b>\$ 26,372</b>	\$ 17,486
Income tax paid	<b>990</b>	1,050
See notes to condensed consolidated financial statements.		

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**Horizon Bancorp and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements**  
(Table Dollar Amounts in Thousands, Except Per Share Data)

**Note 1 Accounting Policies**

The accompanying consolidated financial statements include the accounts of Horizon Bancorp (Horizon) and its wholly-owned subsidiary, Horizon Bank, N.A. (Bank). All inter-company balances and transactions have been eliminated. The results of operations for the periods ended September 30, 2006 and September 30, 2005, are not necessarily indicative of the operating results for the full year of 2006 or 2005. 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 consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in Horizon's Form 10-K annual report for 2005 filed with the Securities and Exchange Commission. The consolidated balance sheet of Horizon as of December 31, 2005, has been derived from the audited balance sheet of Horizon as of that date.

Basic earnings per share is computed by dividing net income by the weighted-average number of shares outstanding. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. In August 2002, substantially all of the participants in Horizon's Stock Option and Stock Appreciation Rights Plans voluntarily entered into an agreement with Horizon to cap the value of their stock appreciation rights (SARS) at \$14.67 per share and cease any future vesting of the SARS. These agreements with option holders make it more advantageous to exercise an option rather than a SAR whenever Horizon's stock price exceeds \$14.67 per share, therefore the option becomes potentially dilutive at \$14.67 per share or higher. The number of shares used in the computation of basic earnings per share is 3,189,004 and 3,074,705 for the three-month period ended September 30, 2006 and 2005. The number of shares used in the computation of diluted earnings per share is 3,211,777 and 3,165,847 for the three-month period ended September 30, 2006 and 2005. The number shares used in the computation of basic earnings per share is 3,171,869 and 3,052,821 for the nine-month period ended September 30, 2006 and 2005. The number of shares used in the computation of diluted earnings per share is 3,209,940 and 3,154,808 for the nine-month period ended September 30, 2006 and 2005.

Horizon has share-based employee compensation plans, which are described in the notes to the financial statements included in the December 31, 2005, Annual Report to Shareholders.

Effective January 1, 2006, Horizon adopted Statement of Financial Accounting Standards No. 123(R), Share-Based Payment (SFAS 123(R)). SFAS 123(R) addresses all forms of share-based payment awards, including shares under employee stock purchase plans, stock options, restricted stock and stock appreciation rights. SFAS 123(R) requires all share-based payments to be recognized as expense, based upon their fair values, in the financial statements over the vesting period of the awards. Horizon has elected the modified prospective application and, as a result, has recorded approximately \$29 thousand in compensation expense relating to vesting of stock options less estimated forfeitures for the nine month period ended September 30, 2006. Certain disclosures required by SFAS 123(R) have been omitted due to their immaterial nature. Prior to adoption of SFAS 123(R), unearned compensation related to restricted stock awards was classified as a separate component of stockholders' equity. Upon the adoption of SFAS 123(R) on January 1, 2006, the balance in unearned compensation was reclassified to additional paid-in capital.

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**Horizon Bancorp and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements**

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

Prior to the adoption of SFAS 123(R), Horizon accounted for these plans under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. No stock-based employee compensation cost was reflected in net income, as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the grant date. The following table illustrates the effect on net income and earnings per share if Horizon had applied the fair value provisions of Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

	<b>Three Months Ended September 30, 2005</b>	<b>Nine Months Ended September 30, 2005</b>
Net income, as reported	\$2,028	\$ 5,011
Less: Total stock-based employee compensation cost determined under the fair value based method, net of income taxes	(7)	(27)
Pro forma net income	\$2,021	\$ 4,984
Earnings per share:		
Basic as reported	.66	1.64
Basic pro forma	.66	1.63
Diluted as reported	.64	1.59
Diluted pro forma	.64	1.58

**Note 2 Investment Securities**

	<b>2006</b>			
<b>September 30</b>	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
Available for sale				
U. S. Treasury and federal agencies	\$ 51,684	\$	\$ (330)	\$ 51,354
State and municipal	80,961	1,107	(332)	81,736
Federal agency collateralized mortgage obligations	11,544	7	(278)	11,273
Federal agency mortgage backed pools	98,157	39	(3,348)	94,848

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Corporate Notes	632	26		658
Total investment securities	\$242,978	\$1,179	\$(4,288)	\$239,869
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**Horizon Bancorp and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements**  
(Table Dollar Amounts in Thousands, Except Per Share Data)

		<b>2005</b>		
<b>December 31</b>	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
Available for sale				
U. S. Treasury and federal agencies	\$ 72,153	\$	\$(1,786)	\$ 70,367
State and Municipal	64,608	1,794	(430)	65,972
Federal agency collateralized mortgage obligations	22,781		(628)	22,153
Federal agency mortgage backed pools	119,392	125	(3,497)	116,020
Corporate notes	632	33		665
 Total investment securities	 \$279,566	 \$1,952	 \$(6,341)	 \$275,177

The amortized cost and fair value of securities available for sale at September 30, 2006, 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.

	<b>Available for Sale</b>	
	<b>Amortized Cost</b>	<b>Fair Value</b>
Within one year	\$ 5,544	\$ 5,473
One to five years	13,133	13,038
Five to ten years	32,286	32,221
After ten years	82,314	83,016
	133,277	133,748
Federal agency collateralized mortgage obligations	11,544	11,273
Federal agency mortgage backed pools	98,157	94,848
	\$242,978	\$239,869

Proceeds from sales of securities available for sale during the nine months ended September 30, 2006, were \$91,265,000. Gross gains of \$1,247,000 and gross losses of \$2,011,000 were recognized on these sales. Certain investments in debt securities are reported in the financial statements at an amount less than their historical cost. Total fair value of these investments at September 30, 2006 and December 31, 2005, was \$186,039,000 and \$226,292,000, respectively, which is approximately 78% and 82% of Horizon's available-for-sale investment portfolio. These declines primarily resulted from recent increases in market interest rates. 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. 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.



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**Horizon Bancorp and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements**  
(Table Dollar Amounts in Thousands, Except Per Share Data)

The following table shows our investments gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2006 and December 31, 2005.

Description of Securities	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>September 30, 2006</b>						
U. S. Treasury and federal agencies	\$ 12,252	\$ 77	\$ 15,428	\$ 253	\$ 27,680	\$ 330
State and municipal Federal agency collateralized mortgage obligations	4,951	25	12,693	307	17,644	332
	0	0	9,479	278	9,479	278
Federal agency mortgage backed pools	43,797	38	87,439	3,310	131,236	3,348
Total temporarily impaired securities	\$ 61,000	\$ 140	\$ 125,039	\$ 4,148	\$ 186,039	\$ 4,288

Description of Securities	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>December 31, 2005</b>						
U. S. Treasury and Federal agencies	\$ 11,957	\$ 243	\$ 57,010	\$ 1,542	\$ 68,967	\$ 1,785
State and municipal Federal agency collateralized mortgage obligations	25,335	388	1,968	42	27,303	430
	10,313	317	11,840	312	22,153	629
Federal agency mortgage-backed pools	40,983	950	66,886	2,547	107,869	3,497
Total temporarily impaired securities	\$ 88,588	\$ 1,898	\$ 137,704	\$ 4,443	\$ 226,292	\$ 6,341

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**Horizon Bancorp and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements**  
(Table Dollar Amounts in Thousands, Except Per Share Data)

**Note 3   Loans**

	<b>September 30, 2006</b>	<b>December 31, 2005</b>
Commercial loans	\$261,134	\$273,310
Mortgage warehouse loans	113,596	97,729
Real estate loans	220,387	159,312
Installment loans	234,074	202,383
	829,191	732,734
Allowance for loan losses	(8,810)	(8,368)
Total loans	\$820,381	\$724,366

**Note 4   Allowance for Loan Losses**

	<b>September 30, 2006</b>	<b>September 30, 2005</b>
Allowance for loan losses		
Balances, beginning of period	\$8,368	\$ 7,193
Allowance acquired in acquisition		557
Provision for losses	725	1,071
Recoveries on loans	471	342
Loans charged off	(754)	(773)
Balances, end of period	\$8,810	\$ 8,390

**Note 5   Nonperforming Assets**

	<b>September 30, 2006</b>	<b>December 31, 2005</b>
Nonperforming loans	\$1,428	\$ 1,822
Other real estate owned	25	23

Total nonperforming assets	\$1,453	\$ 1,845
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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

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

**For the Three and Nine Month Periods Ended September 30, 2006**

**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 "Company" ) and Horizon Bank, N.A. ( "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. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of Horizon, are generally identifiable by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project" or similar expressions. Horizon's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on Horizon's future activities and operating results include, but are not limited to:

credit risk: the risk that loan customers or other parties will be unable to perform their contractual obligations;

market risk: the risk that changes in market rates and prices will adversely affect our financial condition or results of operation;

liquidity risk: the risk that Horizon or the Bank will have insufficient cash or access to cash to meet its operating needs; and

operational risk: the risk of loss resulting from inadequate or failed internal processes, people and systems, or external events.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

**Introduction**

The purpose of this discussion is to focus on Horizon's financial condition, changes in financial condition and the results of operations in order to provide a better understanding of the consolidated financial statements included elsewhere herein. This discussion should be read in conjunction with the consolidated financial statements and the related notes.

**Overview**

Net income increased from the second quarter of 2006, and also improved from the first nine months of 2005. The major factors causing the improved performance from the first two quarters of 2006 was an increase in mortgage banking activity. The major factor causing improved performance from the prior year was the income generated from the additional assets and deposits obtained in the acquisition of Alliance Bank. This acquisition closed on June 10, 2005. The additional assets caused an increase in net interest income despite a decline in net interest margin. Non-interest expense, particularly salaries and employee benefits, were held in check. Non-interest income was impacted by losses taken on the sale of securities to restructure the investment portfolio. This was partially offset by a gain on the sale of mortgage servicing rights.

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### **Critical Accounting Policies**

The notes to the consolidated financial statements included in Item 8 on Form 10-K contain a summary of the Company's significant accounting policies and are presented on pages 44-48 of Form 10-K for 2005. 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 the allowance for loan losses as a critical accounting policy.

An allowance for loan losses is maintained to absorb 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 estimated losses inherent in the loan portfolio. Horizon's methodology for assessing the appropriateness of the allowance consists of several key elements, which include the formula allowance, specific allowances for identified problem loans, and the unallocated allowance.

The formula allowance is calculated by applying loss factors to outstanding loans and certain unused commitments.

Loss factors are based on historical loss experience and may be adjusted for significant factors that, in management's judgment, affect the collectibility of the portfolio as of the evaluation date.

Specific allowances are established in cases where management has identified significant conditions or circumstances related to a credit that management believes indicate the probability that a loss has been incurred in excess of the amount determined by the application of the formula allowance. The unallocated allowance is based upon management's evaluation of various conditions, the effects of which are not directly measured in the determination of the formula and specific allowances. The evaluation of the inherent loss with respect to these conditions is subject to a higher degree of uncertainty because they are not identified with specific credits. The conditions evaluated in connection with the unallocated allowance may include factors such as local, regional, and national economic conditions and forecasts, and adequacy of loan policies and internal controls, the experience of the lending staff, bank regulatory examination results, and changes in the composition of the portfolio.

Horizon considers the allowance for loan losses of \$8.810 million adequate to cover losses inherent in the loan portfolio as of September 30, 2006. However, 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.

### **Financial Condition**

#### **Liquidity**

The Bank maintains a stable base of core deposits provided by long standing relationships with consumers 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, sale of real estate loans and borrowing relationships with correspondent banks, including the Federal Home Loan Bank (FHLB). During the nine months ended September 30, 2006, cash and cash equivalents decreased by approximately \$17.5 million. At September 30, 2006, in addition to liquidity provided from the normal operating, funding, and investing activities of Horizon, the Bank has available approximately \$161 million in unused credit lines with various money center banks including the FHLB.

There have been no other material changes in the liquidity of Horizon from December 31, 2005 to September 30, 2006.

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### **Capital Resources**

As a condition of approval for the Alliance acquisition, the OCC required Horizon Bank to maintain regulatory capital ratios at 100 basis points above the well capitalized minimums. The capital resources of Horizon and the Bank exceed the OCC required levels at September 30, 2006. Stockholders' equity totaled \$59.490 million as of September 30, 2006 compared to \$53.530 million as of December 31, 2005. The increase in stockholders' equity during the nine months ended September 30, 2006 is primarily the result of net income, net of dividends declared and the amortization of unearned compensation. At September 30, 2006, the ratio of stockholders' equity to assets was 5.13% compared to 4.75% at December 31, 2005.

During the course of a periodic examination by the Bank's regulators that commenced in February 2003, the examination personnel raised the issue of whether the Bank's mortgage warehouse loans should be treated as other loans rather than home mortgages for call report purposes. If these loans are treated as other loans for regulatory reporting purposes, it would change the calculations for risk-based capital and reduce the Bank's risk-based capital ratios. Management believes that it has properly characterized the loans in its mortgage warehouse loan portfolio for risk-based capital purposes, but there is no assurance that the regulators will concur with that determination. Should the call report classification of the loans be changed, Horizon and the Bank would still be categorized as well capitalized at September 30, 2006.

There have been no other material changes in Horizon's capital resources from December 31, 2005 to September 30, 2006.

### **Material Changes in Financial Condition – September 30, 2006 compared to December 31, 2005**

During the first nine months of 2006, investment securities decreased approximately \$35.3 million and loans outstanding increased approximately \$96.5 million. During the first nine months of 2006, Horizon sold approximately \$91.5 million of lower yielding investment securities, recognizing a loss on the sale of \$764 thousand. The proceeds from the sale have been used to reduce short-term debt, fund anticipated loan growth and reinvest in higher yielding securities. These transactions are anticipated to have a negative impact on net income in 2006 but will positively effect future accounting periods. With the exception of commercial loans, loans have shown strong growth since December 31, 2005. Growth came in real estate loans, where the Bank's loan customers continued to favor adjustable rate mortgages, which are held in the Bank's portfolio. While this caused growth in the loan portfolio, it had a negative impact on gain on sale of loans, as fewer loans are available for sale. Mortgage warehouse loans increased as mortgage loan activity increased in general due to the seasonality of mortgage lending. Installment loans grew due to increased indirect volume and the purchase of approximately \$10 million of automobile loans from a third party. This growth was offset by a decline in commercial loans caused by unanticipated payoffs.

Premises and equipment increased approximately \$1.5 million during the first nine months of 2006 due primarily to the construction of the Elkhart branch, which opened in June of 2006.

Deposits declined, as a large deposit made by a local municipality at year-end 2005 was withdrawn in their normal course of business in early January 2006. Total average deposits for the third quarter of 2006 increased \$44 million from the fourth quarter of 2005. Short-term borrowings increased and investments decreased to fund the growth in loans.

There have been no other material changes in the financial condition of Horizon from December 31, 2005 to September 30, 2006.

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**Results of Operations**

**Material Changes in Results of Operations Three months ended September 30, 2006 compared to the three months ended September 30, 2005**

During the three months ended September 30, 2006, net income totaled \$1.968 million or \$.61 per diluted share compared to \$2.028 million or \$.64 per diluted share for the same period in 2005.

Net interest income for the quarter ended September 30, 2006, was \$7.812 million, a decrease of \$736 thousand or 8.6% from the same period of the prior year. This decrease resulted from a decrease in net interest margin from 3.36% in the third quarter of 2005 to 2.96% for the current quarter. Competitive interest rate pressures on consumer deposits, particularly money market and time deposit accounts, without corresponding commercial loan growth contributed to the margin decline. Average earning assets when compared to the same quarter of the prior year showed an increase of \$50 million or 5.0%. This growth in average earning assets, which came in mortgage loans mentioned above and from indirect auto loans, partially offset the decline in net interest income caused by the decline in net interest margin.

Non-interest income increased \$359 thousand or 14.3% from the third quarter of 2005. The main contributing factors to the third quarter increase was: (a) a gain on the sale of mortgage servicing rights of \$656 thousand. During the quarter, Horizon sold substantially all of its mortgage servicing rights with a book value of \$803 thousand. The sale will allow Horizon to better focus on its core lending activities. (b) a loss on the sale of investment securities of \$515 thousand. A total of \$21.6 million of securities were sold, including \$1.6 million of tax-exempt municipals. These securities had an average yield of approximately 3.35%. The proceeds from the sale were reinvested in securities with a yield of approximately 5.75%. This sale will have a negative after tax impact on 2006 of approximately \$258 thousand but will positively impact 2007 by approximately \$301 thousand. (c) Income from fiduciary activities increased \$113 thousand due to the additional ESOP trustee business and an increase in assets under management.

Non-interest expense increased \$64 thousand or less than one per cent from the third quarter of 2005. Expenses related to the newly established mortgage wholesale operation totaled \$274 thousand, which accounted for more than 100% of the increase. On January 1, 2006, Horizon adopted Statement of Financial Accounting Standards No. 123(R), Share-Based Payment ( SFAS 123(R) ). For the quarter ended September 30, 2006, Horizon recorded \$14 thousand of employee compensation expense related to expensing of stock options. See Note 1 to the financial statements for additional discussion of the adoption of SFAS 123(R).

There have been no other material changes in the results of operations of Horizon for the three months ending September 30, 2006 and 2005.

**Material Changes in Results of Operations Nine months ended September 30, 2006 compared to the Nine months ended September 30, 2005**

During the Nine months ended September 30, 2006, net income totaled \$5.251 million or \$1.64 per diluted share compared to \$5.011 million or \$1.59 per diluted share for the same period in 2005.

Net interest income for the nine month period ended September 30, 2006, was \$23.458 million, an increase of \$878 thousand and an increase of 3.9% over the same period of the prior year. This increase resulted from an increase in average earning assets from the same quarter of the prior year of \$107.0 million or 11.9%. The growth in earning assets was the result of the Alliance Bank acquisition that contributed approximately \$116 million in earning assets. The net interest margin declined from 3.28% for the 2005 period to 3.08% for 2006. Contributing to net interest income in the first nine months of 2006 was approximately \$399 thousand of income, which related to commercial loans that were

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acquired at a discount in the Alliance acquisition and were paid in full during the quarter. Without this income, the net interest margin would have been approximately 3.03%.

Non-interest income for the first nine months of 2006 increased by \$18 thousand. Service charges on deposit accounts increased due to the inclusion of the former Alliance checking account customers in the Horizon Bank overdraft protection product. Fiduciary fees increased as discussed above. Offsetting these increases was a decline in gain on sale of loans and brokered loan fees. While mortgage loan volume, which is the source loans to be sold, increased in the third quarter, it is still down from 2005 levels. Other income in 2005 included approximately \$160 thousand in pre-tax income from the sale of the retail property and casualty insurance lines of Horizon Insurance Services, Inc. Non-interest expense increased \$1.052 million or 4.8% from the first nine months of 2005. This increase relates primarily to additional on-going expenses related to the Alliance Bank acquisition, which closed in June of 2005, including core deposit intangible amortization of approximately \$277 thousand.

There have been no other material changes in the results of operations of Horizon for the nine months ending September 30, 2006 and 2005.



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

Horizon currently does not engage in any derivative or hedging activity. Refer to Horizon's 2005 Form 10-K for analysis of its interest rate sensitivity. Horizon believes there have been no significant changes in its interest rate sensitivity since it was reported in its 2005 Form 10-K.

**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation Of Disclosure Controls And Procedures**

Based on an evaluation of disclosure controls and procedures as of September 30, 2006, Horizon's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of Horizon's disclosure controls (as defined in Exchange Act Rule 13a-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act")). Based on such evaluation, such officers have concluded that, as of the evaluation date, Horizon's disclosure controls and procedures are effective to ensure that the information required to be disclosed by Horizon in the reports it files under the Exchange Act is recorded, processed, summarized and reported within the time specified in Securities and Exchange Commission rules and forms and are designed to ensure that information required to be disclosed in those reports is accumulated and communicated to management as appropriate to allow timely decisions regarding disclosure.

**Changes In Internal Controls**

Horizon's management, including its Chief Executive Officer and Chief Financial Officer, also have concluded that during the fiscal quarter ended September 30, 2006, there have been no changes in Horizon's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, Horizon's internal control over financial reporting.

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**Horizon Bancorp And Subsidiaries**

**Part II Other Information**

**For the Nine Months Ended September 30, 2006**

**ITEM 1. LEGAL PROCEEDINGS**

Not Applicable

**ITEM 1A. RISK FACTORS**

No material changes from the factors included in the December 31, 2005 Form 10-K

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

Not applicable

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not Applicable

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

Not Applicable

**ITEM 5. OTHER INFORMATION**

Not Applicable

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**ITEM 6. EXHIBITS**

(a) Exhibits

Exhibit 10.1	Employment Agreement, dated July 19, 2006, among Horizon Trust & Investment Management, N.A., Horizon Bank, N.A., Horizon Bancorp and Lawrence J. Mazur
Exhibit 10.2	Amendment to Horizon Bancorp Restricted Stock Award Agreement, dated July, 19, 2006.
Exhibit 11	Statement Regarding Computation of Per Share Earnings
Exhibit 31.1	Certification of Craig M. Dwight
Exhibit 31.2	Certification of James H. Foglesong
Exhibit 32	Certification of Chief Executive and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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**SIGNATURES**

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

HORIZON BANCORP

November 9, 2006  
Date:

BY: /s/ Craig M. Dwight  
Craig M. Dwight  
President and Chief Executive Officer

November 9, 2006  
Date:

BY: /s/ James H. Foglesong  
James H. Foglesong  
Chief Financial Officer

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**INDEX TO EXHIBITS**

The following documents are included as Exhibits to this Report.

<b>Exhibit</b>	<b>Description</b>	<b>Location</b>
10.1	Employment Agreement, dated July 19, 2006, among Horizon Trust & Investment Management, N.A., Horizon Bank, N.A., Horizon Bancorp and Lawrence J. Mazur.	Incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed July 21, 2006
10.2	Amendment to Horizon Bancorp Restricted Stock Award Agreement, dated July, 19, 2006.	Incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed July 21, 2006
11	Statement Regarding Computation of Per Share Earnings	Attached
31.1	Certification of Craig M. Dwight	Attached
31.2	Certification of James H. Foglesong	Attached
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Attached