HORIZON BANCORP /IN/
Form 10-K
March 12, 2013
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-K

**(Mark One)**

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

**For the fiscal year ended December 31, 2012**

**Commission file number 0-10792**

# Horizon Bancorp

**(Exact name of registrant as specified in its charter)**

| **Indiana** | **35-1562417** |
|---|---|
| **(State or other jurisdiction of** | **(I.R.S. Employer** |

| **incorporation or organization)** | **Identification No.)** |
|---|---|

| **515 Franklin Square, Michigan City** | **46360** |
|---|---|
| **(Address of principal executive offices)** | **(Zip Code)** |

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

**Securities registered pursuant to Section 12(b) of the Act:**

| **Title of each class** | **Name of each exchange on which registered** |
|---|---|
| **Common Stock, no par value** | **The NASDAQ Stock Market, LLC** |

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act Yes ¨ No x

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to the Form 10-K ¨

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

| Large Accelerated Filer ¨ | Accelerated Filer | x |
|---|---|---|
| Non-Accelerated Filer ¨ (Do not check if a smaller reporting company) | Smaller Reporting Company | ¨ |

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

The aggregate market value of the registrant s common stock held by non-affiliates of the registrant, based on the average bid price of such stock as of June 30, 2012, the last day of the registrant s most recently completed second fiscal quarter, was approximately $117.4 million.

As of March 12, 2013, the registrant had 8,617,466 shares of common stock outstanding.

| **Documents Incorporated by Reference Document** | **Part of Form 10-K into which portion of document is incorporated** |
|---|---|

| | |
|---|---|
| **Portions of the Registrant s Proxy Statement to be filed for its May 2, 2013 annual meeting of shareholders** | **III** |

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**HORIZON BANCORP**

**2012 Annual Report on Form 10-K**

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**FORWARD-LOOKING STATEMENTS**

**A cautionary note about forward-looking statements:** In addition to historical information, information included and incorporated by reference in this Annual Report on Form 10-K contains certain forward-looking statements within the meaning of the federal securities laws. Horizon intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 and is including this statement for purposes of invoking those safe-harbor provisions. Forward-looking statements can include statements about estimated cost savings, plans and objectives for future operations and expectations about Horizon s financial and business performance as well as economic and market conditions. They often can be identified by the use of words such as expect, may, could, will, intend, project, estimate, believe, anticipate, seek, plan and variations of such words and

Horizon may include forward-looking statements in filings it makes with the Securities and Exchange Commission ( SEC ), such as this Form 10-K, in other written materials, and in oral statements made by senior management to analysts, investors, representatives of the media and others. It is intended that these forward-looking statements speak only as of the date they are made, and Horizon undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the forward-looking statement is made or to reflect the occurrence of unanticipated events.

By their nature, forward-looking statements are based on assumptions, which although believed to be reasonable, and are subject to risks, uncertainties, and other factors, such as the following:

- 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;
- 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;

- 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;
- 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.

You are cautioned that actual results may differ materially from those contained in the forward-looking statements. The Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of this Form 10-K lists some of the factors that could cause Horizon s actual results to vary materially from those expressed in or implied by any forward-looking statements. Your attention is directed to this discussion.

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Other risks and uncertainties that could affect Horizon s future performance are set forth below in Item 1A - Risk Factors.

## PART I

## ITEM 1. BUSINESS

The disclosures in this Item 1 are qualified by the disclosures below in Item 1A, Risk Factors, and Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operation, and in other cautionary statements set forth elsewhere in this Annual Report on Form 10-K.

### General

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

On July 17, 2012, Horizon completed its acquisition of Heartland Bancshares, Inc. ( Heartland ) and Heartland s wholly owned subsidiary, Heartland Community Bank ( Heartland Bank ). Heartland was merged into Horizon, and Heartland Bank was merged into the Bank. The exchange ratio was 0.81 shares of Horizon s common stock for each share of Heartland common stock outstanding. Horizon acquired the 1,442,449 outstanding shares of Heartland common stock in exchange for 1,168,383 shares of Horizon common stock, which had a market price of $16.83 per share at the close of business on July 17, 2012. Horizon also purchased and retired all shares of preferred stock that Heartland had issued pursuant to the Troubled Asset Relief Program Capital Purchase Program ( TARP ). Based upon the $16.83 market price and the TARP preferred stock purchase, the total value of the consideration for the acquisition was $26.9 million. As a result of the acquisition, the Company experienced, and expects to continue to experience, increases in its deposit base and reductions in transaction costs. The Company also expects to reduce cost through economies of scale.

On June 1, 2010, the Company announced the completion of the purchase of assets and the assumption of liabilities of American Trust & Savings Bank ( American ) in Whiting, Indiana. The transaction was consummated on May 28, 2010. The Company purchased most of the banking-related assets of American, totaling $107.8 million and assumed all the deposits, federal home loan bank advances, trust preferred securities, and accrued interest payable in the approximate amount of $110.3 million. The Company paid a deposit premium on core deposits of approximately $2.1 million and $500,000 in additional consideration. As a result of the acquisition, the Company experienced, and expects to continue to experience, increases in its deposit base and reductions in transaction costs. The Company also expects to reduce cost through economies of scale.

The Bank maintains 29 full service offices. At December 31, 2012, the Bank had total assets of $1.85 billion and total deposits of $1.29 billion. The Bank has three wholly-owned subsidiaries: Horizon Investments, Inc. ( Horizon Investments ), Horizon Insurance Services, Inc. ( Horizon Insurance ) and Horizon Grantor Trust. Horizon Investments manages the investment portfolio of the Bank. Horizon Insurance offered a full line of personal and corporate insurance products until March 2005, at which time the majority of its assets were sold to a third party. Horizon Insurance is no longer an operating subsidiary and is primarily used to collect residual insurance income. Horizon Grantor Trust holds title to certain company owned life insurance policies.

Horizon formed Horizon Bancorp Capital Trust II in 2004 ( Trust II ) and Horizon Bancorp Capital Trust III in 2006 ( Trust III ) for the purpose of participating in pooled trust preferred securities offerings. The Company assumed additional debentures as the result of the acquisition of Alliance Financial Corporation in 2005, which formed Alliance Financial Statutory Trust I ( Alliance Trust ). The Company also assumed additional debentures as the result of the

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American transaction, which formed Am Tru Statutory Trust I ( Am Tru Trust ). The Company also assumed additional debentures as the result of the Heartland transaction, which formed Heartland (IN) Statutory Trust II ( Heartland Trust ). See Note 13 of the Consolidated Financial Statements for further discussion regarding these previously consolidated entities that are now reported separately. The business of Horizon is not seasonal to any material degree.

No material part of Horizon s business is dependent upon a single or small group of customers, the loss of any one or more of which would have a materially adverse effect on the business of Horizon. In 2012, revenues from loans accounted for 59.8% of the total consolidated revenue, and revenues from investment securities accounted for 12.8% of total consolidated revenue.

**Available Information**

The Company s Internet address is www.accesshorizon.com. The Company makes available, free of charge through the Investor Relations SEC Filings section of its Internet website, copies of the Company s Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after those reports are filed with or furnished to the SEC.

**Employees**

The Bank employed approximately 419 full and part-time employees as of December 31, 2012. Horizon, Horizon Insurance and Horizon Grantor Trust do not have any employees.

**Competition**

Horizon faces a high degree of competition in all of its primary markets. The Bank s primary market consists of Porter, LaPorte, St. Joseph, Elkhart, Lake, Marion and Johnson Counties Indiana, and Berrien and Kalamazoo Counties Michigan. The Bank competes with other commercial banks as well as with savings and loan associations, consumer finance companies and credit unions. To a more moderate extent, the Bank competes with Chicago money center banks, mortgage banking companies, insurance companies, brokerage houses, other institutions engaged in money market financial services and certain government agencies.

Based on deposits as of June 30, 2012, Horizon was the largest of the 10 bank and thrift institutions in LaPorte County with a 33.28% market share and the sixth largest of the 15 institutions in Porter County with a 9.31% market share. In Berrien County, Michigan, Horizon was the fourth largest of the 10 bank and thrift institutions with a 7.45% market share. Horizon s market share of deposits in Lake County, Indiana was just over 1% at 1.43%, and less than 1% in each of St. Joseph and Elkhart Counties in Indiana and Kalamazoo County in Michigan. The branches of Horizon Bank acquired in the merger with Heartland Bank, which operate under the Heartland Community Bank a Horizon Bank Company name, are located throughout Johnson County Indiana and have a 13.29% market share, giving Horizon the largest share of the 19 bank and thrift institutions in the Johnson County market. (Source: FDIC Summary of Deposits Market Share Reports, available at www.fdic.gov).

**Regulation and Supervision**

As a bank holding company, the Company is subject to extensive regulation, supervision, and examination by the Board of Governors of the Federal Reserve System (the Federal Reserve Board or FRB ) as its primary federal regulator. The Bank, as a nationally chartered bank, is subject to extensive regulation, supervision and examination by the Office of the Comptroller of the Currency ( OCC ) as its primary federal regulator and, as to certain matters, by the FRB and the Federal Deposit Insurance Corporation ( FDIC ). Both federal and state law extensively regulate various aspects of the banking business, such as reserve requirements, truth-in-lending and truth-in-savings disclosures, equal credit opportunity, fair credit reporting, trading in securities and other aspects of banking operations. Branching by the Bank is subject to the jurisdiction and requires notice to, or the prior approval of, the OCC. The Dodd-Frank Act permits the establishment of de novo branches in states where such branches could be opened by a state bank chartered by that state. The consent of the state is no longer required.

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**The Bank Holding Company Act**

Horizon is registered as a bank holding company under the Bank Holding Company Act of 1956, as amended ( BHC Act ). Federal Reserve Board policy has historically required bank holding companies to act as a source of financial and management strength for their subsidiary banks. The Dodd-Frank Act, which was signed into law on July 21, 2010, codified this policy. Under this requirement, Horizon is required to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances in which Horizon might not otherwise do so. For this purpose, source of financial strength means Horizon s ability to provide financial assistance to the Bank in the event of the Bank s financial distress.

The BHC Act requires the prior approval of the Federal Reserve to acquire more than a 5% voting interest of any bank or bank holding company. Additionally, the BHC Act restricts Horizon s non-banking activities to those which are determined by the Federal Reserve to be so closely related to banking and a proper incident thereto.

Under the Federal Deposit Insurance Corporation Improvement Act of 1991 (the FDICIA ), a bank holding company is required to guarantee the compliance of any insured depository institution subsidiary that may become undercapitalized (as defined in FDICIA) with the terms of any capital restoration plan filed by such subsidiary with its appropriate federal bank regulatory agency.

Bank holding companies are required to comply with the Federal Reserve s risk-based capital guidelines. The Federal Deposit Insurance Corporation (the FDIC ) and the Office of the Comptroller of the Currency (the OCC ) also have risk-based capital ratio guidelines to which depository institutions under their respective supervision are subject. The guidelines establish a systematic analytical framework that makes regulatory capital requirements more sensitive to differences in risk profiles among banking organizations. Risk-based capital ratios are determined by allocating assets and specified off-balance sheet commitments to four risk weighted categories, with higher levels of capital being required for the categories perceived as representing greater risk. For Horizon s regulatory capital ratios and regulatory requirements as of December 31, 2012, see the information in Management s Discussion and Analysis of Financial Condition and Results of Operation in Item 7 below, which is incorporated herein by reference.

**National Bank Act**

As a national bank, the Bank is subject to the provisions of the National Bank Act. The Bank is supervised, regulated, and examined by the OCC, and is subject to the rules and regulations of the OCC, Federal Reserve, and the FDIC.

**Deposit Insurance and Assessments**

The Bank s deposits are insured to applicable limits by the Deposit Insurance Fund ( DIF ) of the Federal Deposit Insurance Corporation ( FDIC ). Banks are subject to deposit insurance premiums and assessments to maintain the DIF. A bank s deposit insurance premium assessment rate depends on the capital category and supervisory category to which it is assigned. The FDIC has authority to raise or lower assessment rates on insured banks in order to achieve statutorily required reserve ratios in the DIF and to impose special additional assessments.

The Dodd-Frank Act has resulted in significant changes to the FDIC s deposit insurance system. Under the Dodd-Frank Act, the FDIC is authorized to set the reserve ratio for the Deposit Insurance Fund at no less than 1.35%, and must achieve the 1.35% designated reserve ratio by September 30, 2020. The FDIC must offset the effect of the increase in the minimum designated reserve ratio from 1.15% to 1.35% on insured depository institutions of less than $10 billion and may declare dividends to depository institutions when the reserve ratio at the end of a calendar quarter is at least 1.5%, although the FDIC has the authority to suspend or limit such permitted dividend declarations. In December 2010, the FDIC adopted a final rule setting the designated reserve ratio for the deposit insurance fund at 2% of estimated insured deposits.

Also as a consequence of the Dodd-Frank Act, the assessment base for deposit insurance premiums was changed, effective April 1, 2011, from adjusted domestic deposits to average consolidated total assets minus average tangible equity. Tangible equity for this purpose means Tier 1 capital. Effective April 1, 2011, the initial base assessment rates were as follows:

For small Risk Category I banks, such as Horizon, the rates range from 5-9 basis points.

The rates for small institutions in Risk Categories II, III and IV are 14, 23 and 35 basis points, respectively.

For large institutions and large, highly complex institutions, the rate schedule ranges from 5 to 35 basis points.

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Adjustments are made to the initial assessment rates based on long-term unsecured debt, depository institution debt, and brokered deposits. Horizon s FDIC deposit insurance expense decreased during 2012 compared to 2011 as the new assessment calculation resulted in lower expense for the Bank. In addition, the Bank used $3.7 million of the $6.0 million of the premiums prepaid on December 30, 2009 to offset the assessment paid. The FDIC is continuing to offset the regular insurance assessments until the earlier of the exhaustion of an institution s prepaid assessments or June 30, 2013. Any prepaid assessment remaining after collection of the amount due on June 30, 2013, will be returned to the institution.

The Dodd-Frank Act also extended unlimited insurance on noninterest bearing accounts for no additional charges through December 31, 2012. Under this program, traditional noninterest demand deposit (or checking) accounts that allowed for an unlimited number of transfers and withdrawals at any time, whether held for a business, individual, or other type of depositor, were covered. Later, Congress added Lawyers Trust Accounts (IOLTA) to this unlimited insurance protection through December 31, 2012. On December 31, 2012, as scheduled, the unlimited insurance coverage for noninterest-bearing transaction accounts provided under the Dodd-Frank Act expired. Deposits held in noninterest-bearing transaction account are now aggregated with any interest-bearing deposits the owner may hold in the same ownership category, and the combined total is insured up to at least $250,000.

The FDIC may terminate the deposit insurance of any insured depository institution if the FDIC determines, after a hearing, that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe and unsound condition to continue operations or has violated any applicable law, regulation, order or any condition imposed in writing by, or written agreement with, the FDIC. The FDIC may also suspend deposit insurance temporarily during the hearing process for a permanent termination of insurance if the institution has no tangible capital.

FDIC-insured institutions are also subject to the requirement to pay assessments to the FDIC to fund interest payments on bonds issued by the Financing Corporation ( FICO ), an agency of the Federal government established to recapitalize the predecessor to the Savings Association Insurance Fund ( SAIF ). These assessments will continue until the FICO bonds are repaid between 2017 and 2019. The FICO assessment rate was 0.66 basis points for each $100 of insured deposits for each quarter of 2012. For the first quarter of 2013, the FICO assessment rate is 0.64 basis points for each $100 in domestic deposits maintained at an institution.

**Transactions with Affiliates and Insiders**

Horizon and the Bank are subject to the Federal Reserve Act, which restricts financial transactions between banks, affiliated companies and their executive officers, including limits on credit transactions between these parties. The statute prescribes terms and conditions for bank affiliate transactions deemed to be consistent with safe and sound banking practices, and restricts the types of collateral security permitted in connection with a bank s extension of credit to an affiliate.

Effective July 21, 2011, among other changes, the Dodd-Frank Act eliminated the exceptions under Section 23A of the Federal Reserve Act for transactions with financial subsidiaries and expanded the scope of transactions treated as covered transactions to include derivatives transactions and securities repurchase agreements. The Dodd-Frank Act also expands the types of transactions subject to insider lending limits.

**Capital Regulation**

The federal bank regulatory authorities have adopted risk-based capital guidelines for banks and bank holding companies that are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies and account for off-balance sheet items. Risk-based capital ratios are determined by allocating assets and specified off-balance sheet commitments to four risk weighted categories of 0%, 20%, 50%, or 100%, with higher levels of capital being required for the categories perceived as representing greater risk.

The capital guidelines divide a bank holding company s or bank s capital into two tiers. The first tier ( Tier I ) includes common equity, certain non-cumulative perpetual preferred stock and minority interests in equity accounts of consolidated subsidiaries, less goodwill and certain other intangible assets (except mortgage servicing rights and purchased credit card relationships, subject to certain limitations). Supplementary capital ( Tier II ) includes, among other items, cumulative perpetual and long-term limited-life preferred stock, mandatory convertible securities, certain hybrid capital instruments, term subordinated debt and the allowance for loan and lease losses, subject to certain limitations, less required deductions.

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Banks and bank holding companies are required to maintain a total risk-based capital ratio of at least 8%, of which 4% must be Tier I capital. The federal banking regulators may, however, set higher capital requirements when a bank s particular circumstances warrant. Banks experiencing or anticipating significant growth are expected to maintain capital ratios, including tangible capital positions, well above the minimum levels.

Also required by the regulations is the maintenance of a leverage ratio designed to supplement the risk-based capital guidelines. This ratio is computed by dividing Tier I capital, net of all intangibles, by the quarterly average of total assets. The minimum leverage ratio is 3% for the most highly rated institutions, and 1% to 2% higher for institutions not meeting those standards. Pursuant to the regulations, banks must maintain capital levels commensurate with the level of risk, including the volume and severity of problem loans to which they are exposed.

In June 2012, the federal banking agencies issued notices of proposed rulemakings that revise each agency s risk-based and leverage capital requirements consistent with agreements reached by the Basel Committee on Banking Supervision ( Basel III ), including implementation of a new common equity tier 1 minimum capital requirement and a higher minimum tier 1 capital requirement. The agencies also proposed, consistent with Basel III, to apply limits on a banking organization s capital distributions and certain discretionary bonus payments if the banking organization does not hold a specified buffer of common equity tier 1 capital in addition to the minimum risk-based capital requirements. The proposed rulemaking also would revise the agencies prompt corrective action framework by incorporating the new regulatory capital minimums and updating the definition of tangible common equity. Such proposed capital requirements were originally proposed to be phased in beginning on January 1, 2013 for all depository institution holding companies; however, in late 2012, the agencies issued guidance indicating that they did not expect the regulatory capital rules to actually become effective on such date due to the volume of comments received and the wide range of views expressed during the comment period. Basel III specified that banks should be compliant with the new capital requirements by January 2, 2015, but on January 6, 2013, the restrictions were eased to provide for annual increases that would result in full compliance in 2019. Since final rules have not been issued by the Federal Reserve Board and the OCC, the Basel III framework does not yet apply to Horizon and the Bank and, therefore, it is difficult to predict the potential impact of the Basel III changes.

On November 10, 2010, Horizon repurchased from the U.S. Department of the Treasury (the Treasury ) 6,250 shares, or 25%, of the 25,000 outstanding shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the Series A Preferred Stock ), that Horizon had issued to the Treasury in December 2008 in connection with Horizon s participation in the Troubled Asset Relief Program Capital Purchase Program. On August 25, 2011, Horizon issued 12,500 shares of Senior Non-Cumulative Perpetual Preferred Stock, Series B (the Series B Preferred Stock ), for proceeds of $12.5 million and used those proceeds, together with otherwise available funds, to redeem the remaining 18,750 of the outstanding shares of Series A Preferred Stock held by the Treasury.

The following is a summary of Horizon s and the Bank s regulatory capital and capital requirements at December 31, 2012.

| | Actual | | For Capital[1] Adequacy Purposes | | For Well[1] Capitalized Purposes | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| **As of December 31, 2012** | | | | | | |
| Total capital[1] (to risk-weighted assets) | | | | | | |
| Consolidated | $ 178,638 | 13.72% | $ 104,162 | 8.00% | N/A | N/A |
| Bank | 161,557 | 12.42% | 104,062 | 8.00% | $ 130,078 | 10.00% |
| Tier 1 capital[1] (to risk-weighted assets) | | | | | | |
| Consolidated | 162,354 | 12.47% | 52,078 | 4.00% | N/A | N/A |
| Bank | 145,273 | 11.17% | 52,023 | 4.00% | 78,034 | 6.00% |
| Tier 1 capital[1] (to average assets) | | | | | | |
| Consolidated | 162,354 | 9.17% | 70,820 | 4.00% | N/A | N/A |
| Bank | 145,273 | 8.22% | 70,692 | 4.00% | 88,366 | 5.00% |

[1] As defined by regulatory agencies

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The Dodd-Frank Act also requires the Federal Reserve to set minimum capital levels for bank holding companies that are as stringent as those required for insured depository subsidiaries, except that bank holding companies with less than $500 million in assets are exempt from these capital requirements.

**Dividends**

Dividends received from the Bank are the primary source of Horizon s revenues. The Bank s payment of dividends, without prior regulatory approval, is subject to regulatory limitations. Under the National Bank Act, the Bank, as a national bank, is required to obtain the prior approval of the OCC for the payment of dividends if the total of all dividends declared by it in one year would exceed its net profits for the current year plus its retained net profits for the two preceding years, less any required transfers to surplus. In addition, the Bank may only pay dividends to the extent that its retained net profits (including the portion transferred to surplus) exceed the bank s undivided profits after deducting statutory bad debt in excess of the bank s allowance for loan losses. Under the Federal Deposit Insurance Act, the Bank is prohibited from paying any dividends, making other distributions or paying any management fees if, after such payment, it would fail to satisfy its minimum capital requirements.

During the period that the Series A Preferred Stock issued to the Treasury was outstanding, Horizon s ability to declare, pay or increase dividends on its shares of common stock was further restricted. These restrictions terminated on August 25, 2011, when Horizon completed the redemption of all of the outstanding shares of Series A Preferred Stock. However, the issuance to the Treasury of the Series B Preferred Stock resulted in the imposition of new limitations on Horizon s ability to pay dividends. Under the terms of the Series B Preferred Stock, no repurchases may be effected, and no dividends may be declared or paid on preferred shares ranking *pari passu* with the Series B Preferred Stock, junior preferred shares, or other junior securities, including the common stock, during the current quarter and for the next three quarters following the failure to declare and pay dividends on the Series B Preferred Stock, except that, in any such quarter in which the dividend is paid, dividend payments on shares ranking *pari passu* may be paid to the extent necessary to avoid any resulting material covenant breach. Horizon does not anticipate that these restrictions will affect its ability to pay the required dividends on the Series B Preferred Stock or its ability to continue to pay dividends on its common stock.

**Prompt Corrective Regulatory Action.**

Federal law provides the federal banking regulators with broad powers to require the bank to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators powers depends on whether the institution in question is well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized, as defined by regulation. Depending upon the capital category to which an institution is assigned, the regulators corrective powers include: (i) requiring the submission of a capital restoration plan; (ii) placing limits on asset growth and restrictions on activities; (iii) requiring the institution to issue additional capital stock (including additional voting stock) or to be acquired; (iv) restricting transactions with affiliates; (v) restricting the interest rate the institution may pay on deposits; (vi) ordering a new election of directors of the institution; (vii) requiring that senior executive officers or directors be dismissed; (viii) prohibiting the institution from accepting deposits from correspondent banks; (ix) requiring the institution to divest certain subsidiaries; (x) prohibiting the payment of principal or interest on subordinated debt; and (xi) ultimately, appointing a receiver for the institution. At December 31, 2012, the Bank was categorized as well capitalized, meaning that the Bank s total risk-based capital ratio exceeded 10%, the Bank s Tier I risk-based capital ratio exceeded 6%, the Bank s leverage ratio exceeded 5%, and the Bank was not subject to a regulatory order, agreement or directive to meet and maintain a specific capital level for any capital measure.

**Anti-Money Laundering and the USA Patriot Act**

Horizon is subject to the provisions of the USA PATRIOT Act of 2001, which contains anti-money laundering and financial transparency laws and requires financial institutions to implement additional policies and procedures with respect to, or additional measures designed to address, any or all of the following matters, among others: money laundering, suspicious activities and currency transaction reporting, and currency crimes.

**Sarbanes-Oxley Act of 2002**

Horizon also is subject to the Sarbanes-Oxley Act of 2002 (the Sarbanes-Oxley Act ), which revised the laws affecting corporate governance, accounting obligations and corporate reporting. The Sarbanes-Oxley Act applies to all companies with equity or debt securities registered under the Securities Exchange Act of 1934. In particular, the Sarbanes-Oxley Act established: (i) new requirements for audit committees, including independence, expertise and responsibilities; (ii) additional

responsibilities regarding financial statements for the Chief Executive Officer and Chief Financial Officer of the reporting company; (iii) new standards for auditors and regulation of audits; (iv) increased disclosure and reporting obligations for the reporting company and its directors and executive officers; and (v) new and increased civil and criminal penalties for violation of the securities laws. Management expects that significant additional efforts and expense will continue to be required to comply with the provisions of the Sarbanes-Oxley Act.

Pursuant to the final rules adopted by the Securities and Exchange Commission to implement Section 404 of the Sarbanes-Oxley Act of 2002, Horizon is required to include in each Form 10-K it files a report of management on Horizon s internal control over financial reporting. The internal control report must include a statement of management s responsibility for establishing and maintaining adequate control over financial reporting of Horizon, identify the framework used by management to evaluate the effectiveness of Horizon s internal control over financial reporting and provide management s assessment of the effectiveness of Horizon s internal control over financial reporting. This Annual Report on Form 10-K also includes an attestation report issued by Horizon s registered public accounting firm on Horizon s internal control over financial reporting. For fiscal years prior to the year ended December 31, 2012, Horizon was not an accelerated filer and, therefore, Horizon was exempt from the attestation report requirements. Significant efforts have been required to comply with Section 404, and Horizon anticipates additional efforts will be required in future years.

**Recent Legislative Developments**

On July 21, 2010, President Obama signed into law the Dodd-Frank Act, which significantly changes the regulation of financial institutions and the financial services industry. The Dodd-Frank Act includes provisions affecting large and small financial institutions alike, including several provisions that profoundly affect how community banks, thrifts, and small bank and thrift holding companies are regulated in the future. Among other things, these provisions have resulted in the abolishment of the Office of Thrift Supervision and the transfer on its functions to the other federal banking agencies, relaxed rules regarding interstate branching, allowed financial institutions to pay interest on business checking accounts, changed the scope of federal deposit insurance coverage and imposed new capital requirements on bank and thrift holding companies.

The Dodd-Frank Act also established the Bureau of Consumer Financial Protection ( CFPB ) as an independent entity within the Federal Reserve, which has the authority to promulgate consumer protection regulations applicable to all entities offering consumer financial services or products, including banks. Effective July 21, 2011, the CFPB assumed primary responsibility for administering substantially all of the consumer compliance regulations formerly administered by other federal agencies. The CFPB also has the authority to promulgate consumer protection regulations that will apply to all entities, including banks, that offer consumer financial services or products. Additionally, the Dodd-Frank Act includes a series of provisions covering mortgage loan origination standards affecting, among other things, originator compensation, minimum repayment standards and pre-payments. The Dodd-Frank Act contains numerous other provisions affecting financial institutions of all types, many of which may have an impact on the operating environment of Horizon in substantial and unpredictable ways.

The ultimate effect of the Dodd-Frank Act on the financial services industry in general, and Horizon in particular, remains uncertain. Many aspects of the Dodd-Frank Act are subject to future rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on Horizon and the financial services industry more generally. Horizon s management continues to review rules and regulations adopted pursuant to the Dodd-Frank Act and assess their probable impact on the business, financial condition and results of operations of Horizon.

**Other Regulation**

In addition to the matters discussed above, the Bank is subject to additional regulation of its activities, including a variety of consumer protection regulations affecting its lending, deposit, and collection activities and regulations affecting secondary mortgage market activities.

**Effect of Governmental Monetary Policies**

The Bank s earnings are affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The Federal Reserve s monetary policies have had, and are likely to continue to have, an important impact on the operating results of commercial banks through its power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The monetary policies of the Federal Reserve have major effects upon the levels of bank loans, investments and deposits through its

open market operations in United States government securities and through its regulation of the discount rate on borrowings of member banks and the reserve requirements against member bank deposits. It is not possible to predict the nature or impact of future changes in monetary and fiscal policies.

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(Table dollars in thousands except per share data)

**Federal Home Loan Bank System**

The Bank is a member of the FHLB of Indianapolis, which is one of twelve regional FHLBs. Each FHLB serves as a reserve or central bank for its members within its assigned region. The FHLB is funded primarily from funds deposited by banks and savings associations and proceeds derived from the sale of consolidated obligations of the FHLB system. It makes loans to members (i.e., advances) in accordance with policies and procedures established by the Board of Directors of the FHLB. All FHLB advances must be fully secured by sufficient collateral as determined by the FHLB. The Federal Housing Finance Board ( FHFB ), an independent agency, controls the FHLB System, including the FHLB of Indianapolis.

As a member of the FHLB, the Bank is required to purchase and maintain stock in the FHLB of Indianapolis in an amount equal to at least 1% of its aggregate unpaid residential mortgage loans, home purchase contracts, or similar obligations at the beginning of each year. At December 31, 2012, the Bank s investment in stock of the FHLB of Indianapolis was $11.0 million. The FHLB imposes various limitations on advances such as limiting the amount of certain types of real estate related collateral to 30% of a member s capital and limiting total advances to a member. Interest rates charged for advances vary depending upon maturity, the cost of funds to the FHLB of Indianapolis and the purpose of the borrowing.

The FHLBs are required to provide funds for the resolution of troubled savings associations and to contribute to affordable housing programs through direct loans or interest subsidies on advances targeted for community investment and low and moderate income housing projects. For the year ended December 31, 2012, dividends paid by the FHLB of Indianapolis to the Bank totaled approximately $331,000, for an annualized rate of 3.14%.

**Limitations on Rates Paid for Deposits**

FDIC regulations place limitations on the interest rates that less than well-capitalized insured depository institutions may pay on deposits. Under these regulations, well capitalized depository institutions may accept, renew or roll such deposits over without restriction, adequately capitalized depository institutions may accept, renew or roll such deposits over with a waiver from the FDIC (subject to certain restrictions on payments of rates) and undercapitalized depository institutions may not accept, renew or roll such deposits over. The regulations contemplate that the definitions of well capitalized, adequately capitalized and undercapitalized will be the same as the definition adopted by the agencies to implement the corrective action provisions of federal law. Management does not believe that these regulations will have a materially adverse effect on the Bank s current operations.

**Legislative Initiatives**

Additional legislative and administrative actions affecting the banking industry may be considered by the United States Congress, state legislatures and various regulatory agencies, including those referred to above. It cannot be predicted with certainty whether such legislative or administrative action will be enacted or the extent to which the banking industry in general or Horizon and its affiliates will be affected.

**BANK HOLDING COMPANY STATISTICAL DISCLOSURES**

**I. DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS EQUITY; INTEREST RATES AND INTEREST DIFFERENTIAL**

Information required by this section of Securities Act Industry Guide 3 is presented in Management s Discussion and Analysis as set forth in Item 7 below, herein incorporated by reference.

**II. INVESTMENT PORTFOLIO**

A. The following is a schedule of the amortized cost and fair value of investment securities available for sale and held to maturity.

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(Table dollars in thousands except per share data)

| | December 31, 2012 | | December 31, 2011 | | December 31, 2010 | |
|---|---|---|---|---|---|---|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| **Available for sale** | | | | | | |
| U.S. Treasury and federal agencies | $ 51,458 | $ 51,779 | $ 12,693 | $ 13,022 | $ 24,727 | $ 25,251 |
| State and municipal | 162,147 | 172,905 | 135,011 | 143,890 | 132,380 | 131,489 |
| Federal agency collateralized mtg. obligations | 95,337 | 96,831 | 89,016 | 91,122 | 100,106 | 101,837 |
| Federal agency mortgage-backed pools | 152,372 | 159,204 | 173,797 | 179,351 | 114,390 | 117,895 |
| Private labeled mortgage-backed pools | 1,960 | 2,031 | 3,518 | 3,636 | 5,197 | 5,323 |
| Corporate notes | 32 | 51 | 32 | 24 | 555 | 549 |
| **Total available for sale** | 463,306 | 482,801 | 414,067 | 431,045 | 377,355 | 382,344 |
| Total held to maturity, state and municipal | | | 7,100 | 7,134 | 9,595 | 9,595 |
| **Total investment securities** | $ 463,306 | $ 482,801 | $ 421,167 | $ 438,179 | $ 386,950 | $ 391,939 |

B. The following is a schedule of maturities of each category of available for sale and held to maturity debt securities and the related weighted-average yield of such securities as of December 31, 2012:

| | One Year or Less | | After One Year Through Five Years | | After Five Years Through Ten Years | | After Ten Years | |
|---|---|---|---|---|---|---|---|---|
| | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield |
| **Available for sale** | | | | | | | | |
| U.S. Treasury and federal agencies[1] | $ 2,552 | 4.13% | $ 23,213 | 1.41% | $ 26,014 | 1.67% | $ | 0.00% |
| State and municipal | 1,816 | 2.87% | 27,461 | 3.69% | 78,244 | 3.63% | 65,385 | 3.72% |
| Federal agency collateralized mtg. obligations[2] | | 0.00% | | 0.00% | 9,470 | 3.53% | 87,361 | 2.97% |
| Federal agency mortgage-backed pools[2] | 108 | 3.92% | 362 | 4.61% | 38,732 | 3.51% | 120,001 | 3.43% |
| Private labeled mortgage-backed pools[2] | | 0.00% | | 0.00% | 2,031 | 5.01% | | 0.00% |
| Corporate notes | | 0.00% | | 0.00% | | 0.00% | 51 | 0.00% |
| **Total available for sale** | $ 4,476 | 3.61% | $ 51,036 | 2.66% | $ 154,491 | 3.22% | $ 272,798 | 3.35% |
| Total held to maturity, state and municipal | $ | 0.00% | $ | 0.00% | $ | 0.00% | $ | 0.00% |
| **Total investment securities** | $ 4,476 | 3.61% | $ 51,036 | 2.66% | $ 154,491 | 3.22% | $ 272,798 | 3.35% |

(1) Fair value is based on contractual maturity or call date where a call option exists

(2) Maturity based upon final maturity date

The weighted-average interest rates are based on coupon rates for securities purchased at par value and on effective interest rates considering amortization or accretion if the securities were purchased at a premium or discount. Yields are not presented on a tax-equivalent basis.

Excluding those holdings of the investment portfolio in Treasury securities and other agencies and corporations of the U.S. Government, there were no investments in securities of any one issuer that exceeded 10% of the consolidated stockholders equity of Horizon at December 31, 2012.

**III. LOAN PORTFOLIO**

A. **Types of Loans** Total loans on the balance sheet are comprised of the following classifications for the years indicated.

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**HORIZON BANCORP**

(Table dollars in thousands except per share data)

| | December 31 2012 | December 31 2011 | December 31 2010 | December 31 2009 | December 31 2008 |
|---|---|---|---|---|---|
| Commercial | $ 460,471 | $ 352,376 | $ 330,018 | $ 314,517 | $ 310,842 |
| Real estate | 189,714 | 157,141 | 162,435 | 133,892 | 167,766 |
| Mortgage warehouse | 251,448 | 208,299 | 123,743 | 166,698 | 123,287 |
| Consumer | 289,084 | 265,377 | 266,681 | 271,210 | 280,072 |
| | 1,190,717 | 983,193 | 882,877 | 886,317 | 881,967 |
| Allowance for loan losses | (18,270) | (18,882) | (19,064) | (16,015) | (11,410) |
| Total loans | $ 1,172,447 | $ 964,311 | $ 863,813 | $ 870,302 | $ 870,557 |

B. **Maturities and Sensitivities of Loans to Changes in Interest Rates** The following is a schedule of maturities and sensitivities of loans to changes in interest rates, excluding real estate mortgage, mortgage warehousing and installment loans, as of December 31, 2012:

| | One Year or Less | One Through Five Years | After Five Years | Total |
|---|---|---|---|---|
| Maturing or repricing | | | | |
| Commercial, financial, agricultural and commercial tax-exempt loans | $ 339,775 | $ 97,946 | $ 22,750 | $ 460,471 |

The following is a schedule of fixed-rate and variable-rate commercial, financial, agricultural and commercial tax-exempt loans due after one year. (Variable-rate loans are those loans with floating or adjustable interest rates.)

| | Fixed Rate | Variable Rate |
|---|---|---|
| Total commercial, financial, agricultural and commercial tax-exempt loans due after one year | $ 117,974 | $ 2,722 |

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(Table dollars in thousands except per share data)

C. **Risk Elements**

**Non-accrual, Past Due and Restructured Loans** The following schedule summarizes non-accrual, past due and restructured loans.

| | December 31 2012 | December 31 2011 | December 31 2010 | December 31 2009 | December 31 2008 |
|---|---|---|---|---|---|
| **Non-performing loans** | | | | | |
| Commercial | | | | | |
| More than 90 days past due | $ | $ | $ | $ 1,086 | $ 49 |
| Non-accrual | 5,754 | 6,905 | 7,508 | 8,143 | 5,118 |
| Trouble debt restructuring accruing | 1,265 | | 574 | | |
| Trouble debt restructuring non-accrual | 3,674 | 1,053 | | | |
| Real estate | | | | | |
| More than 90 days past due | 2 | | 222 | 296 | 464 |
| Non-accrual | 4,565 | 4,694 | 5,483 | 1,257 | 1,440 |
| Trouble debt restructuring accruing | 1,761 | 2,682 | 3,380 | 3,266 | |
| Trouble debt restructuring non-accrual | 2,827 | 1,120 | 241 | | |
| Mortgage warehouse | | | | | |
| More than 90 days past due | | | | | |
| Non-accrual | | | | | |
| Trouble debt restructuring accruing | | | | | |
| Trouble debt restructuring non-accrual | | | | | |
| Consumer | | | | | |
| More than 90 days past due | 52 | 37 | 136 | 376 | 318 |
| Non-accrual | 3,055 | 2,769 | 3,682 | 2,515 | 474 |
| Trouble debt restructuring accruing | 676 | 858 | 165 | 206 | |
| Trouble debt restructuring non-accrual | 148 | 25 | 37 | | |
| **Total non-performing loans** | 23,779 | 20,143 | 21,428 | 17,145 | 7,863 |
| **Other real estate owned and repossessed collateral** | | | | | |
| Commercial | 1,337 | 1,092 | 1,622 | 544 | |
| Real estate | 1,228 | 1,708 | 1,042 | 1,186 | 2,772 |
| Mortgage warehouse | | | | | |
| Consumer | 11 | 49 | | 23 | 207 |
| **Total other real estate owned and repossessed collateral** | 2,576 | 2,849 | 2,664 | 1,753 | 2,979 |
| **Total non-performing assets** | $ 26,355 | $ 22,992 | $ 24,092 | $ 18,898 | $ 10,842 |

| | |
|---|---|
| Gross interest income that would have been recorded on non-accrual loans outstanding as of December 31, 2012, in the period if the loans had been current, in accordance with their original terms and had been outstanding throughout the period or since origination if held for part of the period. | $ 1,828 |
| Interest income actually recorded on non-accrual loans outstanding as of December 31, 2012, and included in net income for the period. | 840 |

| | |
|---|---|
| Interest income not recognized during the period on non-accrual loans outstanding as of December 31, 2012. | $ 988 |

**Discussion of Non-Accrual Policy**

1. From time to time, the Bank obtains information, which may lead management to believe that the collection of payments may be doubtful on a particular loan. In recognition of such, it is management s policy to convert the loan from an earning asset to a non-accruing loan. Further, it is management s policy to place a commercial loan on a non-accrual status when delinquent in excess of 90 days or have had the accrual of interest discontinued by management. The officer responsible for the loan, the Chief Operating Officer and the senior collection officer must review all loans placed on non-accrual status.

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(Table dollars in thousands except per share data)

2. Potential Problem Loans:

Impaired and non-accrual loans for which the discounted cash flows or collateral value exceeded the carrying value of the loan totaled $23.8 million and $20.1 million at December 31, 2012 and 2011. The allowance for impaired and non-accrual loans, included in the Bank s allowance for loan losses totaled $5.5 million and $4.6 million at those respective dates. The average balance of impaired loans during 2012 and 2011 was $6.1 million and $4.8 million.

3. Foreign Outstandings:

None

4. Loan Concentrations:

As of December 31, 2012, there are no significant concentrations of loans exceeding 10% of total loans. See Item III A above for a listing of the types of loans by concentration.

D. **Other Interest-Bearing Assets**

There are no other interest-bearing assets as of December 31, 2012, which would be required to be disclosed under Item III C.1 or 2 if such assets were loans.

**IV. SUMMARY OF LOAN LOSS EXPERIENCE**

A. The following is an analysis of the activity in the allowance for loan losses account:

| | December 31 2012 | December 31 2011 | December 31 2010 | December 31 2009 | December 31 2008 |
|---|---|---|---|---|---|
| Loans outstanding at the end of the period [(1)] | $ 1,190,717 | $ 983,193 | $ 882,877 | $ 886,317 | $ 886,317 |
| Average loans outstanding during the period [(1)] | 1,043,620 | 862,498 | 878,181 | 892,431 | 848,279 |

(1) Net of unearned income and deferred loan fees

| | December 31 2012 | December 31 2011 | December 31 2010 | December 31 2009 | December 31 2008 |
|---|---|---|---|---|---|
| Balance at beginning of the period | $ 18,882 | $ 19,064 | $ 16,015 | $ 11,410 | $ 9,791 |
| Loans charged-off: | | | | | |
| Commercial | 2,388 | 967 | 3,856 | 2,461 | 1,358 |
| Real estate | 597 | 956 | 811 | 432 | 351 |
| Consumer | 2,958 | 4,757 | 5,067 | 7,354 | 5,277 |

| | | | | | |
|---|---|---|---|---|---|
| Total loans charged-off | 5,943 | 6,680 | 9,734 | 10,247 | 6,986 |
| Recoveries of loans previously charged-off: | | | | | |
| Commercial | 782 | 163 | 233 | 66 | 15 |
| Real estate | 77 | 10 | 1 | | 50 |
| Consumer | 948 | 1,043 | 995 | 1,183 | 972 |
| Total loan recoveries | 1,807 | 1,216 | 1,229 | 1,249 | 1,037 |
| Net loans charged-off | 4,136 | 5,464 | 8,505 | 8,998 | 5,949 |
| Provision charged to operating expense | 3,524 | 5,282 | 11,554 | 13,603 | 7,568 |
| Balance at the end of the period | $ 18,270 | $ 18,882 | $ 19,064 | $ 16,015 | $ 11,410 |
| Percent of net charge-offs to average loans outstanding for the period | 0.40% | 0.63% | 0.97% | 1.01% | 0.70% |

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(Table dollars in thousands except per share data)

**B.** The following schedule is a breakdown of the allowance for loan losses allocated by type of loan and the percentage of loans in each category to total loans.

| | December 31 2012 | | December 31 2011 | | December 31 2010 | | December 31 2009 | | December 31 2008 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Allowance Amount | % of Loans to Total Loans | Allowance Amount | % of Loans to Total Loans | Allowance Amount | % of Loans to Total Loans | Allowance Amount | % of Loans to Total Loans | Allowance Amount | % of Loans to Total Loans |
| Commercial, financial and agricultural | $ 7,771 | 39% | $ 8,017 | 36% | $ 7,554 | 38% | $ 5,766 | 35% | $ 3,202 | 35% |
| Real estate | 3,204 | 16% | 2,472 | 16% | 2,379 | 18% | 1,933 | 15% | 973 | 19% |
| Mortgage warehousing | 1,705 | 21% | 1,695 | 21% | 1,435 | 14% | 1,455 | 19% | 1,354 | 14% |
| Consumer | 5,590 | 24% | 6,698 | 27% | 7,696 | 30% | 6,861 | 31% | 5,881 | 32% |
| Unallocated | | | | | | | | | | |
| Total | $ 18,270 | 100% | $ 18,882 | 100% | $ 19,064 | 100% | $ 16,015 | 100% | $ 11,410 | 100% |

In 1999, Horizon began a mortgage warehousing program. This program is described in Management s Discussion and Analysis of Financial Condition and Results of Operation in Item 7 below and in the Notes to the Financial Statements in Item 8 below, which are incorporated herein by reference. The greatest risk related to these loans is transaction and fraud risk. During 2012, Horizon processed approximately $3.9 billion in mortgage warehouse loans.

**V. DEPOSITS**

Information required by this section is found in Management s Discussion and Analysis of Financial Condition and Results of Operation in Item 7 below and in the Consolidated Financial Statements and related notes in Item 8 below, which are incorporated herein by reference.

**VI. RETURN ON EQUITY AND ASSETS**

Information required by this section is found in Management s Discussion and Analysis of Financial Condition and Results of Operation in Item 7 below and in the Consolidated Financial Statements and related notes in Item 8 below, which are incorporated herein by reference.

**VII. SHORT TERM BORROWINGS**

The following is a schedule of statistical information relative to securities sold under agreements to repurchase which are secured by Treasury and U.S. Government agency securities and mature within one year. There were no other categories of short-term borrowings for which the average balance outstanding during the period was 30 percent or more of stockholders equity at the end of the period.

| | December 31 2012 | December 31 2011 |
|---|---|---|
| Outstanding at year end | $ 43,448 | $ 43,849 |
| Approximate weighted-average interest rate at year-end | 0.14% | 0.14% |
| Highest amount outstanding as of any month-end during the year | $ 43,448 | $ 43,849 |
| Approximate average outstanding during the year | $ 40,210 | $ 40,291 |
| Approximate weighted-average interest during the year | 0.14% | 0.16% |

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## ITEM 1A. RISK FACTORS

An investment in Horizon s securities is subject to risks inherent to our business. The material risks and uncertainties that management believes currently affect Horizon are described below. Before making an investment decision, you should carefully consider these risks as well as information we include or incorporate by reference in this report and other filings we make with the SEC. The risks and uncertainties we have described are not the only ones facing our company. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may affect our business operations.

If any of these risks or uncertainties materializes or any of these assumptions proves incorrect, our results could differ materially from the forward-looking statements. All forward-looking statements in this report are current only as of the date on which the statements were made. We do not undertake any obligation to publicly update any forward-looking statement to reflect events or circumstances after the date on which any statement is made or to reflect the occurrence of unanticipated events.

**Risks Related to Our Business**

As a financial institution, we are subject to a number of risks relating to our daily business. Although we undertake a variety of efforts to manage and control those risks, many of the risks are outside of our control. Among the risks we face are the following:

- **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;

- **Operational risk**: the risk of loss resulting from fraud, inadequate or failed internal processes, people and systems, or external events;

- **Economic risk**: the risk that the economy in our markets could decline further resulting in increased unemployment, decreased real estate values and increased loan charge-offs; and

- **Compliance risk**: the risk of additional action by our regulators or additional regulation could hinder our ability to do business profitably.

***The current economic environment poses significant challenges for us and could adversely affect our financial condition and results of operations.***

We are operating in a challenging and uncertain economic environment, including generally uncertain world, national and local conditions in our markets. The capital and credit markets have been experiencing volatility and disruption since 2008. This presents financial institutions with unprecedented circumstances and challenges that in some cases have resulted in large declines in the fair values of investments and other assets, constraints on liquidity and significant credit quality problems, including severe volatility in the valuation of real estate and other collateral supporting loans. Our financial statements have been prepared using values and information currently available to us, but given this volatility, the values of assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments in asset

values and the allowance for loan losses, which could negatively impact our ability to meet regulatory capital requirements and maintain sufficient liquidity. The risks associated with our business become more acute in periods of a slowing economy or slow growth such as we began experiencing in the latter half of 2008 and which continued through 2011. Financial institutions continue to be affected by sharp declines in the real estate market and constrained financial markets. While we continue to take steps to decrease and limit our exposure to residential construction and land development loans and home equity loans, we nonetheless retain direct exposure to the residential and commercial real estate markets, and we are affected by these events.

Continued declines in real estate values, home sales volumes and financial stress on borrowers as a result of the uncertain economic environment, including job loss, could have an adverse effect on our borrowers or their customers, which could adversely affect our financial condition and results of operations. In addition, the national economic recession or further deterioration in local economic conditions in our markets could drive losses beyond that which is provided for in our allowance for loan losses and result in the following other consequences: increases in loan delinquencies, problem assets

and foreclosures; demand for our products and services may decline; deposits may decrease, which would adversely impact our liquidity position; and collateral for our loans, especially real estate, may decline in value, in turn reducing customers borrowing power, and reducing the value of assets and collateral associated with our existing loans.

***Our financial performance may be adversely impacted if we are unable to continue to grow our commercial and consumer loan portfolios, obtain low-cost funds and compete with other providers of financial services.***

Our ability to maintain our history of record earnings year after year will depend, in large part, on our ability to continue to grow our loan portfolios and obtain low-cost funds. For the past seven years, we focused on increasing consumer loans, and we intend to continue to emphasize and grow consumer, as well as commercial loans in the foreseeable future. This represented a shift in our emphasis from prior years when we focused on mortgage banking services, which generated a large portion of our income during those years.

We have also funded our growth with low-cost consumer deposits, and our ability to sustain our growth will depend in part on our continued success in attracting and retaining such deposits or finding other sources of low-cost funds.

Another factor in maintaining our history of record earnings will be our ability to expand our scope of available financial services to our customers in an increasingly competitive environment. In addition to other banks, our competitors include credit unions, securities brokers and dealers, mortgage brokers, mortgage bankers, investment advisors, and finance and insurance companies. Competition is intense in most of our markets. We compete on price and service with our competitors. Competition could intensify in the future as a result of industry consolidation, the increasing availability of products and services from non-banks, greater technological developments in the industry, and banking reform.

***The recent repeal of federal prohibitions on payment of interest on demand deposits could increase our interest expense.***

All federal prohibitions on the ability of financial institutions to pay interest on demand deposit accounts were repealed as part of the Dodd-Frank Act. As a result, since July 21, 2011, financial institutions can offer interest on demand deposits to compete for customers. We are offering interest on demand deposits, but we do not expect this change to have a material adverse effect on our financial condition and results of operations.

***Our commercial and consumer loans expose us to increased credit risks.***

We have a large percentage of commercial and consumer loans. Commercial loans generally have greater credit risk than residential mortgage loans because repayment of these loans often depends on the successful business operations of the borrowers. These loans also typically have much larger loan balances than residential mortgage loans. Consumer loans generally involve greater risk than residential mortgage loans because they are unsecured or secured by assets that depreciate in value. Although we undertake a variety of underwriting, monitoring and reserving protections with respect to these types of loans, there can be no guarantee that we will not suffer unexpected losses, and recently, we have experienced an increase in the default rates in our consumer loan portfolio, particularly relating to indirect auto loans.

***Our holdings of construction, land and home equity loans may pose more credit risk than other types of mortgage loans.***

In light of current economic conditions, construction loans, loans secured by commercial real estate and home equity loans are considered more risky than other types of mortgage loans. Due to the disruptions in credit and housing markets, real estate values have decreased in most areas of the U.S., and many of the developers to whom we lend experienced a decline in sales of new homes from their projects. As a result of this market disruption, some of our land and construction loans have become non-performing as developers are unable to build and sell homes in volumes large enough for orderly repayment of loans and as other owners of such real estate (including homeowners) were unable to keep up with their payments. We believe we have established adequate reserves on our financial statements to cover the credit risk of these loan portfolios. However, there can be no assurance that losses will not exceed our reserves, and ultimately result in a material level of charge-offs, which could adversely impact our results of operations, liquidity and capital.

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(Table dollars in thousands except per share data)

***The allowance for loan losses may prove inadequate or be negatively affected by credit risk exposures.***

Our business depends on the creditworthiness of our customers. We periodically review the allowance for loan and lease losses for adequacy considering economic conditions and trends, collateral values, and credit quality indicators, including past charge-off experience and levels of past due loans and non-performing assets. There is no certainty that the allowance for loan losses will be adequate over time to cover credit losses in the portfolio because of unanticipated adverse changes in the economy, market conditions or events adversely affecting specific customers, industries or markets. If the credit quality of the customer base materially decreases, if the risk profile of a market, industry or group of customers changes materially, or if the allowance for loan losses is not adequate, our business, financial condition, liquidity, capital, and results of operations could be materially adversely affected.

***Changes in market interest rates could adversely affect our financial condition and results of operations.***

Our financial condition and results of operations are significantly affected by changes in market interest rates. Our results of operations depend substantially on our net interest income, which is the difference between the interest income that we earn on our interest-earning assets and the interest expense that we pay on our interest-bearing liabilities. Our profitability depends on our ability to manage our assets and liabilities during periods of changing market interest rates. If rates increase rapidly as a result of an improving economy, we may have to increase the rates paid on our deposits and borrowed funds more quickly than loans and investments re-price, resulting in a negative impact on interest spreads and net interest income. The impact of rising rates could be compounded if deposit customers move funds from savings accounts to higher rate certificate of deposit accounts. Conversely, should market interest rates fall below current levels, our net interest margin could also be negatively affected, as competitive pressures could keep us from further reducing rates on our deposits, and prepayments and curtailments on assets may continue. Such movements may cause a decrease in our interest rate spread and net interest margin, and therefore, decrease our profitability.

Changes in interest rates also could affect loan volume. For instance, an increase in interest rates could cause a decrease in the demand for mortgage loans (and other loans), which could result in a significant decline in our revenue stream.

We also are subject to reinvestment risk associated with changes in interest rates. Changes in interest rates may affect the average life of loans and mortgage-related securities. Increases in interest rates may decrease loan demand and/or may make it more difficult for borrowers to repay adjustable rate loans. Decreases in interest rates often result in increased prepayments of loans and mortgage-related securities, as borrowers refinance their loans to reduce borrowing costs. Under these circumstances, we are subject to reinvestment risk to the extent that we are unable to reinvest the cash received from such prepayments in loans or other investments that have interest rates that are comparable to the interest rates on existing loans and securities.

***A continued economic slowdown in Northwestern Indiana and Southwestern Michigan could affect our business.***

Our primary market area for deposits and loans consists of LaPorte and Porter Counties in Northwestern Indiana and Berrien County in Southwestern Michigan. During 2012, unemployment rates remained at elevated levels in our primary market area, resulting in continued high levels of consumer delinquencies and bankruptcy filings. The continued economic slowdown could hurt our business. The possible consequences of such a continued downturn could include the following:

- increases in loan delinquencies and foreclosures;
- declines in the value of real estate and other collateral for loans;
- an increase in loans charged off;

an increase in the Company s expense to fund loan loss reserves;

an increase in collection costs;

a decline in the demand for our products and services;

an increase in non-accrual loans and other real estate owned.

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(Table dollars in thousands except per share data)

***The loss of key members of our senior management team could affect our ability to operate effectively.***

We depend heavily on the services of our existing senior management team, particularly our CEO Craig M. Dwight, to carry out our business and investment strategies. As we continue to grow and expand our business and our locations, products and services, we will increasingly need to rely on Mr. Dwight s experience, judgment and expertise as well as that of the other members of our senior management team and will also need to continue to attract and retain qualified banking personnel at all levels. Competition for such personnel is intense in our geographic market areas. If we are unable to attract and retain talented people, our business could suffer. The loss of the services of any senior management personnel, particularly Mr. Dwight, or the inability to recruit and retain qualified personnel in the future, could have a material adverse effect on our consolidated results of operations, financial condition and prospects.

***We may need to raise additional capital in the future, and such capital may not be available when needed or at all.***

We may need to raise additional capital in the future to fund acquisitions and to provide us with sufficient capital resources and liquidity to meet our commitments, regulatory capital requirements and business needs, particularly if our asset quality or earnings were to deteriorate significantly. Although we are currently, and have historically been, well capitalized for regulatory purposes, our capital levels are not far in excess of the well capitalized threshold, and in the past we have been required to maintain increased levels of capital in connection with certain acquisitions. Additionally, we periodically explore acquisition opportunities with other financial institutions, some of which are in distressed financial condition. Any future acquisition, particularly the acquisition of a significantly troubled institution or an institution of comparable size to us, may require us to raise additional capital in order to obtain regulatory approval and/or to remain well capitalized.

Our ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time, which are outside of our control, and our financial performance. Economic conditions and the loss of confidence in financial institutions may increase our cost of funding and limit access to certain customary sources of capital, including inter-bank borrowings, repurchase agreements and borrowings from the discount window of the Federal Reserve.

We cannot guaranty that such capital will be available on acceptable terms or at all. Any occurrence that may limit our access to the capital markets, such as a decline in the confidence of debt purchasers, our depositors or counterparties participating in the capital markets may adversely affect our capital costs and our ability to raise capital and, in turn, our liquidity. Moreover, if we need to raise capital in the future, we may have to do so when many other financial institutions are also seeking to raise capital and would have to compete with those institutions for investors. An inability to raise additional capital on acceptable terms when needed could have a materially adverse effect on our businesses, financial condition and results of operations and may restrict our ability to grow.

***Potential acquisitions may disrupt our business and dilute stockholder value.***

We periodically evaluate merger and acquisition opportunities and conduct due diligence activities related to possible transactions with other financial institutions and financial services companies. We generally seek merger or acquisition partners that are culturally similar and possess either significant market presence or have potential for improved profitability through financial management, economies of scale or expanded services. Acquiring other banks, businesses, or branches involves various risks commonly associated with acquisitions, including, among other things:

- Potential exposure to unknown or contingent liabilities of the target company,
- Exposure to potential asset quality issues of the target company,
- Potential disruption to our business,

Potential diversion of our management s time and attention away from day-to-day operations,

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(Table dollars in thousands except per share data)

The possible loss of key employees, business and customers of the target company,

Difficulty in estimating the value of the target company, and

Potential problems in integrating the target company s systems, customers and employees with ours.

As a result, merger or acquisition discussions and, in some cases, negotiations may take place and future mergers or acquisitions involving the payment of cash or the issuance of our debt or equity securities may occur at any time. Acquisitions typically involve the payment of a premium over book and market values, and, therefore, some dilution of our tangible book value and net income per common share may occur in connection with any future transaction. To the extent we were to issue additional common shares in any such transaction, our current shareholders would be diluted and such an issuance may have the effect of decreasing our stock price, perhaps significantly. Furthermore, failure to realize the expected revenue increases, cost savings, increases in geographic or product presence, and/or other projected benefits from an acquisition could have a material adverse effect on our financial condition and results of operations.

***The preparation of our financial statements requires the use of estimates that may vary from actual results.***

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make significant estimates that affect the financial statements. One of our most critical estimates is the level of the allowance for loan losses. Due to the inherent nature of these estimates, we cannot provide absolute assurance that we will not have to increase the allowance for loan losses and/or sustain loan losses that are significantly higher than the provided allowance.

***Our mortgage warehouse and indirect lending operations are subject to a higher fraud risk than our other lending operations.***

We buy loans originated by mortgage bankers and automobile dealers. Because we must rely on the mortgage bankers and automobile dealers in making and documenting these loans, there is an increased risk of fraud to us on the part of the third-party originators and the underlying borrowers. In order to guard against this increased risk, we perform investigations on the mortgage companies with whom we do business, and we review the loan files and loan documents we purchase to attempt to detect any irregularities or legal noncompliance. However, there is no guarantee that our procedures will detect all cases of fraud or legal noncompliance.

***Our mortgage lending profitability could be significantly reduced if we are not able to resell mortgages or experience other problems with the secondary market process or are unable to retain our mortgage loan sales force due to regulatory changes.***

Currently, we sell a substantial portion of the mortgage loans we originate. The profitability of our mortgage banking operations depends in large part upon our ability to aggregate a high volume of loans and to sell them in the secondary market at a gain. Thus, we are dependent upon the existence of an active secondary market and our ability to profitably sell loans into that market.

Our ability to sell mortgage loans readily is dependent upon the availability of an active secondary market for single-family mortgage loans, which in turn depends in part upon the continuation of programs currently offered by Fannie Mae, Freddie Mac and Ginnie Mae (the Agencies ) and other institutional and non-institutional investors. These entities account for a substantial portion of the secondary market in residential mortgage loans. Some of the largest participants in the secondary market, including the Agencies, are government-sponsored enterprises whose activities are governed by federal law. Any future changes in laws that significantly affect the activity of such government-sponsored enterprises could, in turn, adversely affect our operations.

In September 2008, Fannie Mae and Freddie Mac were placed into conservatorship by the U.S. government. Although to date, the conservatorship has not had a significant or adverse effect on our operations, and during 2010 and 2011 the Federal Housing Administration Agency indicated that the Treasury Department is committed to fund Fannie Mae and Freddie Mac to levels needed in order to sufficiently meet their funding needs; it is currently unclear whether further

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changes would significantly and adversely affect our operations. In addition, our ability to sell mortgage loans readily is dependent upon our ability to remain eligible for the programs offered by the Agencies and other institutional and non-institutional investors. Our ability to remain eligible may also depend on having an acceptable peer-relative delinquency ratio for Federal Housing Authority ( FHA ) and maintaining a delinquency rate with respect to Ginnie Mae pools that are below Ginnie Mae guidelines. In the case of Ginnie Mae pools, we have repurchased delinquent loans from them in the past to maintain compliance with the minimum required delinquency ratios. Although these loans are typically insured as to principal by the FHA, such repurchases increase our capital and liquidity needs, and there can be no assurance that we will have sufficient capital or liquidity to continue to purchase such loans out of the Ginnie Mae pools if required to do so.

Any significant impairment of our eligibility with any of the Agencies could materially and adversely affect our operations. Further, the criteria for loans to be accepted under such programs may be changed from time-to-time by the sponsoring entity which could result in a lower volume of corresponding loan originations. The profitability of participating in specific programs may vary depending on a number of factors, including our administrative costs of originating and purchasing qualifying loans and our costs of meeting such criteria.

The banking industry s methodology for paying its mortgage loan sales force is currently under regulatory scrutiny and dependent upon the outcome may materially change the manner in how the sales force is paid. This change in compensation may make it difficult for banks to retain their sales force, which in turn may affect future retail mortgage volume.

***We are exposed to intangible asset risk in that our goodwill may become impaired.***

As of December 31, 2012, we had $23.8 million of goodwill and other intangible assets. A significant and sustained decline in our stock price and market capitalization, a significant decline in our expected future cash flows, a significant adverse change in the business climate, or slower growth rates could result in further impairment of goodwill. If we were to conclude that a future write-down of our goodwill is necessary, then we would record the appropriate charge, which could be materially adverse to our operating results and financial position. For further discussion, see Notes 1 and 10, Nature of Operations and Summary of Significant Accounting Policies and Intangible Assets , to the Consolidated Financial Statements included in Item 8 of our Annual Report on Form 10-K for the year ended December 31, 2012.

***We are subject to extensive regulation and changes in laws and regulatory policies could adversely affect our business.***

Our operations are subject to extensive regulation by federal agencies. See Supervision and Regulation in the description of our Business in Item 1 of Part I of this report for detailed information on the laws and regulations to which we are subject. Changes in applicable laws, regulations or regulator policies can materially affect our business. The likelihood of any major changes in the future and their effects are impossible to determine. As an example, the Bank could experience higher credit losses because of federal or state legislation or by regulatory or bankruptcy court action that reduces the amount the Bank s borrowers are otherwise contractually required to pay under existing loan contracts. Also, the Bank could experience higher credit losses because of federal or state legislation or regulatory action that limits its ability to foreclose on property or other collateral or makes foreclosure less economically feasible.

Legislation enacted in recent years, together with additional actions announced by the U.S. Treasury and other regulatory agencies, continue to develop. It is not clear at this time what impact the Dodd-Frank Act, other recent legislation and liquidity and funding initiatives of the U.S. Treasury and other bank regulatory agencies, and additional programs that may be initiated in the future will have on the financial markets and the financial services industry. The extreme levels of volatility and limited credit availability currently being experienced could continue to effect the U.S. banking industry and the broader U.S. and global economies, which will have an effect on all financial institutions, including Horizon.

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***Our inability to continue to accurately process large volumes of transactions could adversely impact our business and financial results.***

In the normal course of business, we process large volumes of transactions. If systems of internal control should fail to work as expected, if systems are used in an unauthorized manner, or if employees subvert the system of internal controls, significant losses could result.

We process large volumes of transactions on a daily basis and are exposed to numerous types of operational risk. Operational risk resulting from inadequate or failed internal processes, people and systems includes the risk of fraud by persons inside or outside Horizon, the execution of unauthorized transactions by employees, errors relating to transaction processing and systems, and breaches of the internal control system and compliance requirements. This risk of loss also includes the potential legal actions that could arise as a result of the operational deficiency or as a result of noncompliance with applicable regulatory standards.

We establish and maintain systems of internal operational controls that are designed to provide us with timely and accurate information about our level of operational risk. While not foolproof, these systems have been designed to manage operational risk at appropriate, cost-effective levels. Procedures also exist that are designed to ensure that policies relating to conduct, ethics and business practices are followed. From time to time, losses from operational risk may occur, including the consequences of operational errors.

While we continually monitor and improve the system of internal controls, data processing systems and corporate-wide processes and procedures, there can be no assurance that future losses will not occur.

***Our information systems may experience an interruption or breach in security.***

We rely heavily on communications and information systems to conduct our business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan and other systems. While we have policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of our information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately or timely addressed. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

***We continually encounter technological changes.***

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements, and we may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on our business and, in turn, our financial condition and results of operations.

***We rely on other companies to provide key components of our business infrastructure.***

Third-party vendors provide key components of our business infrastructure, including Internet connections, network access and transaction and other processing services. Although we have selected these third-party vendors carefully, we do not control their actions. Any problems caused by these third parties, including as a result of inadequate or interrupted service, could adversely affect our ability to deliver products and services to our customers and otherwise to conduct our business. Replacing these third- party vendors also could result in significant delay and expense.

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***Damage to our reputation could damage our business.***

Our business depends upon earning and maintaining the trust and confidence of our customers, investors and employees. Damage to our reputation could cause significant harm to our business and prospects. Harm to our reputation can arise from numerous sources, including, among others, employee misconduct, compliance failures, litigation or regulatory outcomes or governmental investigations. In addition, a failure to deliver appropriate standards of service and quality, or a failure or perceived failure to treat customers and clients fairly, can result in customer dissatisfaction, litigation and heightened regulatory scrutiny, all of which can lead to lost revenue, higher operating costs and harm to our reputation our reputation. Adverse publicity about Horizon, whether or not true, may result in harm to our prospects. Should any events or factors that can undermine our reputation occur, there is no assurance that the additional costs and expenses that we may need to incur to address the issues giving rise to the reputational harm would not adversely affect our earnings and results of operations.

***The soundness of other financial institutions could adversely affect us.***

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds, and other institutional clients. Many of these transactions expose us to credit risk in the event of default by our counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by us cannot be realized or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure due us. There is no assurance that any such losses would not materially and adversely affect our results of operations or earnings.

***The Standard & Poor s downgrade in the U.S. government s sovereign credit rating, and in the credit ratings of instruments issued, insured or guaranteed by certain related institutions, agencies and instrumentalities, could result in risks to Horizon and general economic conditions that we are not able to predict.***

On August 5, 2011, Standard & Poor s downgraded the United States long-term debt rating from its AAA rating to AA+. On August 8, 2011, Standard & Poor s downgraded the credit ratings of certain long-term debt instruments issued by Fannie Mae and Freddie Mac and other U.S. government agencies linked to long-term U.S. debt. Instruments of this nature are key assets on the balance sheets of financial institutions, including the Bank. These downgrades could adversely affect the market value of such instruments, and could adversely impact our ability to obtain funding that is collateralized by affected instruments, as well as affecting the pricing of that funding when it is available. We cannot predict if, when or how these changes to the credit ratings will affect economic conditions. These ratings downgrades could result in a significant adverse impact to Horizon and could exacerbate the other risks to which Horizon is subject.

***A world crisis could affect the U.S. economy and liquidity markets for community banks.***

Current worldwide events may lead to further erosion in the U.S. economy and limit community banks access to the liquidity markets. These events include possible regional conflicts that may interrupt the supply of energy products; European contagion that may affect the liquidity markets and increasing dependence upon Asian investors which may affect the bond markets and long-term interest rates.

**Risks Related to our Common Stock**

***The price of our common stock may fluctuate significantly, and this may make it difficult for you to resell our common stock at times or at prices you find attractive.***

Although our common stock is listed on the NASDAQ Global Market, our stock price constantly changes, and we expect our stock price to continue to fluctuate in the future. Our stock price is impacted by a variety of factors, some of which are beyond our control.

These factors include:

- variations in our operating results or the quality of our assets;
- operating results that vary from the expectations of management, securities analysts and investors;
- increase in loan losses, non-performing loans and other real estate owned;
- changes in expectations as to our future financial performance;
- announcements of new products, strategic developments, acquisitions and other material events by us or our competitors;
- the operating and securities price performance of other companies that investors believe are comparable to us;
- currently on the Russell 3000 index and could come off the index;
- actual or anticipated sales of our equity or equity-related securities;
- our past and future dividend practice;
- our creditworthiness;
- interest rates;
- the credit, mortgage and housing markets, the markets for securities relating to mortgages or housing;
- developments with respect to financial institutions generally; and
- economic, financial, geopolitical, regulatory, congressional or judicial events that affect us or the financial markets.

In addition the stock market in general has recently experienced extreme price and volume fluctuations. This volatility has had a significant effect on the market price of securities issued by many companies and particularly those in the financial services and banking sector, including for reasons unrelated to their operating performance. These broad market fluctuations may adversely affect our stock price, notwithstanding our operating results.

***Because our stock is thinly traded, it may be more difficult for you to sell your shares or buy additional shares when you desire to do so and the price may be volatile.***

Although our common stock has been listed on the NASDAQ stock market since December 2001, our common stock is thinly traded. The prices of thinly traded stocks, such as ours, are typically more volatile than stocks traded in a large, active public market and can be more easily impacted by sales or purchases of large blocks of stock. Thinly traded stocks are also less liquid, and because of the low volume of trades, you may be unable to sell your shares when you desire to do so.

***Our participation in the Small Business Lending Fund program restricts our ability to pay dividends and to repurchase our securities and could have other negative effects.***

On August 25, 2011, we sold 12,500 shares of Senior Non-Cumulative Perpetual Preferred Stock, Series B ( Series B Preferred Stock ), to the U.S. Treasury pursuant to the Small Business Lending Fund program, a $30 billion fund established under the Small Business Jobs Act of 2010 that encourages lending to small businesses by providing capital to qualified community banks with assets of less than $10 billion. The terms of the Series B Preferred Stock impose limits on our ability to pay dividends and repurchase shares of common stock. Under the terms of the Series B Preferred Stock, no repurchases may be effected, and no dividends may be declared or paid on preferred shares ranking *pari passu* with the Series B Preferred Stock, junior preferred shares, or other junior securities (including our common stock) during the current quarter and for the next three quarters following the failure to declare and pay dividends on the Series B Preferred Stock, except that, in any such quarter in which the dividend is paid, dividend payments on shares ranking *pari passu* may be paid to the extent necessary to avoid any resulting material covenant breach. In addition, we may declare and pay a dividend on our common stock or other stock ranking junior to the Series B Preferred Stock, or repurchase shares of any such class or series of stock, only if, after payment of such dividend, the dollar amount of the Company s Tier 1 Capital would be at least 90% of the Signing Date Tier 1 Capital, which was $118,724,000, excluding any subsequent net charge-offs and any redemption of the Series B Preferred Stock. Horizon does not anticipate that these restrictions will affect its ability to pay dividends on its common stock; however, given the possibility of unforeseen developments or events, there can be no guarantee that Horizon will be able to pay dividends on its common stock.

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(Table dollars in thousands except per share data)

***Provisions in our articles of incorporation, our by-laws, and Indiana law may delay or prevent an acquisition of us by a third party.***

Our articles of incorporation and by-laws and Indiana law contain provisions that have certain anti-takeover effects. While the purpose of these provisions is to strengthen the negotiating position of the board in the event of a hostile takeover attempt, the overall effects of these provisions may be to render more difficult or discourage a merger, tender offer or proxy contest, the assumption of control by a holder of a larger block of our shares, and the removal of incumbent directors and key management.

Our articles of incorporation provide for a staggered board, which means that only one-third of our board can be replaced by shareholders at any annual meeting. Our articles also provide that our directors may only be removed without cause by shareholders owning 70% or more of our outstanding common stock. Furthermore, our articles provide that only our board of directors, and not our shareholders, may adopt, alter, amend and repeal our by-laws.

Our articles also preempt Indiana law with respect to business combinations with a person who acquires 10% or more of our common stock and provide that such transactions are subject to independent and super-majority shareholder approval requirements unless certain pricing and board pre-approval requirements are satisfied.

Our by-laws do not permit cumulative voting of shareholders in the election of directors, allowing the holders of a majority of our outstanding shares to control the election of all our directors, and our directors are elected by plurality (not majority) voting. Our by-laws also establish detailed procedures that shareholders must follow if they desire to nominate directors for election or otherwise present issues for consideration at a shareholders meeting. We also have a mandatory retirement age for directors.

These and other provisions of our governing documents and Indiana law are intended to provide the board of directors with the negotiating leverage to achieve a more favorable outcome for our shareholders in the event of an offer for the company. However, there is no assurance that these same anti-takeover provisions could not have the effect of delaying, deferring or preventing a transaction or a change in control that might be in the best interest of our shareholders.

**Risks Related to the Series B Preferred Stock**

***The Series B Preferred Stock is equity and is subordinate to all of our existing and future indebtedness; regulatory and contractual restrictions may limit or prevent us from paying dividends on the Series B Preferred Stock; and the Series B Preferred Stock places no limitations on the amount of indebtedness we and our subsidiaries may incur in the future.***

Shares of the Series B Preferred Stock are equity interests in Horizon and do not constitute indebtedness. As such, the Series B Preferred Stock, like our common stock, ranks junior to all indebtedness and other non-equity claims against Horizon with respect to assets available to satisfy claims against Horizon, including in a liquidation of Horizon. Additionally, unlike indebtedness, where principal and interest would customarily be payable on specified due dates, in the case of preferred stock like the Series B Preferred Stock, dividends are payable only when, as and if authorized and declared by, our Board of Directors and depend on, among other things, our results of operations, financial condition, debt service requirements, other cash needs and any other factors our Board of Directors deems relevant. The current terms of the Series B Preferred Stock require dividends to be paid in arrears on January 1, April 1, July 1 and October 1 of each year.

Horizon is an entity separate and distinct from the Bank, our principal subsidiary, and derives a significant portion of its revenue in the form of dividends from the Bank. Accordingly, Horizon is and will be dependent upon dividends from the Bank to pay the principal of, and interest on, its indebtedness, to satisfy its other cash needs and to pay dividends on the Series B Preferred Stock. Horizon s ability to pay dividends is subject to its ability to earn net income and to meet certain regulatory requirements while maintaining its required capital. In the event the Bank is unable to pay dividends to Horizon, Horizon may not be able to pay dividends on the Series B Preferred Stock. In addition, the Series B Preferred Stock does not limit the amount of debt or other obligations we or our subsidiaries may incur in the future. Accordingly, we and our subsidiaries may incur substantial amounts of additional debt and other obligations that will rank senior to the Series B Preferred Stock or to which the Series B Preferred Stock will be structurally subordinated.

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(Table dollars in thousands except per share data)

***An active trading market for the Series B Preferred Stock does not currently exist and is unlikely to develop.***

The Series B Preferred Stock is not currently listed on any national securities exchange, and we do not intend to list the Series B Preferred Stock on a national securities exchange unless we are requested to do so by the U.S. Treasury. Even if requested to so do by the U.S. Treasury, it is not certain that such a listing can be achieved given the current exchange listing requirements, and even if listing is achieved, it is unlikely that an active trading market for the Series B Preferred Stock will develop, or, if developed, that an active trading market will be maintained. If an active trading market does not develop, the market value and liquidity of the Series B Preferred Stock may be adversely affected.

***Dividends on the Series B Preferred Stock are non-cumulative.***

Dividends on the shares of Series B Preferred Stock are non-cumulative. If our Board of Directors does not authorize and declare a dividend on the Series B Preferred Stock for any dividend period, such unpaid dividend will not accrue and will not be payable to holders of the Series B Preferred Stock even if dividends are declared for any subsequent dividend period. However, a failure to pay dividends on the Series B Preferred Stock will restrict our ability to pay dividends with respect to and repurchase shares of other classes and series of stock.

***Initially the dividend rate on the Series Preferred Stock will fluctuate based on our level of Qualified Small Business Lending as compared to our Small Business Lending Baseline.***

The per annum dividend rate on the shares of Series B Preferred Stock applicable to the first quarter is 5%. For the second through tenth quarters, the rate will be adjusted quarterly to reflect the percent of change in our Qualified Small Business Lending from our Small Business Lending baseline and may fluctuate between 1% and 5% per annum. The dividend rate will be a fixed rate for the eleventh quarter through the date that is four-and-a-half years from the issuance date of the shares of Series B Preferred Stock and will be based on the rate in effect for the tenth quarter. Depending on the percentage increase in our Qualified Small Business Lending over our Small Business Lending baseline, the fixed rate will be between 1% and 5% per annum. If there has been no increase (or a decrease) in our Qualified Small Business Lending over our Small Business Lending baseline, the fixed rate will be 7% per annum. For all quarters subsequent to the four-and-one-half year anniversary of issuance, the rate will be 9% per annum.

***Holders of the Series B Preferred Stock have limited voting rights.***

Holders of the Series B Preferred Stock only have the right to vote as a separate class on certain matters relating to the rights of holders of Series B Preferred Stock and on certain corporate transactions. Except with respect to such matters, the Series B Preferred Stock does not have voting rights. The matters on which the holders of Series B Preferred Stock would have the right to vote include amendments to Horizon s Articles of Incorporation adversely affecting the Series B Preferred Stock or certain fundamental transactions affecting the Series B Preferred Stock, and in connection with the authorization of stock senior to the Series B Preferred Stock. If Horizon misses five dividend payments on the Series B Preferred Stock, whether or not consecutive, the holder of the Series B Preferred Stock will have the right, but not the obligation, to appoint a representative as an observer who will attend all meetings of Horizon s Board of Directors, but such observer will not have the right to vote.

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**ITEM 1B. UNRESOLVED STAFF COMMENTS**

Not applicable.

**ITEM 2. PROPERTIES**

The main office and full service branch of Horizon and the Bank is located at 515 Franklin Square, Michigan City, Indiana. The building located across the street from the main office of Horizon and the Bank, at 502 Franklin Square, houses the credit administration, operations, facilities and purchasing, and information technology departments of the Bank. In addition to these principal facilities, the Bank has 28 sales offices located at:

| | | |
|---|---|---|
| 3631 South Franklin Street | Michigan City | Indiana |
| 113 West First Street | Wanatah | Indiana |
| 1500 West Lincolnway | LaPorte | Indiana |
| 423 South Roosevelt Street | Chesterton | Indiana |
| 4208 North Calumet | Valparaiso | Indiana |
| 902 Lincolnway | Valparaiso | Indiana |
| 455 Morthland Drive | Valparaiso | Indiana |
| 2650 Willowcreek Road | Portage | Indiana |
| 8590 Broadway | Merrillville | Indiana |
| 10429 Calumet Avenue | Munster | Indiana |
| 17400 State Road 23 | South Bend | Indiana |
| 1909 East Bristol Street | Elkhart | Indiana |
| 4574 Elkhart Road | Goshen | Indiana |
| 1321 119th Street | Whiting | Indiana |
| 1349 Calumet Avenue | Hammond | Indiana |
| 1300 North Main Street | Crown Point | Indiana |
| 420 North Morton Street | Franklin | Indiana |
| 489 State Road 135 | Greenwood | Indiana |
| 800 US 31 | Greenwood | Indiana |
| 2433 East Main Street | Greenwood | Indiana |
| 507 Three Notch Lane | Bargersville | Indiana |
| 117 East Washington Street | Indianapolis | Indiana |
| 811 Ship Street | St. Joseph | Michigan |
| 2608 Niles Road | St. Joseph | Michigan |
| 1041 East Napier Avenue | Benton Harbor | Michigan |
| 500 West Buffalo Street | New Buffalo | Michigan |
| 6801 West U.S. 12 | Three Oaks | Michigan |
| 3250 West Centre Avenue | Portage | Michigan |

Horizon owns all of the facilities except for the Indiana offices located at 117 E Washington Street, Indianapolis, 489 State Road 135, Greenwood and 800 US 31, Greenwood, each of which is leased.

**ITEM 3. LEGAL PROCEEDINGS**

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

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable

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**SPECIAL ITEM: EXECUTIVE OFFICERS OF REGISTRANT**

| | | |
|---|---|---|
| Robert C. Dabagia | 74 | Chairman of Horizon since 1998; Chief Executive Officer of Horizon and the Bank until July 1, 2001. |
| Craig M. Dwight | 56 | Chairman and Chief Executive Officer of the Bank since January 2003; President and Chief Executive Officer of Horizon and the Bank since July 1, 2001. |
| Thomas H. Edwards | 60 | President and Chief Operating Officer of the Bank since January 2003. |
| Mark E. Secor | 46 | Chief Financial Officer of Horizon and the Bank since January 2009. Vice President, Chief Investment and Asset Liability Manager since June 2007, Chief Financial Officer of St. Joseph Capital Corp., Mishawaka, Indiana since January 2004. |
| James D. Neff | 53 | Corporate Secretary of Horizon since 2007; Executive Vice President-Mortgage Banking of the Bank since January 2004; Senior Vice President of the Bank since October 1999. |

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**PART II**

**ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

**Repurchases of Securities**

There were no purchases by the Company of its common stock during the fourth quarter of 2012.

**Performance Graph**

The Securities and Exchange Commission requires Horizon to include a line graph comparing Horizon s cumulative five-year total shareholder returns on the common shares with market and industry returns over the past five years. SNL Financial LC prepared the following graph. The return represented in the graph assumes the investment of $100 on January 1, 2008, and further assumes reinvestment of all dividends. The Company s common stock began trading on the NASDAQ Global Market on February 1, 2008. Prior to that date, the common stock was traded on the NASDAQ Capital Market.

| | Period Ending | | | | | |
|---|---|---|---|---|---|---|
| **Index** | **December 31 2007** | **December 31 2008** | **December 31 2009** | **December 31 2010** | **December 31 2011** | **December 31 2012** |
| Horizon Bancorp | 100.00 | 50.93 | 69.19 | 116.92 | 117.27 | 203.98 |
| Russell 2000 | 100.00 | 66.21 | 84.20 | 106.82 | 102.36 | 119.09 |
| SNL Bank $1B-$5B | 100.00 | 82.94 | 59.45 | 67.39 | 61.46 | 75.78 |
| SNL Micro Cap Bank | 100.00 | 61.90 | 45.65 | 46.98 | 44.68 | 56.46 |

Source : SNL Financial LC, Charlottesville, VA
@ 2012 www.snl.com

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The following chart, prepared by the investment banking firm of Keefe, Bruyette and Woods compares the change in market price of Horizon s common stock to that of publicly traded banks in Indiana and Michigan, excluding the reinvestment of dividends.

| | Period Ending | | | | | |
|---|---|---|---|---|---|---|
| **Index** | **December 31 2007** | **December 31 2008** | **December 31 2009** | **December 31 2010** | **December 31 2011** | **December 31 2012** |
| Horizon Bancorp | 100.00 | 48.73 | 63.23 | 103.70 | 101.35 | 172.37 |
| Indiana Banks | 100.00 | 114.92 | 73.84 | 86.12 | 88.66 | 95.67 |
| Michigan Banks | 100.00 | 46.58 | 27.38 | 26.38 | 29.16 | 48.42 |

The other information regarding Horizon s common stock, including the approximate number of holders of the common stock, is included under the caption Horizon s Common Stock and Related Stockholders Matters in Item 8 below, which is incorporated by reference.

**ITEM 6. SELECTED FINANCIAL DATA**

The information required under this item is incorporated by reference to the information appearing under the caption Summary of Selected Financial Data in Item 8 of this Form 10-K.

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## ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

### Overview

Horizon is a registered bank holding company incorporated in Indiana and headquartered in Michigan City, Indiana. Horizon provides a broad range of banking services in Northwestern and Central Indiana and Southwestern Michigan through its bank subsidiary. Horizon operates as a single segment, which is commercial banking. Horizon s common stock is traded on the NASDAQ Global Market under the symbol HBNC. The Bank was chartered as a national banking association in 1873 and has operated continuously since that time. The Bank is a full-service commercial bank offering commercial and retail banking services, corporate and individual trust and agency services, and other services incident to banking. All share data included below has been adjusted to reflect Horizon s three-for-two stock splits paid on November 9, 2012 and December 9, 2011.

Following are some highlights of Horizons financial performance during 2012:

- Horizon s net income of $19.5 million for the twelve months ending 2012 surpassed the $12.8 million earned in the prior year and represented the highest annual net income in the Company s history.

- Horizon s diluted earnings per share was $2.30 in 2012, a 52% increase in diluted earnings per share compared to 2011.

- On July 17, 2012 Horizon completed its acquisition of Heartland. On that date, Horizon recorded $229.5 million in assets and $218.7 million in liabilities.

- As a result of the acquisition and organic growth, total assets increased to a record $1.8 billion at December 31, 2012, compared with $1.5 billion at December 31, 2011.

- Total loans increased $207.5 million during 2012, consisting of $92.9 million in organic loan growth and $114.6 million net loans acquired from Heartland.

- Total deposits increased $284.3 million during 2012, consisting of $73.1 million in organic deposit growth and $211.2 million in deposits acquired from Heartland.

- Net interest income, after provisions for loan losses, for 2012 was $54.7 million compared with $42.8 million for 2011.

- The provision for loan losses decreased to $3.5 million for the year ended December 31, 2012 compared to $5.3 million for 2011.

Net charge-offs in 2012 were $4.1 million compared to $5.5 million in 2011.

Substandard and 30-to-89 day delinquent loans in total decreased by $1.9 million during 2012 from $60.8 million at December 31, 2011 to $58.9 million at December 31, 2012 including $21.5 million at December 31, 2012 acquired from the Heartland merger.

Return on average assets was 1.19% for the year ended December 31, 2012.

Return on average common equity was 14.72% for the year ended December 31, 2012.

Horizon Bank s capital ratios 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 this Annual Report on Form 10-K for 2012 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 the allowance for loan losses, goodwill and intangible asset, mortgage servicing rights, hedge accounting and valuation measurements as critical accounting policies.

***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

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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.

Acquired credit-impaired loans are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality (FASB ASC 310-30) and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loans. Accordingly, allowances for credit losses related to these loans are not carried over and recorded at the acquisition dates. Loans acquired through business combinations that do not meet the specific criteria of FASB ASC 310-30, but for which a discount is attributable, at least in part to the credit quality, are also accounted for under this guidance. As a result, related discounts are recognized subsequently through accretion based on the expected cash flows of the acquired loans. For purposes of applying FASB ASC 310-30, loans acquired in business combinations are aggregated into pools of loans with common risk characteristic.

***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 December 31, 2012, Horizon had core deposit intangibles of $4.0 million subject to amortization and $19.7 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 December 31, 2012 was $19.65 per share compared to a tangible book value of $14.23 per common share. Horizon reported record earnings for the 13th consecutive year in 2012.

***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

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could result in significant earnings volatility. To estimate prepayment speeds, Horizon utilizes a third-party prepayment model, which is based upon statistically derived data linked to certain key principal indicators involving historical borrower prepayment activity associated with mortgage loans in the secondary market, current market interest rates and other factors, including Horizon s own historical prepayment experience. For purposes of model valuation, estimates are made for each product type within the mortgage servicing rights portfolio on a monthly basis. In addition, on a quarterly basis Horizon engages a third party to independently test the value of its servicing asset.

***Derivative Instruments***

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

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.

**Analysis of Financial Condition**

Horizon s total assets were $1.85 billion as of December 31, 2012, an increase of $300.5 million from December 31, 2011.

***Investment Securities***

Investment securities totaled $482.8 million at December 31, 2012, and consisted of Treasury and federal agency securities of $51.8 million (10.7%); state and municipal securities of $172.9 million (35.8%); federal agency mortgage-backed pools of $159.2 million, federal agency

collateralized mortgage obligations of $96.8 million, private labeled mortgage-backed pools of $2.0 million (53.4%); and corporate securities of $51,000 (0.1%). Investment securities increased $44.7 million during 2012 primarily from the Heartland acquisition of $63.7 million net of $19.0 million of investment securities used for liquidity.

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As indicated above, 53.4% of the investment portfolio consists of mortgage-backed securities and collateralized mortgage obligations. Approximately 0.4% of the portfolio or $2.0 million are private label collateralized mortgage obligations, the remainder are issued by agencies of the Federal Government. Horizon had three private label CMO s at December 31, 2012, with an amortized cost of $2.0 million and carried at a market value of $2.0 million. The gross unrealized gain on these investments at December 31, 2012 was approximately $71,000. The private label securities generally have loan to value ratios of approximately 50% and management feels these securities are not impaired. These instruments are secured by residential mortgages of varying maturities. Principal and interest payments are received monthly as the underlying mortgages are repaid. These payments also include prepayments of mortgage balances as borrowers either sell their homes or refinance their mortgages. Therefore, mortgage-backed securities and collateralized mortgage obligations have maturities that are stated in terms of average life. The average life is the average amount of time that each dollar of principal is expected to be outstanding. As of December 31, 2012, the mortgage-backed securities and collateralized mortgage obligations in the investment portfolio had an average life of 6.3 years. Securities that have interest rates above current market rates are purchased at a premium. These securities may experience a significant increase in prepayments when lower market interest rates create an incentive for the borrower to refinance the underlying mortgage as occurred during 2011 and 2012. This may result in a decrease of current income; however, this risk is mitigated by a shorter average life. Management monitors these investments periodically for other than temporary impairment by obtaining and reviewing the underlying collateral details and has concluded at December 31, 2012 this unrealized loss is temporary and that the Company has the intent and ability to hold these investments to maturity.

Available-for-sale municipal securities are priced by a third party using a pricing grid which estimates prices based on recent sales of similar securities. All municipal securities are investment grade or local non-rated issues and management does not believe there is other than temporary deterioration in market value. A credit review is performed annually on the municipal securities portfolio.

At December 31, 2012, 100.0% and at December 31, 2011, 98.4% of investment securities were classified as available for sale. Securities classified as available for sale are carried at their fair value, with both unrealized gains and losses recorded, net of tax, directly to stockholders equity. Net appreciation on these securities totaled $19.5 million, which resulted in a balance of $12.7 million, net of tax, included in stockholders equity at December 31, 2012. This compared to $11.0 million, net of tax, included in stockholders equity at December 31, 2011.

Fair value is defined 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. A fair value hierarchy is also established which requires an entity to maximize the use of observable and minimize the use of unobservable inputs. 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. |

When quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. There are no Level 1 securities. 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 collateralized mortgage obligations and Federal agency mortgage-backed pools. For level 2 securities, Horizon uses a third party service to determine fair value. In performing the valuations, the pricing service relies on models that consider security-specific details as well as relevant industry and economic factors. The most significant of these inputs are quoted market prices, interest rate spreads on relevant benchmark securities and certain prepayment assumptions. To verify the reasonableness of the fair value determination by the service, Horizon has a portion of the level 2 securities priced by an independent securities broker dealer.

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Unrealized gains and losses on available-for-sale securities, deemed temporary, are recorded, net of income tax, in a separate component of other comprehensive income on the balance sheet. No unrealized losses were deemed to be other-than-temporary .

As a member of the Federal Reserve and Federal Home Loan Bank systems, Horizon is required to maintain an investment in the common stock of each entity. The investment in common stock is based on a predetermined formula. At December 31, 2012 Horizon had investments in the common stock of the Federal Reserve and Federal Home Loan Banks totaling $13.3 million and at December 31, 2011, investments totaled $12.4 million.

At December 31, 2012, Horizon did not maintain a trading account.

For more information about securities, see Note 4 (Investment Securities) to the consolidated financial statements.

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***Loans***

Total loans, net of deferred fees/costs, the principal earning asset of the Bank, were $1.19 billion at December 31, 2012. The current level of loans is an increase of 21.1% from the December 31, 2011, level of $983.2 million. The table below provides comparative detail on the loan categories.

| | December 31 2012 | December 31 2011 | Dollar Change | Percent Change |
|---|---|---|---|---|
| Commercial | | | | |
| Working capital and equipment | **$ 198,805** | $ 170,325 | $ 28,480 | 16.7% |
| Real estate, including agriculture | **247,108** | 172,910 | 74,198 | 42.9% |
| Tax exempt | **4,579** | 3,818 | 761 | 19.9% |
| Other | **9,979** | 5,323 | 4,656 | 87.5% |
| Total | **460,471** | 352,376 | 108,095 | 30.7% |
| Real estate | | | | |
| 1 4 family | **185,940** | 153,039 | 32,901 | 21.5% |
| Other | **3,774** | 4,102 | (328) | -8.0% |
| Total | **189,714** | 157,141 | 32,573 | 20.7% |
| Consumer | | | | |
| Auto | **142,149** | 134,686 | 7,463 | 5.5% |
| Recreation | **5,163** | 4,737 | 426 | 9.0% |
| Real estate/home improvement | **29,989** | 27,729 | 2,260 | 8.2% |
| Home equity | **104,974** | 92,249 | 12,725 | 13.8% |
| Unsecured | **4,194** | 3,183 | 1,011 | 31.8% |
| Other | **2,615** | 2,793 | (178) | -6.4% |
| Total | **289,084** | 265,377 | 23,707 | 8.9% |
| Mortgage warehouse | **251,448** | 208,299 | 43,149 | 20.7% |
| Total loans | **1,190,717** | 983,193 | 207,524 | 21.1% |
| Allowance for loan losses | **(18,270)** | (18,882) | 612 | |
| Loans, net | **$ 1,172,447** | $ 964,311 | $ 208,136 | |

The acceptance and management of credit risk is an integral part of the Bank s business as a financial intermediary. The Bank has established underwriting standards including a policy that monitors the lending function through strict administrative and reporting requirements as well as an internal loan review of consumer and small business loans. The Bank also uses an independent third-party loan review function that regularly reviews asset quality.

Changes in the mix of the loan portfolio averages are shown in the following table.

| | December 31 2012 | December 31 2011 | December 31 2010 |
|---|---|---|---|
| Commercial | $ 393,580 | $ 339,072 | $ 320,783 |
| Real estate | 179,622 | 170,790 | 163,597 |
| Mortgage warehouse | 193,006 | 90,316 | 124,787 |
| Consumer | 277,412 | 262,320 | 269,014 |
| Total average loans | $ 1,043,620 | $ 862,498 | $ 878,181 |

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***Residential Real Estate Loans***

Residential real estate loans totaled $189.7 million or 15.9% of total loans as of December 31, 2012, compared to $157.1 million or 16.0% of total loans as of December 31, 2011. This category consists of home mortgages that generally require a loan to value of no more than 80%. Some special guaranteed or insured real estate loan programs do permit a higher loan to collateral value ratio. The increase during 2012 was primarily related to the $20.8 million of real estate loans acquired in the Heartland acquisition along with organic growth net of principal reductions from payments.

In addition to the customary real estate loans described above, the Bank also has outstanding on December 31, 2012, $105.0 million in home equity lines of credit compared to $92.2 million at December 31, 2011. Credit lines normally limit the loan to collateral value to no more than 89%. Home equity credits lines are primarily not combined with a first mortgage and are therefore evaluated in the allowance for loan losses as a separate pool. These loans are classified as consumer loans in the table above and in Note 5 of the consolidated financial statements.

Residential real estate lending is a highly competitive business. As of December 31, 2012, the real estate loan portfolio reflected a wide range of interest rates and repayment patterns, but could generally be categorized as follows:

| | December 31, 2012 | | | December 31, 2011 | | |
|---|---|---|---|---|---|---|
| | Amount | Percent of Portfolio | Yield | Amount | Percent of Portfolio | Yield |
| Fixed rate | | | | | | |
| Monthly payment | $ 93,999 | 49.5% | 4.77% | $ 57,219 | 36.4% | 5.34% |
| Biweekly payment | 483 | 0.3% | 6.38% | 677 | 0.4% | 6.34% |
| Adjustable rate | | | | | | |
| Monthly payment | 95,232 | 50.2% | 4.29% | 99,245 | 63.2% | 4.72% |
| Biweekly payment | | 0.0% | 0.00% | | 0.0% | 0.00% |
| Sub total | 189,714 | 100.0% | 4.53% | 157,141 | 100.0% | 4.95% |
| Loans held for sale | 13,744 | | | 14,090 | | |
| Total real estate loans | $ 203,458 | | | $ 171,231 | | |

The increase in fixed rate loans during 2012 was primarily due to the real estate loans acquired in the Heartland acquisition along with organic growth from retaining a portion of originated 10 and 15 year real estate loans. In addition to the real estate loan portfolio, the Bank originates and sells real estate loans and retains the servicing rights. During 2012 and 2011, approximately $386.9 million and $275.9 million of residential mortgages were sold into the secondary market. Loans serviced for others are not included in the consolidated balance sheets. The unpaid principal balances of loans serviced for others totaled approximately $772.1 million and $599.1 million at December 31, 2012 and 2011.

The Bank began capitalizing mortgage servicing rights during 2000, and the aggregate fair value of capitalized mortgage servicing rights at December 31, 2012, totaled approximately $6.6 million compared to the carrying value of $5.1 million. Comparable market values and a valuation model that calculates the present value of future cash flows were used to estimate fair value. For purposes of measuring impairment, risk characteristics including product type, investor type and interest rates, were used to stratify the originated mortgage servicing rights.

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| | December 31 2012 | December 31 2011 | December 31 2010 |
|---|---|---|---|
| **Mortgage servicing rights** | | | |
| Balances, January 1 | $ 5,049 | $ 4,175 | $ 3,010 |
| Servicing rights capitalized | 2,439 | 1,866 | 2,000 |
| Amortization of servicing rights | (1,319) | (992) | (835) |
| Balances, December 31 | 6,169 | 5,049 | 4,175 |
| **Impairment allowance** | | | |
| Balances, January 1 | (856) | (803) | (139) |
| Additions | (762) | (792) | (776) |
| Reductions | 594 | 739 | 112 |
| Balances, December 31 | (1,024) | (856) | (803) |
| **Mortgage servicing rights, net** | $ 5,145 | $ 4,193 | $ 3,372 |

***Commercial Loans***

Commercial loans totaled $460.5 million, or 38.7% of total loans as of December 31, 2012, compared to $352.4 million, or 35.8% as of December 31, 2011. The increase during 2012 was primarily related to the $70.3 million of commercial loans acquired in the Heartland acquisition along with organic growth net of principal reductions from payments.

Commercial loans consisted of the following types of loans at December 31:

| | December 31, 2012 | | | December 31, 2011 | | |
|---|---|---|---|---|---|---|
| | Number | Amount | Percent of Portfolio | Number | Amount | Percent of Portfolio |
| SBA guaranteed loans | 155 | $ 26,421 | 5.7% | 118 | $ 20,646 | 5.9% |
| Municipal government | 1 | 740 | 0.2% | 2 | 831 | 0.2% |
| Lines of credit | 522 | 58,409 | 12.7% | 357 | 45,072 | 12.8% |
| Real estate and equipment term loans | 1,400 | 374,901 | 81.4% | 912 | 285,827 | 81.1% |
| Total | 2,078 | $ 460,471 | 100.0% | 1,389 | $ 352,376 | 100.0% |

Fixed rate term loans with a book value of $81.0 million and a fair value of $78.8 million have been swapped to a variable rate using derivative instruments. The loans are carried at fair value in the financial statements and the related swap is carried at fair value and is included with other liabilities in the balance sheet. The recognition of the loan and swap fair values are recorded in the income statement and for 2012 equally offset each other. Fair values are determined by the counter party using a proprietary model that uses live market inputs to value interest rate swaps. The model is subject to daily market tests as current and future positions are priced and valued. These are level 3 inputs under the fair value hierarchy as described above.

At December 31, 2012 the commercial loan portfolio held $87.0 million of adjustable rate loans that had interest rate floors in the terms of the note. Of the commercial loans with interest rate floors, loans totaling $76.9 million were at their floor at December 31, 2011.

***Consumer Loans***

Consumer loans totaled $289.1 million, or 24.3% of total loans as of December 31, 2012, compared to $265.4 million, or 27.0% as of December 31, 2011. The increase during 2012 was primarily related to the $23.4 million of consumer loans acquired in the Heartland acquisition along with organic growth net of principal reductions from payments.

***Mortgage Warehouse Loans***

Horizon s mortgage warehousing 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 pledge of collateral under Horizon s agreement with the mortgage company. Each individual mortgage is assigned to Horizon until the loan is sold

to the secondary market by the mortgage company. In addition, Horizon takes possession of each original note and forwards such note to the end investor once the mortgage company has sold the loan. At the time a loan is transferred to the secondary market, the mortgage company repurchases the loan under its option within the agreement. Due to the repurchase feature contained in the agreement, the transaction does not qualify as a sale and therefore is accounted for as a secured borrowing with 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 is typically less than 30 days.

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

***Allowance and Provision for Loan Losses/Critical Accounting Policy***

At December 31, 2012, the allowance for loan losses was $18.3 million, or 1.52% of total loans outstanding, compared to $18.9 million, or 1.89% at December 31, 2011. The decrease in the ratio was primarily due to the increase in total loans resulting from the Heartland acquisition in which loans were recorded at fair value with no allowance allocated to them at December 31, 2012. During 2012, the expense for provision for loan losses totaled $3.5 million compared to $5.3 million in 2011.

Horizon assesses the adequacy of its Allowance for Loan and Lease Losses (ALLL) by regularly reviewing the performance of all of its loan portfolios. As a result of its quarterly reviews, a provision for loan losses is determined to bring the total ALLL to a level called for by the analysis. For the year 2012, the provision of $3.5 million represented a 34.0% decrease from the prior year due to a reduction in net charge-offs. Loan charge-offs continue to require provisions for loan losses during the year but appeared to be stabilizing as the amount of charge-offs have decreased during 2012 compared to 2011. As the Company s non-performing loans decrease and charge-off experience improves, the assessment for the adequacy of the ALLL reduces the ALLL balance resulting in provision expense less than charge-offs.

Despite the decreased allowance, 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 adequate to cover losses inherent in the loan portfolio as of December 31, 2012.

***Non-performing Loans***

Non-performing loans are defined as loans that are greater than 90 days delinquent or have had the accrual of interest discontinued by management. Management continues to work diligently toward returning non-performing loans to an earning asset basis. Non-performing loans for the previous three years ending December 31 are as follows:

| | December 31 | December 31 | December 31 |
|---|---|---|---|

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| Non-performing loans | $ 23,779 | $ 20,143 | $ 21,428 |

Non-performing loans total 130.2%, 106.7% and 112.4% of the allowance for loan losses at December 31, 2012, 2011 and 2010, respectively. Non-performing loans at December 31, 2012 totaled $23.8 million, which was 1.97% of total loans.

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This was an increase from a balance of $20.1 million on December 31, 2011, but a decrease as a percent of total loans from 2.02%.

Non-performing loans totaled $23.8 million on December 31, 2012, an increase from $20.1 million on December 31, 2011. The increase from December 31, 2011 was due to the Heartland acquisition. Excluding Heartland, non-performing loans would have declined to $16.5 million at December 31, 2012. At December 31, 2012, loans acquired in the Heartland acquisition represented $7.3 million of non-performing loans.

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, 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. (See Note 7 of the audited financial statements for further discussion of impaired loans.)

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 90 days or more past due. These loans are often considered impaired. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

Other Real Estate Owned (OREO) net of any related allowance for OREO losses for the previous three years ending December 31 were as follows:

| | December 31 2012 | December 31 2011 | December 31 2010 |
|---|---|---|---|
| Other real estate owned | $ 2,565 | $ 2,800 | $ 2,664 |

OREO totaled $2.6 million on December 31, 2012, a decrease from $2.8 million on December 31, 2011. On December 31, 2012, OREO was comprised of 20 properties. Of these properties, five totaling $1.3 million were commercial real estate and 15 totaling $1.3 million were residential real estate.

No mortgage warehouse loans were non-performing or OREO as of December 31, 2012, 2011 or 2010.

***Deferred Tax***

Horizon had a net deferred tax asset at December 31, 2012 totaling $3.1 million and a net deferred tax liability at December 31, 2011 totaling $485,000. The following table shows the major components of deferred tax:

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| | December 31 2012 | December 31 2011 |
|---|---|---|
| **Assets** | | |
| Allowance for loan losses | $ 6,442 | $ 7,079 |
| Net operating loss | 1,452 | |
| Intangible assets | 2,151 | |
| Director and employee benefits | 1,357 | 1,150 |
| Other | 581 | 534 |
| Total assets | 11,983 | 8,763 |
| **Liabilities** | | |
| Depreciation | (1,418) | (1,545) |
| Difference in expense recognition | (519) | (66) |
| State tax | (374) | |
| Federal Home Loan Bank stock dividends | (296) | (272) |
| Difference in basis of intangible assets | | (1,843) |
| FHLB Penalty | (748) | (965) |
| Unrealized gain on securities available for sale | (4,901) | (4,222) |
| Other | (580) | (335) |
| Total liabilities | (8,836) | (9,248) |
| Net deferred tax asset (liability) | $ 3,147 | $ (485) |

Horizon anticipates continued earnings and therefore determined there is no impairment to this asset.

***Deposits***

The primary source of funds for the Bank comes from the acceptance of demand and time deposits. However, at times the Bank will use its ability to borrow funds from the Federal Home Loan Bank and other sources when it can do so at interest rates and terms that are more favorable than those required for deposited funds or loan demand is greater than the ability to grow deposits. Total deposits were $1.3 billion at December 31, 2012, compared to $1.0 billion at December 31, 2011, or an increase of 28.1%. Average deposits and rates by category for the three years ended December 31, 2012 are as follows:

| | Average Balance Outstanding for the Year Ending December 31 | | | Average Rate Paid for the Year Ending December 31 | | |
|---|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | 2012 | 2011 | 2010 |
| Noninterest-bearing demand deposits | $ 165,340 | $ 119,504 | $ 97,665 | | | |
| Interest-bearing demand deposits | 489,877 | 376,383 | 359,411 | 0.14% | 0.15% | 0.22% |
| Savings deposits | 106,898 | 83,374 | 61,175 | 0.11% | 0.16% | 0.23% |
| Money market | 90,339 | 83,958 | 78,561 | 0.13% | 0.12% | 0.16% |
| Time deposits | 305,766 | 343,972 | 372,379 | 1.72% | 2.19% | 2.60% |

| | | | |
|---|---|---|---|
| Total deposits | $ 1,158,220 | $ 1,007,191 | $ 969,191 |

The $155.6 million increase in average deposits during 2012 was primarily from the $211.2 million of deposits acquired in the Heartland acquisition which closed in July 2012. The transactional accounts average balances, as the lower cost funding sources, increased $192.5 million and the average balances for higher cost time deposits declined $37.0 million. Horizon continually enhances its interest-bearing consumer and commercial demand deposit products based on local market conditions and its need for funding to support various types of assets.

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Certificates of deposit of $100,000 or more, which are considered to be rate sensitive and are not considered a part of core deposits, mature as follows as of December 31, 2012:

| | |
|---|---|
| Due in three months or less | $ 19,416 |
| Due after three months through six months | 15,818 |
| Due after six months through one year | 29,302 |
| Due after one year | 89,150 |
| Total | $ 153,686 |

Interest expense on time certificates of $100,000 or more was approximately $2.9 million, $3.6 million, and $4.5 million for 2012, 2011 and 2010.

***Off-Balance Sheet Arrangements***

As of December 31, 2012, Horizon did not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the Company s financial condition, change in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors. The term off-balance sheet arrangement generally means any transaction, agreement, or other contractual arrangement to which an entity unconsolidated with the Company is a party and under which the Company has (i) any obligation arising under a guarantee contract, derivative instrument or variable interest; or (ii) a retained or contingent interest in assets transferred to such entity or similar arrangement that serves as credit, liquidity or market risk support for such assets.

***Contractual Obligations***

The following tables summarize Horizon s contractual obligations and other commitments to make payment as of December 31, 2012:

| | Total | Within One Year | One to Three Years | Three to Five Years | After Five Years |
|---|---|---|---|---|---|
| Deposits | $ 315,131 | $ 140,877 | $ 83,704 | $ 59,192 | $ 31,358 |
| Borrowings [1] | 345,764 | 186,768 | 21,034 | 78,589 | 59,373 |
| Subordinated debentures [2] | 32,331 | | | | 32,331 |

(1) Includes debt obligations to the Federal Home Loan Bank and term repurchase agreements with maturities beyond one year borrowed by Horizon s banking subsidiary. See Note 12 in Horizon s Consolidated Financial Statements.

(2) Includes Trust Preferred Capital Securities issued by Horizon Statutory Trusts II and III and those assumed in the acquisitions of Alliance Bank in 2005, American Trust in 2009 and Heartland in 2011. See Note 13 in Horizon s Consolidated Financial Statements.

| | Expiration by Period | |
|---|---|---|
| | Within One Year | Greater Than One Year |
| Letters of credit | $ 1,576 | $ 10 |
| Unfunded loan commitments | 116,792 | 212,124 |

***Capital Resources***

The capital resources of Horizon and the Bank exceed regulatory capital ratios for well capitalized banks at December 31, 2012. Stockholders equity totaled $159.0 million as of December 31, 2012, compared to $121.5 million as of December 31, 2011. At year-end 2012, the ratio of stockholders equity to assets was 8.60%, compared to 7.85% for 2011. Tangible equity to tangible assets was 6.73% at December 31, 2012, compared to 6.55% at December 31, 2011. Book value per common share at December 31, 2012 increased to $17.00, compared to $14.68 at December 31, 2011. Horizon s capital increased during 2012 as a result of the issuance of common stock for the Heartland acquisition, earnings, an increase in other comprehensive income and the exercise of stock options, net of tax, and offset by dividends declared.

In December 2008, Horizon received an investment of $25 million through participation in the Treasury s Capital Purchase Program. Under the program, the Treasury acquired 25,000 Series A shares of Horizon s Fixed Rate Cumulative Perpetual Preferred Stock (Series A Preferred Stock), which was required to pay a 5% per annum dividend for the first five years of

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the investment (a total of $1,250,000 a year) and 9% per annum thereafter (a total of $2,250,000 a year) until Horizon redeemed the shares. The preferred shares qualified as Tier I capital. As part of its investment, the Treasury also received a warrant to purchase 477,234 shares of common stock of Horizon, with an exercise price of $7.86 per share. On August 25, 2011, the Company completed the redemption of the Series A Preferred Stock.

On August 25, 2011, the Company sold 12,500 shares of Senior Non-Cumulative Perpetual Preferred Stock, Series B (Series B Preferred Stock), for aggregate consideration of $12.5 million, to the Treasury pursuant to the Small Business Lending Fund program. Concurrently with this transaction, Horizon redeemed all 18,750 shares of our Series A Preferred Stock that remained outstanding under the Treasury s Capital Purchase Program. The redemption of the Series A Preferred stock was funded by the $12.5 million in proceeds from the sale of the Series B Preferred Stock together with other available funds.

The Company currently intends to continue its participation in the Small Business Lending Fund, pursuant to which it issued preferred stock to the Treasury, since the growth in the Company s small business lending has reduced the dividend cost. For the three months ending December 31, 2012, the dividend cost was approximately $156,250, or 5.0% annualized. For the first quarter of 2013, the dividend cost will be approximately $146,168, or 4.7% annualized, for the second quarter of 2013, the dividend cost will be approximately $140,573 or 4.5% annualized and for the third quarter of 2013, the dividend cost will be approximately $62,500 or 2.0% annualized. The Company plans to reserve cash so that it has the ability to redeem this preferred stock if and when the cost of this capital exceeds the cost of other forms of capital.

Horizon declared dividends in the amount of $.38 per share in 2012, $.31 per share in 2011, and $.30 per share in 2010. The dividend payout ratio (dividends as a percent of net income) was 15.9% for 2012, 20.1% for 2011, and 24.6% for 2010. For additional information regarding dividend conditions, see Note 1 of the Notes to the Consolidated Financial Statements.

In October of 2004, Horizon formed Horizon Statutory Trust II (Trust II), a wholly owned statutory business trust. Trust II sold $10.3 million of Trust Preferred Capital Securities as a participant in a pooled trust preferred securities offering. The proceeds from the sale of the trust preferred securities were used by the trust to purchase an equivalent amount of subordinated debentures from Horizon. The junior subordinated debentures are the sole assets of Trust II and are fully and unconditionally guaranteed by Horizon. The junior subordinated debentures and the trust preferred securities pay interest and dividends on a quarterly basis. The junior subordinated debentures and the securities bear interest at a rate of 90 day LIBOR plus 1.95% (2.26% at December 31, 2012) and mature on October 21, 2034, and securities may be called at any quarterly interest payment date at par. Costs associated with the issuance of the securities totaling $17,500 were capitalized and were amortized to the October 31, 2009, first call date of the securities.

In December of 2006, Horizon formed Horizon Bancorp Capital Trust III (Trust III), a wholly owned statutory business trust. Trust III sold $12.4 million of Trust Preferred Capital Securities as a participant in a pooled trust preferred securities offering. The proceeds from the sale of the trust preferred securities were used by the trust to purchase an equivalent amount of subordinated debentures from Horizon. The junior subordinated debentures are the sole assets of Trust III and are fully and unconditionally guaranteed by Horizon. The junior subordinated debentures and the trust preferred securities pay interest and dividends on a quarterly basis. The junior subordinated debentures and the securities bear interest at a rate of 90 day LIBOR plus 1.65% (1.95% at December 31, 2012) and mature on January 30, 2037, and securities may be called at any quarterly interest payment date at par. Costs associated with the issuance of the securities totaling $12,647 were capitalized and are being amortized to the first call date of the securities. The proceeds of this issue were used to redeem the securities issued by Trust I on March 26, 2007.

The Company assumed additional debentures as the result of the acquisition of Alliance Bank Corporation in 2005. In June 2004, Alliance formed Alliance Financial Statutory Trust I a wholly owned business trust (Alliance Trust) to sell $5.2 million in trust preferred securities. The proceeds from the sale of the trust preferred securities were used by the trust to purchase an equivalent amount of subordinated debentures from Alliance. The junior subordinated debentures are the sole assets of Alliance Trust and are fully and unconditionally guaranteed by Horizon. The junior subordinated debentures and the trust preferred securities pay interest and dividends on a quarterly basis. The junior subordinated

debentures and the securities bear interest at a rate of 90-day LIBOR plus 2.65% (2.96% at December 31, 2012) and mature in June 2034, and securities may be called at any quarterly interest payment date at par.

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The Company assumed additional debentures as the result of the American Trust & Savings Bank purchase and assumption in 2010. In March 2004, Am Tru Inc., the holding company for American Trust & Savings Bank, formed Am Tru Statutory Trust I a wholly owned business trust (Am Tru Trust) to sell $3.5 million in trust preferred securities. The proceeds from the sale of the trust preferred securities were used by the trust to purchase an equivalent amount of subordinated debentures from Am Tru Inc. The junior subordinated debentures are the sole assets of Am Tru Trust and are fully and unconditionally guaranteed by Horizon. The junior subordinated debentures and the trust preferred securities pay interest and dividends on a quarterly basis. The junior subordinated debentures and the securities bear interest at a rate of 90-day LIBOR plus 2.85% (3.16% at December 31, 2012) and mature in March 2034, and securities may be called at any quarterly interest payment date at par. The carrying value was $2.8 million, net of the remaining purchase discount, at December 31, 2012.

The Company assumed additional debentures as the result of the Heartland merger in July 2012. In December 2006, Heartland. formed Heartland (IN) Statutory Trust II a wholly owned business trust (Heartland Trust) to sell $3.0 million in trust preferred securities. The proceeds from the sale of the trust preferred securities were used by the trust to purchase an equivalent amount of subordinated debentures from Heartland. The junior subordinated debentures are the sole assets of Heartland Trust and are fully and unconditionally guaranteed by Horizon. The junior subordinated debentures and the trust preferred securities pay interest and dividends on a quarterly basis. The junior subordinated debentures and the securities bear interest at a rate of 90-day LIBOR plus 1.67% (1.98% at December 31, 2012) and mature in December 2036, and securities may be called at any quarterly interest payment date at par. The carrying value was $1.5 million, net of the remaining purchase discount, at December 31, 2012.

The Trust Preferred Capital Securities, subject to certain limitations, are included in Tier 1 Capital for regulatory purposes. Dividends on the Trust Preferred Capital Securities are recorded as interest expense.

**Results of Operations**

***Net Income***

Consolidated net income was $19.5 million or $2.30 per diluted share in 2012, $12.8 million or $1.51 per diluted share in 2011, and $10.5 million or $1.21 per diluted share in 2010. Diluted earnings per share were reduced by $0.06 for the twelve months ending December 31, 2012, $0.17 for the twelve months ending December 31, 2011 and $0.19 for the twelve months ending December 31, 2010 resulting from the decrease in preferred stock dividends and the accretion of the discount on the preferred stock.

***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.

The reduction in interest rates during 2012 and 2011 has influenced the cost of the Company s interest bearing liabilities more significantly than the reduction in yields received on the Company s interest earning assets, resulting in an increase of the net interest margin during 2012. Management believes that the current level of interest rates is driven by external factors and therefore impacts the results of the Company s net interest margin. Management does not expect a significant rise in interest rates in the short term, but an increase in rates is expected at some time in the future due to the current historically low interest rate environment.

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Net interest income during 2012 was $58.2 million, an increase of $10.1 million or 21.0% over the $48.1 million earned in 2011. Yields on the Company s interest-earning assets decreased by 15 basis points to 4.83% during 2012 from 4.98% in 2011. Interest income increased $7.9 million to $72.5 million for 2012 from $64.6 million in 2011. This increase was due to increased volume in interest earning assets partially offset by the lower yield on interest earning assets. Interest income was also increased due to the recognition of approximately $1.5 million of interest income from the Heartland loan discounts.

Rates paid on interest-bearing liabilities decreased by 32 basis points during the same period due to the lower interest rate environment. Interest expense decreased $2.2 million from $16.5 million for 2011 to $14.3 million in 2012. This decrease was due to the lower rates being paid on the Company s interest bearing liabilities but offset by the increased volume of interest bearing liabilities. Due to a larger decrease in the rates paid on the Company s interest-bearing liabilities compared to the decrease in the yield on the Company s interest-earning assets, along with the growth of the Company s interest earning assets and interest bearing liabilities, the net interest margin increased 15 basis points from 3.74% for 2011 to 3.89% in 2012. The increase in the margin in 2012 compared to 2011 was due to the recognition of approximately $1.5 million of interest income from the Heartland loan discounts. Excluding the interest income recognized from the loan discounts, the margin would have been 3.81% for 2012.

| | Twelve Months Ended December 31, 2012 | | | Twelve Months Ended December 31, 2011 | | | Twelve Months Ended December 31, 2010 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Average Balance | Interest | Average Rate | Average Balance | Interest | Average Rate | Average Balance | Interest | Average Rate |
| **ASSETS** | | | | | | | | | |
| Interest-earning assets | | | | | | | | | |
| Federal funds sold | $ 5,609 | $ 13 | 0.23% | $ 20,307 | $ 49 | 0.24% | $ 23,917 | $ 53 | 0.22% |
| Interest-earning deposits | 2,770 | 6 | 0.22% | 7,262 | 2 | 0.03% | 8,684 | 17 | 0.20% |
| Investment securities taxable | 365,693 | 8,814 | 2.41% | 332,551 | 10,150 | 3.05% | 282,507 | 9,535 | 3.38% |
| Investment securities non-taxable (1) | 115,398 | 3,968 | 4.65% | 111,934 | 4,073 | 5.20% | 108,809 | 4,148 | 5.45% |
| Loans receivable (2)(3)(4) | 1,043,620 | 59,727 | 5.73% | 862,498 | 50,340 | 5.84% | 878,181 | 54,738 | 6.24% |
| Total interest-earning assets (1) | 1,533,090 | 72,528 | 4.83% | 1,334,552 | 64,614 | 4.98% | 1,302,098 | 68,491 | 5.40% |
| Noninterest-earning assets | | | | | | | | | |
| Cash and due from banks | 19,365 | | | 15,834 | | | 15,341 | | |
| Allowance for loan losses | (18,738) | | | (19,047) | | | (17,058) | | |
| Other assets | 112,739 | | | 98,069 | | | 93,671 | | |
| | $ 1,646,456 | | | $ 1,429,408 | | | $ 1,394,052 | | |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | | | | | | | | |
| Interest-bearing liabilities | | | | | | | | | |
| Interest-bearing deposits | $ 992,880 | $ 6,206 | 0.63% | $ 887,687 | $ 8,346 | 0.94% | $ 871,526 | $ 10,711 | 1.23% |
| Borrowings | 297,597 | 6,166 | 2.07% | 261,255 | 6,334 | 2.42% | 264,293 | 8,476 | 3.21% |
| Subordinated debentures | 32,408 | 1,950 | 6.02% | 31,446 | 1,821 | 5.79% | 32,005 | 1,688 | 5.27% |
| Total interest-bearing liabilities | 1,322,885 | 14,322 | 1.08% | 1,180,388 | 16,501 | 1.40% | 1,167,824 | 20,875 | 1.79% |
| Noninterest-bearing liabilities | | | | | | | | | |
| Demand deposits | 165,340 | | | 119,504 | | | 97,665 | | |
| Accrued interest payable and other liabilities | 16,190 | | | 10,841 | | | 10,466 | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Shareholders equity | 142,041 | | | 118,675 | | | 118,097 | | |
| | $ 1,646,456 | | | $ 1,429,408 | | | $ 1,394,052 | | |
| Net interest income/spread | | $ 58,206 | 3.75% | | $ 48,113 | 3.58% | | $ 47,616 | 3.61% |
| Net interest income as a percent of average interest earning assets (1) | | | 3.89% | | | 3.74% | | | 3.80% |

(1) Horizon has no foreign office and, accordingly, no assets or liabilities to foreign operations. Horizon s subsidiary bank had no funds invested in Eurodollar Certificates of Deposit at December 31, 2012.

(2) Yields are presented on a tax-equivalent basis.

(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.

(4) Loan fees and late fees included in interest on loans aggregated $5.0 million, $3.5 million, and $3.9 million in 2012, 2011 and 2010.

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| | 2012 - 2011 | | | 2011 -2010 | | |
|---|---|---|---|---|---|---|
| | Total Change | Change Due To Volume | Change Due To Rate | Total Change | Change Due To Volume | Change Due To Rate |
| **Interest Income** | | | | | | |
| Federal funds sold | $ (36) | $ (34) | $ (2) | $ (4) | $ (8) | $ 4 |
| Interest-earning deposits | 4 | (2) | 6 | (15) | (2) | (13) |
| Investment securities taxable | (1,336) | 943 | (2,279) | 615 | 1,585 | (970) |
| Investment securities non-taxable | (105) | 176 | (281) | (75) | 167 | (242) |
| Loans receivable | 9,387 | 10,391 | (1,004) | (4,398) | (965) | (3,433) |
| Total interest income | 7,914 | 11,474 | (3,560) | (3,877) | 777 | (4,654) |
| **Interest Expense** | | | | | | |
| Interest-bearing deposits | (2,140) | 902 | (3,042) | (2,365) | 195 | (2,560) |
| Borrowings | (168) | 817 | (985) | (2,142) | (96) | (2,046) |
| Subordinated debentures | 129 | 57 | 72 | 133 | (30) | 163 |
| Total interest expense | (2,179) | 1,776 | (3,955) | (4,374) | 69 | (4,443) |
| **Net interest income** | $ 10,093 | $ 9,698 | $ 395 | $ 497 | $ 708 | $ (211) |

Net interest income during 2011 was $48.1 million, an increase of $500,000 or 1.1% over the $47.6 million earned in 2010. Yields on the Company s interest-earning assets decreased by 42 basis points to 4.98% during 2011 from 5.40% in 2010. Interest income decreased $3.9 million to $64.6 million for 2011 from $68.5 million in 2010. This decrease was due to the lower yield on interest earning assets partially offset by the increased volume in interest earning assets.

Rates paid on interest-bearing liabilities decreased by 39 basis points during the same period due to the lower interest rate environment. Interest expense decreased $4.4 million from $20.9 million for 2010 to $16.5 million in 2011. This decrease was due to the lower rates being paid on the Company s interest bearing liabilities but offset by the increased volume of interest bearing liabilities. Due to a larger decrease in the yield on the Company s interest-earning assets compared to the decrease in the rates paid on the Company s interest-bearing liabilities, offset with the growth of the Company s interest earning assets and interest bearing liabilities, the net interest margin decreased 6 basis points from 3.80% for 2010 to 3.74% for 2011.

***Provision for Loan Losses***

Horizon assesses the adequacy of its Allowance for Loan and Lease Losses (ALLL) by regularly reviewing the performance of its loan portfolios. During 2012, the provision for loan losses totaled $3.5 million, compared to $5.3 million in the prior year. Commercial loan net charge-offs during 2012 were $1.6 million, residential mortgage loan net charge-offs were $520,000, and installment loan net charge-offs were $2.0 million. Loan charge-offs continue to require provisions for loan losses during the year but appeared to be decreasing as the amount of charge-offs decreased during 2012 compared to 2011. The provision for loan losses during 2012 also included $431,000 of charge-offs related to the credit losses resulting from the Heartland loans acquired that exceeded the loan discounts recorded at the time of the acquisition.

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**Management s Discussion and Analysis of**

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(Table dollars in thousands except per share data)

***Non-interest Income***

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

| | Twelve Months Ended | | 2011 to 2012 | | | 2010 to 2011 | |
|---|---|---|---|---|---|---|---|
| | December 31 2012 | December 31 2011 | Amount Change | Percent Change | December 31 2010 | Amount Change | Percent Change |
| **Other income** | | | | | | | |
| Service charges on deposit accounts | **$ 3,470** | $ 3,164 | $ 306 | 9.7% | $ 3,607 | $ (443) | -12.3% |
| Wire transfer fees | **892** | 619 | 273 | 44.1% | 756 | (137) | -18.1% |
| Interchange fees | **3,122** | 2,594 | 528 | 20.4% | 2,247 | 347 | 15.4% |
| Fiduciary activities | **3,997** | 3,983 | 14 | 0.4% | 3,979 | 4 | 0.1% |
| Gain on sale of securities | **2** | 1,777 | (1,775) | -99.9% | 533 | 1,244 | 233.4% |
| Gain on sale of mortgage loans | **14,123** | 6,449 | 7,674 | 119.0% | 7,538 | (1,089) | -14.4% |
| Mortgage servicing net of impairment | **234** | 267 | (33) | -12.4% | (565) | 832 | -147.3% |
| Increase in cash surrender value of bank owned life insurance | **1,025** | 891 | 134 | 15.0% | 803 | 88 | 11.0% |
| Death benefit on officer life insurance | | 453 | (453) | -100.0% | | 453 | 0.0% |
| Other income | **466** | 102 | 364 | 356.9% | 1,008 | (906) | -89.9% |
| **Total other income** | **$ 27,331** | $ 20,299 | $ 7,032 | 34.6% | $ 19,906 | $ 393 | 2.0% |

The increase in service charges on deposit accounts and interchange fee income has been the result of growth in transactional deposit accounts during 2012. Wire transfer fee income increased compared to the prior year as the Company s mortgage warehouse lending had more activity due to increased residential mortgage loan refinancing volume compared to 2011. During 2012, the Company originated approximately $386.9 million of mortgage loans to be sold on the secondary market, compared to $275.9 million last year. The increased volume in the secondary market sales and a higher percentage gains on the sale of mortgage loans compared to 2011 increased the overall gain on sale of mortgage loans compared to the prior year. The increase in the cash surrender value of bank owned life insurance during 2012 was due to additional life insurance from the Heartland acquisition and an increase in the investment return. These increases were offset by decreases in gain on the sale of securities and death benefit on officer life insurance compared to 2011.

***Non-interest Expense***

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

| | Twelve Months Ended | | | 2011 to 2012 | | 2010 to 2011 | |
|---|---|---|---|---|---|---|---|
| | December 31 2012 | December 31 2011 | Amount Change | Percent Change | December 31 2010 | Amount Change | Percent Change |
| **Other expense** | | | | | | | |
| Salaries | **$ 18,471** | $ 15,254 | $ 3,217 | 21.1% | $ 14,396 | $ 858 | 6.0% |
| Commission and bonuses | **4,878** | 3,277 | 1,601 | 48.9% | 3,731 | (454) | -12.2% |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Employee benefits | **5,034** | 4,344 | 690 | 15.9% | 3,963 | 381 | 9.6% |
| Net occupancy expenses | **4,529** | 4,267 | 262 | 6.1% | 4,195 | 72 | 1.7% |
| Data processing | **2,717** | 2,006 | 711 | 35.4% | 1,925 | 81 | 4.2% |
| Professional fees | **1,990** | 1,497 | 493 | 32.9% | 1,701 | (204) | -12.0% |
| Outside services and consultants | **2,313** | 1,741 | 572 | 32.9% | 1,694 | 47 | 2.8% |
| Loan expense | **4,276** | 3,586 | 690 | 19.2% | 3,208 | 378 | 11.8% |
| FDIC deposit insurance | **1,108** | 1,220 | (112) | -9.2% | 1,635 | (415) | -25.4% |
| Other losses | **619** | 2,383 | (1,764) | -74.0% | 504 | 1,879 | 372.8% |
| Other expenses | 8,089 | 6,572 | 1,517 | 23.1% | 5,619 | 953 | 17.0% |
| **Total other expense** | **$ 54,024** | $ 46,147 | $ 7,877 | 17.1% | $ 42,571 | $ 3,576 | 8.4% |

Salaries, commission and bonuses, and employee benefits increased during 2012 compared to 2011. These increases were primarily the result of changes to annual merit pay, increased employee benefits costs, commissions earned and bonus accruals. In addition, compensation expense was higher due to the Heartland merger and directly related to Horizon s investment in growth markets. Net occupancy expense also increased due to the Heartland transaction and the Company s expansion efforts. Data processing, professional fees, outside services and consultants and other expenses increased during 2012 due to the Heartland acquisition and from the cost of continued growth and expansion. Loan expense increased in 2012 compared to 2011 due to problem loan, bankruptcy, collection costs and indirect loan dealer fees. Included in 2012 s

non-interest expense was approximately $1.5 million of transaction expenses directly related to the Heartland acquisition. FDIC deposit insurance expense decreased during 2012 compared to 2011 as assessment calculations have resulted in lower expense for the Bank. Other losses were down in 2012 due to 2011 including $798,000 pre-payment penalty for the repayment of an FHLB advance before its scheduled maturity, $597,000 in OREO write downs, $528,000 from write downs on two bank-owned properties from branches that were closed and $210,000 lawsuit settlement.

***Income Taxes***

Income tax expense for 2012 was $8.4 million, compared to $4.2 million of tax expense for during 2011. The effective tax rate for 2012 was 30.2% compared to 24.6% in 2011 and 22.0% in 2010. The increase in the effective tax rates in 2012 was primarily due to higher income before income tax.

***Liquidity and Rate Sensitivity Management***

Management and the Board of Directors meet regularly to review both the liquidity and rate sensitivity position of Horizon. Effective asset and liability management ensures Horizon s ability to monitor the cash flow requirements of depositors along with the demands of borrowers and to measure and manage interest rate risk. Horizon utilizes an interest rate risk assessment model designed to highlight sources of existing interest rate risk and consider the effect of these risks on strategic planning. Management maintains (within certain parameters) an essentially balanced ratio of interest sensitive assets to liabilities in order to protect against the effects of wide interest rate fluctuations.

***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 repayments, investment security sales and maturities, sale of real estate loans and borrowing relationships with correspondent banks, including the Federal Home Loan Bank (FHLB) and the Federal Reserve Bank (FRB). At December 31, 2012, Horizon had available approximately $349.6 million in available credit from various money center banks, including the FHLB and the FRB Discount Window. Factors which could impact Horizon s funding needs in the future include:

Horizon had outstanding borrowings of over $114.6 million with the FHLB and total borrowing capacity with the FHLB of $351.9 million. Generally, the loan terms from the FHLB are better than the terms Horizon can receive from other sources, making it less expensive to borrow money from the FHLB. Continued and additional financial difficulties at the FHLB could reduce or eliminate Horizon s additional borrowing capacity with the FHLB or FHLB could change collateral requirements, which could lower the Company s borrowing availability.

If residential mortgage loan rates remain low, Horizon s mortgage warehouse loans could create an additional need for funding.

Horizon had a total of $119.0 million of Federal Fund lines from various money center banks. These are uncommitted lines and could be withdrawn at any time by the correspondent banks.

Horizon had a total of $87.8 million of available collateral at the Federal Reserve Bank secured by municipal securities. These securities may mature, call, or be sold, which would reduce the available collateral.

A downgrade in Horizon s public credit rating by a rating agency due to factors such as deterioration in asset quality, a large charge to earnings, a decline in profitability or other financial measures, or a significant merger or acquisition.

An act of terrorism or war, natural disasters, political events, or the default or bankruptcy of a major corporation, mutual fund, hedge fund or a government agency.

Market speculation or rumors about Horizon or the banking industry in general may adversely affect the cost and availability of normal funding sources.

Horizon anticipates spending $5.0 million for premises and equipment during 2013, including two full service offices. These purchases will be funded through normal operations.

If any of these events occur, they could force Horizon to borrow money from other sources including negotiable certificates of deposit. Such other monies may only be available at higher interest rates and on less advantageous terms, which will impact our net income and could impact our ability to grow. Management believes Horizon has adequate funding sources to meet short and long term needs.

HORIZON BANCORP AND SUBSIDIARIES

**Management s Discussion and Analysis of**

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(Table dollars in thousands except per share data)

Horizon maintains a liquidity contingency plan that outlines the process for addressing a liquidity crisis. The plan provides for an evaluation of funding sources under various market conditions. It also assigns specific roles and responsibilities for effectively managing liquidity through a problem period.

During 2012, cash flows were generated primarily from the sales, maturities, and prepayments of investment securities of $132.2 million and increase in deposits by $73.0 million. Cash flows were used to purchase investments totaling $113.9 million, increase in loans totaling $102.6 million and decrease borrowings by $25.4 million. The net cash and cash equivalent position increased by $10.3 million during 2012.

The following table sets forth contractual obligations and other commitments representing required and potential cash outflows as of December 31, 2012. Interest on subordinated debentures and long-term borrowed funds is calculated based on current contractual interest rates.

| (dollars in thousands) | Total | Within one year | After one but within three years | After three but within five years | After five years |
|---|---|---|---|---|---|
| Remaining contractual maturities of time deposits | $ 315,131 | $ 140,878 | $ 83,704 | $ 59,191 | $ 31,358 |
| Borrowings | 345,764 | 186,767 | 21,034 | 78,590 | 59,373 |
| Subordinated debentures | 32,331 | | | | 32,331 |
| Loan Commitments | 328,916 | 328,916 | | | |
| Preferred stock | 12,500 | | 12,500 | | |
| Letters of credit | 1,586 | 1,586 | | | |
| Total | $ 1,036,228 | $ 658,147 | $ 117,238 | $ 137,781 | $ 123,062 |

***Interest Sensitivity***

The degree by which net interest income may fluctuate due to changes in interest rates is monitored by Horizon using computer simulation models, incorporating not only the current GAP position but the effect of expected repricing of specific financial assets and liabilities. When repricing opportunities are not properly aligned, net interest income may be affected when interest rates change. Forecasting results of the possible outcomes determines the exposure to interest rate risk inherent in Horizon s balance sheet. The goal is to manage imbalanced positions that arise when the total amount of assets that reprice or mature in a given time period differs significantly from liabilities that reprice or mature in the same time period. The theory behind managing the difference between repricing assets and liabilities is to have more assets repricing in a rising rate environment and more liabilities repricing in a declining rate environment. Based on one model that assumes a lag in repricing, at December 31, 2012, the amount of assets that reprice within one year was 246% of liabilities that reprice within one year. At December 31, 2011, this same model, reported that the amount of assets that reprice within one year was approximately 183% of the amount of liabilities that reprice within the same time period. The year 2012 was a declining rate environment and the rates on liabilities continued to reprice at lower rates due to management s ability to lower those rates. The impact of the interest rate reduction along with interest rate floors on certain loans positively impacted the net interest margin during 2012.

HORIZON BANCORP AND SUBSIDIARIES

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| | Rate Sensitivity | | | | |
|---|---|---|---|---|---|
| | 3 Months or Less | > 3 Months & < 6 Months | > 6 Months & < 1 Year | Greater Than 1 Year | Total |
| Loans | $ 619,830 | $ 97,720 | $ 149,828 | $ 337,084 | $ 1,204,462 |
| Federal Funds Sold | 13 | | | | 13 |
| Interest-Bearing balances with Banks | 2,492 | | | | 2,492 |
| Investment securities with FRB and FHLB stock | 41,621 | 33,541 | 49,934 | 371,038 | 496,134 |
| Other assets | | | | 145,126 | 145,126 |
| Total Assets | $ 663,956 | $ 131,261 | $ 199,762 | $ 853,248 | $ 1,848,227 |
| Noninterest-bearing deposits | $ 5,336 | $ 5,336 | $ 10,672 | $ 187,856 | $ 209,200 |
| Interest-bearing deposits | 69,988 | 57,478 | 103,859 | 853,626 | 1,084,951 |
| Borrowed Funds | 146,881 | 1,813 | 3,463 | 225,939 | 378,096 |
| Other Liabilities | | | | 17,012 | 17,012 |
| Stockholders equity | | | | 158,968 | 158,968 |
| Total liabilities and stockholder s equity | $ 222,205 | $ 64,627 | $ 117,994 | $ 1,443,401 | $ 1,848,227 |
| GAP | $ 441,751 | $ 66,634 | $ 81,768 | $ (590,153) | |
| Cumulative GAP | $ 441,751 | $ 508,385 | $ 590,153 | | |

Included in the GAP analysis are certain interest-bearing demand accounts and savings accounts. These interest-bearing accounts are subject to immediate withdrawal. However, Horizon considers approximately 87% of these deposits to be insensitive to gradual changes in interest rates and generally to behave like deposits with longer maturities based upon historical experience and management s ability to change rates. Due to management s ability to change some deposit rates along with $452.6 million of Horizon s adjustable rate loans at their floor, another model was developed to better assist management in determining the balance sheet repricing sensitivity to these variables. This model reported that the amount of assets that reprice within one year was approximately 76% of the amount of liabilities that reprice within the same time period. Management utilizes both models to best determine its balance sheet management strategy.

| | Repricing Sensitivity | | | | |
|---|---|---|---|---|---|
| | 3 Months or Less | > 3 Months & < 6 Months | > 6 Months & < 1 Year | Greater Than 1 Year | Total |
| Loans | $ 619,830 | $ 97,720 | $ 149,828 | $ 337,084 | $ 1,204,462 |
| Federal Funds Sold | 13 | | | | 13 |
| Interest-Bearing balances with Banks | 2,492 | | | | 2,492 |
| Investment securities with FRB and FHLB stock | 41,621 | 33,541 | 49,934 | 371,038 | 496,134 |
| Other assets | | | | 145,126 | 145,126 |
| Total Assets | $ 663,956 | $ 131,261 | $ 199,762 | $ 853,248 | $ 1,848,227 |

| | | | | | |
|---|---|---|---|---|---|
| Noninterest-bearing deposits | $ 209,200 | $ | $ | $ | $ 209,200 |
| Interest-bearing deposits | 813,228 | 36,188 | 61,282 | 174,253 | 1,084,951 |
| Borrowed Funds | 188,002 | 108 | 167 | 189,819 | 378,096 |
| Other Liabilities | | | | 17,012 | 17,012 |
| Stockholders equity | | | | 158,968 | 158,968 |
| Total liabilities and stockholder s equity | $ 1,210,430 | $ 36,296 | $ 61,449 | $ 540,052 | $ 1,848,227 |
| GAP | $ (546,474) | $ 94,965 | $ 138,313 | $ 313,196 | |
| Cumulative GAP | $ (546,474) | $ (451,509) | $ (313,196) | | |

**Horizon Bancorp and Subsidiaries**

**Management s Discussion and Analysis of**

**Financial Condition and Results of Operations**

(Table dollars in thousands except per share data)

***Quantitative and Qualitative Disclosures about Market Risk***

Horizon s primary market risk exposure is interest rate risk. Interest rate risk (IRR) is the risk that Horizon s earnings and capital will be adversely affected by changes in interest rates. The primary approach to IRR management is one that focuses on adjustments to the asset/liability mix in order to limit the magnitude of IRR.

Horizon s exposure to interest rate risk arises from repricing or mismatch risk, embedded options risk, and yield curve risk. Repricing risk is the risk of adverse consequence from a change in interest rates that arise because of differences in the timing of when those interest rate changes affect Horizon s assets and liabilities. Basis risk is the risk that the spread, or rate difference, between instruments of similar maturities will change. Options risk arises whenever products give the customer the right, but not the obligation, to alter the quantity or timing of cash flows. Yield curve risk is the risk that changes in prevailing interest rates will affect instruments of different maturities by different amounts. Horizon s objective is to remain reasonably neutral with respect to IRR. Horizon utilizes a variety of strategies to maintain this position including the sale of mortgage loans on the secondary market, hedging certain balance sheet items using derivatives, varying maturities of FHLB advances, certificates of deposit funding and investment securities.

The table, which follows, provides information about Horizon s financial instruments that were sensitive to changes in interest rates as of December 31, 2012. The table incorporates Horizon s internal system generated data related to the maturity and repayment/withdrawal of interest-earning assets and interest-bearing liabilities. For loans, securities and liabilities with contractual maturities, the table presents principal cash flows and related weighted-average interest rates by contractual maturities as well as the historical experience of Horizon related to the impact of interest rate fluctuations on the prepayment of residential loans and mortgage-backed securities. From a risk management perspective, Horizon believes that repricing dates are more relevant than contractual maturity dates when analyzing the value of financial instruments. For deposits with no contractual maturity dates, the table presents principal cash flows and weighted average rate, as applicable, based upon Horizon s experience and management s judgment concerning the most likely withdrawal behaviors.

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(Table dollars in thousands except per share data)

***Quantitative Disclosure of Market Risk***

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 & Beyond | Total | Fair Value December 31 2012 |
|---|---|---|---|---|---|---|---|---|
| **Rate-sensitive assets** | | | | | | | | |
| Fixed interest rate loans | $ 272,007 | $ 113,264 | $ 68,920 | $ 40,646 | $ 21,408 | $ 52,518 | $ 568,763 | $ 529,661 |
| Average interest rate | 5.30% | 5.45% | 5.32% | 5.25% | 5.22% | 5.52% | 5.35% | |
| Variable interest rate loans | 584,159 | 17,091 | 11,410 | 9,390 | 6,401 | 7,247 | 635,698 | 703,840 |
| Average interest rate | 4.43% | 4.60% | 4.25% | 4.06% | 4.26% | 4.02% | 4.42% | |
| Total loans | 856,166 | 130,355 | 80,330 | 50,036 | 27,809 | 59,765 | 1,204,461 | 1,233,501 |
| Average interest rate | 4.71% | 5.34% | 5.16% | 5.02% | 5.00% | 5.34% | 4.86% | |
| Securities, including FRB and FHLB stock | 125,097 | 89,282 | 58,405 | 55,007 | 27,540 | 140,804 | 496,134 | 496,134 |
| Average interest rate | 3.08% | 2.94% | 3.24% | 3.63% | 3.54% | 3.91% | 3.40% | |
| Other interest-bearing assets | 2,506 | | | | | | 2,506 | 2,506 |
| Average interest rate | 0.48% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.48% | |
| Total earnings assets | $ 983,769 | $ 219,637 | $ 138,735 | $ 105,042 | $ 55,349 | $ 200,569 | $ 1,703,101 | $ 1,732,141 |
| Average interest rate | 4.49% | 4.37% | 4.35% | 4.30% | 4.37% | 4.34% | 4.43% | |
| **Rate-sensitive liabilities** | | | | | | | | |
| Noninterest-bearing deposits | $ 21,895 | $ 19,161 | $ 17,201 | $ 15,441 | $ 13,862 | $ 121,639 | $ 209,200 | $ 209,200 |
| NOW accounts | 55,941 | 50,040 | 44,760 | 40,038 | 35,814 | 303,656 | 530,250 | 530,620 |
| Average interest rate | 0.14% | 0.14% | 0.14% | 0.14% | 0.14% | 0.14% | 0.14% | |
| Savings and money market accounts | 29,213 | 24,979 | 21,421 | 18,427 | 15,900 | 124,339 | 234,279 | 237,581 |
| Average interest rate | 0.14% | 0.14% | 0.14% | 0.13% | 0.13% | 0.10% | 0.12% | |
| Certificates of deposit | 146,170 | 51,833 | 31,871 | 29,369 | 29,822 | 31,358 | 320,423 | 323,983 |
| Average interest rate | 0.95% | 1.61% | 1.95% | 3.04% | 2.85% | 2.16% | 1.64% | |
| Total deposits | 253,219 | 146,012 | 115,254 | 103,276 | 95,398 | 580,993 | 1,294,152 | 1,301,384 |
| Average interest rate | 0.60% | 0.64% | 0.62% | 0.94% | 0.96% | 0.21% | 0.48% | |
| Fixed interest rate borrowings | 141,368 | 251 | 20,783 | 21,956 | 56,634 | 61,325 | 302,317 | 309,444 |
| Average interest rate | 0.49% | 4.64% | 2.28% | 2.76% | 3.89% | 3.30% | 1.99% | |
| Variable interest rate borrowings | 75,778 | | | | | | 75,778 | 75,715 |
| Average interest rate | 2.49% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 2.49% | |
| Total funds | $ 470,365 | $ 146,264 | $ 136,037 | $ 125,231 | $ 152,032 | $ 642,318 | $ 1,672,246 | $ 1,686,543 |

| Average interest rate | 0.87% | 0.65% | 0.87% | 1.26% | 2.05% | 0.50% | 0.85% |
|---|---|---|---|---|---|---|---|

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The information required under this item is incorporated by reference to the information appearing in management s discussion and analysis of financial condition and results of operation included in Item 7.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**HORIZON BANCORP AND SUBSIDIARIES**

**Consolidated Financial Statements**

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HORIZON BANCORP AND SUBSIDIARIES

**Consolidated Balance Sheets**

(Dollar Amounts in Thousands)

| | December 31 2012 | December 31 2011 |
|---|---|---|
| **Assets** | | |
| Cash and due from banks | **$ 30,735** | $ 20,447 |
| Investment securities, available for sale | **482,801** | 431,045 |
| Investment securities, held to maturity | | 7,100 |
| Loans held for sale | **13,744** | 14,090 |
| Loans, net of allowance for loan losses of $18,270 and $18,882 | **1,172,447** | 964,311 |
| Premises and equipment | **42,184** | 34,665 |
| Federal Reserve and Federal Home Loan Bank stock | **13,333** | 12,390 |
| Goodwill | **19,748** | 5,910 |
| Other intangible assets | **4,048** | 2,292 |
| Interest receivable | **7,716** | 6,671 |
| Cash value life insurance | **35,192** | 30,190 |
| Other assets | **26,279** | 18,051 |
| Total assets | **$ 1,848,227** | $ 1,547,162 |
| **Liabilities** | | |
| Deposits | | |
| Non-interest bearing | **$ 209,200** | $ 130,673 |
| Interest bearing | **1,084,953** | 879,192 |
| Total deposits | **1,294,153** | 1,009,865 |
| Borrowings | **345,764** | 370,111 |
| Subordinated debentures | **32,331** | 30,676 |
| Interest payable | **560** | 596 |
| Other liabilities | **16,451** | 14,449 |
| Total liabilities | **1,689,259** | 1,425,697 |
| **Commitments and contingent liabilities** | | |
| **Stockholders Equity** | | |
| Preferred stock, $.01 par value, $1,000 liquidation value | | |
| Authorized, 1,000,000 Series B shares | | |
| Issued 12,500 and 12,500 shares | 12,500 | 12,500 |
| Common stock, no par value | | |
| Authorized, 22,500,000 shares | | |
| Issued, 8,693,471 and 7,450,794 shares | | |
| Outstanding, 8,617,466 and 7,421,544 shares | | |
| Additional paid-in capital | **31,965** | 11,736 |
| Retained earnings | **105,402** | 89,387 |
| Accumulated other comprehensive income | **9,101** | 7,842 |
| Total stockholders equity | **158,968** | 121,465 |
| Total liabilities and stockholders equity | **$ 1,848,227** | $ 1,547,162 |

See notes to consolidated financial statements

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**Horizon Bancorp And Subsidiaries**

**Consolidated Statements of Income**

(Dollar Amounts in Thousands, Except Per Share Data)

| | Years Ended December 31 | | |
|---|---|---|---|
| | **2012** | **2011** | **2010** |
| **Interest Income** | | | |
| Loans receivable | **$ 59,727** | $ 50,340 | $ 54,738 |
| Investment securities | | | |
| Taxable | **8,833** | 10,201 | 9,605 |
| Tax exempt | **3,968** | 4,073 | 4,148 |
| Total interest income | **72,528** | 64,614 | 68,491 |
| **Interest Expense** | | | |
| Deposits | **6,206** | 8,346 | 10,711 |
| Borrowed funds | **6,166** | 6,334 | 8,476 |
| Subordinated debentures | **1,950** | 1,821 | 1,688 |
| Total interest expense | **14,322** | 16,501 | 20,875 |
| **Net Interest Income** | **58,206** | 48,113 | 47,616 |
| Provision for loan losses | **3,524** | 5,282 | 11,554 |
| **Net Interest Income after Provision for Loan Losses** | **54,682** | 42,831 | 36,062 |
| **Other Income** | | | |
| Service charges on deposit accounts | **3,470** | 3,164 | 3,607 |
| Wire transfer fees | **892** | 619 | 756 |
| Interchange fees | **3,122** | 2,594 | 2,247 |
| Fiduciary activities | **3,997** | 3,983 | 3,979 |
| Gain on sale of investment securities | **2** | 1,777 | 533 |
| Gain on sale of mortgage loans | **14,123** | 6,449 | 7,538 |
| Mortgage servicing income net of impairment | **234** | 267 | (565) |
| Increase in cash value of bank owned life insurance | **1,025** | 891 | 803 |
| Death benefit on bank owned life insurance | | 453 | |
| Other income | **466** | 102 | 1,008 |
| Total other income | **27,331** | 20,299 | 19,906 |
| **Other Expenses** | | | |
| Salaries and employee benefits | **28,383** | 22,875 | 22,090 |
| Net occupancy expenses | **4,529** | 4,267 | 4,195 |
| Data processing | **2,717** | 2,006 | 1,925 |
| Professional fees | **1,990** | 1,497 | 1,701 |
| Outside services and consultants | **2,313** | 1,741 | 1,694 |
| Loan expense | **4,276** | 3,586 | 3,208 |
| FDIC insurance expense | **1,108** | 1,220 | 1,635 |
| Other losses | **619** | 2,383 | 504 |
| Other expenses | **8,089** | 6,572 | 5,619 |

| | | | |
|---|---|---|---|
| Total other expenses | **54,024** | 46,147 | 42,571 |
| | | | |
| **Income Before Income Tax** | **27,989** | 16,983 | 13,397 |
| Income tax expense | **8,446** | 4,186 | 2,942 |
| | | | |
| **Net Income** | **19,543** | 12,797 | 10,455 |
| Preferred stock dividend and discount accretion | **(481)** | (1,325) | (1,406) |
| | | | |
| **Net Income Available to Common Shareholders** | **$ 19,062** | $ 11,472 | $ 9,049 |
| | | | |
| **Basic Earnings Per Share** | **$ 2.39** | $ 1.55 | $ 1.23 |
| **Diluted Earnings Per Share** | **2.30** | 1.51 | 1.21 |

See notes to consolidated financial statements

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**HORIZON BANCORP AND SUBSIDIARIES**

**Consolidated Statements of Comprehensive Income**

(Dollar Amounts in Thousands)

| | Years Ended December 31 | | |
|---|---|---|---|
| | **2012** | **2011** | **2010** |
| **Net Income** | **$ 19,543** | $ 12,797 | $ 10,455 |
| **Other Comprehensive Income (Loss)** | | | |
| Change in fair value of derivative instruments, net of taxes of $(203) for 2012, $(1,239) for 2011 and $(631) for 2010, respectively | **(376)** | (2,300) | (1,172) |
| Unrealized appreciation (depreciation) on available-for-sale securities, net of taxes of $881 for 2012, $4,819 for 2011 and $(998) for 2010, respectively | **1,636** | | |