FIRST CAPITAL INC
Form 10-K
March 27, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _________ to __________

Commission File Number: 0-25023

FIRST CAPITAL, INC.

(Exact name of registrant as specified in its charter)

Indiana	**35-2056949**
(State or other jurisdiction of	**(I.R.S. Employer**

incorporation or organization)	Identification No.)
220 Federal Drive, N.W., Corydon, Indiana	**47112**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (812) 738-2198

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.01 per share	Nasdaq Global Stock Market

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 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 Web Site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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 this Form 10-K. x

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 accelerated filer, large accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

(Check one):

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	x

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates was $53.9 million, based upon the closing price of $20.77 per share as quoted on the Nasdaq Stock Market as of the last business day of the registrant s most recently completed second fiscal quarter.

The number of shares outstanding of the registrant s common stock as of March 8, 2013 was 2,784,997.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2013 Annual Meeting of Stockholders

are incorporated by reference in Part III of this Form 10-K.

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This report contains certain forward-looking statements within the meaning of the federal securities laws. These statements are not historical facts, rather statements based on First Capital, Inc. s current expectations regarding its business strategies, intended results and future performance. Forward-looking statements are preceded by terms such as expects, believes, anticipates, intends and similar expressions.

Forward-looking statements are not guarantees of future performance. Management s ability to predict results or the effect of future plans or strategies is inherently uncertain. Numerous risks and uncertainties could cause or contribute to the Company s actual results, performance and achievements to materially differ from those expressed or implied by the forward-looking statements. Factors which could affect actual results include, but are not limited to, interest rate trends; the general economic climate in the specific market area in which First Capital operates, as well as nationwide; First Capital s ability to control costs and expenses; competitive products and pricing; loan delinquency rates; changes in federal and state legislation and regulation; and other factors disclosed periodically in the Company s filings with the Securities and Exchange Commission. Additional factors that may affect our results are discussed in Item 1A to this Annual Report on Form 10-K titled Risk Factors below. These factors should be considered in evaluating the forward-looking statements and undue reliance should not be placed on such statements, whether included in this report or made elsewhere from time to time by the Company or on its behalf. Except as may be required by applicable law or regulation, First Capital assumes no obligation to update any forward-looking statements.

PART I

ITEM 1. BUSINESS

General

First Capital, Inc. (the Company or First Capital) was incorporated under Indiana law on September 11, 1998. On December 31, 1998, the Company became the holding company for First Federal Bank, A Federal Savings Bank (the Bank) upon the Bank s reorganization as a wholly owned subsidiary of the Company resulting from the conversion of First Capital, Inc., M.H.C. (the MHC), from a federal mutual holding company to a stock holding company. On January 12, 2000, the Company completed a merger of equals with HCB Bancorp, the former holding company for Harrison County Bank, and the Bank changed its name to First Harrison Bank. On March 20, 2003, the Company acquired Hometown Bancshares, Inc. (Hometown), a bank holding company located in New Albany, Indiana.

The Company has no significant assets, other than all of the outstanding shares of the Bank and the portion of the net proceeds from the offering retained by the Company, and no significant liabilities. Management of the Company and the Bank are substantially similar and the Company neither owns nor leases any property, but instead uses the premises, equipment and furniture of the Bank in accordance with applicable regulations.

The Bank is regulated by the Office of the Comptroller of the Currency (the OCC) and the Federal Deposit Insurance Corporation (the FDIC). The Bank s deposits are federally insured by the FDIC under the Deposit Insurance Fund. The Bank is a member of the Federal Home Loan Bank System.

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Availability of Information

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 such reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are made available free of charge on the Company s Internet website, www.firstharrison.com, as soon as practicable after the Company electronically files such material with, or furnishes it to, the Securities and Exchange Commission. The contents of the Company s website shall not be incorporated by reference into this Form 10-K or into any reports the Company files with or furnishes to the Securities and Exchange Commission.

Market Area and Competition

The Bank considers Harrison, Floyd, Clark and Washington counties in Indiana its primary market area. All of its offices are located in these four counties, which results in most of the Bank s loans being made in these four counties. The main office of the Bank is located in Corydon, Indiana, 35 miles west of Louisville, Kentucky. The Bank aggressively competes for business with local banks, as well as large regional banks. Its most direct competition for deposit and loan business comes from the commercial banks operating in these four counties. Based on data published by the FDIC, the Bank is the leader among FDIC-insured institutions in deposit market share in Harrison County, the Bank s primary county of operation.

Lending Activities

General. Over the last few years, the Bank has continued to transform the composition of its balance sheet from that of a traditional thrift institution to that of a commercial bank. On the asset side, this is being accomplished in part by selling in the secondary market the newly-originated qualified fixed-rate residential mortgage loans while retaining variable rate residential mortgage loans in the portfolio. This transformation is also enhanced by an expanded commercial lending staff dedicated to growing commercial real estate and commercial business loans. The Bank also continues to originate consumer loans and residential construction loans for the loan portfolio. The Bank does not offer, and has not offered, Alt-A, sub-prime or no-document mortgage loans.

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Loan Portfolio Analysis. The following table presents the composition of the Bank s loan portfolio by type of loan at the dates indicated.

	At December 31,									
	2012		2011		2010		2009		2008	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in thousands)									
Mortgage Loans:										
Residential[1]	$ 108,097	37.37%	$ 116,338	40.84%	$ 130,143	43.11%	$ 139,085	43.45%	$ 150,576	45.96%
Land	9,607	3.32	9,910	3.48	9,534	3.16	10,288	3.21	9,475	2.89
Commercial real estate	68,731	23.76	57,680	20.25	59,901	19.84	60,580	18.92	65,367	19.95
Residential construction[2]	12,753	4.41	10,988	3.86	8,151	2.70	13,862	4.33	9,577	2.92
Commercial real estate construction	3,299	1.14	743	0.26	0	0.00	0	0.00	0	0.00
Total mortgage loans	202,487	70.00	195,659	68.69	207,729	68.81	223,815	69.91	234,995	71.72
Consumer Loans:										
Home equity and second mortgage loans	36,962	12.78	38,641	13.57	43,046	14.26	46,360	14.48	43,031	13.14
Automobile loans	21,922	7.58	20,627	7.24	19,384	6.42	17,714	5.53	16,523	5.04
Loans secured by savings accounts	770	0.27	767	0.27	1,042	0.34	1,361	0.43	1,972	0.60
Unsecured loans	3,191	1.10	3,126	1.10	3,076	1.02	2,677	0.84	2,807	0.86
Other[3]	5,303	1.84	5,312	1.86	5,732	1.90	5,321	1.66	5,419	1.65
Total consumer loans	68,148	23.57	68,473	24.04	72,280	23.94	73,433	22.94	69,752	21.29
Commercial business loans	18,612	6.43	20,722	7.27	21,911	7.25	22,861	7.15	22,881	6.99
Total gross loans	289,247	100.00%	284,854	100.00%	301,920	100.00%	320,109	100.00%	327,628	100.00%
Less:										
Due to borrowers on loans in process	4,306		4,768		3,119		4,372		2,828	
Deferred loan fees net of direct costs	(202)		(143)		(222)		(286)		(247)	
Allowance for loan losses	4,736		4,182		4,473		4,931		2,662	
Total loans, net	$ 280,407		$ 276,047		$ 294,550		$ 311,092		$ 322,385	

(1) Includes conventional one-to four-family and multi-family residential loans.
(2) Includes construction loans for which the Bank has committed to provide permanent financing.
(3) Includes loans secured by lawn and farm equipment, mobile homes and other personal property.

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Residential Loans. The Bank s lending activities have concentrated on the origination of residential mortgages, both for sale in the secondary market and for retention in the Bank s loan portfolio. Residential mortgages secured by multi-family properties are an immaterial portion of the residential loan portfolio. Substantially all residential mortgages are collateralized by properties within the Bank s market area.

The Bank offers both fixed-rate mortgage loans and adjustable rate mortgage (ARM) loans typically with terms of 15 to 30 years. The Bank uses loan documents approved by the Federal National Mortgage Corporation (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) whether the loan is originated for investment or sale in the secondary market.

Historically, the Bank has retained its residential loan originations in its portfolio. Retaining fixed-rate loans in its portfolio subjects the Bank to a higher degree of interest rate risk. See *Item 1A. Risk Factors Above Average Interest Rate Risk Associated with Fixed-Rate Loans* for a further discussion of the risks of rising interest rates. Beginning in 2004, one of the Bank s strategic goals was to expand its mortgage business by originating mortgage loans for sale, while offering a full line of mortgage products to prospective customers. This practice increases the Bank s lending capacity and allows the Bank to more effectively manage its profitability since it is not required to predict the prepayment, credit or interest rate risks associated with retaining either the loan or the servicing asset. For the year ended December 31, 2012, the Bank originated and funded $42.7 million of residential mortgage loans for sale in the secondary market. For a full discussion of the Bank s mortgage banking operations, see *Item 1. Business Mortgage Banking Activities*.

ARM loans originated have interest rates that adjust at regular intervals of one to five years, with up to 2.0% caps per adjustment period and 6.0% lifetime caps, based upon changes in the prevailing interest rates on United States Treasury Bills. The Bank also originates hybrid ARM loans, which are fixed for an initial period three or five years and adjust annually thereafter. The Bank may occasionally use below market interest rates and other marketing inducements to attract ARM loan borrowers. The majority of ARM loans provide that the amount of any increase or decrease in the interest rate is limited to 2.0% (upward or downward) per adjustment period and generally contains minimum and maximum interest rates. Borrower demand for ARMs versus fixed-rate mortgage loans is a function of the level of interest rates, the expectations of changes in the level of interest rates and the difference between the interest rates and loan fees offered for fixed-rate mortgage loans and interest rates and loan fees for ARM loans. The relative amount of fixed-rate and ARM loans that can be originated at any time is largely determined by the demand for each in a competitive environment.

The Bank s lending policies generally limit the maximum loan-to-value ratio on fixed-rate and ARM loans to 80% of the lesser of the appraised value or purchase price of the underlying residential property unless private mortgage insurance to cover the excess over 80% is obtained, in which case the mortgage is limited to 95% (or 97% under a Freddie Mac program) of the lesser of appraised value or purchase price. The loan-to-value ratio, maturity and other provisions of the loans made by the Bank are generally reflected in the policy of making less than the maximum loan permissible under federal regulations, in accordance with established lending practices, market conditions and underwriting standards maintained by the Bank. The Bank requires title, fire and extended insurance coverage on all mortgage loans originated. All of the Bank s real estate loans contain due on sale clauses. The Bank generally obtains appraisals on all its real estate loans from outside appraisers.

Construction Loans. The Bank originates construction loans for residential properties and, to a lesser extent, commercial properties. Although the Bank originates construction loans that are repaid with the proceeds of a limited number of mortgage loans obtained by the borrower from another lender, the majority of the construction loans that the Bank originates are permanently financed in the secondary market by the Bank. Construction loans originated without a commitment by the Bank to provide permanent financing are generally originated for a term of six to 12 months and at a fixed interest rate based on the prime rate.

The Bank originates speculative construction loans to a limited number of builders operating and based in the Bank s primary market area and with whom the Bank has well-established business relationships. At December 31, 2012, the Bank had approved speculative construction loans, a construction loan for which there is not a commitment for permanent financing in place at the time the construction loan was originated, with total commitments of $2.0 million and outstanding balances of $1.9 million. The Bank limits the number of speculative construction loans outstanding to any one builder based on the Bank s assessment of the builder s capacity to service the debt.

Most construction loans are originated with a loan-to-value ratio not to exceed 80% of the appraised estimated value of the completed property. The construction loan documents require the disbursement of the loan proceeds in increments as construction progresses. Disbursements are based on periodic on-site inspections by an independent appraiser.

Construction lending is inherently riskier than residential mortgage lending. Construction loans, on average, generally have higher loan balances than residential mortgage loans. In addition, the potential for cost overruns because of the inherent difficulties in estimating construction costs and, therefore, collateral values and the difficulties and costs associated with monitoring construction progress, among other things, are major contributing factors to this greater credit risk. Speculative construction loans have the added risk that there is not an identified buyer for the completed home when the loan is originated, with the risk that the builder will have to service the construction loan debt and finance the other carrying costs of the completed home for an extended time period until a buyer is identified. Furthermore, the demand for construction loans and the ability of construction loan borrowers to service their debt depends highly on the state of the general economy, including market interest rate levels and the state of the economy of the Bank s primary market area. A material downturn in economic conditions could be expected to have a material adverse effect on the credit quality of the construction loan portfolio.

Commercial Real Estate Loans. Commercial real estate loans are generally secured by small retail stores, professional office space and, in certain instances, farm properties. Commercial real estate loans are generally originated with a loan-to-value ratio not to exceed 75% of the appraised value of the property. Property appraisals are performed by independent appraisers approved by the Bank s board of directors. The Bank seeks to originate commercial real estate loans at variable interest rates based on the prime lending rate or the United States Treasury Bill rate for terms ranging from ten to 15 years and with interest rate adjustment intervals of five years. The Bank also originates fixed-rate balloon loans with a short maturity, but a longer amortization schedule.

Commercial real estate lending affords the Bank an opportunity to receive interest at rates higher than those generally available from residential mortgage lending. However, loans secured by such properties usually are greater in amount, more difficult to evaluate and monitor and, therefore, involve a greater degree of risk than residential mortgage loans. Because payments on loans secured by multi-family and commercial properties are often dependent on the successful operation and management of the properties, repayment of such loans may be affected by adverse conditions in the real estate market or the economy. The Bank seeks to minimize these risks by limiting the maximum loan-to-value ratio to 75% and strictly scrutinizing the financial condition of the borrower, the quality of the collateral and the management of the property securing the loan. The Bank also obtains loan guarantees from financially capable parties based on a review of personal financial statements.

Commercial Business Loans. Commercial business loans are generally secured by inventory, accounts receivable, and business equipment such as trucks and tractors. Many commercial business loans also have real estate as collateral. The Bank generally requires a personal guaranty of payment by the principals of a corporate borrower, and reviews the personal financial statements and income tax returns of the guarantors. Commercial business loans are generally originated with loan-to-value ratios not exceeding 75%.

Aside from lines of credit, commercial business loans are generally originated for terms not to exceed seven years with variable interest rates based on the prime lending rate. Approved credit lines totaled $24.4 million at December 31, 2012, of which $11.3 million was outstanding. Lines of credit are originated at fixed and variable interest rates for one-year renewable terms.

A director of the Bank is a shareholder of a farm implement dealership that contracts with the Bank to provide sales financing to the dealership s customers. The Bank does not grant preferential credit under this arrangement. During the year ended December 31, 2012, the Bank granted approximately $473,000 of credit to customers of the dealership and all loans purchased from the corporation had an aggregate outstanding balance of $1.0 million at December 31, 2012. At December 31, 2012, three loans purchased from the corporation were delinquent 30 days or more with an aggregate outstanding balance of $51,000.

Commercial business lending generally involves greater risk than residential mortgage lending and involves risks that are different from those associated with residential and commercial real estate lending. Real estate lending is generally considered to be collateral-based lending with loan amounts based on predetermined loan-to-collateral values and liquidation of the underlying real estate collateral is viewed as the primary source of repayment in the event of borrower default. Although commercial business loans are often collateralized by equipment, inventory, accounts receivable or other business assets, the liquidation of collateral in the event of a borrower default is often an insufficient source of repayment because accounts receivable may be uncollectible and inventories and equipment may be obsolete or of limited use, among other things. Accordingly, the repayment of a commercial business loan depends primarily on the creditworthiness of the borrower (and any guarantors), while liquidation of collateral is a secondary, and often insufficient, source of repayment. The Bank has five commercial lenders and one commercial credit analyst committed to growing commercial business loans to facilitate the changes desired in the Bank s balance sheet. The Bank also uses an outside loan review company to review selected commercial credits on an annual basis.

Consumer Loans. The Bank offers a variety of secured or guaranteed consumer loans, including automobile and truck loans, home equity loans, home improvement loans, boat loans, mobile home loans and loans secured by savings deposits. In addition, the Bank offers unsecured consumer loans. Consumer loans are generally originated at fixed interest rates and for terms not to exceed seven years. The largest portion of the Bank s consumer loan portfolio consists of home equity and second mortgage loans followed by automobile and truck loans. Automobile and truck loans are originated on both new and used vehicles. Such loans are generally originated at fixed interest rates for terms up to five years and at loan-to-value ratios up to 90% of the blue book value in the case of used vehicles and 90% of the purchase price in the case of new vehicles.

The Bank originates variable-rate home equity and fixed-rate second mortgage loans generally for terms not to exceed five years. The loan-to-value ratio on such loans is limited to 80%, taking into account the outstanding balance on the first mortgage loan.

The Bank s underwriting procedures for consumer loans includes an assessment of the applicant s payment history on other debts and ability to meet existing obligations and payments on the proposed loans. Although the applicant s creditworthiness is a primary consideration, the underwriting process also includes a comparison of the value of the security, if any, to the proposed loan amount. The Bank underwrites and originates the majority of its consumer loans internally, which management believes limits exposure to credit risks relating to loans underwritten or purchased from brokers or other outside sources.

Consumer loans generally entail greater risk than do residential mortgage loans, particularly in the case of consumer loans which are unsecured or secured by assets that depreciate rapidly, such as automobiles. In the latter case, repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan and the remaining deficiency often does not warrant further substantial collection efforts against the borrower. In addition, consumer loan collections depend on the borrower s continuing financial stability, and, therefore, are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans. Such loans may also give rise to claims and defenses by the borrower against the Bank as the holder of the loan, and a borrower may be able to assert claims and defenses that it has against the seller of the underlying collateral.

Loan Maturity and Repricing

The following table sets forth certain information at December 31, 2012 regarding the dollar amount of loans maturing in the Bank s portfolio based on their contractual terms to maturity, but does not include potential prepayments. Demand loans, which are loans having neither a stated schedule of repayments nor a stated maturity, and overdrafts are reported as due in one year or less. Loan balances do not include undisbursed loan proceeds, unearned income and allowance for loan losses.

	Within One Year	After One Year Through 3 Years	After 3 Years Through 5 Years	After 5 Years Through 10 Years	After 10 Years Through 15 Years	After 15 Years	Total
				(Dollars in thousands)			
Mortgage loans:							
Residential	$ 8,602	$ 13,107	$ 14,272	$ 22,395	$ 18,951	$ 30,770	$ 108,097
Commercial real estate and land loans[1]	11,034	14,232	11,498	21,485	13,421	9,967	81,637
Residential construction[2]	10,194	2,559	0	0	0	0	12,753
Consumer loans	19,756	26,812	14,281	7,044	66	189	68,148
Commercial business	10,071	4,383	1,315	1,541	745	557	18,612
Total gross loans	$ 59,657	$ 61,093	$ 41,366	$ 52,465	$ 33,183	$ 41,483	$ 289,247

(1) Includes commercial real estate construction loans.

(2) Includes construction loans for which the bank has committed to provide permanent financing. The contractual maturities reflect the principal payments due following the period of construction.

The following table sets forth the dollar amount of all loans due after December 31, 2013, which have fixed interest rates and floating or adjustable interest rates.

	Fixed Rates	Floating or Adjustable Rates
	(Dollars in thousands)	
Mortgage loans:		
Residential	$ 52,830	$ 46,665
Commercial real estate and land loans	16,689	53,914
Residential construction	233	2,326
Consumer loans	25,888	22,504
Commercial business	3,861	4,680
Total gross loans	$ 99,501	$ 130,089

Loan Solicitation and Processing. A majority of the Bank s loan originations are made to existing customers. Walk-ins and customer referrals are also a source of loan originations. Upon receipt of a loan application, a credit report is ordered to verify specific information relating to the loan applicant s employment, income and credit standing. A loan applicant s income is verified through the applicant s employer or from the applicant s tax returns. In the case of a real estate loan, an appraisal of the real estate intended to secure the proposed loan is undertaken, generally by an independent appraiser approved by the Bank. The mortgage loan documents used by the Bank conform to secondary market standards.

The Bank requires that borrowers obtain certain types of insurance to protect its interest in the collateral securing the loan. The Bank requires either a title insurance policy insuring that the Bank has a valid first lien on the mortgaged real estate or an opinion by an attorney regarding the validity of title. Fire and casualty insurance is also required on collateral for loans.

Loan Commitments and Letters of Credit. The Bank issues commitments for fixed and adjustable-rate single-family residential mortgage loans conditioned upon the occurrence of certain events. Such commitments are made in writing on specified terms and conditions and are honored for up to 60 days from the date of application, depending on the type of transaction. The Bank had outstanding loan commitments of approximately $13.2 million at December 31, 2012.

As an accommodation to its commercial business loan borrowers, the Bank issues standby letters of credit or performance bonds usually in favor of municipalities for whom its borrowers are performing services. At December 31, 2012, the Bank had outstanding letters of credit of $781,000.

Loan Origination and Other Fees. Loan fees and points are a percentage of the principal amount of the mortgage loan that is charged to the borrower for funding the loan. The Bank usually charges a fixed origination fee on residential real estate loans and long-term commercial real estate loans. Current accounting standards require loan origination fees and certain direct costs of underwriting and closing loans to be deferred and amortized into interest income over the contractual life of the loan. Deferred fees and costs associated with loans that are sold are recognized as income at the time of sale. The Bank had $202,000 of net deferred loan costs at December 31, 2012.

Mortgage Banking Activities. Mortgage loans originated and funded by the Bank and intended for sale in the secondary market are carried at the lower of aggregate cost or market value. Aggregate market value is determined based on the quoted prices under a best efforts sales agreement with a third party. Net unrealized losses are recognized through a valuation allowance by charges to income. Realized gains on sales of mortgage loans are included in noninterest income.

Commitments to originate and fund mortgage loans for sale in the secondary market are considered derivative financial instruments to be accounted for at fair value. The Bank s mortgage loan commitments subject to derivative accounting are fixed rate mortgage commitments at market rates when initiated. At December 31, 2012, the Bank had commitments to originate $830,000 in fixed-rate mortgage loans intended for sale in the secondary market after the loans are closed. Fair value is estimated based on fees that would be charged on commitments with similar terms.

Delinquencies. The Bank s collection procedures provide for a series of contacts with delinquent borrowers. A late charge is assessed and a late charge notice is sent to the borrower after the 15th day of delinquency. After 20 days, the collector places a phone call to the borrower. When a payment becomes 60 days past due, the collector issues a default letter. If a loan continues in a delinquent status for 90 days or more, the Bank generally initiates foreclosure or other litigation proceedings.

Nonperforming Assets. Loans are reviewed regularly and when loans become 90 days delinquent, the loan is placed on nonaccrual status and the previously accrued interest income is reversed unless, in the opinion of management, the outstanding interest remains collectible. Typically, payments received on a nonaccrual loan are applied to the outstanding principal and interest as determined at the time of collection of the loan when the likelihood of further loss on the loan is remote. Otherwise, the Bank applies the cost recovery method and applies all payments as a reduction of the unpaid principal balance.

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The following table sets forth information with respect to the Bank s nonperforming assets for the dates indicated. Nonperforming assets include nonaccrual loans, accruing loans that are 90 days or more past due, and foreclosed real estate.

	At December 31,				
	2012	2011	2010	2009	2008
	(Dollars in thousands)				
Loans accounted for on a nonaccrual basis:					
Residential real estate(1)	$ 2,773	$ 2,528	$ 3,230	$ 2,295	$ 2,013
Commercial real estate(2)	2,961	2,858	1,780	3,445	2,088
Commercial business	1,776	1,928	2,148	2,238	82
Consumer	73	87	390	456	258
Total	7,583	7,401	7,548	8,434	4,441
Accruing loans past due 90 days or more:					
Residential real estate(1)	215	143	334	563	735
Commercial real estate(2)	0	38	0	202	27
Commercial business	0	0	20	0	0
Consumer	74	182	25	317	330
Total	289	363	379	1,082	1,092
Total nonperforming loans	7,872	7,764	7,927	9,516	5,533
Foreclosed real estate, net	295	661	591	877	881
Total nonperforming assets	$ 8,167	$ 8,425	$ 8,518	$ 10,393	$ 6,414
Total nonperforming loans to net loans	2.81%	2.81%	2.69%	3.06%	1.72%
Total nonperforming loans to total assets	1.71%	1.77%	1.75%	2.09%	1.21%
Total nonperforming assets to total assets	1.78%	1.92%	1.88%	2.28%	1.40%

(1) Includes residential construction loans.
(2) Includes commercial real estate construction and land loans.

The Bank accrues interest on loans over 90 days past due when, in the opinion of management, the estimated value of collateral and collection efforts are deemed sufficient to ensure full recovery. The Bank recognized $9,000 in interest income on nonaccrual loans for the fiscal year ended December 31, 2012. The Bank would have recorded interest income of $350,000 for the year ended December 31, 2012 had nonaccrual loans been current in accordance with their original terms.

Restructured Loans. Periodically, the Bank modifies loans to extend the term or make other concessions to help borrowers stay current on their loans and avoid foreclosure. The Bank does not forgive principal or interest on loans or modify interest rates to rates that are below market rates. These modified loans are also referred to as troubled debt restructurings.

Restructured loans can involve loans remaining on nonaccrual, moving to nonaccrual, or continuing on accrual status, depending on the individual facts and circumstances of the borrower. Generally, a nonaccrual loan that is restructured in a TDR remains on nonaccrual status for a period of at least six months following the restructuring to ensure that the borrower performs in accordance with the restructured terms including consistent and timely payments. At December 31, 2012, troubled debt restructurings totaled $4.3 million and the related allowance for loan losses on troubled debt restructurings was $1.3 million. Troubled debt restructurings on nonaccrual status totaling $4.1 million at December 31, 2012 are included in the nonperforming loans totals in the table above. Troubled debt restructurings performing according to their restructured terms and on accrual status totaled $221,000 at December 31, 2012. See Note 4 in the accompanying Notes to Consolidated Financial Statements for additional information regarding troubled debt restructurings.

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Classified Assets. The OCC has adopted various regulations regarding problem assets of financial institutions. The regulations require that each insured institution review and classify its assets on a regular basis. In addition, in connection with examinations of insured institutions, OCC examiners have the authority to identify problem assets and, if appropriate, require them to be classified. There are three classifications for problem assets: substandard, doubtful and loss. Substandard assets have one or more defined weaknesses and are characterized by the distinct possibility that the insured institution will sustain some loss if the deficiencies are not corrected. Doubtful assets have the weaknesses of substandard assets with the additional characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. An asset classified as loss is considered uncollectible and of such little value that continuance as an asset of the institution, without establishment of a specific valuation allowance or charge-off, is not warranted. If an asset or portion thereof is classified as loss, the insured institution charges off an amount equal to 100% of the portion of the asset classified as loss. The regulations also provide for a special mention category, described as assets which do not currently expose the institution to sufficient risk to warrant adverse classification, but have potential weaknesses that deserve management s close attention.

The Company held a corporate collateralized mortgage obligation security that was downgraded to a substandard regulatory classification in 2009 due to a downgrade of the security s credit quality rating by various rating agencies. Based on an independent third party analysis performed in December 2011, the Company recognized at that time an other-than-temporary impairment loss on this security of $36,000 representing the credit loss component of the unrealized loss. In December 31, 2012, the Company sold the remainder of the impaired privately-issued CMO which resulted in a realized loss on the sale of $9,000.

At December 31, 2012, the Bank had $7.6 million in doubtful loans and $8.1 million in substandard loans, of which all but $7.8 million are included in total nonperforming loans disclosed in the above table. In addition, the Bank identified $4.0 million in loans as special mention loans at December 31, 2012.

Current accounting rules require that impaired loans be measured based on the present value of expected future cash flows discounted at the loan s effective interest rate, the loan s observable market price or the fair value of collateral if the loan is collateral dependent. A loan is classified as impaired by management when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due in accordance with the terms of the loan agreement. If the fair value, as measured by one of these methods, is less than the recorded investment in the impaired loan, the Bank establishes a valuation allowance with a provision charged to expense. Management reviews the valuation of impaired loans on a quarterly basis to consider changes due to the passage of time or revised estimates. At December 31, 2012, all impaired loans were considered to be collateral dependent for the purposes of determining fair value.

Values for collateral dependent loans are generally based on appraisals obtained from independent licensed real estate appraisers, with adjustments applied for estimated costs to sell the property, costs to complete unfinished or repair damaged property and other factors. New appraisals are generally obtained for all significant properties when a loan is identified as impaired, and a property is considered significant if the value of the property is estimated to exceed $200,000. Subsequent appraisals are obtained as needed or if management believes there has been a significant change in the market value of the property. In instances where it is not deemed necessary to obtain a new appraisal, management bases its impairment and allowance for loan loss analysis on the original appraisal with adjustments for current conditions based on management s assessment of market factors and management s inspection of the property. At December 31, 2012, discounts from appraised values used to value impaired loans ranged from 10% to 20% for estimates of changes in market conditions and the condition of the collateral, and estimated costs to sell the property ranged from 10% to 15%.

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An insured institution is required to establish and maintain an allowance for loan losses at a level that is adequate to absorb estimated credit losses associated with the loan portfolio, including binding commitments to lend. General allowances represent loss allowances which have been established to recognize the inherent risk associated with lending activities. When an insured institution classifies problem assets as loss, it is required either to establish an allowance for losses equal to 100% of the amount of the assets, or charge off the classified asset. The amount of its valuation allowance is subject to review by the OCC, which can order the establishment of additional general loss allowances. The Bank regularly reviews the loan portfolio to determine whether any loans require classification in accordance with applicable regulations.

At December 31, 2012, 2011 and 2010, the aggregate amounts of the Bank s classified assets were as follows:

	At December 31,		
	2012	2011	2010
	(Dollars in thousands)		
Classified assets:			
Loss	$ 0	$ 0	$ 0
Doubtful	7,583	7,401	7,548
Substandard[(1)]	8,072	6,981	7,788
Special mention	4,041	8,385	9,554

(1) Includes substandard loans and one available for sale security downgraded below investment grade by various rating agencies with a carrying value of $237,000 at December 31, 2011 and $668,000 at December 31, 2010.

Loans classified as impaired in accordance with accounting standards included in the above regulatory classifications and the related allowance for loan losses are summarized below at the dates indicated:

	At December 31,		
	2012	2011	2010
	(Dollars in thousands)		
Impaired loans with related allowance	$ 4,093	$ 4,698	$ 6,430
Impaired loans with no allowance	3,490	2,703	1,118
Total impaired loans	$ 7,583	$ 7,401	$ 7,548
Allowance for loan losses:			
Related to impaired loans	$ 1,652	$ 1,658	$ 2,492
Related to other loans	3,084	2,524	1,981

See Note 4 in the accompanying Notes to Consolidated Financial Statements for additional information regarding impaired loans and the related allowance for loan losses.

Foreclosed Real Estate. Foreclosed real estate held for sale is carried at fair value minus estimated costs to sell. Costs of holding foreclosed real estate are charged to expense in the current period, except for significant property improvements, which are capitalized. Valuations are periodically performed by management and an allowance is established by a charge to non-interest expense if the carrying value exceeds the fair value minus estimated costs to sell. The net income from operations of foreclosed real estate held for sale is reported in non-interest income. At December 31, 2012, the Bank had foreclosed real estate totaling $295,000. See Note 6 in the accompanying Notes to Consolidated Financial Statements for additional information regarding foreclosed real estate.

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Allowance for Loan Losses. Loans are the Bank s largest concentration of assets and continue to represent the most significant potential risk. In originating loans, the Bank recognizes that losses will be experienced and that the risk of loss will vary with, among other things, the type of loan made, the creditworthiness of the borrower over the term of the loan, general economic conditions and, in the case of a secured loan, the quality of the collateral. The Bank maintains an allowance for loan losses to absorb losses inherent in the loan portfolio. The allowance for loan losses represents management s estimate of probable loan losses based on information available as of the date of the financial statements. The allowance for loan losses is based on management s evaluation of the loan portfolio, including historical loan loss experience, delinquencies, known and inherent risks in the nature and volume of the loan portfolio, information about specific borrower situations, estimated collateral values, and economic conditions.

The loan portfolio is reviewed quarterly by management to evaluate the adequacy of the allowance for loan losses to determine the amount of any adjustment required after considering the loan charge-offs and recoveries for the quarter. Management applies a systematic methodology that incorporates its current judgments about the credit quality of the loan portfolio. In addition, the OCC, as an integral part of its examination process, periodically reviews the Bank s allowance for loan losses and may require the Bank to make additional provisions for estimated losses based on their judgments about information available to them at the time of their examination.

The methodology used in determining the allowance for loan losses includes segmenting the loan portfolio by identifying risk characteristics common to pools of loans, determining and measuring impairment of individual loans based on the present value of expected future cash flows or the fair value of collateral, and determining and measuring impairment for pools of loans with similar characteristics by applying loss factors that consider the qualitative factors which may affect the loss rates.

Specific allowances related to impaired loans and other classified loans are established where the present value of the loan s discounted cash flows, observable market price or collateral value (for collateral dependent loans) is lower than the carrying value of the loan. The identification of these loans results from the loan review process that identifies and monitors credits with weaknesses or conditions which call into question the full collection of the contractual payments due under the terms of the loan agreement. Factors considered by management include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. At December 31, 2012, the Company s specific allowances totaled $1.7 million, including a specific allowance of $1.1 million on a commercial loan secured by a medical office facility and medical equipment. The loan had a balance of $1.8 million at December 31, 2012 and the loan was on nonaccrual status.

For loans evaluated on a pool basis, management applies loss factors to pools of loans with common risk characteristics (i.e., residential mortgage loans, home equity loans, commercial real estate loans). The loss factors are derived from the Bank s historical loss experience. Loss factors are adjusted for significant qualitative factors that, in management s judgment, affect the collectability of the loan portfolio segment. The significant qualitative factors include the levels and trends in charge-offs and recoveries, trends in volume and terms of loans, levels and trends in delinquencies, the effects of changes in underwriting standards and other lending practices or procedures, the experience and depth of the lending management and staff, effects of changes in credit concentration, changes in industry and market conditions and national and local economic trends and conditions. Management evaluates these conditions on a quarterly basis and evaluates and modifies the assumptions used in establishing the loss factors.

At December 31, 2011, the historical loss experience used to estimate the allowance for loan losses was for the most recent eight calendar quarters. Effective as of December 31, 2012, the Company began using the most recent twelve calendar quarters as the basis for developing the historical loss factors, which increased the estimated allowance for loan losses by approximately $575,000. Also at December 31, 2012, management adjusted the qualitative factors for the home equity and second mortgage portfolio segment which increased the estimated allowance for loan losses related to that portfolio segment by approximately $511,000. These qualitative factors applied to the home equity and second mortgage loan portfolio considered risks associated with loan to value ratios, delinquency history and whether the Bank does not hold the first lien on the collateral. These changes were made to better reflect management s analysis of inherent losses in the loan portfolio at December 31, 2012.

At December 31, 2012, for each loan portfolio segment management applied an overall qualitative factor of 1.15 to the Company s historical loss factors. The overall qualitative factor is derived from management s analysis of changes and trends in the following qualitative factors:

Underwriting Standards Management reviews the findings of periodic internal audit loan reviews, independent outsourced loan reviews and loan reviews performed by the banking regulators to evaluate the risk associated with changes in underwriting standards. At December 31, 2012, management assessed the risk associated with this component as neutral, requiring no adjustment to the historical loss factors.

Economic Conditions Management analyzes trends in housing and unemployment data in the Harrison, Floyd and Clark counties of Indiana, the Company s primary market area, to evaluate the risk associated with economic conditions. Due to a decrease in new home construction and an increase in unemployment in the Company s primary market area, management assigned a risk factor of 1.20 for this component at December 31, 2012.

Past Due Loans Management analyzes trends in past due loans for the Company to evaluate the risk associated with delinquent loans. In general, past due loan ratios have remained at elevated levels compared to historical amounts since 2007, and management assigned a risk factor of 1.20 for this component at December 31, 2012.

Other Internal and External Factors This component includes management s consideration of other qualitative factors such as loan portfolio composition. The Company has focused on origination of commercial business and real estate loans in an effort to convert the Company s balance sheet from that of a traditional thrift institution to a commercial bank. In addition, the Company has increased its investment in mortgage loans in which it does not hold a first lien position. Commercial loans and second mortgage loans generally entail greater credit risk than residential mortgage loans secured by a first lien. As a result of changes in the loan portfolio composition, management assigned a risk factor of 1.20 for this component at December 31, 2012.

Each of the four factors above was assigned an equal weight to arrive at an average for the overall qualitative factor of 1.15 at December 31, 2012. The effect of the overall qualitative factor was to increase the estimated allowance for loan losses by $419,000 at December 31, 2012.

Management also adjusts the historical loss factors for loans classified as watch, special mention and substandard that are not individually evaluated for impairment. The adjustments consider the increased likelihood of loss on classified loans based on the Company s separate historical loss experience for classified loans. The effect of these adjustments for classified loans was to increase the estimated allowance for loan losses by $664,000 at December 31, 2012.

See Notes 1 and 4 in the accompanying Notes to Consolidated Financial Statements for additional information regarding management s methodology for estimating the allowance for loan losses.

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The following table sets forth an analysis of the Bank s allowance for loan losses for the periods indicated.

	Year Ended December 31,				
	2012	2011	2010	2009	2008
	(Dollars in thousands)				
Allowance at beginning of period	$ 4,182	$ 4,473	$ 4,931	$ 2,662	$ 2,232
Provision for loan losses	1,525	1,825	2,037	4,289	1,570
	5,707	6,298	6,968	6,951	3,802
Recoveries:					
Residential real estate	16	18	9	26	4
Commercial real estate and land	1	0	4	6	0
Commercial business	10	45	9	14	13
Consumer	200	248	214	209	179
Total recoveries	227	311	236	255	196
Charge-offs:					
Residential real estate	418	819	620	425	357
Commercial real estate and land	108	396	1,326	920	96
Commercial business	17	333	29	181	210
Consumer	655	879	756	749	673
Total charge-offs	1,198	2,427	2,731	2,275	1,336
Net (charge-offs) recoveries	(971)	(2,116)	(2,495)	(2,020)	(1,140)
Balance at end of period	$ 4,736	$ 4,182	$ 4,473	$ 4,931	$ 2,662
Ratio of allowance to total loans outstanding at the end of the period	1.64%	1.47%	1.48%	1.54%	0.81%
Ratio of net charge-offs to average loans outstanding during the period	0.35%	0.72%	0.80%	0.63%	0.35%

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Allowance for Loan Losses Analysis

The following table sets forth the breakdown of the allowance for loan losses by loan category at the dates indicated.

	At December 31,									
	2012		2011		2010		2009		2008	
	Amount	Percent of Outstanding Loans in Category	Amount	Percent of Outstanding Loans in Category	Amount	Percent of Outstanding Loans in Category	Amount	Percent of Outstanding Loans in Category	Amount	Percent of Outstanding Loans in Category
	(Dollars in thousands)									
Residential real estate[1]	$ 922	41.78%	$ 861	44.70%	$ 1,045	45.81%	$ 1,297	47.78%	$ 608	48.88%
Commercial real estate and land loans[2]	1,381	28.22	1,362	23.99	1,106	23.00	1,772	22.13	737	22.84
Commercial business	1,223	6.43	1,160	7.27	1,251	7.25	1,264	7.15	240	6.99
Consumer	1,210	23.57	799	24.04	1,071	23.94	598	22.94	1,077	21.29
Total allowance for loan losses	$ 4,736	100.00%	$ 4,182	100.00%	$ 4,473	100.00%	$ 4,931	100.00%	$ 2,662	100.00%

(1) Includes residential construction loans.
(2) Includes commercial real estate construction loans.

Investment Activities

Federally chartered savings institutions have authority to invest in various types of liquid assets, including United States Treasury obligations, securities of various federal agencies and of state and municipal governments, deposits at the applicable Federal Home Loan Bank, certificates of deposit of federally insured institutions, certain bankers acceptances and federal funds. Subject to various restrictions, such savings institutions may also invest a portion of their assets in commercial paper, corporate debt securities and mutual funds, the assets of which conform to the investments that federally chartered savings institutions are otherwise authorized to make directly. Savings institutions are also required to maintain minimum levels of liquid assets that vary from time to time. The Bank may decide to increase its liquidity above the required levels depending upon the availability of funds and comparative yields on investments in relation to return on loans.

The Bank is required under federal regulations to maintain a minimum amount of liquid assets and is also permitted to make certain other securities investments. The balance of the Bank s investments in short-term securities in excess of regulatory requirements reflects management s response to the significantly increasing percentage of deposits with short maturities. Management intends to hold securities with short maturities in the Bank s investment portfolio in order to enable the Bank to match more closely the interest-rate sensitivities of its assets and liabilities.

The Bank periodically invests in mortgage-backed securities, including mortgage-backed securities guaranteed or insured by Ginnie Mae, Fannie Mae or Freddie Mac. Mortgage-backed securities generally increase the quality of the Bank s assets by virtue of the guarantees that back them, are more liquid than individual mortgage loans and may be used to collateralize borrowings or other obligations of the Bank. Of the Bank s total mortgage-backed securities portfolio at December 31, 2012, securities with a market value of $448,000 have adjustable rates as of that date.

The Bank also invests in collateralized mortgage obligations (CMOs) issued by Ginnie Mae, Fannie Mae and Freddie Mac, as well as private issuers. CMOs are complex mortgage-backed securities that restructure the cash flows and risks of the underlying mortgage collateral.

At December 31, 2012, neither the Company nor the Bank had an investment in securities (other than United States Government and agency securities), which exceeded 10% of the Company s consolidated stockholders equity at that date.

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The following table sets forth the securities portfolio at the dates indicated.

	At December 31,											
	2012				2011				2010			
	Fair Value	Amortized Cost	Percent of Portfolio	Weighted Average Yield[1]	Fair Value	Amortized Cost	Percent of Portfolio	Weighted Average Yield[1]	Fair Value	Amortized Cost	Percent of Portfolio	Weighted Average Yield[1]
					(Dollars in thousands)							
curities Held to Maturity[2]												
unicipal:												
ue in one year or less	$ 0	$ 0	0.00%	0.00%	$ 0	$ 0	0.00%	0.00%	$ 14	$ 14	0.01%	10.23
ue after one year through five ars	0	0	0.00	0.00%	0	0	0.00	0.00%	0	0	0.00	0.00
ortgage-backed securities and MOs[3]	12	12	0.01	1.96%	16	16	0.01	2.34%	18	18	0.02	2.64
	$ 12	$ 12	0.01%		$ 16	$ 16	0.01%		$ 32	$ 32	0.03%	
curities Available for Sale												
ebt securities:												
S. agency:												
ue in one year or less	$ 0	$ 0	0.00%	0.00%	$ 894	$ 892	0.82%	4.36%	$ 0	$ 0	0.00%	0.00
ue after one year through five ars	7,509	7,445	6.19	1.27%	8,607	8,543	7.84	1.96%	13,161	13,056	13.02	1.94
ue after five years through ten ars	7,098	6,999	5.82	1.50%	11,134	11,014	10.11	1.86%	7,071	7,023	7.00	2.14
ue after ten years through teen years	23,946	23,829	19.80	1.63%	21,728	21,522	19.76	1.99%	22,148	22,321	22.26	2.09
ortgage-backed securities and MOs [3]	45,866	45,220	37.58	1.84%	36,388	35,781	32.85	2.40%	26,301	25,776	25.70	3.33
unicipal:												
ue in one year or less	507	505	0.42	5.51%	1,419	1,407	1.29	4.19%	1,529	1,518	1.51	4.25
ue after one year through five ars	1,074	1,018	0.85	5.55%	2,000	1,952	1.79	5.30%	3,873	3,775	3.77	5.13
ue after five years through ten ars	9,299	8,915	7.41	4.37%	6,443	6,011	5.52	5.68%	5,288	5,208	5.19	5.44
ue after ten years	23,437	22,167	18.42	4.98%	17,439	16,430	15.08	5.95%	18,766	18,865	18.82	5.81
uity securities:												
utual funds	4,237	4,213	3.50	N/A	5,388	5,369	4.93	N/A	2,714	2,705	2.70	N/A
	$ 122,973	$ 120,311	99.99%		$ 111,440	$ 108,921	99.99%		$ 100,851	$ 100,247	99.97%	

(1) Yields are calculated on a fully taxable equivalent basis using a marginal federal income tax rate of 34%. Weighted average yields are calculated using average prepayment rates for the most recent three-month period.

(2) Securities held to maturity are carried at amortized cost.

(3) The expected maturities of mortgage-backed securities and collateralized mortgage obligations (CMOs) may differ from contractual maturities because the mortgages underlying the obligations may be prepaid without penalty.

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Deposit Activities and Other Sources of Funds

General. Deposits and loan repayments are the major source of the Bank s funds for lending and investment activities and for its general business purposes. Loan repayments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are significantly influenced by general interest rates and money market conditions. Borrowing may be used on a short-term basis to compensate for reductions in the availability of funds from other sources or may also be used on a longer-term basis for interest rate risk management.

Deposit Accounts. Deposits are attracted from within the Bank s primary market area through the offering of a broad selection of deposit instruments, including non-interest bearing checking accounts, negotiable order of withdrawal (NOW) accounts, money market accounts, regular savings accounts, certificates of deposit and retirement savings plans. Deposit account terms vary, according to the minimum balance required, the time periods the funds must remain on deposit and the interest rate, among other factors. In determining the terms of its deposit accounts, the Bank considers the rates offered by its competition, profitability to the Bank, matching deposit and loan products and its customer preferences and concerns. The Bank generally reviews its deposit mix and pricing weekly.

The following table presents the maturity distributions of time deposits of $100,000 or more as of December 31, 2012.

Maturity Period	Amount at December 31, 2012 (Dollars in thousands)
Three months or less	$ 5,213
Over three through six months	2,296
Over six through 12 months	7,959
Over 12 months	14,221
Total	$ 29,689

The following table sets forth the balances of deposits in the various types of accounts offered by the Bank at the dates indicated.

	At December 31,								
	2012			2011			2010		
	Amount	Percent of Total	Increase/ (Decrease)	Amount	Percent of Total	Increase/ (Decrease)	Amount	Percent of Total	Increase/ (Decrease)
	(Dollars in thousands)								
Non-interest bearing demand	$ 56,715	14.76%	$ 9,402	$ 47,313	12.99%	$ 6,539	$ 40,774	10.79%	$ 301
NOW accounts	154,613	40.23	12,762	141,851	38.93	(12,534)	154,385	40.84	21,133
Savings accounts	60,952	15.86	12,849	48,103	13.20	4,615	43,488	11.50	1,966
Money market accounts	11,240	2.92	(3,270)	14,510	3.98	951	13,559	3.59	(671)
Fixed rate time deposits which mature:									
Within one year	53,373	13.89	3,276	50,097	13.75	(31,117)	81,214	21.48	(4,650)
After one year, but within three years	39,136	10.18	(10,174)	49,310	13.53	12,787	36,523	9.66	(12,760)
After three years, but within five years	8,227	2.14	(4,850)	13,077	3.59	5,138	7,939	2.10	(1,652)
After five years	5	0.00	(33)	38	0.01	(20)	58	0.02	(137)
Club accounts	82	0.02	7	75	0.02	12	63	0.02	(3)

Total	$ 384,343	100.00%	$ 19,969	$ 364,374	100.00%	$ (13,629)	$ 378,003	100.00%	$ 3,527

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The following table sets forth the amount and maturities of time deposits by rates at December 31, 2012.

	Amount Due					
	Less Than One Year	1-3 Years	3-5 Years	After 5 Years	Total	Percent of Total
	(Dollars in thousands)					
0.00% 0.99%	$ 30,647	$ 7,176	$ 4,033	$ 0	$ 41,856	41.55%
1.00% 1.99%	10,894	27,092	3,994	0	41,980	41.67
2.00% 2.99%	8,263	4,544	159	0	12,966	12.87
3.00% 3.99%	1,670	45	0	0	1,715	1.70
4.00% 4.99%	1,899	149	41	5	2,094	2.08
5.00% 5.99%	0	130	0	0	130	0.13
Total	$ 53,373	$ 39,136	$ 8,227	$ 5	$ 100,741	100.00%

Borrowings. The Bank has at times relied upon advances from the Federal Home Loan Bank of Indianapolis to supplement its supply of lendable funds and to meet deposit withdrawal requirements. Advances from the Federal Home Loan Bank of Indianapolis are secured by certain first mortgage loans and a mutual fund investment. The Bank also uses retail repurchase agreements as a source of borrowings.

The Federal Home Loan Bank functions as a central reserve bank providing credit for savings and loan associations and certain other member financial institutions. As a member, the Bank is required to own capital stock in the Federal Home Loan Bank and is authorized to apply for advances on the security of such stock and certain of its mortgage loans and other assets (principally a mutual fund investment held by the Bank) provided certain standards related to creditworthiness have been met. Advances are made pursuant to several different programs. Each credit program has its own interest rate and range of maturities. Depending on the program, limitations on the amount of advances are based either on a fixed percentage of an institution s net worth or on the Federal Home Loan Bank s assessment of the institution s creditworthiness. Under its current credit policies, the Federal Home Loan Bank generally limits advances to 20% of a member s assets, and short-term borrowing of less than one year may not exceed 10% of the institution s assets. The Federal Home Loan Bank determines specific lines of credit for each member institution.

The following table sets forth certain information regarding the Bank s use of Federal Home Loan Bank advances.

	At or For the Years Ended December 31,		
	2012	2011	2010
	(Dollars in thousands)		
Maximum balance at any month end	$ 10,925	$ 16,529	$ 29,001
Average balance	10,287	14,557	23,116
Period end balance	5,100	12,350	15,729
Weighted average interest rate:			
At end of period	3.63%	3.78%	4.05%
During the period	3.75%	4.02%	4.37%

The following table sets forth certain information regarding the Bank s use of retail repurchase agreements.

	At or For the Years Ended December 31,		
	2012	2011	2010
	(Dollars in thousands)		
Maximum balance at any month end	$ 14,092	$ 9,608	$ 9,223
Average balance	10,074	9,174	8,142
Period end balance	14,092	9,125	8,669
Weighted average interest rate:			
At end of period	0.25%	0.51%	0.76%
During the period	0.38%	0.64%	0.90%

Subsidiary Activities

The Bank is the Company s only subsidiary, and is wholly-owned by the Company. First Harrison Investments, Inc. and First Harrison Holdings, Inc. are wholly-owned Nevada corporate subsidiaries of the Bank that jointly own First Harrison, LLC, a Nevada limited liability corporation that holds and manages an investment securities portfolio. First Harrison REIT, Inc. was incorporated on July 3, 2008 to hold a portion of the Bank s real estate mortgage loan portfolio. First Harrison REIT, Inc. is a wholly-owned subsidiary of First Harrison Holdings, Inc.

Personnel

As of December 31, 2012, the Bank had 113 full-time employees and 20 part-time employees. A collective bargaining unit does not represent the employees and the Bank considers its relationship with its employees to be good.

REGULATION AND SUPERVISION

General

As a savings and loan holding company, the Company is required by federal law to report to, and otherwise comply with the rules and regulations of, the Board of Governors of the Federal Reserve Board (the Federal Reserve Board). The Bank, an insured federal savings association, is subject to extensive regulation, examination and supervision by the OCC, as its primary federal regulator, and the FDIC, as the deposit insurer.

The Bank is a member of the Federal Home Loan Bank System and, with respect to deposit insurance, of the Deposit Insurance Fund managed by the FDIC. The Bank must file reports with the OCC and the FDIC concerning its activities and financial condition and obtain regulatory approvals before entering into certain transactions such as mergers with, or acquisitions of, other savings associations. The OCC and/or the FDIC conduct periodic examinations to test the Bank s safety and soundness and compliance with various regulatory requirements. This regulation and supervision establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of the insurance fund and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulatory requirements and policies, whether by the OCC, the FDIC or Congress, could have a material adverse impact on the Company, the Bank and their operations.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act) made extensive changes to the regulation of the Bank. Under the Dodd-Frank Act, the Office of Thrift Supervision (the OTS) was eliminated and responsibility for the supervision and regulation of federal savings associations such as the Bank was transferred to the OCC on July 21, 2011. The OCC is the agency that is primarily responsible for the regulation and supervision of national banks. Additionally, the Dodd-Frank Act created a new Consumer Financial Protection Bureau as an independent bureau of the Federal Reserve Board. The Consumer Financial Protection Bureau assumed responsibility for the implementation of the federal financial consumer protection and fair lending laws and regulations and has authority to impose new requirements. However, institutions of less than $10 billion in assets, such as the Bank, will continue to be examined for compliance with consumer protection and fair lending laws and regulations by, and be subject to the enforcement authority of, their prudential regulators.

Certain regulatory requirements applicable to the Bank and to the Company are referred to below or elsewhere herein. The summary of statutory provisions and regulations applicable to savings associations and their holding companies set forth below and elsewhere in this document does not purport to be a complete description of such statutes and regulations and their effects on the Bank and the Company and is qualified in its entirety by reference to the actual laws and regulations.

Holding Company Regulation

General. The Company is a unitary savings and loan holding company within the meaning of federal law. As such, the Company is registered with the Federal Reserve Board and subject to Federal Reserve Board regulations, examination, supervision and reporting requirements. In addition, the Federal Reserve board has enforcement authorities over the Company and its non-savings association subsidiaries. Among other things, that authority permits the Federal Reserve Board to restrict or prohibit activities that it determines to be a serious risk to the subsidiary savings association.

Activities Restrictions. Pursuant to federal law and regulations and policy, a savings and loan holding company such as the Company may generally engage in the activities permitted for financial holding companies under Section 4(k) of the Bank Holding Company Act and certain other activities that have been authorized for savings and loan holding companies by regulation.

Federal law prohibits a savings and loan holding company from, directly or indirectly, or through one or more subsidiaries, acquiring more than 5% of the voting stock of another savings association or savings and loan holding company, without prior written approval of the Federal Reserve Board or from acquiring or retaining, with certain exceptions, more than 5% of a non-subsidiary savings association, a non-subsidiary holding company, or a non-subsidiary company engaged in activities other than those authorized by federal law, or from acquiring or retaining control of a depository institution that is not insured by the FDIC. In evaluating applications by holding companies to acquire savings associations, the Federal Reserve Board considers, among other things, factors such as the financial and managerial resources and future prospects of the Company and institution involved, the effect of the acquisition on the risk to the deposit insurance funds, the convenience and needs of the community and competitive effects.

The Federal Reserve Board may not approve any acquisition that would result in a multiple savings and loan holding company controlling savings associations in more than one state, subject to two exceptions: (i) the approval of interstate supervisory acquisitions by savings and loan holding companies; and (ii) the acquisition of a savings association in another state if the laws of the state of the target savings association specifically permit such acquisitions. The states vary in the extent to which they permit interstate savings and loan holding company acquisitions.

Capital. Savings and loan holding companies are not currently subject to specific regulatory capital requirements. The Dodd-Frank Act, however, requires the Federal Reserve Board to promulgate consolidated capital requirements for depository institution holding companies that are no less stringent, both quantitatively and in terms of components of capital, than those applicable to institutions themselves. Instruments such as cumulative preferred stock and trust preferred securities will no longer be includable as Tier 1 capital as is currently the case with bank holding companies. Instruments issued by May 19, 2010 will be grandfathered for companies with consolidated assets of $15 billion or less. There is a five-year transition period (from the July 21, 2010 effective date of the Dodd-Frank Act) before the capital requirements will apply to savings and loan holding companies.

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Source of Strength. The Dodd-Frank Act also extends the source of strength doctrine to savings and loan holding companies. The regulatory agencies must issue regulations requiring that all bank and savings and loan holding companies serve as a source of strength to their subsidiary depository institutions by providing capital, liquidity and other support to their subsidiary depository institutions in times of financial stress.

Dividends. The Bank must notify the Federal Reserve Board thirty (30) days before declaring any dividend to the Company. The financial impact of a holding company on its subsidiary institution is a matter that is evaluated by the Federal Reserve Board and the agency has authority to order cessation of activities or divestiture of subsidiaries deemed to pose a threat to the safety and soundness of the institution.

***Acquisition of the Company*.** Under the Federal Change in Control Act, a notice must be submitted to the Federal Reserve Board if any person (including a company), or group acting in concert, seeks to acquire direct or indirect control of a savings and loan holding company or savings association. Under certain circumstances, a change of control may occur, and prior notice is required, upon the acquisition of 10% or more of the Company s outstanding voting stock, unless the Federal Reserve Board has found that the acquisition will not result in control of the Company. A change in control definitively occurs upon the acquisition of 25% or more of the Company s outstanding voting stock. Under the Change in Control Act, the Federal Reserve Board generally has 60 days from the filing of a complete notice to act, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the competitive effects of the acquisition. Any company that acquires control would then be subject to regulation as a savings and loan holding company.

Federal Banking Regulation

Business Activities. The activities of federal savings banks are governed by federal laws and regulations. Those laws and regulations delineate the nature and extent of the business activities in which federal savings banks may engage. In particular, certain lending authority for federal savings banks, *e.g.*, commercial, non-residential real property loans and consumer loans, is limited to a specified percentage of the institution s capital or assets.

The Dodd-Frank Act authorized the payment of interest on commercial checking accounts, effective July 21, 2011.

***Capital Requirements*.** The applicable capital regulations require savings associations to meet three minimum capital standards: a 1.5% tangible capital to total assets ratio; a 4% tier 1 capital to total assets leverage ratio (3% for institutions receiving the highest rating on the CAMELS examination rating system) and an 8% risk-based capital ratio. In addition, the prompt corrective action standards discussed below also establish, in effect, a minimum 2% tangible capital standard, a 4% leverage ratio (3% for institutions receiving the highest rating on the CAMELS system) and, together with the risk-based capital standard itself, a 4% Tier 1 risk-based capital standard. The regulations also require that, in meeting the tangible, leverage and risk-based capital standards, institutions must generally deduct investments in and loans to subsidiaries engaged in activities as principal that are not permissible for a national bank.

The risk-based capital standard for savings associations requires the maintenance of Tier 1 (core) and total capital (which is defined as core capital and supplementary capital less certain specified deductions from total capital such as reciprocal holdings of depository institution capital instruments and equity investments) to risk-weighted assets of at least 4% and 8%, respectively. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet activities, recourse obligations, residual interests and direct credit substitutes, are multiplied by a risk-weight factor of 0% to 100%, assigned by the capital regulation based on the risks believed inherent in the type of asset. Core (Tier 1) capital is generally defined as common stockholders equity (including retained earnings), certain non-cumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries less intangibles other than certain mortgage servicing rights and credit card relationships. The components of supplementary capital (Tier 2 Capital) includes cumulative preferred stock, long-term perpetual preferred stock, mandatory convertible debt securities, subordinated debt and intermediate preferred stock, the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets, and up to 45% of unrealized gains on available-for-sale equity securities with readily determinable fair market values. Overall, the amount of supplementary capital included as part of total capital cannot exceed 100% of core capital.

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The OCC also has authority to establish individual minimum capital requirements in appropriate cases upon a determination that an institution s capital level is or may become inadequate in light of the particular circumstances.

At December 31, 2012, the Bank met each of its capital requirements. See Note 19 in the accompanying Notes to Consolidated Financial Statements.

The current risk-based capital guidelines that apply to the Bank are based on the 1988 capital accord of the International Basel Committee on Banking Supervision (Basel Committee), a committee of central banks and bank supervisors, as implemented by the Federal Reserve Board. In 2004, the Basel Committee published a new capital accord, which is referred to as Basel II, to replace Basel I. Basel II provides two approaches for setting capital standards for credit risk: an internal ratings-based approach tailored to individual institutions circumstances and a standardized approach that bases risk weightings on external credit assessments to a much greater extent than permitted in existing risk-based capital guidelines, which became effective in 2008 for large international banks (total assets of $250 billion or more or consolidated foreign exposure of $10 billion or more). Other U.S. banking organizations can elect to adopt the requirements of this rule (if they meet applicable qualification requirements), but they are not required to apply them. Basel II emphasizes internal assessment of credit, market and operational risk, as well as supervisory assessment and market discipline in determining minimum capital requirements.

In December 2010 and January 2011, the Basel Committee published the final texts of reforms on capital and liquidity, which is referred to as Basel III. Although Basel III is intended to be implemented by participating countries for large, internationally active banks, its provisions are likely to be considered by United States banking regulators in developing new regulations applicable to other banks in the United States. Basel III will require bank holding companies and their bank subsidiaries to maintain substantially more capital, with a greater emphasis on common equity. The implementation of the Basel III final framework was originally scheduled to commence on January 1, 2013 but has been delayed by federal regulators. Upon implementation, banking institutions will be required to meet the following minimum capital ratios: (i) 3.5% Common Equity Tier 1 (generally consisting of common shares and retained earnings) to risk-weighted assets; (ii) 4.5% Tier 1 capital to risk-weighted assets; and (iii) 8.0% Total capital to risk-weighted assets.

When fully phased-in on January 1, 2019, and if implemented by the U.S. banking agencies, Basel III will require banks to maintain:

- a minimum ratio of Common Equity Tier 1 to risk-weighted assets of at least 4.5%, plus a 2.5% capital conservation buffer ;
- a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer;
- a minimum ratio of Total capital to risk-weighted assets of at least 8.0%, plus the capital conservation buffer; and
- a minimum leverage ratio of 3%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures.

Basel III also includes the following significant provisions:

- An additional countercyclical capital buffer to be imposed by applicable national banking regulators periodically at their discretion, with advance notice;
- Restrictions on capital distributions and discretionary bonuses applicable when capital ratios fall within the buffer zone;
- Deduction from common equity of deferred tax assets that depend on future profitability to be realized; and

For capital instruments issued on or after January 13, 2013 (other than common equity), a loss-absorbency requirement that the instrument must be written off or converted to common equity if a triggering event occurs, either pursuant to applicable law or at the direction of the banking regulator. A triggering event is an event that would cause the banking organization to become nonviable without the write off or conversion, or without an injection of capital from the public sector.

Since the Basel III framework is not self-executing, the rules and standards promulgated under Basel III require that the U.S. federal banking regulators adopt them prior to becoming effective in the U.S. Although U.S. federal banking regulators have expressed support for Basel III, the timing and scope of its implementation, as well as any potential modifications or adjustments that may result during the implementation process, are not yet known.

Prompt Corrective Regulatory Action. The OCC is required to take certain supervisory actions against undercapitalized institutions, the severity of which depends upon the institution s degree of undercapitalization. Generally, a savings association that has a ratio of total capital to risk weighted assets of less than 8%, a ratio of Tier 1 (core) capital to risk-weighted assets of less than 4% or a ratio of core capital to total assets of less than 4% (3% or less for institutions with the highest examination rating) is considered to be undercapitalized. A savings association that has a total risk-based capital ratio less than 6%, a Tier 1 capital ratio of less than 3% or a leverage ratio that is less than 3% is considered to be significantly undercapitalized and a savings association that has a tangible capital to assets ratio equal to or less than 2% is deemed to be critically undercapitalized. Subject to a narrow exception, the OCC is required to appoint a receiver or conservator within specified time frames for an institution that is critically undercapitalized. The regulation also provides that a capital restoration plan must be filed with the OCC within 45 days of the date a savings association is deemed to have received notice that it is undercapitalized, significantly undercapitalized or critically undercapitalized. Compliance with the plan must be guaranteed by any parent holding company up to the lesser of 5% of the savings association s total assets when it was deemed to be undercapitalized or the amount necessary to achieve compliance with applicable capital requirements. In addition, numerous mandatory supervisory actions become immediately applicable to an undercapitalized institution, including, but not limited to, increased monitoring by regulators and restrictions on growth, capital distributions and expansion. The OCC could also take any one of a number of discretionary supervisory actions, including the issuance of a capital directive and the replacement of senior executive officers and directors. Significantly and critically undercapitalized institutions are subject to additional mandatory and discretionary measures.

Insurance of Deposit Accounts. The Bank s deposits are insured up to applicable limits by the Deposit Insurance Fund of the FDIC.

Under the FDIC s existing risk-based assessment system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital levels and certain other factors, with less risky institutions paying lower assessments. An institution s assessment rate depends upon the category to which it is assigned. Effective April 1, 2009, assessment rates ranged from seven to 77.5 basis points. On February 7, 2011, the FDIC issued final rules, effective April 1, 2011, implementing changes to the assessment rules resulting from the Dodd-Frank Act. Initially, the base assessment rates will range from two and one half to 45 basis points. The rate schedules will automatically adjust in the future when the Deposit Insurance Fund reaches certain milestones. No institution may pay a dividend if in default of the federal deposit insurance assessment.

The FDIC imposed on all insured institutions a special emergency assessment of five basis points of total assets minus Tier 1 capital (as of June 30, 2009), capped at ten basis points of an institution s deposit assessment base, in order to cover losses to the Deposit Insurance Fund. That special assessment was collected on September 30, 2009. In lieu of further special assessments, however, the FDIC required insured institutions to prepay estimated quarterly risk-based assessments for the fourth quarter of 2009 through the fourth quarter of 2012. The estimated assessments, which included an assumed annual assessment base increase of 5%, were recorded as a prepaid expense asset as of December 30, 2009. As of December 31, 2009, and each quarter thereafter, a charge to earnings is recorded for each regular assessment with an offsetting credit to the prepaid asset.

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Due to the recent difficult economic conditions, deposit insurance per account owner has been raised to $250,000. That coverage was made permanent by the Dodd-Frank Act. In addition, the FDIC adopted an optional Temporary Liquidity Guarantee Program by which, for a fee, noninterest-bearing transaction accounts would receive unlimited insurance coverage until June 30, 2010, subsequently extended to December 31, 2010, and certain senior unsecured debt issued by institutions and their holding companies between October 13, 2008 and October 31, 2009 would be guaranteed by the FDIC through June 30, 2012, or in some cases, December 31, 2012. The Bank opted to participate in the unlimited noninterest bearing transaction account coverage and the Bank and the Company opted not to participate in the unsecured debt guarantee program. The Dodd-Frank Act extended the unlimited coverage for certain noninterest-bearing transaction accounts from January 1, 2011 until December 31, 2012 without the opportunity for opt out.

The Dodd-Frank Act increased the minimum target Deposit Insurance Fund ratio from 1.15% of estimated insured deposits to 1.35% of estimated insured deposits. The FDIC must seek to achieve the 1.35% ratio by September 30, 2020. Insured institutions with assets of $10 billion or more are supposed to fund the increase. The Dodd-Frank Act eliminated the 1.5% maximum fund ratio, instead leaving it to the discretion of the FDIC.

The FDIC has authority to increase insurance assessments. A significant increase in insurance premiums would likely have an adverse effect on the operating expenses and results of operations of the Bank. Management cannot predict what insurance assessment rates will be in the future.

Insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or regulatory condition imposed in writing by the FDIC or the OCC. The management of the Bank does not know of any practice, condition or violation that might lead to termination of deposit insurance.

Loans to One Borrower. Federal law provides that savings associations are generally subject to the limits on loans to one borrower applicable to national banks. Generally, subject to certain exceptions, a savings association may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of its unimpaired capital and surplus. An additional amount may be lent, equal to 10% of unimpaired capital and surplus, if secured by specified readily-marketable collateral.

Qualified Thrift Lender (QTL) Test. Federal law requires savings associations to meet a qualified thrift lender test. Under the test, a savings association is required to either qualify as a domestic building and loan association under the Internal Revenue Code or maintain at least 65% of its portfolio assets (total assets less: (i) specified liquid assets up to 20% of total assets; (ii) intangibles, including goodwill; and (iii) the value of property used to conduct business) in certain qualified thrift investments (primarily residential mortgages and related investments, including certain mortgage-backed securities but also including education, credit card and small business loans) in at least nine months out of each 12-month period.

A savings association that fails the qualified thrift lender test is subject to certain operating restrictions and the Dodd-Frank Act also specifies that failing the qualified thrift lender test is a violation of law that could result in an enforcement action and dividend limitations. As of December 31, 2011, the Bank maintained 70% of its portfolio assets in qualified thrift investments and, therefore, met the qualified thrift lender test.

Limitation on Capital Distributions. Federal regulations impose limitations upon all capital distributions by a savings association, including cash dividends, payments to repurchase its shares and payments to shareholders of another institution in a cash-out merger. Under the regulations, an application to and prior approval of the OCC is required before any capital distribution if the institution does not meet the criteria for expedited treatment of applications under OCC regulations (i.e., generally, examination and Community Reinvestment Act ratings in the two top categories), the total capital distributions for the calendar year exceed net income for that year plus the amount of retained net income for the preceding two years, the institution would be undercapitalized following the distribution or the distribution would otherwise be contrary to a statute, regulation or agreement with the OCC. If an application is not required, the institution must still provide 30 days prior written notice to the Board of Governors of the Federal Reserve System of the capital distribution if, like the Bank, it is a subsidiary of a holding company, as well as an informational notice filing to the OCC.

If the Bank s capital fell below its regulatory requirements or the OCC notified it that it was in need of increased supervision, the Bank s ability to make capital distributions could be restricted. In addition, the OCC could prohibit a proposed capital distribution by any institution, which would otherwise be permitted by the regulation, if the OCC determines that such distribution would constitute an unsafe or unsound practice.

Standards for Safety and Soundness. The federal banking agencies have adopted Interagency Guidelines prescribing Standards for Safety and Soundness in various areas such as internal controls and information systems, internal audit, loan documentation and credit underwriting, interest rate exposure, asset growth and quality, earnings and compensation, fees and benefits. The guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. If the OCC determines that a savings association fails to meet any standard prescribed by the guidelines, the OCC may require the institution to submit an acceptable plan to achieve compliance with the standard.

Community Reinvestment Act. All federal savings associations have a responsibility under the Community Reinvestment Act and related regulations to help meet the credit needs of their communities, including low and moderate-income neighborhoods. An institution s failure to satisfactorily comply with the provisions of the Community Reinvestment Act could result in denials of regulatory applications. Responsibility for administering the Community Reinvestment Act, unlike other fair lending laws, is not being transferred to the Consumer Financial Protection Bureau. The Bank received a satisfactory Community Reinvestment Act rating in its most recently completed examination.

Transactions with Related Parties. The Bank s authority to engage in transactions with affiliates (e.g., any entity that controls or is under common control with the Bank, including the Company and its other subsidiaries) is limited by federal law. The aggregate amount of covered transactions with any individual affiliate is limited to 10% of the capital and surplus of the savings association. The aggregate amount of covered transactions with all affiliates is limited to 20% of the savings association s capital and surplus. Certain transactions with affiliates are required to be secured by collateral in an amount and of a type specified by federal law. The purchase of low quality assets from affiliates is generally prohibited. Transactions with affiliates must generally be on terms and under circumstances, that are at least as favorable to the institution as those prevailing at the time for comparable transactions with non-affiliated companies. In addition, savings associations are prohibited from lending to any affiliate that is engaged in activities that are not permissible for bank holding companies and no savings association may purchase the securities of any affiliate other than a subsidiary.

The Sarbanes-Oxley Act of 2002 generally prohibits loans by the Company to its executive officers and directors. However, the law contains a specific exception for loans by a depository institution to its executive officers and directors in compliance with federal banking laws. Under such laws, the Bank s authority to extend credit to executive officers, directors and 10% shareholders (insiders), as well as entities such persons control, is limited. The laws limit both the individual and aggregate amount of loans that the Bank may make to insiders based, in part, on the Bank s capital level and requires that certain board approval procedures be followed. Such loans are required to be made on terms substantially the same as those offered to unaffiliated individuals and not involve more than the normal risk of repayment. There is an exception for loans made pursuant to a benefit or compensation program that is widely available to all employees of the institution and does not give preference to insiders over other employees. Loans to executive officers are subject to additional limitations based on the type of loan involved.

Enforcement. The OCC has primary enforcement responsibility over savings associations and has authority to bring actions against the institution and all institution-affiliated parties, including stockholders, and any attorneys, appraisers and accountants who knowingly or recklessly participate in wrongful action likely to have an adverse effect on an insured institution. Formal enforcement action may range from the issuance of a capital directive or cease and desist order to removal of officers and/or directors to institution of receivership, conservatorship or termination of deposit insurance. Civil penalties cover a wide range of violations and can amount to $25,000 per day, or even $1 million per day in especially egregious cases. The FDIC has the authority to recommend to the Director of the OCC that enforcement action to be taken with respect to a particular savings association. If action is not taken by the Director, the FDIC has authority to take such action under certain circumstances. Federal law also establishes criminal penalties for certain violations.

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Assessments. Savings associations were previously required to pay assessments to the OTS to fund the agency s operations. The general assessments, paid on a semi-annual basis, are computer based upon the savings association s (including consolidated subsidiaries) total assets, condition and complexity of portfolio. The OCC assessments paid by the Bank for the year ended December 31, 2012 totaled $121,000.

Federal Home Loan Bank System

The Bank is a member of the Federal Home Loan Bank System, which consists of 12 regional Federal Home Loan Banks. The Federal Home Loan Bank provides a central credit facility primarily for member institutions. The Bank, as a member of the Federal Home Loan Bank, is required to acquire and hold shares of capital stock in that Federal Home Loan Bank. The Bank was in compliance with this requirement with an investment in Federal Home Loan Bank stock at December 31, 2012 of $2.8 million.

The Federal Home Loan Banks have been required to provide funds for the resolution of insolvent thrifts in the late 1980s and contribute funds for affordable housing programs. These and similar requirements, or general economic conditions, could reduce the amount of dividends that the Federal Home Loan Banks pay to their members and result in the Federal Home Loan Banks imposing a higher rate of interest on advances to their members. If dividends were reduced, or interest on future Federal Home Loan Bank advances increased, the Bank s net interest income would likely also be reduced.

Federal Reserve System

The Federal Reserve Board regulations require savings associations to maintain non-interest earning reserves against their transaction accounts (primarily NOW and regular checking accounts). The regulations generally provide that reserves be maintained against aggregate transaction accounts as follows: a 3% reserve ratio is assessed on net transaction accounts up to and including $58.8 million; a 10% reserve ratio is applied above $58.8 million. The first $10.7 million of otherwise reservable balances (subject to adjustments by the Federal Reserve Board) are exempted from the reserve requirements. The amounts are adjusted annually and, for 2011, require a 3% ratio for up to $58.8 million and an exemption of $10.7 million. The Bank complies with the foregoing requirements. In October 2008, the Federal Reserve Board began paying interest on certain reserve balances.

Other Regulations

The Bank s operations are also subject to federal laws applicable to credit transactions, including the:

- Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
- Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- Fair Credit Reporting Act of 1978, governing the use and provision of information to credit reporting agencies;
- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies; and
- Rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws.

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The operations of the Bank also are subject to laws such as the:

- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;

- Electronic Funds Transfer Act and Regulation E promulgated thereunder, which govern automatic deposits to and withdrawals from deposit accounts and customers rights and liabilities arising from the use of automated teller machines and other electronic banking services; and

- Check Clearing for the 21st Century Act (also known as Check 21), which gives substitute checks, such as digital check images and copies made from that image, the same legal standing as the original paper check.

FEDERAL AND STATE TAXATION

Federal Taxation

General. The Company and the Bank report their income on a calendar year basis using the accrual method of accounting and are subject to federal income taxation in the same manner as other corporations with some exceptions, including particularly the Bank s reserve for bad debts, as discussed below. The following discussion of tax matters is intended only as a summary and does not purport to be a comprehensive description of the tax rules applicable to the Bank or the Company. The Company and the Bank have not been audited by the Internal Revenue Service in the past five years.

Bad Debt Reserve. For taxable years beginning after December 31, 1995, the Bank is entitled to take a bad debt deduction for federal income tax purposes which is based on its current or historic net charge-offs by applying the experience reserve method for banks. For tax years beginning before December 31, 1995, the Bank as a qualifying thrift had been permitted to establish a reserve for bad debts and to make annual additions to such reserve, which were deductible for federal income tax purposes. Under such prior tax law, generally the Bank recognized a bad debt deduction equal to 8% of taxable income.

Under the 1996 Tax Act, the Bank was required to recapture all or a portion of its additions to its bad debt reserve made subsequent to the base year (which is the Bank s last taxable year beginning before January 1, 1988). This recapture was required to be made, after a deferral period based on certain specified criteria, ratably over a six-year period commencing in the Bank s calendar 1998 tax year. All post-1987 additions to the statutory bad debt reserve have been recaptured in taxable income as of December 31, 2002.

Potential Recapture of Base Year Bad Debt Reserve. The Bank s bad debt reserve as of the base year is not subject to automatic recapture as long as the Bank continues to carry on the business of banking and does not meet the definition of a large bank as discussed below. If the Bank no longer qualifies as a bank, the balance of the pre-1988 reserves (the base year reserves) are restored to income over a six-year period beginning in the tax year the Bank no longer qualifies as a bank. Such base year bad debt reserve is subject to recapture to the extent that the Bank makes non-dividend distributions that are considered as made from the base year bad debt reserve. To the extent that such reserves exceed the amount that would have been allowed under the experience method (Excess Distributions), then an amount based on the amount distributed will be included in the Bank s taxable income. Non-dividend distributions include distributions in excess of the Bank s current and accumulated earnings and profits, distributions in redemption of stock, and distributions in partial or complete liquidation. However, dividends paid out of the Bank s current or accumulated earnings and profits, as calculated for federal income tax purposes, will not be considered to result in a distribution from the Bank s bad debt reserve. Thus, any dividends to the Company that would reduce amounts appropriated to the Bank s bad debt reserve and deducted for federal income tax purposes would create a tax liability for the Bank. The amount of additional taxable income created from an Excess Distribution is an amount that, when reduced by the tax attributable to the income, is equal to the amount of the distribution. If the Bank makes a non-dividend distribution, then approximately one and one-half times the amount so used would be includable in gross income for federal income tax purposes, assuming a 34% corporate income tax rate (exclusive of state and local taxes). The Bank does not intend to pay dividends that would result in a recapture of any portion of its bad debt reserve.

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Corporate Alternative Minimum Tax. The Internal Revenue Code imposes a tax on alternative minimum taxable income (AMTI) at a rate of 20%. The excess of the bad debt reserve deduction claimed by the Bank over the deduction that would have been allowable under the experience method is treated as a preference item for purposes of computing the AMTI. Only 90% of AMTI can be offset by net operating loss carry-overs, of which the Bank currently has none. AMTI is increased by an amount equal to 75% of the amount by which the Bank s adjusted current earnings exceed its AMTI (determined without regard to this preference and before reduction for net operating losses). In addition, for taxable years beginning after June 30, 1986 and before January 1, 1996, an environmental tax of 0.12% of the excess of AMTI (with certain modifications) over $2.0 million is imposed on corporations, including the Bank, whether or not an Alternative Minimum Tax (AMT) is paid. The Bank does not expect to be subject to the AMT.

Dividends Received Deduction and Other Matters. The Company may exclude from its income 100% of dividends received from the Bank as a member of the same affiliated group of corporations. The corporate dividends received deduction is generally 70% in the case of dividends received from unaffiliated corporations with which the Company and the Bank will not file a consolidated tax return, except that if the Company or the Bank own more than 20% of the stock of a corporation distributing a dividend, then 80% of any dividends received may be deducted.

Indiana Taxation

Indiana imposes an 8.5% franchise tax based on a financial institution s adjusted gross income as defined by statute. In computing adjusted gross income, deductions for municipal interest, United States Government interest, the bad debt deduction computed using the reserve method and pre-1990 net operating losses are disallowed. The Company s Indiana state income tax returns have not been audited in the past five years.

ITEM 1A. RISK FACTORS

Above average interest rate risk associated with fixed-rate loans may have an adverse effect on our financial position or results of operations.

The Bank s loan portfolio includes a significant amount of loans with fixed rates of interest. At December 31, 2012, $129.0 million, or 44.6% of the Bank s total loans receivable, had fixed interest rates all of which were held for investment. The Bank offers ARM loans and fixed-rate loans. Unlike ARM loans, fixed-rate loans carry the risk that, because they do not reprice to market interest rates, their yield may be insufficient to offset increases in the Bank s cost of funds during a rising interest rate environment. Accordingly, a material and prolonged increase in market interest rates could be expected to have a greater adverse effect on the Bank s net interest income compared to other institutions that hold a materially larger portion of their assets in ARM loans. For a discussion of the Bank s loan portfolio, see *Item 1. Business Lending Activities*.

Higher loan losses could require the Company to increase its allowance for loan losses through a charge to earnings.

When we loan money we incur the risk that our borrowers do not repay their loans. We reserve for loan losses by establishing an allowance through a charge to earnings. The amount of this allowance is based on our assessment of loan losses inherent in our loan portfolio. The process for determining the amount of the allowance is critical to our financial results and condition. It requires subjective and complex judgments about the future, including forecasts of economic or market conditions that might impair the ability of our borrowers to repay their loans. We might underestimate the loan losses inherent in our loan portfolio and have loan losses in excess of the amount reserved. We might increase the allowance because of changing economic conditions. For example, in a rising interest rate environment, borrowers with adjustable-rate loans could see their payments increase. There may be a significant increase in the number of borrowers who are unable or unwilling to repay their loans, resulting in our charging off more loans and increasing our allowance. In addition, when real estate values decline, the potential severity of loss on a real estate-secured loan can increase significantly, especially in the case of loans with high combined loan-to-value ratios. Our allowance for loan losses at any particular date may not be sufficient to cover future loan losses. We may be required to increase our allowance for loan losses, thus reducing earnings.

Commercial business lending may expose the Company to increased lending risks.

At December 31, 2012, the Bank s commercial business loan portfolio amounted to $18.6 million, or 6.4% of total loans. Subject to market conditions and other factors, the Bank intends to expand its commercial business lending activities within its primary market area. Commercial business lending is inherently riskier than residential mortgage lending. Although commercial business loans are often collateralized by equipment, inventory, accounts receivable or other business assets, the liquidation value of these assets in the event of a borrower default is often an insufficient source of repayment because accounts receivable may be uncollectible and inventories and equipment may be obsolete or of limited use, among other things. See *Item 1. Business Lending Activities Commercial Business Loans*.

Commercial real estate lending may expose the Company to increased lending risks.

At December 31, 2012, the Bank s commercial real estate loan portfolio amounted to $68.7 million, or 23.8% of total loans. Commercial real estate lending is inherently riskier than residential mortgage lending. Because payments on loans secured by commercial properties often depend upon the successful operation and management of the properties, repayment of such loans may be affected by adverse conditions in the real estate market or the economy, among other things. See *Item 1. Business Lending Activities Commercial Real Estate Loans*.

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A return to recessionary conditions could result in increases in our level of non-performing loans and/or reduce demand for our products and services, which would lead to lower revenue, higher loan losses and lower earnings.

Following a national home price peak in mid-2006, falling home prices and sharply reduced sales volumes, along with the collapse of the United States subprime mortgage industry in early 2007, significantly contributed to a recession that officially lasted until June 2009, although the effects continued thereafter. Dramatic declines in real estate values and high levels of foreclosures resulted in significant asset write-downs by financial institutions, which have caused many financial institutions to seek additional capital, to merge with other institutions and, in some cases, to fail. Concerns over the United States credit rating, the European sovereign debt crisis, and continued high unemployment in the United States, among other economic indicators, have contributed to increased volatility in the capital markets and diminished expectations for the economy. A return of recessionary conditions and/or continued negative developments in the domestic and international credit markets may significantly affect the markets in which we do business, the value of our loans and investments, and our ongoing operations, costs and profitability. Further declines in real estate values and sales volumes and continued high unemployment levels may result in higher than expected loan delinquencies, increases in our levels of nonperforming and classified assets and a decline in demand for our products and services. These negative events may cause us to incur losses and may adversely affect our capital, liquidity, and financial condition.

Increased and/or special FDIC assessments will hurt our earnings.

The recent economic recession has caused a high level of bank failures, which has dramatically increased FDIC resolution costs and led to a significant reduction in the balance of the Deposit Insurance Fund. As a result, the FDIC has significantly increased the initial base assessment rates paid by financial institutions for deposit insurance. Increases in the base assessment rate have increased our deposit insurance costs and negatively impacted our earnings. In addition, in May 2009, the FDIC imposed a special assessment on all insured institutions. Our special assessment, which was reflected in earnings for the quarter ended June 30, 2009, was $205,000. In lieu of imposing an additional special assessment, the FDIC required all institutions to prepay their assessments for all of 2010, 2011 and 2012, which for us totaled $2.3 million. Additional increases in the base assessment rate or additional special assessments would negatively impact our earnings.

Strong competition within the Bank s market area could hurt the Company s profit and growth.

The Bank faces intense competition both in making loans and attracting deposits. This competition has made it more difficult for it to make new loans and at times has forced it to offer higher deposit rates. Price competition for loans and deposits might result in the Bank earning less on loans paying more on deposits, which would reduce net interest income. Competition also makes it more difficult to grow loans and deposits. Some of the institutions with which the Bank competes have substantially greater resources and lending limits than it has and may offer services that the Bank does not provide. Future competition will likely increase because of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. The Company s profitability depends upon the Bank s continued ability to compete successfully in its market area.

We are subject to federal regulations that seek to protect the Deposit Insurance Fund and the depositors and borrowers of the Bank, and our federal regulators may impose restrictions on our operations that are detrimental to holders of the Company s common stock.

We are subject to extensive regulation, supervision and examination by the Federal Reserve Board and the OCC, our primary federal regulators, and the FDIC, as insurer of our deposits. Such regulation and supervision governs the activities in which an institution and its holding company may engage, and are intended primarily for the protection of the insurance fund and the depositors and borrowers of the Bank rather than for holders of the Company s common stock. Our regulators may subject us to supervisory and enforcement actions, such as the imposition of certain restrictions on our operations, the classification of our assets and the determination of the level of our allowance for loan losses, that are aimed at protecting the insurance fund and the depositors and borrowers of the Bank but that are detrimental to holders of the Company s common stock. Any change in our regulation or oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material impact on our operations.

Financial regulatory reform may have a material impact on the Company s operations.

On July 21, 2010, the President signed into law the Dodd-Frank Act. The Dodd-Frank Act restructured the regulation of depository institutions. Under the Dodd-Frank Act, the OTS, which formerly regulated the Bank, was merged into the OCC. Savings and loan holding companies, including the Company, became regulated by the Federal Reserve Board. The Dodd-Frank Act also created a new federal agency to administer consumer protection and fair lending laws, a function that was formerly performed by the depository institution regulators. The federal preemption of state laws that was formerly accorded federally chartered depository institutions was reduced as well and State Attorneys General now have greater authority to bring a suit against a federally chartered institution for violations of certain state and federal consumer protection laws. The Dodd-Frank Act also imposed consolidated capital requirements on savings and loan holding companies effective no more than five years from the date of enactment. The Dodd-Frank Act contains various other provisions designed to enhance the regulation of depository institutions and prevent the recurrence of a financial crisis such as occurred in 2008 and 2009. The full impact of the Dodd-Frank Act on our business and operations will not be known for years until regulations implementing the statute are written and adopted. The Dodd-Frank Act may have a material impact on our operations, particularly through increased regulatory burden and compliance costs.

In addition to the enactment of the Dodd-Frank Act, the federal regulatory agencies recently have begun to take stronger supervisory actions against financial institutions that have experienced increased loan losses and other weaknesses as a result of the recent economic crisis. The actions include the entering into of written agreements and cease and desist orders that place certain limitations on their operations. Federal bank regulators recently have also been using with more frequency their ability to impose individual minimal capital requirements on banks, which requirements may be higher than those imposed under the Dodd-Frank Act or which would otherwise qualify the bank as being well capitalized under the OCC s prompt corrective action regulations. If we were to become subject to a supervisory agreement or higher individual minimum capital requirements, such action may have a negative impact on our ability to execute our business plans, as well as our ability to grow, pay dividends or engage in mergers and acquisitions and may result in restrictions in our operations.

Additionally, on August 30, 2012, the federal banking regulatory agencies issued proposed rules that would implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. If adopted as proposed, Basel III and regulations proposed by the federal banking regulatory agencies will require holding companies and banks to undertake significant activities to demonstrate compliance with the new and higher capital standards. Compliance with these rules, which are still being analyzed, will impose additional costs on banking entities and their holding companies.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

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ITEM 2. PROPERTIES

The following table sets forth certain information regarding the Bank s offices as of December 31, 2012.

Location	Year Opened	Net Book Value[1] (Dollars in thousands)	Owned/ Leased	Approximate Square Footage
Main Office:				
220 Federal Drive, N.W.				
Corydon, Indiana 47112	1997	$ 1,583	Owned	12,000
Branch Offices:				
391 Old Capital Plaza, N.E.				
Corydon, Indiana 47112	1997	7	Leased[2]	425
8095 State Highway 135, N.W.				
New Salisbury, Indiana 47161	1999	609	Owned	3,500
710 Main Street				
Palmyra, Indiana 47164	1991	1,039	Owned	6,000
9849 Highway 150				
Greenville, Indiana 47124	1986	177	Owned	2,484
5100 State Road 64 (Edwardsville Branch)				
Georgetown, Indiana 47122	2008	1,317	Owned	4,988
317 East U.S. Highway 150				
Hardinsburg, Indiana 47125	1996	121	Owned	1,834
4303 Charlestown Crossing				
New Albany, Indiana 47150	1999	751	Owned	3,500
3131 Grant Line Road				
New Albany, Indiana 47150	2003	1,518	Owned	12,200
5609 Williamsburg Station Road				
Floyds Knobs, Indiana 47119	2003	554	Owned	4,160
2744 Allison Lane				
Jeffersonville, Indiana 47130	2003	1,184	Owned	4,090
1312 S. Jackson Street				
Salem, Indiana 47167	2007	974	Owned	3,400

2420 Barron Avenue NE Lanesville, Indiana 47136	2010	868	Owned	1,450

(1) Represents the net value of land, buildings, furniture, fixtures and equipment owned by the Bank.
(2) Lease expires in April 2015.

ITEM 3. LEGAL PROCEEDINGS

At December 31, 2012, neither the Company nor the Bank was involved in any pending legal proceedings believed by management to be material to the Company s financial condition or results of operations. From time to time, the Bank is involved in legal proceedings occurring in the ordinary course of business. Such routine legal proceedings, in the aggregate, are believed by management to be immaterial to the Company s financial condition, results of operations or cash flows.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

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

The common shares of the Company are traded on the NASDAQ Capital Market under the symbol FCAP. As of December 31, 2012, the Company had 1,225 stockholders of record and 2,784,497 common shares outstanding. This does not reflect the number of persons whose shares are in nominee or street name accounts through brokers. See Note 18 in the accompanying Notes to Consolidated Financial Statement for information regarding dividend restrictions applicable to the Company.

The following table lists quarterly market price and dividend information per common share for the years ended December 31, 2012 and 2011 as reported by NASDAQ.

	High Sale	Low Sale	Dividends	Market price end of period
2012:				
First Quarter	$ 21.95	$ 18.51	$ 0.19	$ 21.17
Second Quarter	21.50	20.10	0.19	20.77
Third Quarter	21.00	19.07	0.19	19.50
Fourth Quarter	21.67	18.38	0.19	19.47
2011:				
First Quarter	$ 16.81	$ 15.50	$ 0.19	$ 16.27
Second Quarter	18.50	15.80	0.19	17.90
Third Quarter	18.82	17.00	0.19	18.50
Fourth Quarter	19.21	17.67	0.19	18.53

On August 19, 2008, the board of directors authorized the repurchase of up to 240,467 shares of the Company s outstanding common stock. The stock repurchase program will expire upon the purchase of the maximum number of shares authorized under the program, unless the board of directors terminates the program earlier. The Company purchased no shares under this program during the quarter ended December 31, 2012. The maximum number of shares that may yet be purchased under the plan is 189,582.

ITEM 6. SELECTED FINANCIAL DATA

The consolidated financial data presented below is qualified in its entirety by the more detailed financial data appearing elsewhere in this report, including the Company s audited consolidated financial statements.

			At December 31,		
	2012	2011	2010	2009	2008
			(In thousands)		
FINANCIAL CONDITION DATA:					
Total assets	$ 459,132	$ 438,886	$ 452,378	$ 455,534	$ 458,625
Cash and cash equivalents (1)	23,211	18,923	21,575	15,857	22,149
Securities available for sale	122,973	111,440	100,851	93,729	82,733
Securities held to maturity	12	16	32	62	86
Net loans	280,407	276,047	294,550	311,092	322,385
Deposits	384,343	364,374	378,003	374,476	355,891
Retail repurchase agreements	14,092	9,125	8,669	7,949	4,552
Advances from Federal Home Loan Bank	5,100	12,350	15,729	24,776	47,830
Stockholders equity, net of noncontrolling interest in subsidiary	52,824	50,942	47,893	45,944	47,522

			For the Year Ended December 31,		
	2012	2011	2010	2009	2008
			(In thousands)		
OPERATING DATA:					
Interest income	$ 18,800	$ 20,273	$ 21,834	$ 22,969	$ 25,686
Interest expense	2,465	3,760	5,502	8,388	10,745
Net interest income	16,335	16,513	16,332	14,581	14,941
Provision for loan losses	1,525	1,825	2,037	4,289	1,570
Net interest income after provision for loan losses	14,810	14,688	14,295	10,292	13,371
Noninterest income	4,537	4,051	3,906	3,373	3,573
Noninterest expense	13,853	13,211	12,762	13,473	11,846
Income before income taxes	5,494	5,528	5,439	192	5,098
Income tax expense (benefit)	1,559	1,543	1,561	(586)	1,529
Net Income	3,935	3,985	3,878	778	3,569
Less: net income attributable to noncontrolling interest in subsidiary	13	13	13	12	
Net Income Attributable to First Capital, Inc.	$ 3,922	$ 3,972	$ 3,865	$ 766	$ 3,569
PER SHARE DATA (2):					
Net income basic	$ 1.41	$ 1.43	$ 1.39	$ 0.28	$ 1.27
Net income diluted	1.41	1.43	1.39	0.28	1.27
Dividends	0.76	0.76	0.74	0.72	0.71

(1) Includes cash and due from banks, interest-bearing deposits in other depository institutions and federal funds sold.
(2) Per share data excludes net income attributable to noncontrolling interest in subsidiary.

	At or For the Year Ended December 31,				
	2012	2011	2010	2009	2008
SELECTED FINANCIAL RATIOS:					
Performance Ratios:					
Return on assets (1)	0.86%	0.90%	0.84%	0.17%	0.79%
Return on average equity (2)	7.54%	8.04%	8.10%	1.62%	7.65%
Dividend payout ratio (3)	53.90%	53.15%	53.24%	257.14%	55.91%
Average equity to average assets	11.46%	11.13%	10.43%	10.34%	10.31%
Interest rate spread (4)	3.86%	3.98%	3.74%	3.26%	3.30%
Net interest margin (5)	4.00%	4.14%	3.96%	3.56%	3.68%
Noninterest expense to average assets	3.05%	2.98%	2.79%	2.95%	2.62%
Average interest earning assets to average interest bearing liabilities	124.39%	118.79%	116.24%	115.08%	114.89%
Regulatory Capital Ratios (Bank only):					
Tier I adjusted total assets	10.00%	10.06%	9.32%	8.66%	8.98%
Tier I risk based	14.35%	16.11%	14.83%	13.39%	14.10%
Total risk-based	15.60%	17.05%	15.54%	13.99%	14.77%
Asset Quality Ratios:					
Nonperforming loans as a percent of net loans (6)	2.81%	2.81%	2.69%	3.06%	1.72%
Nonperforming assets as a percent of total assets (7)	1.78%	1.92%	1.88%	2.28%	1.40%
Allowance for loan losses as a percent of gross loans receivable	1.64%	1.47%	1.48%	1.54%	0.81%

(1) Net income attributable to First Capital, Inc. divided by average assets.
(2) Net income attributable to First Capital, Inc. divided by average equity.
(3) Common stock dividends declared per share divided by net income per share.
(4) Difference between weighted average yield on interest-earning assets and weighted average cost of interest-bearing liabilities. Tax exempt income is reported on a tax equivalent basis using a federal marginal tax rate of 34%.
(5) Net interest income as a percentage of average interest-earning assets.
(6) Nonperforming loans consist of loans accounted for on a nonaccrual basis and accruing loans 90 days or more past due.
(7) Nonperforming assets consist of nonperforming loans and real estate acquired in settlement of loans.

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

As the holding company for the Bank, the Company conducts its business primarily through the Bank. The Bank s results of operations depend primarily on net interest income, which is the difference between the income earned on its interest-earning assets, such as loans and investments, and the cost of its interest-bearing liabilities, consisting primarily of deposits, retail repurchase agreements and borrowings from the Federal Home Loan Bank of Indianapolis. The Bank s net income is also affected by, among other things, fee income, provisions for loan losses, operating expenses and income tax provisions. The Bank s results of operations are also significantly affected by general economic and competitive conditions, particularly changes in market interest rates, government legislation and policies concerning monetary and fiscal affairs, housing and financial institutions and the intended actions of the regulatory authorities.

Management uses various indicators to evaluate the Company s financial condition and results of operations, including the following:

Net income and earnings per share Net income attributable to the Company was $3.9 million, or $1.41 per share for 2012 compared to $4.0 million, or $1.43 per share for 2011. However, had the voluntary early retirement program discussed below not been established in 2012, net income would have been $4.3 million, or $1.53 per share for 2012, resulting in increases of 7.4% and 7.0%, respectively.

Return on average assets and return on average equity Return on average assets for 2012 was 0.86% compared to 0.90% for 2012, and return on average equity for 2012 was 7.54% compared to 8.04% for 2011. Excluding the net effect of the voluntary early retirement program would increase the return on average assets for 2012 to 0.94% and the return on average equity to 8.20%, resulting in increases of 4.4% and 2.0%, respectively.

Efficiency ratio The Company s efficiency ratio (defined as noninterest expenses divided by net interest income plus noninterest income) was 66.4% for 2012 compared to 64.2% for 2011. Excluding the expense associated with the voluntary early retirement program, the efficiency ratio would have been 63.7% for 2012 which compares very favorably to our peers.

Asset quality Net loan charge-offs decreased from $2.1 million for 2011 to $971,000 for 2012. In addition, total nonperforming assets (consisting of nonperforming loans and foreclosed real estate) decreased from $8.4 million, or 1.92% of total assets at December 31, 2011 to $8.2 million, or 1.78% of total assets at December 31, 2012. The allowance for loan losses was 1.64% of total loans and 60.16% of nonperforming loans at December 31, 2012 compared to 1.47% of total loans and 53.86% at December 31, 2011.

Shareholder return Total shareholder return, including the increase in the Company s stock price from $18.53 at December 31, 2011 to $19.47 at December 31, 2012 and dividends of $0.76 per share, was 9.2% for 2012.

Management s discussion and analysis of financial condition and results of operations is intended to assist in understanding the financial condition and results of operations of the Company and the Bank. The information contained in this section should be read in conjunction with the consolidated financial statements and the accompanying notes to consolidated financial statements included elsewhere in this report.

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Operating Strategy

The Company is the parent company of an independent community-oriented financial institution that delivers quality customer service and offers a wide range of deposit, loan and investment products to its customers. The commitment to customer needs, the focus on providing consistent customer service, and community service and support are the keys to the Bank s past and future success. The Company has no other material income other than that generated by the Bank and its subsidiaries.

The Bank s primary business strategy is attracting deposits from the general public and using those funds to originate residential mortgage loans, multi-family residential loans, commercial real estate and business loans and consumer loans. The Bank invests excess liquidity primarily in interest-bearing deposits with the Federal Home Loan Bank of Indianapolis and other financial institutions, federal funds sold, U.S. government and agency securities, local municipal obligations and mortgage-backed securities.

In recent years, the Company s operating strategy has also included strategies designed to enhance profitability by increasing sources of noninterest income and improving operating efficiency while managing its capital and limiting its credit risk and interest rate risk exposures. To accomplish these objectives, the Company has focused on the following:

- Monitoring asset quality and credit risk in the loan and investment portfolios, with an emphasis on reducing nonperforming assets and originating high-quality commercial and consumer loans.

- Being active in the local community, particularly through our efforts with local schools, to uphold our high standing in our community and marketing to our next generation of customers.

- Improving profitability by expanding our product offerings to customers and investing in technology to increase the productivity and efficiency of our staff.

- Continuing to emphasize commercial real estate and other commercial business lending as well as consumer lending. The Bank will also continue to focus on increasing secondary market lending as a source of noninterest income.

- Growing commercial and personal demand deposit accounts which provide a low-cost funding source.

- Evaluating vendor contracts for potential cost savings and efficiencies.

- Continuing our capital management strategy to enhance shareholder value through the repurchase of Company stock and the payment of dividends.

- Evaluating growth opportunities to expand the Bank s market area and market share through acquisitions of other financial institutions or branches of other institutions.

Critical Accounting Policies and Estimates

The accounting and reporting policies of the Company comply with accounting principles generally accepted in the United States of America and conform to general practices within the banking industry. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. The financial position and results of operations can be affected by these estimates and assumptions, which are integral to understanding reported results. Critical accounting policies are those policies that require management to make assumptions about matters that are highly uncertain at the time an accounting estimate is made; and different estimates that the Company reasonably could have used in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, would have a material impact on the Company s financial condition, changes in financial condition or results of operations. Most accounting policies are not considered by management to be critical accounting policies. Several factors are considered in determining whether or not a policy is critical in the preparation of financial statements. These factors include, among other things, whether the estimates are significant to the financial statements, the nature of the estimates, the ability to readily validate the estimates with other information including third parties or available prices, and sensitivity of the estimates to changes in economic conditions and whether alternative accounting methods may be utilized under generally accepted accounting principles.

Significant accounting policies, including the impact of recent accounting pronouncements, are discussed in Note 1 of the accompanying Notes to Consolidated Financial Statements. Those policies considered to be critical accounting policies are described below.

Allowances for Loan Losses. The allowance for loan losses is the amount estimated by management as necessary to cover losses inherent in the loan portfolio at the balance sheet date. The allowance is established through the provision for loan losses, which is charged to income. Determining the amount of the allowance for loan losses necessarily involves a high degree of judgment. Among the material estimates required to establish the allowance are: loss exposure at default; the amount and timing of future cash flows on impacted loans; value of collateral; and determination of loss factors to be applied to the various elements of the portfolio. All of these estimates are susceptible to significant change. Management reviews the level of the allowance at least quarterly and establishes the provision for loan losses based upon an evaluation of the portfolio, past loss experience, current economic conditions and other factors related to the collectability of the loan portfolio. Although we believe that we use the best information available to establish the allowance for loan losses, future adjustments to the allowance may be necessary if economic or other conditions differ substantially from the assumptions used in making the evaluation. In addition, the OCC, as an integral part of its examination process, periodically reviews our allowance for loan losses and may require us to recognize adjustments to the allowance based on its judgments about information available to it at the time of its examination. A large loss could deplete the allowance and require increased provisions to replenish the allowance, which would adversely affect earnings. Note 1 and Note 4 of the accompanying Notes to Consolidated Financial Statements describe the methodology used to determine the allowance for loan losses as well as changes to the methodology for determining the allowance for loan losses during the year ended December 31, 2012.

***Valuation Methodologies*.** In the ordinary course of business, management applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when active markets do not exist for the items being valued. Generally, in evaluating various assets for potential impairment, management compares the fair value to the carrying value. Quoted market prices are referred to when estimating fair values for certain assets, such as certain investment securities. For investment securities for which quoted market prices are not available, the Company obtains fair value measurements from an independent pricing service. However, for those items for which market-based prices do not exist and an independent pricing service is not readily available, management utilizes significant estimates and assumptions to value such items. Examples of these items include goodwill and other intangible assets, foreclosed and other repossessed assets, impaired loans, stock-based compensation and certain other financial investments. The use of different assumptions could produce significantly different results, which could have material positive or negative effects on the Company s results of operations. Note 20 and Note 21 of the accompanying Notes to Consolidated Financial Statements describe the methodologies used to determine the fair value of investment securities, impaired loans, foreclosed real estate and other assets. There were no changes in the valuation techniques and related inputs used during the year ended December 31, 2012.

Results of Operations for the Year Ended December 31, 2012 Compared to the Year Ended December 31, 2011

Net Income. Net income attributable to the Company was $3.9 million ($1.41 per share diluted; weighted average common shares outstanding of 2,785,286, as adjusted) for the year ended December 31, 2012 compared to $4.0 million ($1.43 per share diluted; weighted average common shares outstanding of 2,786,410, as adjusted) for the year ended December 31, 2011.

Net Interest Income. Net interest income decreased $178,000, or 1.1%, from $16.5 million for 2011 to $16.3 million for 2012 primarily due to a decrease in the interest rate spread, the difference between the average tax-equivalent yield on interest-earning assets and the average cost of interest-bearing liabilities, partially offset by an increase in interest-earning assets.

Total interest income decreased 7.3% from $20.3 million for 2011 to $18.8 million for 2012. This decrease was primarily a result of the average tax-equivalent yield on interest-earning assets decreasing from 5.06% for 2011 to 4.59% for 2012 partially offset by an increase in the average balance of interest-earning assets from $412.2 million for 2011 to $422.8 million for 2012. Interest on loans decreased $1.2 million as a result of the average tax-equivalent yield on loans decreasing from 5.89% for 2011 to 5.70% for 2012 and the average balance of loans decreasing from $292.1 million for 2011 to $281.4 million for 2012. Interest on investment securities (including Federal Home Loan Bank stock) decreased $319,000 for 2012 compared to 2011 due to the average tax-equivalent yield of investment securities decreasing from 3.34% for 2011 to 2.73% for 2012, partially offset by the average balance of investment securities increasing from $107.7 million for 2011 to $118.4 million for 2012. Management continued to focus loan origination efforts on commercial and consumer loans during 2012. The majority of the new commercial loans originated during 2012 were adjustable-rate loans. Adjustable-rate loans comprised 55% of the total loan portfolio at the end of 2012, compared to 52% at the end of 2011. Market interest rates remained at near historic lows throughout 2012, so as loans and investment securities mature or pay down they are replaced with lower yielding new loan originations and investment purchases.

Total interest expense decreased $1.3 million, from $3.8 million for 2011 to $2.5 million for 2012, due to a decrease in the average cost of funds from 1.08% for 2011 to 0.73% for 2012, and a decrease in the average balance of interest-bearing liabilities from $347.0 million for 2011 to $339.1 million for 2012. Interest expense on deposits decreased 34.5% from $3.1 million for 2011 to $2.0 million for 2012 as a result of a decrease in the average cost of interest-bearing deposits, which decreased from 0.96% for 2011 to 0.64% for 2012 and a decrease in the average balance of interest-bearing deposits from $323.3 million for 2011 to $318.7 million for 2012. Interest expense on Federal Home Loan Bank advances decreased 34.0% from $585,000 for 2011 to $386,000 for 2012. The average cost of Federal Home Loan Bank advances decreased from 4.02% for 2011 to 3.75% for 2012, and the average balance of Federal Home Loan Bank advances decreased from $14.6 million for 2011 to $10.3 million for 2012, due to scheduled pay downs of advances. For further information, see *Average Balance Sheets* below. The changes in interest income and interest expense resulting from changes in volume and changes in rates for 2012 and 2011 are shown in the schedule captioned *Rate/Volume Analysis* included herein.

Provision for Loan Losses. The provision for loan losses was $1.5 million for 2012 compared to $1.8 million for 2011. The consistent application of management s allowance methodology resulted in a decrease in the provision for loan losses for 2012 compared to the prior year primarily due to a decrease in net charge-offs. Net charge-offs decreased when comparing the two periods, from $2.1 million for 2011 to $971,000 for 2012. The provisions were recorded to bring the allowance to the level determined in applying the allowance methodology after reduction for net charge-offs during the year and to allow for inherent loss exposure due to weakened general economic conditions such as depreciating collateral values, job losses and continued pressures on household budgets in the Bank s market area.

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Provisions for loan losses are charges to earnings to maintain the total allowance for loan losses at a level considered reasonable by management to provide for probable known and inherent loan losses based on management s evaluation of the collectability of the loan portfolio, including the nature of the portfolio, credit concentrations, trends in historical loss experience, specified impaired loans and economic conditions. Although management uses the best information available, future adjustments to the allowance may be necessary due to changes in economic, operating, regulatory and other conditions that may be beyond the Bank s control. While the Bank maintains the allowance for loan losses at a level that it considers adequate to provide for estimated losses, there can be no assurance that further additions will not be made to the allowance for loan losses and that actual losses will not exceed the estimated amounts.

Noninterest income. Noninterest income increased $486,000 to $4.5 million for 2012 compared to $4.1 million for 2011. Gains on the sale of loans increased $355,000 when comparing the two periods primarily due to the low rate environment which has led to increased refinancing activity, and the continuing recovery of the local housing market. Service charges on deposit accounts also increased $70,000 for 2012 compared to 2011 due to an increase in ATM and debit card fee income.

Noninterest expense. Noninterest expense increased $642,000, or 4.9%, to $13.9 million for 2012 compared to $13.2 million for 2011. The increase was primarily due to increases of $461,000 in compensation and benefits expenses and $122,000 in data processing expenses. The increase in compensation and benefits expenses was primarily due to the voluntary early retirement program which was effective September 30, 2012. Fourteen employees participated in the program which resulted in a pre-tax charge to earnings of $693,000 on September 30, 2012. This was partially offset by the pre-tax savings of $132,000 the Company recognized during the quarter ended December 31, 2012 due to the overall reduction in compensation and benefits following the voluntary retirements. The increase in data processing expenses was primarily due to an increase in ATM processing fees and more customers using alternate delivery channels for traditional banking services.

Income tax expense. The Company recognized income tax expense of $1.6 million (effective tax rate of 28.4%) for 2012, compared to $1.5 million (effective tax rate of 27.9%) for 2011. The increase in income tax expense and the effective tax rate for 2012 is primarily due to a decrease in tax exempt income.

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Average Balances and Yields. The following table sets forth certain information for the periods indicated regarding average balances of assets and liabilities, as well as the total dollar amounts of interest income from average interest-earnings assets and interest expense on average interest-bearing liabilities and average yields and costs. Such yields and costs for the periods indicated are derived by dividing income or expense by the average historical cost balances of assets or liabilities, respectively, for the periods presented and do not give effect to changes in fair value that are included as a separate component of stockholders equity. Average balances are derived from daily balances. Tax-exempt income on loans and investment securities has been adjusted to a tax equivalent basis using the federal marginal tax rate of 34%.

	Year Ended December 31,								
	2012			2011			2010		
(Dollars in thousands)	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost
Interest-earning assets:									
Loans (1) (2):									
Taxable (3)	$ 278,874	$ 15,916	5.71%	$ 290,527	$ 17,124	5.89%	$ 310,644	$ 18,598	5.99%
Tax-exempt	2,501	135	5.40%	1,533	84	5.48%	187	13	6.95%
Total loans	281,375	16,051	5.70%	292,060	17,208	5.89%	310,831	18,611	5.99%
Investment securities:									
Taxable (3)	92,980	1,771	1.90%	81,085	2,017	2.49%	74,313	2,132	2.87%
Tax-exempt	25,417	1,464	5.76%	26,585	1,574	5.92%	27,029	1,606	5.94%
Total investment securities	118,397	3,235	2.73%	107,670	3,591	3.34%	101,342	3,738	3.69%
Federal funds sold and interest-bearing deposits with banks	21,998	58	0.26%	12,466	38	0.30%	14,679	35	0.24%
Total interest-earning assets	421,770	19,344	4.59%	412,196	20,837	5.06%	426,852	22,384	5.24%
Noninterest-earning assets	31,953			31,596			30,738		
Total assets	$ 453,723			$ 443,792			$ 457,590		
Interest-bearing liabilities:									
Interest-bearing demand deposits	$ 156,704	$ 487	0.31%	$ 157,667	$ 842	0.53%	$ 159,286	$ 1,224	0.77%
Savings accounts	55,369	61	0.11%	46,234	90	0.19%	43,990	103	0.23%
Time deposits	106,625	1,493	1.40%	119,359	2,184	1.83%	132,693	3,092	2.33%
Total deposits	318,698	2,041	0.64%	323,260	3,116	0.96%	335,969	4,419	1.32%
Retail repurchase agreements	10,074	38	0.38%	9,174	59	0.64%	8,142	73	0.90%
FHLB advances	10,287	386	3.75%	14,557	585	4.02%	23,116	1,010	4.37%
Total interest-bearing liabilities	339,059	2,465	0.73%	346,991	3,760	1.08%	367,227	5,502	1.50%
Noninterest-bearing liabilities:									
Noninterest-bearing deposits	60,509			46,001			41,220		
Other liabilities	2,169			1,422			1,407		
Total liabilities	401,737			394,414			409,854		
Stockholders equity	51,986			49,378			47,736		

Total liabilities and stockholders equity (4)	$ 453,723	$ 443,792	$ 457,590
Net interest income	$ 16,879	$ 17,077	$ 16,882
Interest rate spread	3.86%	3.98%	3.74%
Net interest margin	4.00%	4.14%	3.96%
Ratio of average interest earning assets to average interest-bearing liabilities	124.39%	118.79%	116.24%

(1) Interest income on loans includes fee income of $654,000, $662,000 and $633,000 for the years ended December 31, 2012, 2011, and 2010, respectively.
(2) Average loan balances include loans held for sale and nonperforming loans.
(3) Includes taxable debt and equity securities and Federal Home Loan Bank Stock.
(4) Stockholders equity attributable to First Capital, Inc.

***Rate/Volume Analysis*.** The following table sets forth the effects of changing rates and volumes on net interest income and interest expense computed on a tax-equivalent basis. Information is provided with respect to (i) effects on interest income attributable to changes in volume (changes in volume multiplied by prior rate); (ii) effects attributable to changes in rate (changes in rate multiplied by prior volume); and (iii) effects attributable to changes in rate and volume (change in rate multiplied by changes in volume). Tax exempt income on loans and investment securities has been adjusted to a tax-equivalent basis using the federal marginal tax rate of 34%.

	2012 Compared to 2011 Increase (Decrease) Due to				2011 Compared to 2010 Increase (Decrease) Due to			
	Rate	Volume	Rate/ Volume	Net	Rate	Volume	Rate/ Volume	Net
	(In thousands)							
Interest-earning assets:								
Loans:								
Taxable	$ (533)	$ (696)	$ 21	$ (1,208)	$ (303)	$ (1,191)	$ 20	$ (1,474)
Tax-exempt	(1)	53	(1)	51	(3)	94	(20)	71
Total investment securities	(534)	(643)	20	(1,157)	(306)	(1,097)	0	(1,403)
Investment securities:								
Taxable	(476)	300	(70)	(246)	(282)	193	(26)	(115)
Tax-exempt	(43)	(69)	2	(110)	(5)	(27)	0	(32)
Total investment securities	(519)	231	(68)	(356)	(287)	166	(26)	(147)
Federal funds sold and interest-bearing deposits with banks	(5)	29	(4)	20	9	(5)	(1)	3
Total net change in income on interest-earning assets	(1,058)	(383)	(52)	(1,493)	(584)	(936)	(27)	(1,547)
Interest-bearing liabilities:								
Interest-bearing deposits	(1,044)	(46)	15	(1,075)	(1,184)	(165)	46	(1,303)
Retail repurchase agreements	(25)	6	(2)	(21)	(20)	9	(3)	(14)
FHLB advances	(39)	(172)	12	(199)	(81)	(374)	30	(425)
Total net change in expense on interest-bearing liabilities	(1,108)	(212)	25	(1,295)	(1,285)	(530)	73	(1,742)
Net change in net interest income	$ 50	$ (171)	$ (77)	$ (198)	$ 701	$ (406)	$ (100)	$ 195

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Comparison of Financial Condition at December 31, 2012 and 2011

Total assets increased 4.6% from $438.9 million at December 31, 2011 to $459.1 million at December 31, 2012 primarily due to increases in securities available for sale and net loans.

Net loans increased 1.6% from $276.0 million at December 31, 2011 to $280.4 million at December 31, 2012. The primary contributing factor to the increase in net loans was an increase of $11.1 million in commercial real estate loans. This was partially offset by a decrease of $8.2 million in residential mortgage loans as the Bank continued to sell the majority of newly originated residential mortgage loans in the secondary market. The Bank originated $42.7 million in new residential mortgages for sale in the secondary market during 2012 compared to $31.6 million in 2011. These loans were originated and funded by the Bank and sold in the secondary market. Of this total, $7.8 million paid off existing loans in the Bank s portfolio. Originating mortgage loans for sale in the secondary market allows the Bank to better manage its interest rate risk, while offering a full line of mortgage products to prospective customers. In addition to commercial mortgage loans, construction loans also increased by $4.3 million during 2012 while commercial business loans decreased by $2.1 million during the year.

Securities available for sale, at fair value, consisting primarily of U. S. agency mortgage-backed obligations, U. S. agency notes and bonds, and municipal obligations, increased $11.5 million, from $111.4 million at December 31, 2011 to $123.0 million at December 31, 2012. Purchases of securities available for sale totaled $64.3 million in 2012. These purchases were offset by maturities of $33.5 million, principal repayments of $15.0 million and sales of $3.5 million. The Bank invests excess cash in securities that provide safety, liquidity and yield. Accordingly, we purchase mortgage-backed securities to provide cash flow for loan demand and deposit changes, we purchase federal agency notes for short-term yield and low risk, and municipals are purchased to improve our tax equivalent yield focusing on longer term profitability.

The investment in securities held to maturity, consisting of U.S. agency mortgage-backed securities, decreased from $16,000 at December 31, 2011 to $12,000 at December 31, 2012 due to principal repayments of $4,000.

Cash and cash equivalents increased from $18.9 million at December 31, 2011 to $23.2 million at December 31, 2012. The increase is due primarily to increases in interest bearing deposits with banks and federal funds sold as a result of increases in deposit accounts during 2012.

Total deposits increased 5.5%, from $364.4 million at December 31, 2011 to $384.3 million at December 31, 2012. Noninterest-bearing demand deposits increased 19.9% to $56.7 million at December 31, 2012. Interest-bearing demand deposits and savings accounts each increased $12.8 million during 2012, while money market accounts and time deposits decreased $3.3 million and $11.8 million, respectively, during the period. The increase in interest-bearing demand deposits is primarily due to normal fluctuations in the balances of operating accounts of public entities, such as counties, cities and school corporations. Time deposits have decreased as some customers are unwilling to lock into long-term commitments while interest rates are at their current low levels.

Federal Home Loan Bank borrowings decreased $7.3 million from $12.4 million at December 31, 2011 to $5.1 million at December 31, 2012. No new advances were drawn during the year while principal payments on advances totaled $7.3 million during 2012.

Retail repurchase agreements, which represent overnight borrowings from business and local municipal deposit customers, increased from $9.1 million at December 31, 2011 to $14.1 million at December 31, 2012, primarily due to normal balance fluctuations.

Total stockholders equity attributable to the Company increased from $50.9 million at December 31, 2011 to $52.8 million at December 31, 2012. This increase is primarily the result of retained net income of $1.8 million and an increase in net unrealized gains on available for sale securities of $92,000, partially offset by treasury stock purchases of $14,000. During 2012 the Company repurchased 692 shares of its stock at a weighted average price of $20.81 per share. As of December 31, 2012, the Company had repurchased 50,885 shares of the 240,467 shares authorized by the Board of Directors under the current stock repurchase program which was announced in August 2008 and 379,419 shares since the original repurchase program began in 2001.

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Off-Balance-Sheet Arrangements

The Company is a party to financial instruments with off-balance-sheet risk including commitments to extend credit under existing lines of credit and commitments to originate loans. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated financial statements.

Off-balance-sheet financial instruments whose contract amounts represent credit and interest rate risk are summarized as follows:

	At December 31, 2012	2011
	(In thousands)	
Commitments to originate new loans	$ 13,194	$ 2,479
Undisbursed portion of construction loans	4,306	4,768
Unfunded commitments to extend credit under existing commercial and personal lines of credit	38,480	35,375
Standby letters of credit	781	1,685

The Company does not have any special purpose entities, derivative financial instruments or other forms of off-balance-sheet financing arrangements.

Commitments to originate new loans or to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Most equity line commitments are for a term of five to 10 years and commercial lines of credit are generally renewable on an annual basis. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer s creditworthiness on a case-by-case basis. The amounts of collateral obtained, if deemed necessary by the Company upon extension of credit, are based on management s credit evaluation of the borrower.

Contractual Obligations

The following table summarizes information regarding the Company s contractual obligations as of December 31, 2012:

	Payments due by period				
	Total	Less than 1 Year	1 3 Years	3 5 Years	More than 5 Years
	(In thousands)				
Deposits	$ 384,343	$ 336,975	$ 39,136	$ 8,227	$ 5
Federal Home Loan Bank advances	5,100	5,100	0	0	0
Retail repurchase agreements	14,092	14,092	0	0	0
Operating lease obligations	34	15	19	0	0
Total contractual obligations	$ 403,569	$ 356,182	$ 39,155	$ 8,227	$ 5

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Liquidity and Capital Resources

Liquidity refers to the ability of a financial institution to generate sufficient cash flow to fund current loan demand, meet deposit withdrawals and pay operating expenses. The Bank s primary sources of funds are new deposits, proceeds from loan repayments and prepayments and proceeds from the maturity of securities. The Bank may also borrow from the Federal Home Loan Bank of Indianapolis. While loan repayments and maturities of securities are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by market interest rates, general economic conditions and competition. At December 31, 2012, the Bank had cash and interest-bearing deposits with banks of $23.2 million and securities available for sale with a fair value of $123.0 million. If the Bank requires funds beyond its ability to generate them internally, it has additional borrowing capacity with the Federal Home Loan Bank of Indianapolis and collateral eligible for repurchase agreements.

The Bank must maintain an adequate level of liquidity to ensure the availability of sufficient funds to support loan growth and deposit withdrawals, to satisfy financial commitments and to take advantage of investment opportunities. At December 31, 2012, the Bank had total commitments to extend credit of $49.7 million. See Note 16 in the accompanying Notes to Consolidated Financial Statements. At December 31, 2012, the Bank had certificates of deposit scheduled to mature within one year of $53.4 million. Historically, the Bank has been able to retain a significant amount of its deposits as they mature.

The Company is a separate legal entity from the Bank and must provide for its own liquidity. In addition to its operating expenses, the Company requires funds to pay any dividends to its shareholders and to repurchase any shares of its common stock. The Company s primary source of income is dividends received from the Bank. The amount of dividends the Bank may declare and pay to the Company in any calendar year, without the receipt of prior approval from the OCC but with prior notice to the OCC, cannot exceed net income for that year to date plus retained net income (as defined) for the preceding two calendar years. At December 31, 2012, the Company (on an unconsolidated basis) had liquid assets of $239,000.

The Bank is required to maintain specific amounts of capital pursuant to OCC regulations. As of December 31, 2012 the Bank was in compliance with all regulatory capital requirements which were effective as of such date with tangible capital to adjusted total assets, Tier I capital to risk-weighted assets and risk-based capital to risk-weighted assets ratios of 10.0%, 14.4% and 15.6%, respectively. See Note 19 in the accompanying Notes to Consolidated Financial Statements.

Effect of Inflation and Changing Prices

The consolidated financial statements and related financial data presented in this report have been prepared in accordance with generally accepted accounting principles in the United States of America, which generally require the measurement of financial position and operating results in terms of historical dollars, without considering the changes in relative purchasing power of money over time due to inflation. The primary impact of inflation is reflected in the increased cost of the Bank s operations. Unlike most industrial companies, virtually all the assets and liabilities of the financial institution are monetary in nature. As a result, interest rates generally have a more significant impact on the financial institution s performance than do general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

Market Risk Analysis

Qualitative Aspects of Market Risk. Market risk is the risk that the estimated fair value of our assets an d liabilities will decline as a result of changes in interest rates or financial market volatility, or that our net income will be significantly reduced by interest rate changes.

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The Company s principal financial objective is to achieve long-term profitability while reducing its exposure to fluctuating market interest rates by operating within acceptable limits established for interest rate risk and maintaining adequate levels of funding and liquidity. The Company has sought to reduce the exposure of its earnings to changes in market interest rates by attempting to manage the mismatch between asset and liability maturities and interest rates. In order to reduce the exposure to interest rate fluctuations, the Company has developed strategies to manage its liquidity, shorten its effective maturities of certain interest-earning assets and decrease the interest rate sensitivity of its asset base. Management has sought to decrease the average maturity of its assets by emphasizing the origination of short-term commercial and consumer loans, all of which are retained by the Company for its portfolio. The Company relies on retail deposits as its primary source of funds. Management believes the use of retail deposits, compared to brokered deposits reduces the effects of interest rate fluctuations because they generally represent a more stable source of funds.

Quantitative Aspects of Market Risk. The Company does not maintain a trading account for any class of financial instrument nor does the Company engage in hedging activities or purchase high-risk derivative instruments. Furthermore, the Company is not subject to foreign currency exchange rate risk or commodity price risk.

Potential cash flows, sales, or replacement value of many of our assets and liabilities, especially those that earn or pay interest, are sensitive to changes in the general level of interest rates. This interest rate risk arises primarily from our normal business activities of gathering deposits, extending loans and investing in investment securities. Many factors affect the Company s exposure to changes in interest rates, such as general economic and financial conditions, customer preferences, historical pricing relationships, and re-pricing characteristics of financial instruments. The Company s earnings can also be affected by the monetary and fiscal policies of the U.S. Government and its agencies, particularly the Federal Reserve Board.

An element in the Company s ongoing process is to measure and monitor interest rate risk using a Net Interest Income at Risk simulation to model the interest rate sensitivity of the balance sheet and to quantify the impact of changing interest rates on the Company. The model quantifies the effects of various possible interest rate scenarios on projected net interest income over a one-year horizon. The model assumes a semi-static balance sheet and measures the impact on net interest income relative to a base case scenario of hypothetical changes in interest rates over twelve months and provides no effect given to any steps that management might take to counter the effect of the interest rate movements. The scenarios include prepayment assumptions, changes in the level of interest rates, the shape of the yield curve, and spreads between market interest rates in order to capture the impact from re-pricing, yield curve, option, and basis risks.

Results of the Company s simulation modeling, which assumes an immediate and sustained parallel shift in market interest rates, project that the Company s net interest income could change as follows over a one-year horizon, relative to our base case scenario, based on December 31, 2012 financial information. The Company implemented the Net Interest Income at Risk simulation during the quarter ended September 30, 2012 and therefore does not have comparable information as of December 31, 2011.

Immediate Change in the Level of Interest Rates	At December 31, 2012 One Year Horizon	
	Dollar Change	Percent Change
	(Dollars in thousands)	
300bp	$ 112	0.70%
200bp	480	2.97
100bp	488	3.02
Static		
(100)bp	(183)	(1.13)

At December 31, 2012, the Company s simulated exposure to an increase in interest rates shows that an immediate and sustained increase in rates of 1.00% would increase the Company s net interest income by $488,000, or 3.02%, over a one year horizon compared to a flat interest rate scenario. Furthermore, rate increases of 2.00% and 3.00% would cause net interest income to increase by 2.97 % and 0.70 %, respectively. Alternatively, an immediate and sustained decrease in rates of 1.00% would decrease the Company s net interest income by $183,000, or 1.13 %, over a one year horizon compared to a flat interest rate scenario.

The Company also has longer term interest rate risk exposure, which may not be appropriately measured by Net Interest Income at Risk modeling. Therefore, the Company also uses an Economic Value of Equity (EVE) interest rate sensitivity analysis in order to evaluate the impact of its interest rate risk on earnings and capital. This is measured by computing the changes in net EVE for its cash flows from assets, liabilities and off-balance sheet items in the event of a range of assumed changes in market interest rates. EVE modeling involves discounting present values of all cash flows for on and off balance sheet items under different interest rate scenarios and provides no effect given to any steps that management might take to counter the effect of the interest rate movements. The discounted present value of all cash flows represents the Company s EVE and is equal to the market value of assets minus the market value of liabilities, with adjustments made for off-balance sheet items. The amount of base case EVE and its sensitivity to shifts in interest rates provide a measure of the longer term re-pricing and option risk in the balance sheet.

Results of the Company s simulation modeling, which assumes an immediate and sustained parallel shift in market interest rates, project that the Company s EVE could change as follows, relative to the Company s base case scenario, based on December 31, 2012 financial information.

	At December 31, 2012				
Immediate Change	**Economic Value of Equity**			**Economic Value of Equity as a**	
in the Level	**Dollar**	**Dollar**	**Percent**	**Percent of Present Value of Assets**	
of Interest Rates	**Amount**	**Change**	**Change**	**EVE Ratio**	**Change**
	(Dollars in thousands)				
300bp	$ 50,786	$ (13,193)	(20.62)%	11.73%	(193)bp
200bp	56,976	(7,003)	(10.95)	12.81	(85)bp
100bp	61,694	(2,285)	(3.57)	13.51	(15)bp
Static	63,979			13.66	bp
(100)bp	66,799	2,820	4.41	13.92	26bp

The previous table indicates that at December 31, 2012, the Company would expect a decrease in its EVE in the event of a sudden and sustained 100 to 300 basis point increase in prevailing interest rates, and would expect an increase in its EVE in the event of a sudden and sustained 100 basis point decrease in prevailing interest rates.

The models are driven by expected behavior in various interest rate scenarios and many factors besides market interest rates affect the Company s net interest income and EVE. For this reason, the Company models many different combinations of interest rates and balance sheet assumptions to understand its overall sensitivity to market interest rate changes. Therefore, as with any method of measuring interest rate risk, certain shortcomings are inherent in the method of analysis presented in the foregoing tables and it is recognized that the model outputs are not guarantees of actual results. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets, such as adjustable-rate mortgage loans, have features that restrict changes in interest rates on a short-term basis and over the life of the asset. Further, in the event of a change in interest rates, expected rates of prepayments on loans and early withdrawals from certificates of deposit could deviate significantly from those assumed in the modeling scenarios.

Impact of Recent Accounting Pronouncements

For a discussion of the impact of recent accounting pronouncements, see Note 1 of the accompanying Notes to Consolidated Financial Statements.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required by this item is incorporated herein by reference to the section captioned *Management s Discussion and Analysis of Financial Condition and Results of Operations* in this Annual Report on Form 10-K.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements required by this item begin on page F-1.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Company s management, including the Company s principal executive officer and principal financial officer, have evaluated the effectiveness of the Company s disclosure controls and procedures, as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company s disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission (the SEC): (1) is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and (2) is accumulated and communicated to the Company s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Internal Control Over Financial Reporting

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The internal control process has been designed under our supervision to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company s financial statements for external reporting purposes in accordance with accounting principles generally accepted in the United States of America.

Management conducted an assessment of the effectiveness of the Company s internal control over financial reporting as of December 31, 2012, utilizing the framework established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management has determined that the Company s internal control over financial reporting as of December 31, 2012 is effective.

Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that accurately and fairly reflect, in reasonable detail, transactions and dispositions of assets; and provide reasonable assurances that: (1) transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States; (2) receipts and expenditures are being made only in accordance with authorizations of management and the directors of the Company; and (3) unauthorized acquisition, use, or disposition of the Company s assets that could have a material effect on the Company s financial statements are prevented or timely detected.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

This annual report does not include an attestation report of the Company s registered public accounting firm regarding internal control over financial reporting. Management s report was not subject to attestation by the Company s registered public accounting firm pursuant to rules of the SEC that permit the Company to provide only management s report in this annual report

Changes to Internal Control Over Financial Reporting

There have been no changes in the Company s internal control over financial reporting during the quarter ended December 31, 2012 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

Not applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

The information relating to the directors of the Company, information regarding compliance with Section 16(a) of the Exchange Act and information regarding the audit committee and audit committee financial expert is incorporated herein by reference to the sections captioned *Item 1 Election of Directors*, *Section 16(a) Beneficial Ownership Reporting Compliance*, and *Audit Committee* in the Company s Proxy Statement for the 2013 Annual Meeting of Stockholders.

Executive Officers Who Are Not Directors

Name	Age(1)	Position
Jill Keinsley	45	Senior Vice President, Human Resources Director
M. Chris Frederick	45	Senior Vice President, Chief Financial Officer and Treasurer
Dennis L. Thomas	56	Senior Vice President-Lending

(1) As of December 31, 2012.

Biographical Information

Jill Keinsley has been affiliated with the Bank and served in her present position since August 2006.

M. Chris Frederick has been affiliated with the Bank since June 1990 and has served in his present position since 1997.

Dennis L. Thomas has been affiliated with the Bank since January 2000. He was employed by Harrison County Bank from 1981 until its merger with the Bank.

Code of Ethics

The Company maintains a Code of Ethics and Business Conduct that applies to all directors, officers and employees of the Company and its affiliates. The Code of Ethics and Business Conduct is posted on the Company s Internet website, www.firstharrison.com.

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ITEM 11. EXECUTIVE COMPENSATION

The information regarding executive compensation, compensation committee interlocks and insider participation and compensation committee report is incorporated herein by reference to the sections captioned *Director Compensation* and *Executive Compensation* in the Company s Proxy Statement for the 2013 Annual Meeting of Stockholders.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

(a) Security Ownership of Certain Beneficial Owners.

Information required by this item is incorporated herein by reference to the section captioned *Stock Ownership* in the Company s Proxy Statement for the 2013 Annual Meeting of Stockholders.

(b) Security Ownership of Management

Information required by this item is incorporated herein by reference to the section captioned *Stock Ownership* in the Company s Proxy Statement for the 2013 Annual Meeting of Stockholders.

(c) Changes in Control

Management of the Company knows of no arrangements, including any pledge by any person or securities of the Company, the operation of which may at a subsequent date result in a change in control of the registrant.

(d) Equity Compensation Plan Information

Equity Compensation Plan Information as of December 31, 2012

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders		N/A	223,000
Equity compensation plans not approved by security holders		N/A	
Total		N/A	223,000

The Company does not maintain any equity compensation plans that have not been approved by security holders.

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ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTORS INDEPENDENCE

The information relating to certain relationships and related transactions and director independence is incorporated herein by reference to the sections captioned *Transactions with Related Persons* and *Director Independence* in the Company s Proxy Statement for the 2013 Annual Meeting of Stockholders.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information relating to the principal accounting fees and expenses is incorporated herein by reference to the section captioned *Item 2 Ratification of Independent Registered Public Accounting Firm* in the Company s Proxy Statement for the 2013 Annual Meeting of Stockholders.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(1) The financial statements required in response to this item are incorporated by reference from Item 8 of this report.

(2) All financial statement schedules are omitted as the required information either is not required or applicable, or the required information is contained in the financial statements or related notes.

(3) Exhibits

3.1 Articles of Incorporation of First Capital, Inc. (1)

3.2 Fourth Amended and Restated Bylaws of First Capital, Inc. (2)

10.1 *Amended and Restated Employment Agreement between First Capital, Inc., First Harrison Bank and William W. Harrod

10.2 *Amended and Restated Employment Agreement between First Capital, Inc., First Harrison Bank and M. Chris Frederick

10.3 *Change in Control Agreement between First Capital, Inc., First Harrison Bank and Jill Keinsley

10.4 *Employee Severance Compensation Plan (3)

10.5 *First Federal Bank, A Federal Savings Bank 1994 Stock Option Plan (as assumed by First Capital, Inc. effective December 31, 1998) (4)

10.6 *First Capital, Inc. 1999 Stock-Based Incentive Plan (5)

10.7 *1998 Officers and Key Employees Stock Option Plan for HCB Bancorp (5)

10.8 *First Capital, Inc. 2009 Equity Incentive Plan (6)

10.9 *Director Deferred Compensation Agreement between First Federal Savings & Loan Association and James Pendleton (7)

10.10 *Director Deferred Compensation Agreement between First Federal Savings & Loan Association and Gerald Uhl (7)

10.11 * Director Deferred Compensation Agreement between First Federal Savings & Loan Association and Mark Shireman (7)

11.0 Statement Re: Computation of Per Share Earnings (incorporated by reference to Item 8, *Financial Statements and Supplementary Data* of this Form 10-K)

21.0 Subsidiaries of the Registrant (incorporated by reference to Part I, *Business Subsidiary Activities* of this Form 10-K)

23.0 Consent of Monroe Shine and Co., Inc.

31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer

31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer

32.0 Section 1350 Certification of Chief Executive Officer & Chief Financial Officer

101.0 The following materials from the Company s Annual Report on Form 10-K for the year ended December 31, 2012, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statement of Changes in Stockholders Equity, (iv) the Consolidated Statements of Cash Flows and (v) the Notes to the Consolidated Financial Statements. **

* Management contract or compensatory plan, contract or arrangement.
** Furnished, not filed.
(1) Incorporated by reference from the Exhibits filed with the Registration Statement on Form SB-2, and any amendments thereto, Registration No. 333-63515.
(2) Incorporated by reference to the Current Report on Form 8-K filed with the Securities and Exchange Commission on August 22, 2007.
(3) Incorporated by reference to the Quarterly Report on Form 10-QSB for the quarter ended December 31, 1998.
(4) Incorporated by reference from the Exhibits filed with the Registration Statement on Form S-8, and any amendments thereto, Registration Statement No. 333-76543.
(5) Incorporated by reference from the Exhibits filed with the Registration Statement on Form S-8, and any amendments thereto, Registration Statement No. 333-95987.
(6) Incorporated by reference to the appendix to the Definitive Proxy Statement on Schedule 14A filed with the Securities and Exchange Commission on April 9, 2010.
(7) Incorporated by reference to the Exhibits filed with the Annual Report on Form 10-K for the year ended December 31, 2008.

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Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders

First Capital, Inc.

Corydon, Indiana

We have audited the accompanying consolidated balance sheets of **First Capital, Inc. and Subsidiaries** as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, changes in stockholders   equity, and cash flows for the years then ended. The Company   s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company   s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of **First Capital, Inc. and Subsidiaries** as of December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

New Albany, Indiana

March 27, 2013

MONROE SHINE & CO., INC. ¨ CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS CONSULTANTS

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FIRST CAPITAL, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2012 AND 2011

(In thousands, except share and per share data)	**2012**	**2011**
ASSETS		
Cash and due from banks	$ 11,277	$ 10,794
Interest bearing deposits with banks	1,975	525
Federal funds sold	9,959	7,604
Total cash and cash equivalents	23,211	18,923
Securities available for sale, at fair value	122,973	111,440
Securities held to maturity	12	16
Loans, net	280,407	276,047
Loans held for sale	3,609	2,909
Federal Home Loan Bank stock, at cost	2,820	2,820
Foreclosed real estate	295	661
Premises and equipment	10,757	10,721
Accrued interest receivable	1,757	1,801
Cash value of life insurance	6,172	5,991
Goodwill	5,386	5,386
Core deposit intangibles	0	32
Other assets	1,733	2,139
Total Assets	$ 459,132	$ 438,886
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 56,715	$ 47,313
Interest-bearing	327,628	317,061
Total deposits	384,343	364,374
Retail repurchase agreements	14,092	9,125
Advances from Federal Home Loan Bank	5,100	12,350
Accrued interest payable	290	413
Accrued expenses and other liabilities	2,371	1,571
Total liabilities	406,196	387,833
Commitments and Contingencies		
EQUITY		
Preferred stock of $.01 par value per share Authorized 1,000,000 shares; none issued	0	0
Common stock of $.01 par value per share Authorized 5,000,000 shares; issued 3,164,416 shares	32	32
Additional paid-in capital	24,313	24,313
Retained earnings substantially restricted	34,101	32,297
Accumulated other comprehensive income	1,704	1,612
Less treasury stock, at cost 379,419 shares (378,727 shares in 2011)	(7,326)	(7,312)
Total First Capital, Inc. stockholders equity	52,824	50,942
Noncontrolling interest in subsidiary	112	111

Total equity	52,936	51,053
Total Liabilities and Equity	$ 459,132	$ 438,886

See notes to consolidated financial statements.

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FIRST CAPITAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

YEARS ENDED DECEMBER 31, 2012 AND 2011

(In thousands, except per share data)	**2012**	**2011**
INTEREST INCOME		
Loans, including fees	$ 16,005	$ 17,179
Securities:		
Taxable	1,677	1,936
Tax-exempt	966	1,039
Federal Home Loan Bank dividends	94	81
Federal funds sold and interest-bearing deposits in banks	58	38
Total interest income	18,800	20,273
INTEREST EXPENSE		
Deposits	2,041	3,116
Retail repurchase agreements	38	59
Advances from Federal Home Loan Bank	386	585
Total interest expense	2,465	3,760
Net interest income	16,335	16,513
Provision for loan losses	1,525	1,825
Net interest income after provision for loan losses	14,810	14,688
NONINTEREST INCOME		
Service charges on deposit accounts	2,954	2,884
Commission and fee income	220	176
Gain (loss) on sale of securities	11	(8)
Other than temporary impairment loss on securities	0	(36)
Gain on sale of mortgage loans	1,045	690
Mortgage brokerage fee income	33	50
Increase in cash value of life insurance	181	202
Other income	93	93
Total noninterest income	4,537	4,051
NONINTEREST EXPENSE		
Compensation and benefits	7,907	7,446
Occupancy and equipment	1,249	1,261
Data processing	1,324	