

HORIZON BANCORP /IN/  
Form 10-K  
March 23, 2007

**Table of Contents**

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-K**

(Mark One)

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

**For the fiscal year ended December 31, 2006**

**Commission file number 0-10792**

**Horizon Bancorp**

(Exact name of registrant as specified in its charter)

Indiana

35-1562417

(State or other jurisdiction of incorporation or organization)

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

515 Franklin Square, Michigan City

46360

(Address of principal executive offices)

(Zip Code)

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

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

Title of each class  
Common Stock, no par value

Name of each exchange on which registered  
The NASDAQ Stock Market, LLC

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

None

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

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

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

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

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definitions of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one)

Large accelerated filer  Accelerated filer  Non-Accelerated Filer

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

The aggregate market value of the registrant's common stock held by nonaffiliates of the registrant, based on the average bid price of such stock as of June 30, 2005, the last day of the registrant's most recently completed second fiscal quarter, was approximately \$60,671,760.

As of March 15, 2007, the registrant had 3,228,382 shares of Common Stock outstanding.

Documents Incorporated by Reference

Document	Part of Form 10-K into which portion of document is incorporated
Portions of the Registrant's Proxy Statement to be filed for its May 3, 2007 annual meeting of shareholders	III

---

**Horizon Bancorp  
2006 Annual Report on Form 10-K  
Table of Contents**

		Page
<b><u>PART I</u></b>		
<u>Item 1.</u>	<u>Business</u>	3
<u>Item 1A</u>	<u>Risk Factors</u>	12
<u>Item 1B</u>	<u>Unresolved Staff Comments</u>	15
<u>Item 2.</u>	<u>Properties</u>	15
<u>Item 3.</u>	<u>Legal Proceedings</u>	16
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u>	16
	<u>Special Item: Executive Officers of Registrant</u>	17
<b><u>PART II</u></b>		
<u>Item 5.</u>	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	18
<u>Item 6.</u>	<u>Selected Financial Data</u>	19
<u>Item 7.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operation</u>	19
<u>Item 7A.</u>	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	36
<u>Item 8.</u>	<u>Financial Statements and Supplementary Data</u>	37
<u>Item 9.</u>	<u>Changes in and Disagreement with Accountants on Accounting and Financial Disclosure</u>	76
<u>Item 9A.</u>	<u>Controls and Procedures</u>	76
<u>Item 9B.</u>	<u>Other Information</u>	76
<b><u>PART III</u></b>		
<u>Item 10.</u>	<u>Directors, Executive Officers and Corporate Governance</u>	76
<u>Item 11.</u>	<u>Executive Compensation</u>	77
<u>Item 12.</u>	<u>Security Ownership of Certain Beneficial Owners and Management</u>	77
<u>Item 13.</u>	<u>Certain Relationships and Related Transactions; and Director Independence</u>	77

<u>Item 14.</u>	<u>Principal Accountant Fees and Services</u>	77
-----------------	---	----

**PART IV**

<u>Item 15.</u>	<u>Exhibits and Financial Statement Schedules</u>	78
-----------------	---	----

<u>SIGNATURES</u>		79
-------------------	--	----

<u>EXHIBIT INDEX</u>		81
----------------------	--	----

Exhibit 10.14

Exhibit 21

Exhibit 23

Exhibit 31.1

Exhibit 31.2

Exhibit 32.1

Exhibit 32.2

**Table of Contents**

**PART I**

**ITEM 1. BUSINESS**

**General**

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

On June 10, 2005, Horizon acquired Alliance Financial Corporation and its wholly owned bank subsidiary, Alliance Banking Company (collectively referred to as Alliance). Alliance had three offices in southwest Michigan, and one office in Michigan City, Indiana, \$141 million of assets and \$117 million of deposits at the date of the acquisition. See Note 2 of the Consolidated Financial Statements for further discussion regarding the acquisition.

On June 1, 2006, the Bank opened a full service branch in Elkhart, Indiana. The Bank maintains thirteen other full service facilities in Northwest Indiana and Southwest Michigan. The Bank also maintains a loan production office in Lake County Indiana. At December 31, 2006, the Bank had total assets of \$1,222 million and total deposits of \$914 million. The Bank has three wholly-owned subsidiaries: Horizon Trust & Investment Management, N.A. ( Horizon Trust ), Horizon Investments, Inc. ( Horizon Investments ) and Horizon Insurance Services, Inc. ( Horizon Insurance ). Horizon Trust offers corporate and individual trust and agency services and investment management services. Horizon Investments manages the investment portfolio of the Bank. Horizon Insurance offered a full line of personal insurance products until March 2005, at which time the majority of its assets were sold to a third party. Horizon formed Horizon Statutory Trust I in 2002 ( Trust I ), Horizon Bancorp Capital Trust II in 2004 ( Trust II ) and Horizon Bancorp Capital Trust III in 2006 ( Trust III ) for the purpose of participating in pooled trust preferred securities offerings. The Company assumed additional debentures as the result of the acquisition of Alliance in 2005 which formed Alliance Financial Statutory Trust I ( Alliance Trust ). See Note 11 of the Consolidated Financial Statements for further discussion regarding these previously consolidated entities that are now reported separately. The business of Horizon is not seasonal to any material degree.

No material part of Horizon s business is dependent upon a single or small group of customers, the loss of any one or more of whom would have a materially adverse effect on the business of Horizon. In 2006, revenues from loans accounted for 73% of the total consolidated revenue and revenues from investment securities accounted for 14% of total consolidated revenue.

**Employees**

The Bank, Horizon Trust and Horizon Investments employed approximately 277 full and part-time people as of December 31, 2006. Horizon does not have any employees.

**Competition**

A high degree of competition exists in all major areas where Horizon engages in business. The Bank s primary market consists of Porter, LaPorte St. Joseph and Elkhart Counties, Indiana, and Berrien County, Michigan. The Bank competes with commercial banks located in LaPorte County and contiguous counties in Indiana and Michigan, as well as with savings and loan associations, consumer finance companies, and credit unions. To a more moderate extent, the Bank competes with Chicago money center banks, mortgage banking companies, insurance companies, brokerage houses, other institutions engaged in money market financial services and certain government agencies.

**Table of Contents**

Based on deposits as of June 30, 2006, Horizon was the largest of the 11 bank and thrift institutions in LaPorte County with a 39.12% market share and the fifth largest of the 15 such institutions in Porter County with a 7.50% market share. In Berrien County, Michigan, Horizon was the fourth largest of the 10 bank and thrift institutions with a 7.38% market share. In 2005, Horizon opened new offices in St. Joseph and Elkhart Counties, Indiana. Horizon's market share of deposits was less than 1.00% in each of these counties. (Source: FDIC Summary of Deposits Market Share Reports, available at [www.fdic.gov](http://www.fdic.gov)).

**Supervision and Regulation**

Horizon is registered as a bank holding company and is subject to the supervision of, and regulation by, the Board of Governors of the Federal Reserve System ( Federal Reserve ) under the Bank Holding Company Act of 1956, as amended ( BHC Act ). The Federal Reserve has issued regulations under the BHC Act requiring a bank holding company to serve as a source of financial and managerial strength to its subsidiary banks. It is the policy of the Federal Reserve that, pursuant to this requirement, a bank holding company should stand ready to use its resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity.

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

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

Bank holding companies are required to comply with the Federal Reserve's risk-based capital guidelines. The Federal Deposit Insurance Corporation (the FDIC ) and the Office of the Comptroller of the Currency (the OCC ) have adopted risk-based capital ratio guidelines to which depository institutions under their respective supervision are subject. The guidelines establish a systematic analytical framework that makes regulatory capital requirements more sensitive to differences in risk profiles among banking organizations. Risk-based capital ratios are determined by allocating assets and specified off-balance sheet commitments to four risk weighted categories, with higher levels of capital being required for the categories perceived as representing greater risk. As a condition of approval for the Alliance acquisition, the OCC required the Bank to maintain regulatory capital ratios at 100 basis points above the well capitalized minimums. The Bank exceeded the risk-based capital requirements of the FDIC and OCC as of December 31, 2006. For Horizon's regulatory capital ratios and regulatory requirements as of December 31, 2006, see the information in Management's Discussion and Analysis of Financial Condition and Results of Operation in Item 7 below, which is incorporated herein by reference.

The Bank is (i) subject to the provisions of the National Bank Act; (ii) supervised, regulated, and examined by the OCC; and (iii) subject to the rules and regulations of the OCC, Federal Reserve, and the FDIC.

The Bank's deposits are insured to applicable limits by the Federal Deposit Insurance Corporation ( FDIC ). The Federal Deposit Insurance Reform Act of 2005 (the Reform Act ), which was signed into law in February 2006, has resulted in significant changes to the federal deposit insurance program:

Effective March 31, 2006, the Bank Insurance Fund ( BIF ) and the Savings Association Insurance Fund ( SAIF ) were merged to create a new fund, called the Deposit Insurance Fund ( DIF )

The current \$100,000 deposit insurance coverage is subject to adjustment for inflation beginning in 2010 and every succeeding five years

**Table of Contents**

Deposit insurance coverage for individual retirement accounts and certain other retirement accounts has been increased from \$100,000 to \$250,000 and also will be subject to adjustment for inflation. Pursuant to the Reform Act, the FDIC is authorized to set the reserve ratio for the DIF annually at between 1.15% and 1.5% of estimated insured deposits and the FDIC has been given discretion to set assessment rates according to risk regardless of the level of the fund reserve ratio. On November 2, 2006, the FDIC adopted final regulations that set the designated reserve ratio for the DIF at 1.25% beginning January 1, 2007. Insured depository institutions that were in existence on December 31, 1996, and paid assessments prior to that date (or their successors) are entitled to a one-time credit against future assessments based on their past contributions to the BIF or SAIF. In 2006, the Bank received a one-time credit of \$458,184 against future assessments. Also on November 2, 2006, the FDIC adopted final regulations that establish a new risk-based premium system. Under the new system, the FDIC will evaluate each institution's risk based on three primary sources of information: supervisory ratings for all insured institutions, financial ratios for most institutions, and long-term debt issuer ratings for large institutions that have such ratings. An institution's assessments will be based on the insured institution's ranking in one of four risk categories. Effective January 1, 2007, well-capitalized institutions with the CAMELS ratings of 1 or 2 are grouped in Risk Category I and will be assessed for deposit insurance at an annual rate of between five and seven cents for every \$100 of domestic deposits. Institutions in Risk Categories II, III and IV will be assessed at annual rates of 10, 28 and 43 cents, respectively. An increase in assessments could have a material adverse effect on the Company's earnings. FDIC-insured institutions remain subject to the requirement to pay assessments to the FDIC to fund interest payments on bonds issued by the Financing Corporation ( FICO ), an agency of the Federal government established to recapitalize the predecessor to the SAIF. These assessments will continue until the FICO bonds mature in 2017. For the quarter ended December 31, 2006, the FICO assessment rate was equal to 1.24 cents for each \$100 in domestic deposits maintained at an institution. Both federal and state law extensively regulates various aspects of the banking business, such as reserve requirements, truth-in-lending and truth-in-savings disclosures, equal credit opportunity, fair credit reporting, trading in securities and other aspects of banking operations. Branching by the Bank is subject to the jurisdiction and requires notice to or the prior approval of the OCC. Horizon and the Bank are subject to the Federal Reserve Act, which restricts financial transactions between banks and affiliated companies. The statute limits credit transactions between banks, affiliated companies and its executive officers and its affiliates. The statute prescribes terms and conditions for bank affiliate transactions deemed to be consistent with safe and sound banking practices, and restricts the types of collateral security permitted in connection with a bank's extension of credit to an affiliate. The FDICIA accomplished a number of sweeping changes in the regulation of depository institutions and their holding companies. The FDICIA requires, among other things, federal bank regulatory authorities to take prompt corrective action with respect to banks that do not meet minimum capital requirements. The FDICIA further directs that each federal banking agency prescribe standards for depository institutions and depository institution holding companies relating to internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, management compensation, a maximum ratio of classified assets to capital, minimum earnings sufficient to absorb losses, a minimum ratio of market value to book value of publicly traded shares and such other standards as the agency deems appropriate. On November 12, 1999, the President signed into law comprehensive legislation that modernizes the financial services industry for the first time in decades. The Gramm-Leach-Bliley Act ( GLBA ) permits



**Table of Contents**

bank holding companies to conduct essentially unlimited securities and insurance activities, in addition to other activities determined by the Federal Reserve to be related to financial services. As a result of the GLBA, Horizon may underwrite and sell securities and insurance. It may acquire, or be acquired by, brokerage firms and insurance underwriters. Horizon does not anticipate significant changes in its products or services as a result of the GLBA. The USA PATRIOT Act of 2001 (the PATRIOT Act ) is intended to strengthen the ability of U.S. Law Enforcement to combat terrorism on a variety of fronts. The PATRIOT Act contains sweeping anti-money laundering and financial transparency laws and requires financial institutions to implement additional policies and procedures with respect to, or additional measures designed to address, any or all the following matters, among others: money laundering, suspicious activities and currency transaction reporting, and currency crimes. Many of the provisions in the PATRIOT Act were to have expired December 31, 2005, but the U.S. Congress authorized renewals that extended the provisions until March 10, 2006. In early March 2006, the U.S. Congress approved the USA PATRIOT Improvement and Reauthorization Act of 2005 (the Reauthorization Act ) and the USA PATRIOT Act Additional Reauthorizing Amendments Act of 2006 (the PATRIOT Act Amendments ), and they were signed into law by President Bush on March 9, 2006. The Reauthorization Act makes permanent all but two of the provisions that had been set to expire and provides that the remaining two provisions, which relate to surveillance and the production of business records under the Foreign Intelligence Surveillance Act, will expire in three years. The PATRIOT Act Amendments include provisions allowing recipients of certain subpoenas to obtain judicial review of nondisclosure orders and clarifying the use of certain subpoenas to obtain information from libraries. Horizon does not anticipate that these changes will materially affect its operations.

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002 (the Sarbanes-Oxley Act ). The Sarbanes-Oxley Act represents a comprehensive revision of laws affecting corporate governance, accounting obligations and corporate reporting. The Sarbanes-Oxley Act is applicable to all companies with equity or debt securities registered under the Securities Exchange Act of 1934 (the 1934 Act ). In particular, the Sarbanes-Oxley Act establishes: (i) new requirements for audit committees, including independence, expertise and responsibilities; (ii) additional responsibilities regarding financial statements for the Chief Executive Officer and Chief Financial Officer of the reporting company; (iii) new standards for auditors and regulation of audits; (iv) increased disclosure and reporting obligations for the reporting company and their directors and executive officers; and (v) new and increased civil and criminal penalties for violation of the securities laws. Management expects that significant additional efforts and expense will continue to be required to comply with the provisions of the Sarbanes-Oxley Act.

The Fair and Accurate Credit Transactions Act of 2003 (the FACT Act ) amended the Fair Credit Reporting Act and made permanent certain federal preemptions that form the basis for a national credit reporting system. The FACT Act was also intended to (i) address identity theft, (ii) increase access to credit information, (iii) enhance the accuracy of credit reporting, (iv) facilitate the opt-out by consumers from certain marketing solicitations, (v) protect medical information, and (vi) promote financial literacy. The statute applies to credit reporting agencies (commonly referred to as credit bureaus ), financial institutions, other users of credit reports and those who furnish information to credit bureaus.

In addition to the matters discussed above, Horizon Bank is subject to additional regulation of its activities, including a variety of consumer protection regulations affecting its lending, deposit, and collection activities and regulations affecting secondary mortgage market activities. The earnings of financial institutions are also affected by general economic conditions and prevailing interest rates, both domestic and foreign, and by the monetary and fiscal policies of the United States Government and its various agencies, particularly the Federal Reserve.

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

**Table of Contents****BANK HOLDING COMPANY STATISTICAL DISCLOSURES****I. DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS EQUITY; INTEREST RATES AND INTEREST DIFFERENTIAL**

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

**II. INVESTMENT PORTFOLIO**

A. The following is a schedule of the amortized cost and fair value of investment securities available for sale at December 31, 2006, 2005 and 2004:

(In thousands)	2006		2005		2004	
	Cost	Fair Value	Cost	Fair Value	Cost	Fair Value
<b>Available for Sale</b>						
U.S. Treasury and U.S. Government agencies and corporations	\$ 58,595	\$ 58,445	\$ 72,153	\$ 70,367	\$ 86,348	\$ 85,626
State and municipal	81,363	81,800	64,608	65,972	54,881	57,327
Mortgage-backed securities	93,591	91,174	119,392	116,020	124,666	124,308
Collateralized mortgage obligations	11,215	11,010	22,781	22,153	13,380	13,338
Corporate notes	632	649	632	665	632	683
Total investment securities	\$245,396	\$ 243,078	\$279,566	\$ 275,177	\$279,907	\$ 281,282

B. The following is a schedule of maturities of each category of debt securities and the related weighted-average yield of such securities as of December 31, 2006:

(In Thousands)	One Year or Less		After One Year Through Five Years		After Five Years Through Ten Years		After Ten Years	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
<b>Available for Sale</b>								
U.S. Treasury and U.S. Government agency securities (1)	\$ 14,979	4.64%	\$ 9,504	4.31%	\$ 10,250	5.01%	\$ 23,712	5.91%
Obligations of states and political subdivisions	1,086	4.04	5,126	4.65	19,000	4.27	56,588	4.24
Mortgage-backed securities (2)	1	7.50	26,301	3.96	15,169	4.42	49,703	4.70
Collateralized mortgage obligations (2)			1,782	4.75	716	4.50	8,512	4.68
Other securities							649	7.58

Total	\$ 16,066	4.60	\$ 42,713	4.16	\$ 45,135	4.49	\$ 139,164	4.73
-------	-----------	------	-----------	------	-----------	------	------------	------

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

(2) Maturity based upon final maturity date

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

Excluding those holdings of the investment portfolio in U.S. Treasury securities and other agencies and corporations of the U.S. Government, there were no investments in securities of any one issuer that exceeded 10% of the consolidated stockholders' equity of Horizon at December 31, 2006.

**Table of Contents****III. LOAN PORTFOLIO**

A. Types of Loans Total loans on the balance sheet are comprised of the following classifications at December 31 for the years indicated.

(In thousands)	2006	2005	2004	2003	2002
Commercial, financial, agricultural and commercial tax-exempt loans	\$271,457	\$273,310	\$203,966	\$152,362	\$111,897
Mortgage warehouse loans	112,267	97,729	127,992	126,056	268,452
Real estate mortgage loans	222,235	159,312	89,139	67,428	73,910
Installment loans	237,875	202,383	142,945	101,872	81,534
Total loans	\$843,834	\$732,734	\$564,042	\$447,718	\$535,793

B. Maturities and Sensitivities of Loans to Changes in Interest Rates The following is a schedule of maturities and sensitivities of loans to changes in interest rates, excluding real estate mortgage, mortgage warehousing and installment loans, as of December 31, 2006:

(In thousands)	One Year or Less	One Through Five Years	After Five Years	Total
Commercial, financial, agricultural and commercial tax-exempt loans	\$158,013	\$110,053	\$3,391	\$271,457

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

(In thousands)	Fixed Rate	Variable Rate
Total commercial, financial, agricultural and commercial tax-exempt loans due after one year	\$63,174	\$50,270

**C. Risk Elements**

1. Nonaccrual, Past Due and Restructured Loans The following schedule summarizes nonaccrual, past due and restructured loans.

December 31 (In thousands)	2006	2005	2004	2003	2002
a. Loans accounted for on a nonaccrual basis	\$2,481	\$1,822	\$1,358	\$1,707	\$1,217
b. Accruing loans which are contractually past due 90 days or more as to interest and principal payments	144	251		176	76
c. Loans not included in (a) or (b) which are Troubled Debt Restructurings as					

defined by SFAS No. 15

Totals	\$2,625	\$2,073	\$1,358	\$1,883	\$1,293
--------	---------	---------	---------	---------	---------

**Table of Contents****LOAN PORTFOLIO (continued)**

The increase in nonaccrual loans in 2006 is primarily due to an increase in commercial real estate loans of \$761 thousand. This increase was partially offset by a decrease in mortgage loans and consumer loans of \$67 thousand and \$36 thousand, respectively. The increase in nonaccrual loans in 2005 is primarily due to nonaccrual loans acquired from Alliance of \$389 thousand, an increase in consumer and commercial loans of \$44 thousand and \$189 thousand, respectively. The decrease in nonaccrual loans in 2004 is primarily due to decreases in consumer loans of \$125 thousand and mortgage loans of \$337 thousand partially offset by an increase in commercial loans of \$112 thousand. The increase in nonaccrual loans in 2003 is primarily due to increases in consumer loans of \$89 thousand, mortgage loans of \$254 thousand and commercial loans of \$146 thousand. The decrease in nonaccrual loans in 2002 is primarily due to a decrease in commercial loans of \$868 thousand partially offset by an increase in mortgage loans of \$340 thousand.

(In thousands)

Gross interest income that would have been recorded on nonaccrual loans outstanding as of December 31, 2006, in the period if the loans had been current, in accordance with their original terms and had been outstanding throughout the period or since origination if held for part of the period.	\$ 194
Interest income actually recorded on nonaccrual loans outstanding as of December 31, 2006, and included in net income for the period.	117
Interest income not recognized during the period on nonaccrual loans outstanding as of December 31, 2006.	\$ 77

**Discussion of Nonaccrual Policy**

- From time to time, the Bank obtains information, which may lead management to believe that the collection of payments may be doubtful on a particular loan. In recognition of such, it is management's policy to convert the loan from an earning asset to a nonaccruing loan. Further, it is management's policy to place a commercial loan on a nonaccrual status when delinquent in excess of 90 days, unless the Loan Committee approves otherwise. The officer responsible for the loan, the senior lending officer and the senior collections officer must review all loans placed on nonaccrual status. The senior collections officer monitors the loan portfolio for any potential problem loans.

- Potential Problem Loans

Impaired loans for which the discounted cash flows or collateral value exceeded the carrying value of the loan totaled \$1,768,000 and \$583,000 at December 31, 2006 and 2005, respectively. The allowance for impaired loans, included in the Bank's allowance for loan losses totaled \$406,000 and \$492,000 at those respective dates. The average balance of impaired loans during 2006 and 2005 was \$942,000 and \$150,000, respectively.

- Foreign outstandings

None

- Loan Concentrations

As of December 31, 2006, there are no significant concentrations of loans exceeding 10% of total loans. See Item III A above for a listing of the types of loans by concentration.

**D. Other Interest-Bearing Assets**

There are no other interest-bearing assets as of December 31, 2006, which would be required to be disclosed under Item III C.1 or 2 if such assets were loans.



**Table of Contents****IV. SUMMARY OF LOAN LOSS EXPERIENCE**

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

(In thousands)	2006	2005	2004	2003	2002
<b>LOANS</b>					
Loans outstanding at the end of the period (1)	\$843,834	\$732,734	\$564,042	\$447,718	\$535,793
Average loans outstanding during the period (1)	780,555	640,758	514,916	512,441	478,311
(1) Net of unearned income and deferred loan fees					
<b>ALLOWANCE FOR LOAN LOSSES</b>					
	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
Balance at beginning of the period	\$ 8,368	\$ 7,193	\$ 6,909	\$6,255	\$ 5,410
Loans charged-off					
Commercial and agricultural loans	(23)	(305)	(161)		(244)
Real estate mortgage loans		(29)	(41)	(226)	(112)
Installment loans	(1,120)	(1,096)	(863)	(758)	(841)
Total loans charged-off	(1,143)	(1,430)	(1,065)	(984)	(1,197)
Recoveries of loans previously charged-off					
Commercial and agricultural loans	201	161	79	20	90
Real estate mortgage loans		2	2	23	24
Installment loans	407	364	278	245	303
Total loan recoveries	608	527	359	288	417
Net loans charged-off	(535)	(903)	(706)	(696)	(780)
Provision charged to operating expense	905	1,521	990	1,350	1,625
Acquired through acquisition		557			
Balance at the end of the period	\$ 8,738	\$ 8,368	\$ 7,193	\$6,909	\$ 6,255
Ratio of net charge-offs to average loans outstanding for the period	(.07)%	(.14)%	(.14)%	(.14)%	(.16)%

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

**Allocation of the Allowance for Loan Losses at December 31 (thousands)**

2006	2005	2004	2003	2002
------	------	------	------	------



Edgar Filing: HORIZON BANCORP /IN/ - Form 10-K

	<b>% of Loans to Allowance Amount</b>		<b>% of Loans to Allowance Amount</b>		<b>% of Loans to Allowance Amount</b>		<b>% of Loans to Allowance Amount</b>		<b>% of Loans to Allowance Amount</b>	
	<b>Total Loans</b>	<b>Amount</b>	<b>Total Loans</b>	<b>Amount</b>	<b>Total Loans</b>	<b>Amount</b>	<b>Total Loans</b>	<b>Amount</b>	<b>Total Loans</b>	<b>Amount</b>
Commercial, financial and agricultural	\$2,987	32%	\$2,733	37%	\$2,469	36%	\$1,829	28%	\$1,732	21%
Real estate mortgage	768	27	585	22	808	16	834	12	712	14
Mortgage warehousing	1,762	13	1,958	13	2,029	23	2,445	37	2,007	50
Installment	3,181	28	2,958	28	1,860	25	1,524	23	1,574	15
Unallocated	40		134		27		277		230	
<b>Total</b>	<b>\$8,738</b>	<b>100%</b>	<b>\$8,368</b>	<b>100%</b>	<b>\$7,193</b>	<b>100%</b>	<b>\$6,909</b>	<b>100%</b>	<b>\$6,255</b>	<b>100%</b>

In 1999, Horizon began a mortgage warehousing program. This program is described in Management's Discussion and Analysis of Financial Condition and Results of Operation in Item 7 below and in the Notes to the Financial Statements in Item 8 below, which are incorporated herein by reference. The greatest risk related to these loans is transaction and fraud risk. During 2006, Horizon processed over \$2.3 billion in mortgage warehouse loans.

**Table of Contents****V. DEPOSITS**

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

**VI. RETURN ON EQUITY AND ASSETS**

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

**VII. SHORT-TERM BORROWINGS**

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

December 31 (thousands)	2006	2005
Outstanding at year end	\$38,642	\$35,824
Approximate weighted-average interest rate at year-end	3.09%	2.54%
Highest amount outstanding as of any month-end during the year	\$40,179	\$35,868
Approximate average outstanding during the year	\$35,334	\$26,430
Approximate weighted-average interest during the year	2.91%	1.97%

**Table of Contents**

**FORWARD-LOOKING STATEMENTS AND RISK FACTORS**

A cautionary note about forward-looking statements: In its oral and written statements, Horizon from time to time includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements can include statements about estimated cost savings, plans and objectives for future operations and expectations about Horizon's financial and business performance as well as economic and market conditions. They often can be identified by the use of words like expect, may, could, intend, project, estimate, or anticipate.

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

By their nature, forward-looking statements are based on assumptions and are subject to risks, uncertainties, and other factors. You are cautioned that actual results may differ materially from those contained in the forward-looking statement. The discussion in Management's Discussion and Analysis of Financial Condition and Results of Operation in Item 7 of this Form 10-K lists some of the factors that could cause Horizon's actual results to vary materially from those expressed in or implied by any forward-looking statements. Your attention is directed to this discussion.

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

**ITEM 1A. RISK FACTORS**

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

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

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

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

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

Investors should consider carefully these risks and the other risks and uncertainties described below. Any of the following risks could materially adversely affect our business, financial condition or operating results which could cause our stock price to decline. The risks and uncertainties described below are not, however, the only ones that we may face. Additional risks and uncertainties not currently known to us, or that we currently believe are not material, could also materially adversely affect our business, financial condition or operating results.

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

Our ability to maintain our history of record earnings year after year will depend, in large part, on our ability to continue to grow our commercial and consumer loan portfolios and obtain low-cost funds. During 2005 and 2006, we focused on increasing consumer loans, and we intend to continue to emphasize and grow consumer, as well as commercial types of loans in the foreseeable future. This represented a shift in our emphasis from 2002 and 2003 when we focused on mortgage banking services, which generated a large portion of our income during those years.

**Table of Contents**

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

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

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

We have a large percentage of commercial and consumer loans. Commercial loans generally have greater credit risk than residential mortgage loans because repayment of these loans often depends on the successful business operations of the borrowers. These loans also typically have much larger loan balances than residential mortgage loans.

Consumer loans generally involve greater risk than residential mortgage loans because they are unsecured or secured by assets that depreciate in value. Although we undertake a variety of underwriting, monitoring and reserving protections with respect to these types of loans, there can be no guarantee that we will not suffer unexpected losses.

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

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

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

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

Our primary market area for deposits and loans consists of LaPorte and Porter Counties in Northwestern Indiana and Berrien County in Southwestern Michigan. An economic slowdown in these areas could hurt our business. Possible consequences of such a downturn could include the following:

increases in loan delinquencies and foreclosures;

declines in the value of real estate and other collateral for loans; and

a decline in the demand for our products and services.

**Table of Contents**

**We are subject to increased regulatory capital requirements.**

As a condition to the approval of our acquisition of Alliance Financial Corporation in 2005, the OCC, our primary regulator, required us to maintain regulatory capital ratios at 100 basis points above the well capitalized minimums. This could affect our ability to compete with other financial institutions not required to maintain these higher capital levels by limiting our ability to grow assets. The OCC has not told us when these increased capital requirements will be lifted, but as of December 31, 2006, we exceeded these heightened capital requirements.

**If we are required to change the classification of our mortgage warehouse loans for capital purposes, this could restrict the capital we have available for further growth.**

We purchase home mortgages from mortgage companies under warehouse agreements whereby the mortgage company has the right to repurchase the loan. We have historically classified these loans as home mortgage loans for call report and regulatory capital purposes as opposed to treating them as other loans. During the course of a routine, periodic examination by bank regulatory authorities commenced in February 2003, the examination personnel raised the issue of whether our mortgage warehouse loans should be treated as other loans for call report purposes. We submitted a position statement to the regulators in 2003 substantiating our classification of these loans and had various follow-up conversations with them thereafter. The regulatory authorities have never required us to change the classification of these loans, and we believe the matter is resolved; although the regulatory authorities have never told us this matter is settled and recently informed us that they are still considering the issue. If we are required to change our treatment of these loans, it will change our calculations for risk-based capital and reduce our risk-based capital ratios which may restrict our ability to grow our assets.

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

Although our common stock has been listed on the NASDAQ Capital Market since December 2001 and since February 1, 2007, has been listed on NASDAQ Global Market, our common stock is thinly traded. Average daily trading volume during 2006 was only 3,476 shares. The prices of thinly traded stocks, such as ours, are typically more volatile than stocks traded in a large, active public market and can be more easily impacted by sales or purchases of large blocks of stock. Thinly traded stocks are also less liquid, and because of the low volume of trades, you may be unable to sell your shares when you desire to do so.

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

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

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

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

**Table of Contents**

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

Our operations are subject to extensive regulation by federal agencies. See Supervision and Regulation in the description of our Business in Item 1 above for detailed information on the laws and regulations to which we are subject. Changes in applicable laws, regulations or regulator policies could materially affect our business. The likelihood of any major changes in the future and their effects are impossible to determine.

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

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

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

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

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

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

Not applicable.

**ITEM 2. PROPERTIES**

The main office of Horizon and the Bank is located at 515 Franklin Square, Michigan City, Indiana. The building located across the street from the main office of Horizon and the Bank, at 502 Franklin Square, houses the credit administration, operations, facilities and purchasing and information technology departments of the Bank. In addition to these principal facilities, the Bank has 14 sales offices located at:

3631 South Franklin Street, Michigan City, Indiana

113 W. First St., Wanatah, Indiana

1500 W. Lincolnway, LaPorte, Indiana

423 South Roosevelt Street, Chesterton, Indiana

4208 N. Calumet, Valparaiso, Indiana

2650 Willowcreek Road, Portage, Indiana

233 East 84<sup>th</sup> Drive, Merrillville, Indiana

811 Ship Street, St. Joseph, Michigan

2608 Niles Road, St. Joseph, Michigan

233 South Main Street, South Bend, Indiana

1909 East Bristol Street, Elkhart, Indiana

**Table of Contents**

500 West Buffalo Street, New Buffalo, Michigan  
13696 Redarrow Highway, Harbert, Michigan  
6801 West U.S. 12 Three Oaks, Michigan

Horizon owns all of the facilities, except for the South Bend and Merrillville, Indiana offices, which are leased from third parties.

**ITEM 3. LEGAL PROCEEDINGS**

No material pending legal proceedings, other than ordinary routine litigation incidental to the business to which Horizon or any of its subsidiaries is a party or of which any of their property is subject.

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

No matters were submitted to a vote of Horizon's stockholders during the fourth quarter of the 2006 fiscal year.

**Table of Contents**

**SPECIAL ITEM: EXECUTIVE OFFICERS OF REGISTRANT**

Robert C. Dabagia	68	Chairman of Horizon since 1998; Chief Executive Officer of Horizon and the Bank until July 1, 2001.
Craig M. Dwight	50	Chairman and Chief Executive Officer of the Bank since January 2003; President and Chief Executive Officer of Horizon and the Bank since July 1, 2001; President and Chief Administrative Officer of Horizon and President of the Bank since 1998.
Thomas H. Edwards	54	President and Chief Operating Officer of the Bank since January 2003; Executive Vice President and Senior Lender of Horizon and the Bank since 1999.
James H. Foglesong	61	Chief Financial Officer of Horizon and the Bank since January 2001; Executive Vice President and Chief Financial Officer, Security Financial Bancorp since 1995.
James D. Neff	47	Executive Vice President-Mortgage Banking of Horizon Bank since January 2004; Senior Vice President, Horizon Bank since October 1999.



**Table of Contents****PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

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

The Securities and Exchange Commission requires Horizon to include a line graph comparing Horizon's cumulative five-year total shareholder returns on the Common Shares with market and industry returns over the past five years. SNL Financial LC prepared the following graph. The return represented in the graph assumes the investment of \$100 on January 1, 2002, and further assumes reinvestment of all dividends. The Common Shares began trading on the NASDAQ Global Market February 1, 2007. Prior to that date, the Common Shares were traded on the NASDAQ Capital Market.

**Horizon Bancorp  
Total Return Performance**

<i>Index</i>	<i>Period Ending</i>					
	<b>12/31/01</b>	<b>12/31/02</b>	<b>12/31/03</b>	<b>12/31/04</b>	<b>12/30/05</b>	<b>12/31/06</b>
Horizon Bancorp	100.00	118.43	188.36	187.86	186.27	198.01
Russell 2000	100.00	79.52	117.09	138.55	144.86	171.47
SNL Bank \$1B-\$5B	100.00	115.44	156.98	193.74	190.43	220.36

The SNL \$500 million to \$1 billion index was dropped this year as Horizon no longer falls within this size range. The index value for this index at December 31, 2006 was 247.44.

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

**Table of Contents**

**ITEM 6. SELECTED FINANCIAL DATA**

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

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

**Horizon Bancorp and Subsidiaries  
Management's Discussion and Analysis of  
Financial Condition and Results of Operations  
(Table Dollar Amounts in Thousands)**

**Overview**

Throughout 2006, Horizon's net interest margin declined as the cost of funds increased faster than the yield on earning assets. Cost of funds was impacted by competitive rate pressure for deposits and certificates of deposit renewing at higher rates. The yield on earning assets was hampered by a lack of commercial loan growth. Commercial loans carry higher yields than mortgage and consumer loans. Commercial loan growth was negatively impacted by the pay off of approximately \$30 million of loans. The net interest margin declined from 3.27% in 2005 to 3.05% in 2006. This 22 basis point decline had the impact of reducing net interest income by approximately \$2.3 million.

Mortgage loans outstanding grew \$63 million and mortgage loans originated and sold totaled \$96 million, which is comparable to the prior year. Mortgage activity at Horizon continued strong despite the general slow down in residential mortgage activity nationwide. Indirect consumer loan activity continued strong as well, pushing total consumer loans to \$238 million, an increase of \$36 million from the prior year. Restructuring was completed in the investment portfolio. Throughout the year \$764 thousand of losses were taken and the investment portfolio yield was improved by 60 basis points.

Asset growth was funded by an increase of \$58 million in deposits and a \$28 million increase in borrowed funds.

**Critical Accounting Policies**

Horizon has established various accounting policies, which govern the application of accounting principles generally accepted in the United States in the preparation of the Company's financial statements. The significant accounting policies of the Company are described in the notes to the consolidated financial statements included in Part II, Item 8 on Form 10-K. Certain of these policies are important to the portrayal of the Company's financial condition, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Management has identified the following as critical accounting policies:

**Allowance for Loan Losses**

The allowance for loan losses, which is established through the provision for loan losses, is based on management's evaluation of the level of allowance required in relation to the estimated loss exposure in the loan portfolio.

Management believes the allowance for loan losses is a significant estimate and therefore evaluates it for adequacy each quarter. Management considers factors such as previous loss experience, the size and composition of the loan portfolio, current economic and real estate market conditions, the performance of individual loans in relation to contract terms, and estimated fair value of collateral that secures the loans. The use of different estimates or assumptions could produce a different allowance for loan losses. Additional discussion regarding the allowance for loan losses is included in the commentary on Loans in the following Analysis of Financial Condition.

**Table of Contents**

**Goodwill and Intangible Assets**

Management believes that the accounting for goodwill and other intangible assets also involves a higher degree of judgment than most other significant accounting policies. Statement of Financial Accounting Standard (SFAS) No. 142, Accounting for Goodwill and Other Intangible Assets, establishes standards for the amortization of acquired intangible assets and impairment assessment of goodwill. At December 31, 2006, Horizon had core deposit intangibles of \$2.412 million subject to amortization and \$5.787 million of goodwill, which was not subject to amortization. Goodwill arising from business combinations represents the value attributable to unidentifiable intangible assets in the business acquired. Horizon's goodwill relates to the value inherent in the banking industry and that value is dependent upon the ability of Horizon to provide quality, cost effective banking services in a competitive marketplace. The goodwill value is supported by revenue that is in part driven by the volume of business transacted. A decrease in earnings resulting from a decline in the customer base or the inability to deliver cost effective services over sustained periods can lead to impairment of goodwill that could adversely impact earnings in future periods. SFAS No. 142 requires an annual evaluation of goodwill for impairment. The evaluation of goodwill for impairment requires the use of estimates and assumptions. Horizon has concluded that the recorded value of goodwill is not impaired.

**Mortgage Servicing Rights**

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

**Table of Contents**

**Analysis of Financial Condition**

**Investment Securities**

Horizon maintains a high quality investment portfolio with low credit risk. Investment securities totaled \$243.078 million at December 31, 2006, and consisted of U S. Treasury and Government Agency securities of \$58.445 million (24.0%); Municipal securities of \$81.800 million (33.7%); Mortgage-backed securities of \$91.174 million (37.5%); collateralized mortgage obligations of \$11.010 million (4.5%); and corporate securities of \$649 thousand (.3%).

As indicated above, 42.0% of the investment portfolio consists of mortgage-backed securities and collateralized mortgage obligations. These instruments are secured by residential mortgages of varying maturities. Principal and interest payments are received monthly as the underlying mortgages are repaid. These payments also include prepayments of mortgage balances as borrowers either sell their homes or refinance their mortgages. Therefore, mortgage-backed securities and collateralized mortgage obligations have maturities that are stated in terms of average life. The average life is the average amount of time that each dollar of principal is expected to be outstanding. As of December 31, 2006, the mortgage-backed securities and collateralized mortgage obligations in the investment portfolio had an average life of 4.05 years. Securities that have interest rates above current market rates are purchased at a premium. These securities may experience a significant increase in prepayments when lower market interest rates create an incentive for the borrower to refinance the underlying mortgage. This may result in a decrease of current income, however, this risk is mitigated by a shorter average life. Management currently believes that prepayment risk on these securities is nominal.

At December 31, 2006 and 2005, all investment securities were classified as available for sale. Securities classified as available for sale are carried at their fair value, with both unrealized gains and losses added or subtracted, net of tax, directly to stockholders' equity. This accounting method adds potential volatility to stockholders' equity, but net income is not affected unless securities are sold. Net depreciation on these securities totaled \$2.318 million, which resulted in a \$1.507 million reduction, net of tax, to stockholders' equity at December 31, 2006. This compared to a \$2.853 million, net of tax, addition in stockholders' equity at December 31, 2005.

As a member of the Federal Reserve and Federal Home Loan Bank system, Horizon is required to maintain an investment in the common stock of each entity. The investment in common stock is based on a predetermined formula. At December 31, 2006, Horizon has investments in the common stock of the Federal Reserve and Federal Home Loan Bank totaling \$12.136 million compared to \$12.983 million at December 31, 2005.

At December 31, 2006, Horizon does not maintain a trading account and is not using any derivative products for hedging or other purposes.

**Table of Contents****Loans**

Total loans, the principal earning asset of the Bank, were \$843.834 million at December 31, 2006. The current level of loans is an increase of 15.2% from the December 31, 2005, level of \$732.734 million. As the table below indicates, the increase is related to growth in all lending areas except for commercial loans, which declined during 2006.

<b>December 31</b>	<b>2006</b>	<b>2005</b>	<b>Dollar Change</b>	<b>Percent Change</b>
<b>Real estate loans</b>				
1-4 family	\$214,031	\$152,818	\$ 61,213	40.06%
Other	8,204	6,494	1,710	26.33
<b>Total</b>	<b>222,235</b>	<b>159,312</b>	<b>62,923</b>	<b>39.50</b>
<b>Commercial loans</b>				
Working capital and equipment	128,500	130,410	(1,910)	(1.46)
Real estate, including agriculture	131,103	128,240	2,863	2.23
Tax exempt	3,861	2,529	1,332	52.67
Other	7,993	12,131	(4,138)	(34.11)
<b>Total</b>	<b>271,457</b>	<b>273,310</b>	<b>(1,853)</b>	<b>(0.68)</b>
<b>Consumer loans</b>				
Auto	125,542	96,421	29,121	30.20
Recreation	8,862	7,708	1,154	14.97
Real estate/home improvement	43,590	40,968	2,622	6.40
Home equity	54,527	52,129	2,398	4.60
Unsecured	1,979	1,918	61	3.18
Other	3,375	3,239	136	4.20
<b>Total</b>	<b>237,875</b>	<b>202,383</b>	<b>35,492</b>	<b>17.53</b>
<b>Mortgage warehouse loans</b>				
Prime	53,547	48,571	9,460	19.48
Sub-Prime	58,720	49,158	5,078	10.33
<b>Total</b>	<b>112,267</b>	<b>97,729</b>	<b>14,538</b>	<b>14.88</b>
<b>Grand total</b>	<b>\$843,834</b>	<b>\$732,734</b>	<b>\$111,100</b>	<b>15.16%</b>

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

*Real Estate Loans*

Real estate loans totaled \$222.235 million or 26.3% of total loans as of December 31, 2006, compared to \$159.312 million or 21.7% of total loans as of December 31, 2005. This category consists of home mortgages that generally require a loan to value of no more than 80%. Some special guaranteed or insured real estate loan programs do permit a higher loan to collateral value ratio.

**Table of Contents**

In addition to the customary real estate loans described above, the Bank also has outstanding on December 31, 2006, \$54.527 million in home equity lines of credit compared to \$52.129 million at December 31, 2005. Credit lines normally limit the loan to collateral value to no more than 89%. These loans are classified as consumer loans in the table above and in Note 4 of the consolidated financial statements.

Residential real estate lending is a highly competitive business. As of December 31, 2006, the real estate loan portfolio reflected a wide range of interest rates and repayment patterns, but could generally be categorized as follows:

	<b>Amount</b>	<b>2006 Percent of Portfolio</b>	<b>Yield</b>	<b>Amount</b>	<b>2005 Percent of Portfolio</b>	<b>Yield</b>
Fixed rate						
Monthly payment	\$ 46,301	20.84%	6.35%	\$ 43,752	27.46%	6.13%
Biweekly payment	3,047	1.37	6.45	3,275	2.06	6.43
Adjustable rate						
Monthly payment	172,860	77.78	5.72	112,240	70.45	5.29
Biweekly payment	27	.01	7.5	45	.03	6.12
Total	\$222,235	100.00%	5.88%	\$159,312	100.00%	5.54%

During 2006 and 2005, approximately \$96 million and \$98 million, respectively, of residential mortgages were sold into the secondary market.

In addition to the real estate loan portfolio, the Bank sells real estate loans and retains the servicing rights. Loans serviced for others are not included in the consolidated balance sheets. During 2006 Horizon sold a large portion of its mortgage servicing business. The unpaid principal balances and number of loans serviced for others totaled approximately \$23,988,000 and 279 and \$164,885,000 and 1,971 at December 31, 2006 and 2005, respectively. The Bank began capitalizing mortgage servicing rights during 2000 and the aggregate fair value of capitalized mortgage servicing rights at December 31, 2006, totaled approximately \$245,000. Comparable market values and a valuation model that calculates the present value of future cash flows were used to estimate fair value. For purposes of measuring impairment, risk characteristics including product type, investor type and interest rates, were used to stratify the originated mortgage servicing rights.

	<b>2006</b>	<b>2005</b>	<b>2004</b>
Mortgage Servicing Rights			
Balances, January 1	\$ 1,278	\$ 1,473	\$ 1,429
Servicing rights capitalized	83	239	482
Amortization of servicing rights	(251)	(434)	(438)
Servicing rights sold	(862)		
	248	1,278	1,473
Impairment allowance	(3)	(44)	(141)
Balances, December 31	\$ 245	\$ 1,234	\$ 1,332





**Table of Contents***Commercial Loans*

Commercial loans totaled \$271.457 million, or 32.1% of total loans as of December 31, 2006, compared to \$273.310 million, or 36.2% as of December 31, 2005. During the course of the year, Horizon had \$30.944 million in commercial real estate and \$500 thousand of agricultural loans pay off prematurely. Of this dollar amount, approximately 14% were loans that were acquired by Horizon in the Alliance Bank acquisition that had credit issues. Another 43% were commercial real estate loans that either refinanced elsewhere for more favorable terms or the properties were sold. New loan production essentially offset the losses in commercial loan balances arising from the aforementioned early payoffs.

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

	2006			2005		
	Number	Amount	Percent of Portfolio	Number	Amount	Percent of Portfolio
SBA guaranteed loans	20	\$ 4,321	1.60%	26	\$ 4,782	1.75%
Municipal government	42	3,861	1.42	44	2,529	.93
Lines of credit	395	49,549	18.25	406	46,999	17.20
Real estate and equipment term loans	997	213,726	78.73	998	219,000	80.12
Total	1,454	\$271,457	100.00%	1,474	\$273,310	100.00%

*Consumer Loans*

Consumer loans totaled \$237.875 million, or 28.2% of total loans as of December 31, 2006, compared to \$202.383 million, or 27.6% as of December 31, 2005. The total consumer loan portfolio increased 17.5% in 2006. The growth in consumer loans came from the indirect automobile segment of the portfolio as Horizon expanded its dealer network in southwest Michigan and north central Indiana. Direct consumer loans, mostly consisting of home equity term and revolving loans, were relatively stable in 2006.

*Mortgage Warehouse Loans*

In November 1999, Horizon began a mortgage-warehousing program. Horizon enters into agreements with mortgage companies and purchases, at its discretion, mortgage loans from mortgage companies at par, net of certain fees, and later sells them back to the mortgage companies at the same amount and without recourse provisions. Interest income is recorded based upon a rate of interest tied to the prime rate during the funding period, not the rates on the individual note. Such loans are made to individuals and reviewed, prior to purchase, for evidence that the loans are of secondary market quality and meet Horizon's internal underwriting guidelines. An assignment of the mortgage to Horizon is required. In addition, Horizon takes possession of the original note and forwards such note to the end investor. In the event that the end investor would not honor this commitment and the mortgage companies would not be able to honor their repurchase obligations, Horizon would then need to sell these loans in the secondary market at the fair value of these loans. Loans are typically resold within 30 days and are seldom held more than 90 days.

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

An allowance for loan losses is maintained to absorb loan losses inherent in the loan portfolio. The determination of the allowance for loan losses is a critical accounting policy that involves management's ongoing quarterly assessments of the probable estimated losses inherent in the loan portfolio. The identification of loans that may have potential losses is subjective, therefore, a general reserve is maintained to cover all potential losses within the entire loan portfolio. Horizon utilizes a loan grading system that helps identify, monitor and address asset quality problems, in an adequate and timely manner. Each quarter, various factors affecting the quality of the loan portfolio are reviewed.

**Table of Contents**

Large credits are reviewed on an individual basis for loss potential. Other loans are reviewed as a group based upon previous trends of loss experience. Horizon also reviews the current and anticipated economic conditions of its lending market as well as transaction risk to determine the effect they may have on the loss experience of the loan portfolio.

At December 31, 2006, the allowance for loan losses was \$8.738 million, or 1.03% of total loans outstanding, compared to \$8.368 million, or 1.14% at December 31, 2005. During 2006, the provision for loan losses totaled \$905 thousand compared to \$1.521 million in 2005. The allowance as a percent of total loans decreased due to strong credit quality and loan loss ratios that are better than those of Horizon's peers. In addition, the lack of growth in commercial and mortgage warehouse loans resulted in no appreciable increase to reserve allocations for these portfolios. However, no assurance can be given that Horizon will not, in any particular period, sustain loan losses that are significant in relation to the amount reserved, or that subsequent evaluations of the loan portfolio, in light of factors then prevailing, including economic conditions and management's ongoing quarterly assessments of the portfolio, will not require increases in the allowance for loan losses. Horizon considers the allowance for loan losses to be adequate to cover losses inherent in the loan portfolio as of December 31, 2006.

*Nonperforming Loans*

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

	<b>2006</b>	<b>2005</b>	<b>2004</b>
Nonperforming loans	\$2,625	\$1,822	\$1,358

Nonperforming loans total 30% of the allowance for loan losses at December 31, 2006, compared to 22% and 19% of the allowance for loan losses on December 31, 2005 and 2004, respectively.

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

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

Other real estate owned (OREO) net of any related allowance for OREO losses for the previous three years ending December 31 are as follows:

	<b>2006</b>	<b>2005</b>	<b>2004</b>
Other real estate owned	\$75	\$23	\$276

**Table of Contents****Deposits**

The primary source of funds for the Bank comes from the acceptance of demand and time deposits. However, at times the Bank will use its ability to borrow funds from the Federal Home Loan Bank and other sources when it can do so at interest rates and terms that are superior to those required for deposited funds. Total deposits were \$913.973 million at December 31, 2006, compared to \$855.566 million at December 31, 2005, or an increase of 6.8%. Average deposits and rates by category for the previous three years ended December 31 are as follows:

	Average Balance Outstanding for the Year Ended December 31			Average Rate Paid for the Year Ended December 31		
	2006	2005	2004	2006	2005	2004
Noninterest-bearing demand deposits	\$ 78,654	\$ 73,501	\$ 62,634			
Interest-bearing demand deposits	178,773	165,767	104,909	2.43%	1.44%	.46%
Savings deposits	34,637	38,231	36,265	.28	.36	.20
Money market	139,177	143,652	123,013	3.28	2.37	1.27
Time deposits	387,365	320,014	266,201	4.37	3.42	3.22
 Total deposits	 \$818,606	 \$741,165	 \$593,022			

Horizon continually revises and enhances its interest-bearing consumer and commercial demand deposit products based on local market conditions and its need for funding to support various types of assets. These product changes caused the changes in the average balances and rates paid as displayed in the table above.

Certificates of deposit of \$100,000 or more, which are considered to be rate sensitive and are not considered a part of core deposits, mature as follows as of December 31, 2006:

Due in three months or less	\$53,053
Due after three months through six months	5,984
Due after six months through one year	7,772
Due after one year	987

Interest expense on time certificates of \$100,000 or more was approximately \$5.533 million, \$2.059 million and \$1.762 million for 2006, 2005 and 2004, respectively.

**Off-Balance Sheet Arrangements**

As of December 31, 2006, Horizon does not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the Company's financial condition, change in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors. The term off-balance sheet arrangement generally means any transaction, agreement, or other contractual arrangement to which an entity unconsolidated with the Company is a party under which the Company has (i) any obligation arising under a guarantee contract, derivative instrument or variable interest; or (ii) a retained or contingent interest in assets transferred to such entity or similar arrangement that serves as credit, liquidity or market risk support for such assets.

**Table of Contents****Contractual Obligations**

	<b>Within One Year</b>	<b>One to Three Years</b>	<b>Three to Five Years</b>	<b>After Five Years</b>
Deposits	\$ 867,754	\$ 45,435	\$ 276	\$ 508
Long-term debt obligations (1)	23,195	15,411	30,275	47,070
Subordinated debentures (2)				40,209

(1) Includes debt obligations to the Federal Home Loan Bank and term repurchase agreements with maturities beyond one year borrowed by Horizon s banking subsidiary. See Note 10 in Horizon s Consolidated Financial Statements.

(2) Includes Trust Preferred Capital Securities issued by Horizon Statutory Trusts I, II and III and those assumed in the acquisition of Alliance. See Note 11 in Horizon s Consolidated Financial Statements.

**Expiration by Period  
Greater**

	<b>Within One Year</b>	<b>Than One Year</b>
Letters of credit	\$ 1,744	\$ 1,256
Unfunded loan commitments	94,140	60,546

Shareholder Value Plan

During 2001, Horizon initiated a Shareholder Value Plan. The Plan is a comprehensive strategic plan to broaden and improve the market for Horizon's common stock with local community investors who have a long-term, personal interest in helping Horizon remain an independent community bank. It includes improved communications with stockholders and customers as well as efforts to improve the marketability of its common stock. During the fourth quarter of 2001, two important components of the Shareholder Value Plan were completed. These included a 3-for-1 stock split and the listing of Horizon's stock on the NASDAQ Capital Market (formerly named the NASDAQ SmallCap Market) and effective February 1, 2007, Horizon is listed on Nasdaq Global Market. Before this, Horizon's stock was traded on the Bulletin Board. A dividend reinvestment plan was implemented in early 2002 and the quarterly per share dividend was increased to \$.10 2/3 in the fourth quarter of 2002. In October of 2003, Horizon's Board of Directors declared a 3-for-2 stock split and in December of 2003 increased the dividend to \$.12. In December 2004, the Board of Directors increased the quarterly dividend to \$.13 per share and in December 2005, the Board of Directors increased the quarterly dividend to \$.14 per share.

Capital Resources

The capital resources of Horizon and the Bank exceed regulatory capital ratios for well capitalized banks at December 31, 2006. Stockholders' equity totaled \$61.877 million as of December 31, 2006, compared to \$53.530 million as of December 31, 2005. At year-end 2006, the ratio of stockholders' equity to assets was 5.06% compared to 4.75% for 2005. Horizon's capital increased during the year 2006 as a result of increased earnings, net of dividends declared, exercise of stock options and net of tax, decrease in unrealized gain (loss) on securities available for sale and the amortization of unearned compensation. Due to the acquisition of Alliance for cash, the percentage growth in assets was greater than the percentage growth in equity, causing the equity to asset ratio from 2004 to 2005 to decrease.

Horizon declared dividends in the amount of \$.56 per share in 2006, and \$.53 per share in 2005 and \$.49 per share in 2004. The dividend payout ratio (dividends as a percent of net income) was 24% during 2006, 23% during 2005 and 21% during 2004. For additional information regarding dividend conditions, see Note 1 of the Notes to the Consolidated Financial Statements.

**Table of Contents**

In March 2002, Horizon formed Horizon Statutory Trust I (Trust I), a statutory business trust. Trust I issued \$12 million of Trust Preferred Capital Securities as a participant in a pooled trust preferred securities offering. Horizon issued subordinated debentures aggregating \$12 million to Trust I. The junior subordinated debentures are the sole assets of Trust I. The junior subordinated debentures and the trust preferred securities pay interest and dividends, respectively, on a quarterly basis. The junior subordinated debentures and the securities bear interest at a rate of 90 day LIBOR plus 3.60% and mature on March 26, 2032, and are noncallable for five years. After that period, the securities may be called at any quarterly interest payment date at par. These securities have been called and will be redeemed on March 26, 2007. Costs associated with the issuance of the securities totaling \$362 thousand were capitalized and are being amortized to the first call date of the securities.

In October of 2004, Horizon formed Horizon Bancorp Capital Trust II (Trust II), a statutory business trust. Trust II issued \$10 million of Trust Preferred Capital Securities as a participant in a pooled trust preferred securities offering. Horizon issued junior subordinated debentures aggregating \$10 million to Trust II. The junior subordinated debentures are the sole assets of Trust II. The junior subordinated debentures and the trust preferred securities pay interest and dividends, respectively, on a quarterly basis. The junior subordinated debentures and the securities bear interest at a rate of 90 day LIBOR plus 1.95% and mature on October 21, 2034, and are noncallable for five years. After that period, the securities may be called at any quarterly interest payment date at par. Costs associated with the issuance of the securities totaling \$17,500 were capitalized and are being amortized to the first call date of the securities.

The Company assumed additional debentures as the result of the acquisition of Alliance in 2005. In June 2004, Alliance formed Alliance Financial Statutory Trust I (Alliance Trust) to issue the \$5 million in trust preferred securities. Alliance had issued junior subordinated debentures aggregating \$5 million to Alliance Trust. The junior subordinated debentures are the sole assets of Alliance Trust. The junior subordinated debentures and the trust preferred securities pay interest and dividends, respectively, on a quarterly basis. The junior subordinated debentures and the securities bear interest at a rate of 90 day LIBOR plus 2.65%, mature in June 2034, and are noncallable for five years. After that period, the securities may be called at any quarterly interest payment date at par.

In December of 2006, Horizon formed Horizon Bancorp Capital Trust III (Trust III), a statutory business trust. Trust III issued \$12 million of Trust Preferred Capital Securities as a participant in a pooled trust preferred securities offering. Horizon issued junior subordinated debentures aggregating \$12 million to Trust III. The junior subordinated debentures are the sole assets of Trust III. The junior subordinated debentures and the trust preferred securities pay interest and dividends, respectively, on a quarterly basis. The junior subordinated debentures and the securities bear interest at a rate of 90 day LIBOR plus 1.65% and mature on January 30, 2037, and are noncallable for five years. After that period, the securities may be called at any quarterly interest payment date at par. Costs associated with the issuance of the securities totaling \$12,647 were capitalized and are being amortized to the first call date of the securities. The proceeds of this issue will be used to redeem the securities issued by Trust I on March 26, 2007.

The Trust Preferred Capital Securities, subject to certain limitations, are included in Tier 1 Capital for regulatory purposes. At December 31, 2006, \$20.605 million of the \$39 million in securities were not included in Tier 1 Capital for regulatory purposes. Dividends on the Trust Preferred Capital Securities are recorded as interest expense.

The Bank purchases home mortgages from mortgage companies under warehouse agreements whereby the mortgage company has the right to repurchase the loan. Because these transactions are sales of the loans to the Bank and the Bank is the owner of the purchased loans, the Bank has historically treated these loans as home mortgage loans for call report and regulatory capital purposes. During the course of the routine, periodic examination by bank regulatory authorities commenced in February 2003, the examination personnel raised the issue of whether the Bank's mortgage warehouse loans should be treated as other loans rather than as home mortgage loans for call report purposes. If these mortgage loans were treated as other loans, it would change the calculations for risk-based capital and reduce the Bank's risk-based capital ratios. The following table shows, for year-ends in

**Table of Contents**

2006, 2005 and 2004 the amount of the Bank's risk-based and Tier 1 capital ratios as reported and as they would be under this alternative treatment:

<b>Horizon Bank and</b>	<b>Alternative</b>		<b>Minimum</b>
<b>Horizon Bancorp as of:</b>	<b>Reported</b>	<b>Treatment</b>	<b>Required To</b>
			<b>Be Well</b>
			<b>Capitalized</b>
<b>December 31, 2006</b>			
Total capital (to risk-weighted assets)			
Consolidated	12.92%	12.06%	N/A
Bank	11.26%	10.52%	10.00%
Tier 1 Capital (to risk-weighted assets)			
Consolidated	9.23%	8.62%	N/A
Bank	10.16%	9.49%	6.00%
Tier 1 Capital (to average assets)			
Consolidated	6.25%	6.25%	N/A
Bank	6.89%	6.89%	5.00%
<b>December 31, 2005</b>			
Total capital (to risk-weighted assets)			
Consolidated	11.54%	10.81%	N/A
Bank	11.82%	11.06%	10.00%
Tier 1 Capital (to risk-weighted assets)			
Consolidated	8.84%	8.28%	N/A
Bank	10.66%	9.97%	6.00%
Tier 1 Capital (to average assets)			
Consolidated	5.83%	5.83%	N/A
Bank	7.02%	7.03%	5.00%
<b>December 31, 2004</b>			
Total capital (to risk-weighted assets)			
Consolidated	13.95%	12.52%	N/A
Bank	13.62%	12.11%	10.00%
Tier 1 Capital (to risk-weighted assets)			
Consolidated	11.71%	10.51%	N/A
Bank	12.37%	10.97%	6.00%
Tier 1 Capital (to average assets)			
Consolidated	7.37%	7.37%	N/A
Bank	7.78%	7.78%	5.00%

If the Bank is required to reclassify such loans, the Bank still meets the regulatory well capitalized standards for all of 2006, 2005 and 2004. Bank regulators have not issued a final opinion on this matter but management continues to believe that these loans are properly characterized for risk-based capital purposes. However, there is no assurance that the regulators will concur with that determination. If required to treat mortgage warehouse loans as commercial loans, the Bank will consider increasing the amount of its capital through the issuance of subordinated debt, trust preferred securities or equity securities; or consider other alternatives.

As a condition of approval for the Alliance acquisition, the OCC required Horizon Bank to maintain regulatory capital ratios at 100 basis points above the well capitalized minimums shown above.





**Table of Contents**

As of December 31, 2006, management is not aware of any other recommendations by banking regulatory authorities, which, if they were to be implemented, would have or are reasonably likely to have a material effect on Horizon's liquidity, capital resources or operations.

**Results of Operations****Net Income**

Consolidated net income was \$7.484 million or \$2.33 per diluted share in 2006, \$7.091 million or \$2.24 per diluted share in 2005 and \$6.935 million or \$2.22 per share in 2004.

**Net Interest Income**

The primary source of earnings for Horizon is net interest income. Net interest income is the difference between what Horizon has earned on assets it has invested and the interest paid on deposits and other funding sources. The net interest margin is net interest income expressed as a percentage of average earning assets. Horizon's earning assets consist of loans, investment securities and interest-bearing balances in banks.

	2006			2005			2004		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
<b>Assets</b>									
Interest-bearing assets Loans total (1) (3)	\$ 785,448	\$ 57,282	7.29%	\$ 640,758	\$ 44,749	6.98%	\$ 514,916	\$ 33,386	6.48%
Taxable investment securities, including FRB and FHLB stock	190,670	8,348	4.38	244,495	9,610	3.93	192,419	7,211	3.75
Nontaxable investment securities (2)	65,773	2,796	4.25	54,806	2,372	4.32	52,722	2,264	4.29
Interest-bearing balances and money market investments (4)	4,469	153	3.42	1,177	38	3.23	4,924	69	1.40
Federal funds sold	1,890	101	5.34	755	24	3.18	4,560	58	1.28
Total interest-earning assets	1,048,250	68,680	6.55	941,991	56,793	6.03	769,541	42,988	5.59
Noninterest-earning assets Cash and due from banks	21,525			19,610			16,822		
Allowance for loan losses	(8,723)			(7,615)			(6,985)		
Other assets	57,053			46,127			39,547		
Total assets	\$ 1,118,105			\$ 1,000,113			\$ 818,925		

**Liabilities and  
Stockholders  
Equity**

Interest-bearing liabilities Savings deposits	\$ 34,637	96	.28%	\$ 38,231	139	.36	\$ 36,265	74	.20
Money market	139,177	4,559	3.28	143,652	3,414	2.37	123,013	1,558	1.27
Interest-bearing demand deposits	178,773	4,164	2.33	165,767	2,385	1.44	104,909	482	.46
Time deposits	387,365	16,915	4.37	320,014	10,934	3.42	266,200	8,579	3.22
Short-term borrowings	78,747	2,035	2.58	45,517	1,573	3.46	37,205	600	1.61
Long-term debt	157,179	9,366	5.95	155,393	7,475	4.81	135,362	6,273	4.63
Total interest-bearing liabilities	975,878	37,135	3.81	868,574	25,920	2.98	702,954	17,566	2.50
Noninterest-bearing liabilities Demand deposits	78,654			73,501			62,634		
Other liabilities	6,138			6,153			5,013		
Stockholders equity	57,435			51,885			48,324		
Total liabilities and stockholders equity	\$ 1,118,105			\$ 1,000,113			\$ 818,925		
Net interest income	\$ 31,545			\$ 30,873			\$ 25,422		
Net interest income as a percent of interest earning assets			3.01%			3.28%			3.31%

**Table of Contents**

- (1) Nonaccruing loans for the purpose of the computations above are included in the daily average loan amounts outstanding. Loan totals are shown net of unearned income and deferred loans fees.
- (2) Yields are not presented on a tax-equivalent basis.
- (3) Loan fees and late fees included in interest on loans aggregated \$3,470,000, \$3,246,000 and \$3,129,000 in 2006, 2005 and 2004 respectively.
- (4) Horizon has no foreign office and, accordingly, no assets or liabilities to foreign operations. Horizon's subsidiary bank had no funds invested in Eurodollar Certificates of Deposit at

December 31,  
2006.

	2006 2005 Increase/(Decrease)			2005 2004 Increase/(Decrease)		
	Total Change	Change Due to Volume	Change Due to Rate	Total Change	Change Due to Volume	Change Due to Rate
<b>Interest Income</b>						
Loans total	\$ 12,533	\$ 10,479	\$ 2,054	\$ 11,363	\$ 8,638	\$ 2,725
Taxable investment securities	(1,310)	(2,281)	971	2,447	2,051	396
Nontaxable investment securities	424	467	(43)	108	90	18
Interest-bearing balances and money market investments	115	113	2	(31)	(78)	47
Federal funds sold	77	53	24	(34)	(75)	41
Total interest income	11,839	8,831	3,008	13,853	10,626	3,227
<b>Interest Expense</b>						
Savings deposits	(43)	(12)	(31)	65	4	61
Money market	1,145	(109)	1,254	1,856	298	1,558
Interest-bearing demand deposits	1,779	200	1,579	1,903	407	1,496
Time deposits	5,981	2,577	3,404	2,355	1,815	540
Short-term borrowings	462	933	(471)	973	159	814
Long-term debt	1,843	87	1,756	1,250	979	271
Total interest expense	11,167	3,676	7,491	8,402	3,662	4,740
<b>Net Interest Earnings</b>	\$ 672	\$ 5,155	\$ (4,483)	\$ 5,451	\$ 6,964	\$ (1,513)

Horizon's average earning assets were \$1,048.250 million in 2006 compared to \$941.991 million in 2005 and \$769.541 million in 2004. The net interest margin for 2006 was 3.01% compared to 3.28% and 3.31% in 2005 and 2004, respectively. Short-term interest rates began to increase in the third quarter of 2004 and continued through 2005 until June of 2006. Short-term interest rates have remained relatively stable since then.

Horizon began to experience slightly higher loan yields due to the increase in short-term rates throughout 2006. This is due in part to new loans and loan renewals coming in at higher rates than those maturing or paying off and rates on loans with variable rates rising with short-term rates. Average loans outstanding during 2006 showed significant growth from 2005 due to a full year of the Alliance acquisition and concerted effort in new business. The mix of the loan portfolio also showed significant change as shown in the following table.

	2006	2005	2004
Commercial loans	\$ 267,263	\$ 234,971	\$ 174,391
Mortgage warehouse loans	96,334	108,298	134,063
Real estate loans	201,756	123,815	85,314
Installment loans	220,095	173,674	121,148

Total average loans outstanding	\$ 785,448	\$ 640,758	\$ 514,916
---------------------------------	------------	------------	------------

**Table of Contents**

Average commercial loans grew nearly 14%, consumer loans increased by over 27% and residential real estate loans increased by over 63%. Commercial loans grew on average due a full year's impact of the growth achieved in 2005 through the Alliance acquisition and additional lenders. The southwest Michigan market, in which Horizon increased market share through the acquisition of Alliance in 2005, continued to have a strong growth pattern. Average consumer loans grew as a result of expansion of indirect lending into southwest Michigan and north central Indiana. The continued decrease in mortgage refinancing caused mortgage warehouse loans to decrease by over 11%. To help fund the loan growth, investment portfolio was allowed to decrease through normal maturities and security sales. Restructuring of the investment portfolio occurred by selling low yielding investment securities and reinvesting the proceeds in higher yielding securities. The loss taken on the sale will be recovered within one year through improved yield on the new securities.

Average interest-bearing deposits increased by over 11% during 2006. Short-term deposit rates increased throughout the year. The overall cost of time deposits increased as maturing certificates of deposit renewed at higher rates. The increase in net interest income during 2006 and 2005 is primarily the result of increased earning assets, particularly investment securities in 2005 and the loan portfolio in 2005 and 2006. The increase in net interest income resulting from increased earning assets was partially offset by declines in the net interest margin.

**Noninterest Income**

The major components of noninterest income consist of service charges on deposit accounts, gain on sale of loans and fiduciary fees. Service charges on deposit accounts are based upon: a) recovery of direct operating expenses associated with providing the service, b) allowing for a profit margin that provides an adequate return on assets and stockholders' equity and c) competitive factors within the Bank's markets. Service charges on deposits were \$3.102 million, \$2.966 million and \$3.088 million, for 2006, 2005 and 2004, respectively.

Gain on sale of loans was \$1.681 million for 2006, \$1.756 million for 2005 and \$2.126 million in 2004. Horizon has sold between 50% and 60% of its residential mortgage loan production in 2004 through 2006. The loans retained are predominantly adjustable rate mortgage loans. During 2006, Horizon sold \$96 million of current production of residential mortgage loans into the secondary market compared to \$98 million in 2005 and \$106 million in 2004. The 2004 gain includes approximately \$394 thousand from the sale of portfolio loans. Portfolio mortgage loans were sold to reduce the interest rate risk related to long-term fixed rate assets and to provide funding for the growth in other loan areas. Horizon anticipates that the volume of mortgage loan activity will remain fairly constant in 2007 however, it is anticipated that a higher percentage of production will be sold into the secondary market. Overall mortgage activity is anticipated to decline, however, as Horizon enters new markets, originations in these markets should offset the overall decline.

Fiduciary fees were \$3.100 million in 2006 compared to \$2.748 million in 2005 and \$2.694 million in 2004. The fluctuations are primarily due to changes in the market value of assets under administration and an increase in one time Employee Stock Ownership Plan fees.

**Noninterest Expense**

Noninterest expense totaled \$30.455 million in 2006 compared to \$29.129 million in 2005 and \$25.672 million in 2004.

Salaries and benefits decreased .6% during 2006 compared to an increase of 11.9% during 2005. The decrease in 2006 related to a decline in incentive compensation and staff reduction through attrition resulting from an efficiency study conducted during the fourth quarter of 2004, partially offset by the cost of additional staff for the newly created wholesale mortgage lending division created during the third quarter of 2006. The increase for 2005 related to the cost of expansion into new markets,

## **Table of Contents**

including the acquisition of Alliance, partially offset by declines in incentive compensation and commissions paid to mortgage originators.

Total other expenses, excluding salaries and benefits, increased 11.2% in 2006 and 15.6% in 2005. During 2006 and 2005 other expenses were impacted by costs related to the acquisition of Alliance as well as ongoing expenses relative to the operation of the additional branches, including the amortization of the core deposit intangible acquired in the acquisition. 2006 was also impacted by an increase in the deferred loan fees being amortized over the life of the loan.

### **Income Taxes**

Income tax expense totaled \$2.838 million in 2006 compared to \$2.945 million in 2005 and \$2.494 million in 2004. The effective tax rate was 27.5%, 29.3% and 26.45% for 2006, 2005 and 2004, respectively. The decrease in the effective tax rate in 2006 was due to an increase in the percentage of tax-exempt income to pre-tax income. The increase in the effective rate in 2005 was due to a decline in the percentage of tax exempt income to pre-tax income.

### **Liquidity and Rate Sensitivity Management**

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

### **Liquidity**

The Bank maintains a stable base of core deposits provided by long standing relationships with consumers and local businesses. These deposits are the principal source of liquidity for Horizon. Other sources of liquidity for Horizon include earnings, loan repayments, investment security sales and maturities, sale of real estate loans and borrowing relationships with correspondent banks, including the Federal Home Loan Bank (FHLB). At December 31, 2006, Horizon has available approximately \$197.693 million in available credit from various money center banks, including the FHLB. During 2006, cash flows were generated primarily from proceeds from borrowings of \$33.8 million, increase in deposits of \$58.4 million and sales, maturities, and prepayments of investment securities of \$125.0 million. Cash flows were used to purchase investments totaling \$91.8 million and increase loans \$112.2 million. The net cash and cash equivalent position increased by \$13.1 million during 2006.

### **Interest Sensitivity**

The degree by which net interest income may fluctuate due to changes in interest rates is monitored by Horizon using computer simulation models, incorporating not only the current GAP position but the effect of expected repricing of specific financial assets and liabilities. When repricing opportunities are not properly aligned, net interest income may be affected when interest rates change. Forecasting results of the possible outcomes determines the exposure to interest rate risk inherent in Horizon's balance sheet. The goal is to manage imbalanced positions that arise when the total amount of assets that reprice or maturing in a given time period differs significantly from liabilities that reprice or mature in the same time period. The theory behind managing the difference between repricing assets and liabilities is to have more assets repricing in a rising rate environment and more liabilities repricing in a declining rate environment. At December 31, 2006, the amount of assets that reprice within one year were 96% of liabilities that reprice within one year. At December 31, 2005, the amount of assets that reprice within one year were approximately 109% of the amount of liabilities that reprice within the same time period.

**Table of Contents**

	<b>3 Months or Less</b>	<b>&gt; 3 Months and &lt; 6 Months</b>	<b>Rate Sensitivity &gt; 6 Months and &lt; 1 Year</b>	<b>Greater Than 1 Year</b>	<b>Total</b>
Loans	\$ 282,092	\$ 67,725	\$ 102,589	\$ 404,531	\$ 856,937
Federal funds sold	6,500				6,500
Interest-bearing balances with Banks	898				898
Investment securities and FRB and FHLB stock	29,576	11,107	13,077	201,454	255,214
Other assets	13,209			89,672	102,881
<b>Total assets</b>	<b>\$ 332,275</b>	<b>\$ 78,832</b>	<b>\$ 115,666</b>	<b>\$ 695,657</b>	<b>\$ 1,222,430</b>

	<b>3 Months or Less</b>	<b>&gt; 3 Months and &lt; 6 Months</b>	<b>Rate Sensitivity &gt; 6 Months and &lt; 1 Year</b>	<b>Greater Than 1 Year</b>	<b>Total</b>
Noninterest-bearing deposits	\$ 6,781	\$ 6,781	\$ 11,318	\$ 57,069	\$ 81,949
Interest-bearing deposits	273,759	92,562	144,389	321,314	832,024
Borrowed funds	67,161	21,674	18,438	132,729	240,002
Other liabilities				6,578	6,578
Stockholders' equity				61,877	61,877
<b>Total liabilities and stockholders' equity</b>	<b>\$ 347,701</b>	<b>\$ 121,017</b>	<b>\$ 174,145</b>	<b>\$ 579,567</b>	<b>\$ 1,222,430</b>
<b>GAP</b>	<b>\$ (15,426)</b>	<b>\$ (42,185)</b>	<b>\$ (58,479)</b>	<b>\$ 116,090</b>	
<b>Cumulative GAP</b>	<b>\$ (15,426)</b>	<b>\$ (57,611)</b>	<b>\$ (116,090)</b>		

Included in the GAP analysis are certain interest-bearing demand accounts and savings accounts. These interest-bearing accounts are subject to immediate withdrawal. However, Horizon considers approximately 59% of these deposits to be insensitive to gradual changes in interest rates and generally to behave like deposits with longer maturities based upon historical experience.

**Quantitative and Qualitative Disclosures About Market Risk**

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



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

**Table of Contents**

The table, which follows, provides information about Horizon's financial instruments that are sensitive to changes in interest rates as of December 31, 2006. The table incorporates Horizon's internal system generated data related to the maturity and repayment/withdrawal of interest-earning assets and interest-bearing liabilities. For loans, securities and liabilities with contractual maturities, the table presents principal cash flows and related weighted-average interest rates by contractual maturities as well as the historical experience of Horizon related to the impact of interest rate fluctuations on the prepayment of residential loans and mortgage-backed securities. From a risk management perspective, Horizon believes that repricing dates are more relevant than contractual maturity dates when analyzing the value of financial instruments. For deposits with no contractual maturity dates, the table presents principal cash flows and weighted average rate, as applicable, based upon Horizon's experience and management's judgment concerning the most likely withdrawal behaviors.

Horizon had no derivative financial instruments or trading portfolio as of December 31, 2006.

**Table of Contents****Quantitative Disclosure of Market Risk**

	2007	2008	2009	2010	2011	2012 and Beyond	Total	Fair Value 12/31/06
<b>Rate-sensitive assets</b>								
Fixed interest rate loans	\$ 158,555	\$ 86,256	\$ 54,960	\$ 33,637	\$ 18,418	\$ 23,676	\$ 375,502	\$ 377,240
Average interest rate	6.83%	6.91%	7.08%	7.31%	6.70%	7.13%	6.98%	
Variable interest rate loans	293,852	53,116	48,727	38,703	32,213	14,824	481,435	486,968
Average interest rate	8.07%	6.17%	6.00%	6.01%	6.22%	6.75%	7.32%	
Total loans	452,407	139,372	103,687	72,340	50,631	38,500	856,937	864,208
Average interest rate	7.64%	6.63%	6.57%	6.61%	6.70%	6.98%	7.17%	
Securities, including FRB and FHLB stock	53,760	26,838	20,705	21,677	17,689	114,545	255,214	255,214
Average interest rate	4.83%	4.56%	4.71%	5.09%	5.16%	4.46%	4.67%	
Other interest-bearing assets	20,607						20,607	20,607
Average interest rate	6.92%						6.92%	
Total earnings assets	526,774	166,210	124,392	94,017	68,320	153,045	1,132,758	1,140,029
Average interest rate	7.32%	6.29%	6.26%	6.26%	6.30%	5.09%	6.60%	
<b>Rate-sensitive liabilities</b>								
Noninterest-bearing deposits	\$ 24,880	\$ 17,326	\$ 12,066	\$ 8,403	\$ 5,852	\$ 13,422	\$ 81,949	\$ 81,949
NOW accounts	54,494	48,043	39,817	31,856	25,488	107,449	307,147	304,258
Average interest rate	3.14%	3.35%	3.42%	3.49%	3.53%	3.67%	3.46%	
Savings and money market accounts	139,035	6,359	4,528	3,226	2,304	6,024	161,476	155,874
Average interest rate	3.224%	.28%	.28%	.28%	.28%	.28%	2.81%	

Certificates of deposit	317,182	36,115	7,374	1,946	276	508	363,401	304,188
Average interest rate	4.74%	3.76%	3.58%	3.88%	4.29%	1.00%	4.61%	
Total deposits	535,591	107,843	63,785	45,431	33,920	127,403	913,973	903,649
Average interest rate	3.96%	2.77%	2.57%	2.63%	2.71%	3.11%	3.49%	
Fixed interest rate borrowings	43,729	5,458	10,377	348	75,519	485	135,916	151,995
Average interest rate	4.62%	3.59%	4.13%	4.78%	4.74%	5.01%	4.61%	
Variable interest rate borrowings	104,051						104,051	104,466
Average interest rate	5.52%						5.52%	
Total funds	683,371	113,301	74,162	45,779	109,439	127,888	1,153,940	1,160,110
Average interest rate	4.24%	2.81%	2.79%	2.65%	4.11%	3.12%	3.81%	

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

The information required under this item is incorporated by reference to the information appearing in Management's Discussion and Analysis of Financial Condition and Results of Operation included in Item 7.

**Table of Contents**

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

**Horizon Bancorp  
Consolidated Financial Statements**

**Table of Contents**

	<b>Page(s)</b>
<b>Consolidated Financial Statements</b>	
<u>Balance Sheets</u>	38
<u>Statements of Income</u>	39
<u>Statements of Stockholders' Equity</u>	40
<u>Statements of Cash Flows</u>	41-42
<u>Notes to Financial Statements</u>	43-70
<b><u>Report of Independent Registered Public Accounting Firm</u></b>	71
<b>Other Information</b>	
<u>Management's Report on Financial Statements</u>	72
<u>Summary of Selected Financial Data</u>	73-74
<u>Horizon's Common Stock and Related Stockholders' Matters</u>	75

**Table of Contents**

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

<b>December 31</b>	<b>2006</b>	<b>2005</b>
<b>Assets</b>		
Cash and due from banks	\$ 52,311	\$ 39,163
Interest-bearing demand deposits	1	87
Federal funds sold	6,500	
Cash and cash equivalents	58,812	39,250
Interest-bearing deposits	898	15,735
Investment securities, available for sale	243,078	275,177
Loans held for sale	13,103	2,440
Loans, net of allowance for loan losses of \$8,738 and \$8,368	835,096	724,366
Premises and equipment	23,394	21,425
Federal Reserve and Federal Home Loan Bank stock	12,136	12,983
Goodwill	5,787	5,787
Other intangible assets	2,412	2,780
Interest receivable	6,094	5,813
Other assets	21,620	22,119
Total assets	\$ 1,222,430	\$ 1,127,875
<b>Liabilities</b>		
Deposits		
Noninterest bearing	\$ 81,949	\$ 148,127
Interest bearing	832,024	707,439
Total deposits	913,973	855,566
Short-term borrowings	83,842	50,024
Long-term borrowings	115,951	133,609
Subordinated debentures	40,209	27,837
Interest payable	1,771	1,663
Other liabilities	4,807	5,646
Total liabilities	1,160,553	1,074,345

**Commitments and Contingencies****Stockholders Equity**

Preferred stock, no par value
Authorized, 1,000,000 shares
No shares issued
Common stock, \$.2222 stated value

Authorized, 22,500,000 shares		
Issued, 4,998,106 and 4,911,741 shares	<b>1,111</b>	1,092
Additional paid-in capital	<b>25,229</b>	24,552
Retained earnings	<b>54,196</b>	48,523
Restricted stock, unearned compensation		(760)
Accumulated other comprehensive loss	<b>(1,507)</b>	(2,853)
Less treasury stock, at cost, 1,759,424 and 1,755,158 shares	<b>(17,152)</b>	(17,024)
 Total stockholders' equity	 <b>61,877</b>	 53,530
 Total liabilities and stockholders' equity	 <b>\$ 1,222,430</b>	 \$ 1,127,875

See notes to consolidated financial statements

**Table of Contents**

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

<b>Years Ended December 31</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>Interest Income</b>			
Loans receivable	\$ 57,282	\$ 44,749	\$ 33,386
Investment securities			
Taxable	8,602	9,720	7,338
Tax exempt	2,796	2,372	2,264
Total interest income	68,680	56,841	42,988
<b>Interest Expense</b>			
Deposits	25,734	16,374	10,693
Federal funds purchased and short-term borrowings	2,035	1,210	600
Long-term borrowings	7,100	6,789	5,554
Subordinated debentures	2,266	1,595	719
Total interest expense	37,135	25,968	17,566
<b>Net Interest Income</b>	<b>31,545</b>	<b>30,873</b>	<b>25,422</b>
Provision for loan losses	905	1,521	990
<b>Net Interest Income After Provision for Loan Losses</b>	<b>30,640</b>	<b>29,352</b>	<b>24,432</b>
<b>Other Income</b>			
Service charges on deposit accounts	3,102	2,966	3,088
Wire-transfer fee income	396	438	522
Fiduciary activities	3,100	2,748	2,694
Commission income from insurance agency		46	254
Gain on sale of loans	1,681	1,756	2,126
Gain on sale of mortgage servicing rights	656		
Increase in cash surrender value of life insurance	470	487	544
Gain (loss) on sale of securities available for sale	(764)	4	
Other income	1,496	1,368	1,441
Total other income	10,137	9,813	10,669
<b>Other Expenses</b>			
Salaries and employee benefits	16,433	16,518	14,767
Net occupancy expenses	2,338	2,217	1,832
Data processing and equipment expenses	2,560	2,342	1,997
Professional fees	1,386	1,225	1,219



Outside services and consultants	1,100	1,064	978
Loan expenses	1,952	1,427	1,222
Other expenses	4,686	4,336	3,657
Total other expenses	30,455	29,129	25,672
<b>Income Before Income Tax</b>	10,322	10,036	9,429
Income tax expense	2,838	2,945	2,494
<b>Net Income</b>	\$ 7,484	\$ 7,091	\$ 6,935
<b>Basic Earnings Per Share</b>	\$ 2.36	\$ 2.31	\$ 2.32
<b>Diluted Earnings Per Share</b>	\$ 2.33	\$ 2.24	\$ 2.22

See notes to consolidated financial statements.

**Table of Contents**

**Horizon Bancorp**  
**Consolidated Statements of Stockholders Equity**  
(Dollar Amounts in Thousands)

	Common Stock	Additional Paid-in Capital	Comprehensive Income	Retained Earnings	Restricted Stock, Unearned Compensation	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
<b>Balances, January 1, 2004</b>	\$1,041	\$20,994		\$37,638		\$ 2,075	\$(15,525)	\$46,223
Net income			\$6,935	6,935				6,935
Other comprehensive loss, net of tax, unrealized losses on securities			(1,181)			(1,181)		(1,181)
Comprehensive income			\$5,754					
Cash dividends (\$.49 per share)				(1,481)				(1,481)
Exercise of stock options	11	434						445
Tax benefit related to stock options		251						251
Purchase treasury stock							(848)	(848)
Issuance of restricted stock	10	1,050			\$ (1,060)			
Amortization of unearned compensation					88			88
<b>Balances, December 31, 2004</b>	1,062	22,729		43,092	(972)	894	(16,373)	50,432
Net income			\$7,091	7,091				7,091
Other comprehensive loss, net of tax, unrealized losses on securities, net of reclassification adjustment			(3,747)			(3,747)		(3,747)
			\$3,344					

Comprehensive income								
Cash dividends (\$.53 per share)				(1,660)				(1,660)
Exercise of stock options	30	916						946
Tax benefit related to stock options		907						907
Purchase treasury stock						(651)		(651)
Issuance of restricted stock								
Amortization of unearned compensation				212				212
<b>Balances, December 31, 2005</b>	1,092	24,552		48,523	(760)	(2,853)	(17,024)	53,530
Net income			\$7,484	7,484				7,484
Other comprehensive income, net of tax, unrealized gains on securities, net of reclassification adjustment			1,346			1,346		1,346
Comprehensive income			\$8,830					
Cash dividends (\$.56 per share)				(1,811)				(1,811)
Reclassification of restricted stock, unearned compensation to paid-in capital upon adoption of SFAS 123 (R)		(760)			760			
Exercise of stock options	19	716						735
Tax benefit related to stock options		469						469
Stock option expense		40						40
Purchase treasury stock							(128)	(128)
Amortization of unearned compensation		212						212

**Balances,**  
**December 31, 2006**    \$1,111    \$25,229                    \$54,196    \$    0    \$(1,507)    \$(17,152)    \$61,877

See notes to consolidated financial statements.

40

---

**Table of Contents**

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

<b>Years Ended December 31</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>Operating Activities</b>			
Net income	\$ 7,484	\$ 7,091	\$ 6,935
Items not requiring (providing) cash			
Provision for loan losses	905	1,521	990
Depreciation and amortization	2,471	2,281	1,606
Share based compensation	40		
Premium amortization on securities available for sale	240	764	582
Mortgage servicing rights impairment (recovery)	(41)	(97)	(155)
Deferred income tax	(78)	174	(458)
(Gain) loss on sales of securities available for sale	764	(4)	
Gain on sale of mortgage servicing rights	(656)		
Gain on sale of loans	(1,681)	(1,756)	(2,126)
Proceeds from sales of loans	115,608	98,150	114,499
Loans originated for sale	(124,590)	(94,998)	(107,996)
(Gain) loss on sale of other real estate owned	4	(38)	(17)
(Gain) loss on sale of premises and equipment	16	(22)	11
FHLB stock dividends			(458)
Tax benefit of options exercised	(469)	(907)	(251)
Increase in cash surrender value of life insurance	(470)	(487)	(544)
Net change in			
Interest receivable	(281)	(596)	(919)
Interest payable	108	497	273
Other assets	496	912	2,572
Other liabilities	(879)	(1,269)	(226)
Net cash provided by (used in) operating activities	(1,009)	11,216	14,318
<b>Investing Activities</b>			
Net change in interest-bearing deposits	14,837	(10,048)	8,150
Purchases of securities available for sale	(91,791)	(38,417)	(171,180)
Proceeds from maturities, calls and principal repayments of securities available for sale	33,695	54,071	103,227
Proceeds from sales of securities available for sale	91,265	7,150	
Purchase of FRB and FHLB stock	(81)	(712)	
Proceeds from sale of mortgage servicing rights	1,273		
Proceeds from sale of Federal Home loan Bank Stock	928		
Net change in loans	(112,203)	(83,118)	(117,830)
Proceeds from sale of fixed assets	1	723	51
Recoveries on loans previously charged-off	608	527	359
Proceeds from sale of other real estate owned	44	409	165
Purchases of premises and equipment	(3,877)	(1,421)	(2,659)
Purchase of trust preferred securities	(372)		(310)

Purchase of bank owned life insurance			(12,000)
Acquisition, net of cash acquired		(2,901)	
Net cash used in investing activities	(65,673)	(73,737)	(192,027)

**Table of Contents**

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

<b>Years Ended December 31</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
(Continued)			
<b>Financing Activities</b>			
Net change in Deposits	\$ <b>58,407</b>	\$ 126,213	\$ 66,049
Short-term borrowings	<b>33,818</b>	(34,142)	62,040
Proceeds from long-term borrowings		107,000	89,850
Repayment of long-term borrowings	<b>(17,658)</b>	(115,096)	(76,117)
Proceeds from issuance of trust preferred securities	<b>12,372</b>		10,310
Dividends paid	<b>(1,811)</b>	(1,660)	(1,481)
Issuance of stock	<b>775</b>	946	445
Tax benefit of options exercised	<b>469</b>	907	251
Purchase of treasury stock	<b>(128)</b>	(651)	(848)
Net cash provided by financing activities	<b>86,244</b>	83,517	150,499
<b>Net Change in Cash and Cash Equivalents</b>	<b>19,562</b>	20,996	(27,210)
<b>Cash and Cash Equivalents, Beginning of Year</b>	<b>39,250</b>	18,254	45,464
<b>Cash and Cash Equivalents, End of Year</b>	<b>\$ 58,812</b>	\$ 39,250	\$ 18,254
<b>Additional Cash Flows Information</b>			
Interest paid	<b>\$ 36,960</b>	\$ 25,281	\$ 17,293
Income tax paid	<b>1,530</b>	1,870	1,072
See notes to consolidated financial statements.			

**Table of Contents**

**Horizon Bancorp**  
**Notes to Consolidated Financial Statements**  
(Table Dollar Amounts in Thousands)

**Note 1 Nature of Operations and Summary of Significant Accounting Policies**

**Nature of Business** The consolidated financial statements of Horizon Bancorp (Horizon) and its wholly owned subsidiary, Horizon Bank, N.A. (Bank) conform to accounting principles generally accepted in the United States of America and reporting practices followed by the banking industry.

The Bank is a full-service commercial bank offering a broad range of commercial and retail banking and other services incident to banking. The Bank has two active wholly owned subsidiaries: Horizon Trust & Investment Management, Inc. (HTIM) and Horizon Investments, Inc. (Investment Company). HTIM offers corporate and individual trust and agency services and investment management services. Horizon Investments, Inc. manages the investment portfolio of the Bank. The Bank maintains fourteen full service facilities in Northwest Indiana and Southwest Michigan. The Bank also maintains a loan production office in Lake County Indiana. The Bank also wholly owns Horizon Insurance Services, Inc. (Insurance Agency) which is inactive, but previously offered a full line of personal insurance products. The net income generated from the insurance operations was not significant to the overall operations of Horizon and the majority of the insurance agency assets were sold during 2005. Horizon conducts no business except that incident to its ownership of the subsidiaries.

Horizon formed Horizon Statutory Trust I in 2002, Horizon Statutory Trust II in 2004 and Horizon Bancorp Capital Trust III in 2006 for the purpose of participating in Pooled Trust Preferred Stock offerings. The Company assumed additional debentures as the result of the acquisition of Alliance in 2005 which formed Alliance Financial Statutory Trust I (Alliance Trust). See Note 11 for further discussion regarding these previously consolidated entities that are now reported separately.

Horizon formed one nonbank subsidiary, HBC Insurance Group, Inc. (Insurance Company). The Insurance Company previously offered credit life and accident and health insurance and was dissolved during 2004. The net income generated from the Insurance Company was not significant to the overall operations of Horizon.

**Basis of Reporting** The consolidated financial statements include the accounts of Horizon and subsidiaries. All material intercompany accounts and transactions have been eliminated in consolidation.

**Use of Estimates** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**Investment Securities Available for Sale** Horizon designates its investment portfolio as available for sale based on management's plans to use such securities for asset and liability management, liquidity and not to hold such securities as long-term investments. Management repositions the portfolio to take advantage of future expected interest rate trends when Horizon's long-term profitability can be enhanced. Investment securities available for sale and marketable equity securities are carried at estimated fair value and any net unrealized gains/losses (after tax) on these securities are included in accumulated other comprehensive income. Gains/losses on the disposition of securities available for sale are recognized at the time of the transaction and are determined by the specific identification method.



**Table of Contents**

**Horizon Bancorp**

**Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

**Loans Held for Sale** Loans held for sale are reported at the lower of cost or market value in the aggregate.

**Interest and Fees on Loans** Interest on commercial, mortgage and installment loans is recognized over the term of the loans based on the principal amount outstanding. When principal or interest is past due 90 days or more, and the loan is not well secured or in the process of collection, or when serious doubt exists as to the collectibility of a loan, the accrual of interest is discontinued. Loan origination fees, net of direct loan origination costs, are deferred and recognized over the life of the loan as a yield adjustment.

**Concentrations of Credit Risk** The Bank grants commercial, real estate and consumer loans to customers located primarily in Northwest Indiana and southwest Michigan and provides mortgage warehouse lines to mortgage companies in the United States. Commercial loans make up approximately 32% of the loan portfolio and are secured by both real estate and business assets. These loans are expected to be repaid from cash flows from operations of the businesses. Residential real estate loans make up approximately 27% of the loan portfolio and are secured by residential real estate. Installment loans make up approximately 28% of the loan portfolio and are primarily secured by consumer assets. Mortgage warehouse loans make up approximately 13% of the loan portfolio and are secured by residential real estate.

**Mortgage Warehouse Loans** Horizon purchases residential mortgage loans from various mortgage companies prior to sale of these loans by the mortgage companies in the secondary market. Horizon held loans that were purchased under agreements to resell from 32 approved mortgage companies at December 31, 2006. Horizon purchases such loans from mortgage companies, net of certain fees and later sells them back to the mortgage companies at the same amount and without recourse provisions. As a result, no gains and losses are recorded at the resale of loans. Horizon records interest and fee income on the loans during the funding period. Horizon uses the stated interest rate in the agreement with each mortgage company for interest income recognition, and not the interest rates on the individual loans. Horizon does not retain servicing of the loans when they are resold. Loans consist of purchase money and refinance mortgage loans and are generally held no more than 90 days by Horizon and are typically resold within 30 days.

**Allowance for Loan Losses** An allowance for loan losses is maintained to absorb loan losses inherent in the loan portfolio. The allowance is based on ongoing quarterly assessments of the probable estimated losses inherent in the loan portfolio. The allowance is increased by the provision for credit losses, which is charged against current period operating results and decreased by the amount of charge offs, net of recoveries. Horizon's methodology for assessing the appropriateness of the allowance consists of several key elements, which include the formula allowance, specific allowances for identified problem loans and the unallocated allowance.

The formula allowance is calculated by applying loss factors to pools of outstanding loans. Loss factors are based on a historical loss experience and may be adjusted for significant factors that, in management's judgment, affect the collectibility of the portfolio as of the evaluation date.

Specific allowances are established in cases where management has identified conditions or circumstances related to a credit that management believes indicate the probability that a loss will be incurred in excess of the amount determined by the application of the formula allowance.

**Table of Contents****Horizon Bancorp****Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

The unallocated allowance is based upon management's evaluation of various conditions, the effects of which are not directly measured in the determination of the formula and specific allowances. The evaluation of the inherent loss with respect to these conditions is subject to a higher degree of uncertainty because they are not identified with specific credits. The conditions evaluated in connection with the unallocated allowance may include factors such as local, regional and national economic conditions and forecasts, concentrations of credit and changes in the composition of the portfolio.

**Loan Impairment** When analysis determines a borrower's operating results and financial condition are not adequate to meet debt service requirements, the loan is evaluated for impairment. Often this is associated with a delay or shortfall in payments of 30 days or more. Loans are generally placed on nonaccrual status when 90 days or more past due. These loans are also often considered impaired. Impaired loans, or portions thereof, are charged-off when deemed uncollectible. This typically occurs when the loan is 120 or more days past due.

Loans are considered impaired if full principal or interest payments are not made in accordance with the original terms of the loan. Impaired loans are measured and carried at the lower of cost or the present value of expected future cash flows discounted at the loan's effective interest rate, at the loan's observable market price or at the fair value of the collateral if the loan is collateral dependent.

Smaller balance homogenous loans are evaluated for impairment in the aggregate. Such loans include residential first mortgage loans secured by one to four family residences, residential construction loans and automobile, home equity and second mortgages. Commercial loans and mortgage loans secured by other properties are evaluated individually for impairment.

**Premises and Equipment** Buildings and major improvements are capitalized and depreciated using primarily the straight-line method with useful lives ranging from 3 to 40 years. Furniture and equipment are capitalized and depreciated using primarily the straight-line method with useful lives ranging from 2 to 20 years. Maintenance and repairs are expensed as incurred while major additions and improvements are capitalized. Gains and losses on disposition are included in current operations.

**Federal Reserve and Federal Home Loan Bank Stock** The stock is a required investment for institutions that are members of the Federal Reserve Bank (FRB) and Federal Home Loan Bank (FHLB) systems. The required investment in the common stock is based on a predetermined formula.

**Mortgage Servicing Rights** Mortgage servicing rights on originated loans that have been sold are capitalized by allocating the total cost of the mortgage loans between the mortgage servicing rights and the loans based on their relative fair values. Capitalized servicing rights are amortized in proportion to and over the period of estimated servicing revenue. Impairment of mortgage-servicing rights is assessed based on the fair value of those rights. Fair values are estimated using discounted cash flows based on a current market interest rate. For purposes of measuring impairment, the rights are stratified based on the predominant risk characteristics of the underlying loans. The predominant characteristic currently used for stratification is type of loan. The amount of impairment recognized is the amount by which the capitalized mortgage servicing rights for a stratum exceed their fair value. Amortization expense and charges related to an impairment write-down are included in other income.

**Goodwill** Goodwill is tested annually for impairment. If the implied fair value of goodwill is lower than its carrying amount, a goodwill impairment is indicated and goodwill is written down to its implied fair value. Subsequent increases in goodwill value are not recognized in the financial statements. As of December 31, 2004, and for the year then ended, goodwill totaled \$158 thousand. During 2005, \$5.629 million of goodwill was acquired as a result of the Alliance Financial Corporation acquisition resulting in a total of \$5.787 million of goodwill as of December 31, 2005 and 2006.

**Table of Contents****Horizon Bancorp****Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

**Income Taxes** Horizon files annual consolidated income tax returns with its subsidiaries. Income tax in the consolidated statements of income includes deferred income tax provisions or benefits for all significant temporary differences in recognizing income and expenses for financial reporting and income tax purposes.

**Trust Assets and Income** Property, other than cash deposits, held in a fiduciary or agency capacity is not included in the consolidated balance sheets since such property is not owned by Horizon.

**Earnings per Common Share** Basic EPS is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. In August 2002, substantially all of the participants in Horizon's Stock Option and Stock Appreciation Rights Plans voluntarily entered into an agreement with Horizon to cap the value of their stock appreciation rights (SARS) at \$14.67 per share and cease any future vesting of the SARS. These agreements with option holders make it more advantageous to exercise an option rather than a SAR whenever Horizon's stock price exceeds \$14.67 per share, therefore, the option becomes potentially dilutive at \$14.67 per share or higher. The number of shares used in the computation of basic earnings per share is 3,177,272 for 2006, 3,067,632 for 2005 and 2,993,696 for 2004. The number of shares used in the computation of diluted earnings per share is 3,217,050 for 2006, 3,162,950 for 2005 and 3,123,325 for 2004. For 2006 there were 5,000 shares excluded from diluted earnings per share as they were anti-dilutive. There were no anti-dilutive shares for 2005 or 2004.

**Dividend Restrictions** Regulations of the Comptroller of the Currency limit the amount of dividends that may be paid by a national bank to its parent holding company without prior approval of the Comptroller of the Currency. At December 31, 2006, \$4.921 million was available for payment of dividends from the Bank to Horizon. Additionally, the Federal Reserve Board limits the amount of dividends that may be paid by Horizon to its stockholders under its capital adequacy guidelines.

**Consolidated Statements of Cash Flows** For purposes of reporting cash flows, cash and cash equivalents are defined to include cash and due from banks, money market investments and federal funds sold with maturities of one day or less. Horizon reports net cash flows for customer loan transactions, deposit transactions, short-term investments and short-term borrowings.

**Share-Based Compensation** At December 31, 2006, Horizon has stock option plans, which are described more fully in Note 19. Effective January 1, 2006, Horizon adopted Statement of Financial Accounting Standards No. 123(R), Share-Based Payment ( SFAS 123(R) ). SFAS 123(R) addresses all forms of share-based payment awards, including shares under employee stock purchase plans, stock options, restricted stock and stock appreciation rights. SFAS 123(R) requires all share-based payments to be recognized as expense, based upon their fair values, in the financial statements over the vesting period of the awards. Horizon has elected the modified prospective application and, as a result, has recorded approximately \$40 thousand in compensation expense relating to vesting of stock options less estimated forfeitures for the 12 month period ended December 31, 2006. Prior to adoption of SFAS 123(R), unearned compensation related to restricted stock awards was classified as a separate component of stockholders' equity. Upon the adoption of SFAS 123(R) on January 1, 2006, the balance in unearned compensation was reclassified to additional paid-in capital.

**Table of Contents****Horizon Bancorp****Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

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

<b>Years Ended December 31</b>	<b>2005</b>	<b>2004</b>
Net income, as reported	\$ 7,091	\$ 6,935
Less: Total stock-based employee compensation cost determined under the fair value based method, net of income taxes	(35)	(127)
Pro forma net income	\$ 7,056	\$ 6,808
Earnings per share:		
Basic as reported	\$ 2.31	\$ 2.32
Basic pro forma	\$ 2.30	\$ 2.27
Diluted as reported	\$ 2.24	\$ 2.22
Diluted pro forma	\$ 2.23	\$ 2.18

**Reclassifications** Certain reclassifications have been made to the 2005 and 2004 consolidated financial statements to be comparable to 2006. These reclassifications had no effect on net income.

**Recent Accounting Pronouncements**

**Accounting for Servicing of Financial Assets** The FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets (SFAS 156), which amends SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. SFAS 156 permits an entity to choose either of the following subsequent measurement methods for each class of separately recognized servicing assets and servicing liabilities:

§ **Amortization Method** Amortize servicing assets or servicing liabilities in proportion to and over the period of net servicing income or net servicing loss and assess the servicing assets or liabilities for impairment or increased obligation based on fair value at each reporting date.

§ **Fair Value Measurement Method** Measure servicing assets or servicing liabilities at fair value at each reporting date and report changes in fair value in earnings in the periods in which the changes occur.

Horizon adopted the amortization method on January 1, 2007. The adoption of SFAS 156 did not have a material impact on Horizon's consolidated financial condition or results of operations.

**Table of Contents**

**Horizon Bancorp**

**Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

**Fair Value Measurements** In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157) on fair value measurement. SFAS 157 provides guidance for using fair value to measure assets and liabilities. SFAS 157 also responds to investors' requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value and the effect of fair value measurements on earnings. SFAS 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. SFAS 157 does not expand the use of fair value in any new circumstances.

Over forty current accounting standards within generally accepted accounting principles require (or permit) entities to measure assets and liabilities at fair value. Prior to SFAS 157, the methods for measuring fair value were diverse and inconsistent, especially for items that are not actively traded. In the case of derivatives, the FASB consulted with investors, who generally supported fair value, even when market data are not available, along with expanded disclosure of the methods used and the effect on earnings.

Under SFAS 157, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts such sales or transfers. SFAS 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability. In support of this principle, SFAS 157 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, for example, the reporting entity's own data. Under SFAS 157, fair value measurements would be separately disclosed by level within the fair value hierarchy.

SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Early adoption is permitted. Horizon has not determined the impact that SFAS 157 will have on its consolidated financial condition or results of operations.

**Accounting for Uncertainty in Income Taxes** The FASB released the final interpretation of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), which is effective for fiscal years beginning after December 15, 2006. FIN 48 creates a single model to address uncertainty in tax positions. FIN 48 clarifies the accounting for income tax positions by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 utilizes a two-step approach for evaluating tax positions. Recognition (step one) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement (step two) is only addressed if step one has been satisfied (i.e., the position is more-likely-than-not to be sustained). Under step two, the tax benefit is measured as the largest amount of benefit, determined on a cumulative probability basis that is more-likely-than-not to be realized upon ultimate settlement. FIN 48's use of the term more-likely-than-not in steps one and two is consistent with how that term is used in SFAS No. 109, Accounting for Income Taxes (i.e., a likelihood of occurrence greater than 50 percent).

**Table of Contents****Horizon Bancorp****Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

Those tax positions failing to qualify for initial recognition are recognized in the first subsequent interim period in which they meet the more-likely-than-not standard, or are resolved through negotiation or litigation with the taxing authority, or upon expiration of the statute of limitations. Derecognition of a tax position that was previously recognized would occur when a company subsequently determines that a tax position no longer meets the more-likely-than-not threshold of being sustained. FIN 48 specifically prohibits the use of a valuation allowance as a substitute for derecognition of tax positions.

FIN 48 includes expanded disclosure requirements, including a tabular roll forward of the beginning and ending aggregate unrecognized tax benefits as well as specific detail related to tax uncertainties for which it is reasonably possible the amount of unrecognized tax benefit will significantly increase or decrease within twelve months. These disclosures are required at each annual reporting period unless a significant change occurs in an interim period.

Horizon adopted FIN 48 on January 1, 2007. The adoption of FIN 48 did not have a material impact on Horizon's consolidated financial condition or results of operations.

**Note 2 Acquisition**

On June 10, 2005, Horizon acquired Alliance Financial Corporation and its wholly owned bank subsidiary, Alliance Banking Company (collectively referred to as Alliance). Horizon purchased the outstanding shares of Alliance for \$42.50 per share in cash. The cost of the transaction, including legal, accounting, and investment fees was \$13.348 million. The assets and liabilities of Alliance were recorded on the balance sheet at their fair value as of the acquisition date. The results of Alliance's operations have been included in Horizon's consolidated statement of income from the date of acquisition. The \$5,629,000 of goodwill is not deductible for tax purposes.

The following table summarizes the estimated fair values of the net assets acquired as of the June 10, 2005, acquisition date:

**Assets**

Cash and cash equivalents	\$ 10,447
Investment securities	28,922
Loans, net of allowance for loan losses	86,447
Premises and equipment	4,983
Goodwill	5,629
Core deposit intangible	2,952
Other assets	1,711
<b>Total assets</b>	<b>141,091</b>

**Liabilities**

Deposits	117,137
Borrowings	9,040
Other liabilities	1,566
<b>Total liabilities</b>	<b>127,743</b>

<b>Net Assets Acquired</b>	<b>\$ 13,348</b>
----------------------------	------------------

**Table of Contents****Horizon Bancorp****Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

The following pro forma disclosures, including the effect of the purchase accounting adjustments, depict the results of operations as though the merger had taken place January 1, 2004:

<b>Year ended December 31</b>	<b>2005</b>	<b>2004</b>
Net interest income	\$ 32,884	\$ 29,948
Net Income	6,111	6,890
Per Share combined		
Basic net income	\$ 1.99	\$ 2.30
Diluted net income	1.93	2.21

**Note 3 Investment Securities**

<b>December 31</b>	<b>2006</b>			<b>Fair Value</b>
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	
Available for sale				
U.S. Treasury and federal agencies	\$ 58,595	\$ 58	\$ 208	\$ 58,445
State and municipal	81,363	806	369	81,800
Federal agency collateralized mortgage obligations	11,215	19	224	11,010
Federal agency mortgage-backed pools	93,591	54	2,471	91,174
Corporate notes	632	17		649
Total investment securities	\$ 245,396	\$ 954	\$ 3,272	\$ 243,078

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





**Table of Contents****Horizon Bancorp**  
**Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

The amortized cost and fair value of securities available for sale at December 31, 2006, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<b>Amortized Cost</b>	<b>Fair Value</b>
Within one year	\$ 16,111	\$ 16,065
One to five years	14,695	14,630
Five to ten years	29,223	29,250
After ten years	80,561	80,949
	140,590	140,894
Federal agency collateralized mortgage obligations	11,215	11,010
Federal agency mortgage-backed pools	93,591	91,174
Totals	\$ 245,396	\$ 243,078

Securities with a carrying value of \$78,795,000 and \$76,183,000 were pledged at December 31, 2006 and 2005, respectively, to secure certain public and trust deposits and securities sold under agreements to repurchase. Proceeds from sales of securities available for sale during 2006 were \$91,265,000. Gross gains of \$1,247,000 and gross losses of \$2,011,000 were recognized on these sales in 2006. Proceeds from sales of securities available for sale during 2005 were \$7,150,000. Gross gains of \$37,000 and gross losses of \$33,000 were recognized on these sales. There were no sales of securities available for sale during 2004. The tax benefit on net realized losses for 2006 was \$267,000. The tax expense on net realized gains for 2005 was \$1,400.

Certain investments in debt securities are reported in the financial statements at an amount less than their historical cost. Total fair value of these investments at December 31, 2006 and 2005, was \$150,402,000 and \$226,292,000, respectively, which is approximately 62% and 82% of Horizon's available-for-sale investment portfolio. These declines primarily resulted from increases in market interest rates.

Based on evaluation of available evidence, including recent changes in market interest rates, credit rating information and information obtained from regulatory filings, management believes the declines in fair value for these securities are temporary.

Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other-than-temporary impairment is identified.

**Table of Contents****Horizon Bancorp  
Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

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

Description of Securities	Less than 12 Months Unrealized		12 Months or More Unrealized		Total Unrealized	
	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
<b>2006</b>						
U.S. Treasury and federal agencies	\$ 10,804	\$ 30	\$ 10,899	\$ 178	\$ 21,703	\$ 208
State and municipal Federal agency collateralized mortgage obligations	22,354	121	10,615	248	32,969	369
Federal agency mortgage-backed pools	1,742	10	84,785	2,461	86,527	2,471
Total temporarily impaired securities	\$ 34,900	\$ 161	\$ 115,502	\$ 3,111	\$ 150,402	\$ 3,272

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

**Table of Contents****Horizon Bancorp**  
**Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

**Note 4 Loans and Allowance**

<b>December 31</b>	<b>2006</b>	<b>2005</b>
Commercial loans	\$ 271,457	\$ 273,310
Mortgage warehouse loans	112,267	97,729
Real estate loans	222,235	159,312
Installment loans	237,875	202,383
	843,834	732,734
Allowance for loan losses	(8,738)	(8,368)
<b>Total loans</b>	<b>\$ 835,096</b>	<b>\$ 724,366</b>

<b>December 31</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Allowance for loan losses			
Balances, January 1	\$ 8,368	\$ 7,193	\$ 6,909
Acquired through acquisition		557	
Provision for losses	905	1,521	990
Recoveries on loans	608	527	359
Loans charged off	(1,143)	(1,430)	(1,065)
<b>Balances, December 31</b>	<b>\$ 8,738</b>	<b>\$ 8,368</b>	<b>\$ 7,193</b>

Impaired loans for which the carrying value of the loans exceeded the discounted cash flows or collateral value totaled approximately \$1,768,000 and \$583,000 at December 31, 2006 and 2005, respectively. The allowance for impaired loans, included in the Bank's allowance for loan losses, totaled \$406,000 and \$492,000 at December 31, 2006 and 2005, respectively. The average balance of impaired loans during 2006 was \$942,000 and \$150,000 during 2005. There was \$117,000, \$63,000 and \$22,000 of interest income recorded on the cash and accrual basis during 2006, 2005 and 2004, respectively, on impaired loans.

At December 31, 2006, loans past due more than 90 days and still accruing interest totaled approximately \$186,000. At December 31, 2005, loans past due more than 90 days and still accruing interest totaled approximately \$251,000. Nonaccruing loans at December 31, 2006, 2005 and 2004, totaled approximately \$2,481,000, \$1,822,000 and \$1,358,000, respectively. Interest income not recognized on these loans totaled approximately \$77,000, \$60,000 and \$88,000 in 2006, 2005 and 2004, respectively.

Loans to directors and executive officers of Horizon and the Bank, including associates of such persons, amounted to \$5,834,000 and \$5,947,000, as of December 31, 2006 and 2005, respectively. During 2006, new loans or advances were \$2,950,000 and loan payments were \$3,063,000.

**Table of Contents****Horizon Bancorp**  
**Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

**Note 5 Premises and Equipment**

<b>December 31</b>	<b>2006</b>	<b>2005</b>
Land	\$ 6,641	\$ 5,088
Buildings and improvements	23,565	21,986
Furniture and equipment	9,809	9,885
Total cost	40,015	36,959
Accumulated depreciation	(16,621)	(15,534)
Net	\$ 23,394	\$ 21,425

**Note 6 Loan Servicing**

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of loans serviced for others totaled approximately \$23,702,000 and \$163,356,000 at December 31, 2006 and 2005, respectively.

The aggregate fair value of capitalized mortgage servicing rights at December 31, 2006, totaled approximately \$258,000. Comparable market values and a valuation model that calculates the present value of future cash flows were used to estimate fair value. For purposes of measuring impairment, risk characteristics including product type, investor type and interest rates, were used to stratify the originated mortgage servicing rights.

	<b>2006</b>	<b>2005</b>	<b>2004</b>
Mortgage Servicing Rights			
Balances, January 1	\$ 1,278	\$ 1,473	\$ 1,429
Servicing rights capitalized	83	239	482
Servicing rights sold	(862)		
Amortization of servicing rights	(251)	(434)	(438)
	248	1,278	1,473
Impairment allowance	(3)	(44)	(141)
Balances, December 31	\$ 245	\$ 1,234	\$ 1,332

During 2006, the Bank sold mortgage servicing rights with a book value of \$862,000. The principal balance of the loans on which the servicing was sold amounted to \$134,465,000. During 2006 and 2005, the Bank recorded a gross recovery of the impairment allowance totaling approximately \$41,000 and \$97,000, respectively.

**Table of Contents****Horizon Bancorp****Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

**Note 7 Intangible Assets**

As a result of the acquisition of Alliance (Note 2) in 2005, the Company has recorded certain amortizable intangible assets related to core deposit intangibles. The Core deposit intangible is being amortized over ten years using an accelerated method. Additionally, the Company has a noncompete agreement being amortized over four years from the acquisition of a mortgage company in 2003. Amortizable intangible assets are summarized as follows:

	2006		2005	
	Gross		Gross	
December 31	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
Amortizable intangible assets				
Core deposit intangible	\$ 2,952	\$ (553)	\$ 2,952	\$ (208)
Noncompete agreement	90	(77)	90	(54)
	\$ 3,042	\$ (630)	\$ 3,042	\$ (262)

Amortization expense for intangible assets totaled \$368, \$230 and \$22 for the years ended December 31, 2006, 2005 and 2004, respectively. Estimated amortization for the years ending December 31 are as follows:

2007	\$ 344
2008	317
2009	305
2010	292
2011	280
Thereafter	874
	\$2,412

**Note 8 Deposits**

December 31	2006	2005
Noninterest-bearing demand deposits	\$ 81,949	\$ 148,127
Interest-bearing demand deposits	307,147	196,016
Money market (variable rate)	129,981	167,466
Savings deposits	31,495	37,956
Certificates of deposit of \$100,000 or more	151,342	111,843
Other certificates and time deposits	212,059	194,158
Total deposits	\$ 913,973	\$ 855,566



**Table of Contents****Horizon Bancorp**  
**Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

Certificates and other time deposits maturing in years ending December 31 are as follows:

2007	\$317,181
2008	36,116
2009	7,374
2010	1,946
2011	276
Thereafter	508
	\$363,401

**Note 9 Short-Term Borrowings**

<b>December 31</b>	<b>2006</b>	<b>2005</b>
Federal funds purchased	\$	\$ 7,000
Federal Home Loan Bank advances	40,000	
Securities sold under agreements to repurchase	38,642	35,824
Notes payable	5,200	7,200
Total short-term borrowings	\$ 83,842	\$ 50,024

Securities sold under agreements to repurchase consist of obligations of the Bank to other parties. The obligations are secured by U.S. agency and mortgage-backed securities and such collateral is held in safekeeping by third parties. The maximum amount of outstanding agreements at any month end during 2006 and 2005 totaled \$70,179,000 and \$61,825,000 and the daily average of such agreements totaled \$63,098,000 and \$57,526,000, respectively. The agreements at December 31, 2006, mature at various dates through October 27, 2009. Agreements with a maturity of one year or less are included in short-term borrowings, while those with a maturity of more than one year are included in long-term debt.

At December 31, 2006, the Bank had one adjustable rate short-term advance with the Federal Home Loan Bank that matured on January 2, 2007. There were no outstanding adjustable rate short-term advances at December 31, 2005. Horizon has an unsecured \$12,000,000 line of credit, of which, \$5.2 million was outstanding at December 31, 2006. The line of credit is from an unrelated financial institution with interest payable quarterly at a rate indexed to LIBOR. The note matures within one year.

At December 31, 2006, the Bank has available approximately \$197,693,000 in credit lines with various money center banks, including the FHLB.

**Table of Contents****Horizon Bancorp**  
**Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

**Note 10 Long-Term Debt**

<b>December 31</b>	<b>2006</b>	<b>2005</b>
Federal Home Loan Bank advances, variable and fixed rates ranging from 2.86% to 7.53%, due at various dates through November 15, 2024	\$ 97,951	\$ 107,609
Securities sold under repurchase agreements, fixed rate	18,000	26,000
Total long-term debt	\$ 115,951	\$ 133,609

The Federal Home Loan Bank advances are secured by first and second mortgage loans totaling approximately \$436,088,000. Advances are subject to restrictions or penalties in the event of prepayment.

Contractual maturities in years ending December 31

2007	\$ 23,168
2008	5,294
2009	10,134
2010	142
2011	30,143
Thereafter	47,070
	\$ 115,951

**Note 11 Subordinated Debentures**

In March of 2002, Horizon formed Horizon Statutory Trust I (Trust I), a statutory business trust. Trust I issued \$12.372 million of Trust Preferred Capital Securities as a participant in a pooled trust preferred securities offering. Horizon issued junior subordinated debentures aggregating \$12.372 million to Trust I. The junior subordinated debentures are the sole assets of Trust I. The junior subordinated debentures and the trust preferred securities pay interest and dividends, respectively, on a quarterly basis. The junior subordinated debentures and the securities bear interest at a rate of 90-day LIBOR plus 3.60% and mature on March 26, 2032, and are noncallable for five years. After that period, the securities may be called at any quarterly interest payment date at par. These securities have been called and will be redeemed on March 26, 2007. Costs associated with the issuance of the securities totaling \$362,000 were capitalized and are being amortized to the first call date of the securities.

In October of 2004, Horizon formed Horizon Statutory Trust II (Trust II), a statutory business trust. Trust II issued \$10.310 million of Trust Preferred Capital Securities as a participant in a pooled trust preferred securities offering. Horizon issued junior subordinated debentures aggregating \$10.310 million to Trust II. The junior subordinated debentures are the sole assets of Trust II. The junior subordinated debentures and the trust preferred securities pay interest and dividends, respectively, on a quarterly basis. The junior subordinated debentures and the securities bear interest at a rate of 90 day LIBOR plus 1.95% and mature on October 21, 2034, and are noncallable for five years. After that period, the securities may be called at any quarterly interest payment date at par. Costs associated with the issuance of the securities totaling \$17,500 were capitalized and are being amortized to the first call date of the securities.



**Table of Contents****Horizon Bancorp****Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

In December of 2006, Horizon formed Horizon Bancorp Capital Trust III (Trust III), a statutory business trust. Trust III issued \$12.372 million of Trust Preferred Capital Securities as a participant in a pooled trust preferred securities offering. Horizon issued junior subordinated debentures aggregating \$12.372 million to Trust III. The junior subordinated debentures are the sole assets of Trust III. The junior subordinated debentures and the trust preferred securities pay interest and dividends, respectively, on a quarterly basis. The junior subordinated debentures and the securities bear interest at a rate of 90 day LIBOR plus 1.65% and mature on January 30, 2037, and are noncallable for five years. After that period, the securities may be called at any quarterly interest payment date at par. Costs associated with the issuance of the securities totaling \$12,647 were capitalized and are being amortized to the first call date of the securities. The proceeds of this issue will be used to redeem the securities issued by Trust I on March 26, 2007.

The Company assumed additional debentures as the result of the acquisition of Alliance in 2005. In June 2004, Alliance formed Alliance Financial Statutory Trust I (Alliance Trust) to issue the \$5.155 million in trust preferred securities. Alliance had issued junior subordinated debentures aggregating \$5.155 million to Alliance Trust. The junior subordinated debentures are the sole assets of Alliance Trust. The junior subordinated debentures and the trust preferred securities pay interest and dividends, respectively, on a quarterly basis. The junior subordinated debentures and the securities bear interest at a rate of 90-day LIBOR plus 2.65%, mature in June 2034, and are noncallable for five years. After that period, the securities may be called at any quarterly interest payment date at par.

The Trust Preferred Capital Securities, subject to certain limitations, are included in Tier 1 Capital for regulatory purposes. At December 31, 2006, \$20.605 million of the \$40.209 million in securities were not included in Tier 1 Capital for regulatory purposes. Dividends on the Trust Preferred Capital Securities are recorded as interest expense.

**Note 12 Employee Stock Bonus Plan**

Horizon maintains an employee stock bonus plan (Stock Bonus Plan) that covers substantially all employees. The Stock Bonus Plan is noncontributory and Horizon may make matching contributions of amounts contributed by employees to the Employee Thrift Plan and discretionary contributions. Prior to the establishment of the Stock Bonus Plan, Horizon maintained an employee stock ownership plan (ESOP) that was terminated. Effective January 1, 2007, the stock bonus plan was converted back to a new ESOP. The prior ESOP accounts of active employees and the discretionary accounts of active employees will remain in the new ESOP. The Matching contribution accounts under the Stock Bonus Plan will be transferred to the Horizon Bancorp Employees Thrift Plan. The retirement plans of Horizon own approximately 14.7% of the outstanding shares.

Total cash contributions and expense recorded for the Stock Bonus Plan was \$200,000 in 2006 and 2005 and \$250,000 in 2004.

**Table of Contents****Horizon Bancorp****Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

**Note 13 Employee Thrift Plan**

The Employee Thrift Plan (Plan) provides that all employees of Horizon with the requisite hours of service are eligible for the Plan. The Plan permits voluntary employee contributions and Horizon may make discretionary matching and profit sharing contributions. Each eligible employee is vested according to a schedule based upon years of service. Employee voluntary contributions are vested at all times and Horizon's discretionary contributions vest over a six-year period. The Bank's expense related to the thrift plan totaled approximately \$332,000 in 2006, \$384,000 in 2005 and \$300,000 for 2004.

**Note 14 Other Expenses**

<b>Years Ended December 31</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Supplies and printing	\$ 466	\$ 452	\$ 403
Advertising	613	659	553
Communication	479	480	436
Directors fees	279	272	274
Insurance expense	466	509	376
Postage	340	301	264
Amortization of intangibles	367	230	22
Travel and entertainment	530	527	430
Other	1,146	906	899
<b>Total other expenses</b>	<b>\$ 4,686</b>	<b>\$ 4,336</b>	<b>\$ 3,657</b>

**Note 15 Income Tax**

<b>Years Ended December 31</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Income tax expense			
Currently payable			
Federal	\$ 2,381	\$ 2,226	\$ 2,445
State	535	545	507
Deferred	(78)	174	(458)
<b>Total income tax expense</b>	<b>\$ 2,838</b>	<b>\$ 2,945</b>	<b>\$ 2,494</b>
Reconciliation of federal statutory to actual tax expense			
Federal statutory income tax at 34%	\$ 3,510	\$ 3,412	\$ 3,206
Tax exempt interest	(1,009)	(841)	(882)
Tax exempt income	(170)	(175)	(185)
Nondeductible and other	154	189	20
Effect of state income taxes	353	360	335

Actual tax expense	\$ 2,838	\$ 2,945	\$ 2,494
--------------------	----------	----------	----------

**Table of Contents****Horizon Bancorp**  
**Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

A cumulative net deferred tax asset is included in other assets. The components of the asset are as follows:

<b>December 31</b>	<b>2006</b>	<b>2005</b>
<b>Assets</b>		
Allowance for loan losses	\$ 3,757	\$ 4,011
Accrued operating expenses	101	233
Director and employee benefits	855	738
Net operating loss carryforward	60	173
Tax credit carry forward	82	253
Unrealized loss on securities available for sale	811	1,536
<b>Total assets</b>	<b>5,666</b>	<b>6,944</b>
<b>Liabilities</b>		
Depreciation	(1,062)	(1,351)
Federal Home Loan Bank stock dividends	(326)	(378)
Difference in basis of intangible assets	(959)	(1,166)
Difference in basis of assets	(185)	(133)
Difference in basis of liabilities	(5)	(126)
Other	(110)	(124)
<b>Total liabilities</b>	<b>(2,647)</b>	<b>(3,278)</b>
 Net deferred tax asset	 \$ 3,019	 \$ 3,666

**Note 16 Other Comprehensive Income (Loss)**

<b>Years Ended December 31</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Unrealized losses on securities:			
Unrealized holding gains (losses) arising during the year	\$ 1,307	\$ (5,765)	\$ (1,816)
Less: reclassification adjustment for gains (losses) realized in net income	(764)	4	
<b>Net unrealized gains (losses)</b>	<b>2,071</b>	<b>(5,769)</b>	<b>(1,816)</b>
Tax (expense) benefit	(725)	2,022	635
 Other comprehensive income (loss)	 \$ 1,346	 \$ (3,747)	 \$ (1,181)

**Table of Contents**

**Horizon Bancorp**

**Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

**Note 17 Commitments, Off-Balance Sheet Risk and Contingencies**

Because of the nature of its activities, Horizon is subject to pending and threatened legal actions that arise in the normal course of business. In management's opinion, after consultation with counsel, none of the litigation to which Horizon or any of its subsidiaries is a party will have a material effect on the consolidated financial position or results of operations of Horizon.

The Bank was required to have approximately \$1,478,000 of cash on hand or on deposit with the Federal Reserve Bank to meet regulatory reserve and clearing balance requirements at December 31, 2006. These balances are included in cash and cash equivalents and do not earn interest.

The Bank is a party to financial instruments with off-balance sheet risk in the ordinary course of business to meet financing needs of its customers. These financial instruments include commitments to make loans and standby letters of credit. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to make loans and standby letters of credit is represented by the contractual amount of those instruments. The Bank follows the same credit policy to make such commitments as is followed for those loans recorded in the financial statements.

At December 31, 2006 and 2005, commitments to make loans amounted to approximately \$154,686,000 and \$149,429,000 and commitments under outstanding standby letters of credit amounted to approximately \$3,000,000 and \$1,995,000. Since many commitments to make loans and standby letters of credit expire without being used, the amount does not necessarily represent future cash advances. No losses are anticipated as a result of these transactions. Collateral obtained upon exercise of the commitment is determined using management's credit evaluation.

**Note 18 Regulatory Capital**

Horizon and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies and are assigned to a capital category. The assigned capital category is largely determined by three ratios that are calculated according to the regulations: total risk adjusted capital, Tier I capital and Tier I leverage ratios. The ratios are intended to measure capital relative to assets and credit risk associated with those assets and off-balance sheet exposures of the entity. The capital category assigned to an entity can also be affected by qualitative judgments made by regulatory agencies about the risk inherent in the entity's activities that are not part of the calculated ratios. There are five capital categories defined in the regulations, ranging from well capitalized to critically undercapitalized. Classification of a bank in any of the undercapitalized categories can result in actions by regulators that could have a material effect on a bank's operations. As a condition of approval for the Alliance acquisition, the OCC required Horizon Bank to maintain regulatory capital ratios at 100 basis points above the well capitalized minimums shown below. At December 31, 2006 and 2005, Horizon and the Bank are categorized as well capitalized and met all subject capital adequacy requirements including the requirements imposed with the approval of the Alliance acquisition noted above.

**Table of Contents****Horizon Bancorp****Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

During the course of a periodic examination by the Bank's regulators that commenced in February 2003, the examination personnel raised the issue of whether the Bank's mortgage warehouse loans should be treated as other loans rather than home mortgages for call report purposes. If these loans are treated as other loans for regulatory reporting purposes, it would change the calculations for risk based capital and reduce the Bank's risk-based capital ratios. Management believes that it has properly characterized the loans in its mortgage warehouse loan portfolio for risk-based capital purposes, but there is no assurance that the regulators will concur with that determination. Should the call report classification of the loans be changed, Horizon and the Bank would still be categorized as well capitalized at December 31, 2006 and 2005.

Horizon's and the Bank's actual and required capital amounts and ratios are as follows:

	Actual		Minimum Required for Capital <sup>1</sup> Adequacy Purposes		Minimum Required To Be Well Capitalized <sup>1</sup> Under Prompt Corrective Action Requirements	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of December 31, 2006</b>						
Total capital <sup>1</sup> (to risk-weighted assets)						
Consolidated	\$ 102,897	12.92%	\$ 63,738	8.00%	N/A	N/A
Bank	89,327	11.26	63,444	8.00	\$ 79,305	10.00%
Tier I capital <sup>1</sup> (to risk-weighted assets)						
Consolidated	73,554	9.23	31,869	4.00	N/A	N/A
Bank	80,589	10.16	31,722	4.00	47,583	6.00
Tier I capital <sup>1</sup> (to average assets)						
Consolidated	73,554	6.25	47,040	4.00	N/A	N/A
Bank	80,589	6.89	46,760	4.00	58,449	5.00
<b>As of December 31, 2005</b>						
Total capital <sup>1</sup> (to risk-weighted assets)						
Consolidated	\$ 83,052	11.54%	\$ 57,575	8.00%	N/A	N/A
Bank	84,974	11.82	57,512	8.00	\$ 71,890	10.00%
Tier I capital <sup>1</sup> (to risk-weighted assets)						
Consolidated	63,623	8.84	28,789	4.00	N/A	N/A
Bank	76,606	10.66	28,745	4.00	43,118	6.00
Tier I capital <sup>1</sup> (to average assets)						
Consolidated	63,623	5.83	43,652	4.00	N/A	N/A
Bank	76,607	7.02	43,650	4.00	54,563	5.00

<sup>1</sup> As defined by regulatory agencies

**Table of Contents****Horizon Bancorp****Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

**Note 19 Share Based Compensation**

Horizon maintained the 1987 Nonqualified Stock Option and Stock Appreciation Right Plan (1987 Plan). As of December 31, 2006, no options or stock appreciation rights for the 1987 Plan were outstanding or available for grant. No compensation expense relating to the 1987 Plan was recorded in 2006 or 2005.

Under Horizon's 1997 Stock Option and Stock Appreciation Right Plan (1997 Plan), which is accounted for in accordance with Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123 (revised 2004) Share-Based Payment (FAS 123R), Horizon may grant certain officers and employees stock option awards or stock appreciation rights which vest and become fully exercisable at the end of five years of continued employment. SARs entitle eligible employees to receive cash, stock or a combination of cash and stock totaling the excess, on the date of exercise, of the fair market value of the shares of common stock covered by the option over the option exercise price. The underlying stock options are deemed to have been cancelled upon exercise of the SARs. In the third quarter of 2002, Horizon entered into agreements with participants that capped the value of their SARs at \$14.67 per share and discontinued any future vesting. No additional compensation expense is recognized when the fair value of Horizon stock exceeds \$14.67 per share as there is a presumption that participants will exercise their options rather than the SARs. No compensation expense relating to the SARs was recorded in 2006, 2005 or 2004.

A summary of option activity under the 1997 Plan as of December 31, 2006 and changes during the year then ended, is presented below:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Term	Aggregate Intrinsic Value
Outstanding, beginning of year	127,799	\$ 8.73		
Granted				
Exercised	(90,279)	8.85		
Forfeited or expired				
Outstanding, end of year	37,520	\$ 8.43	\$ 4.46	\$ 713
Exercisable, end of year	35,720	\$ 7.95	\$ 4.38	\$ 696

There were no options granted during the years 2006, 2005 and 2004. The total intrinsic value of options exercised during the years ended December 31, 2006, 2005 and 2004, was \$1,860,528, \$3,321,166 and \$835,291, respectively.

**Table of Contents****Horizon Bancorp****Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

On January 21, 2003, the Board of Directors adopted the Horizon Bancorp 2003 Omnibus Equity Incentive Plan (2003 Plan) which was approved by stockholders on May 8, 2003. Under the 2003 Plan, Horizon may issue up to 150,000 common shares, plus the number of shares that are tendered to or withheld by Horizon in connection with the exercise of options plus that number of shares that are purchased by Horizon with the cash proceeds received upon option exercises. The 2003 Plan limits the number of shares available to 150,000 for incentive stock options and to 75,000 for the grant of nonqualified option awards. The shares available for issuance under the 2003 Plan may be divided among the various types of awards and among the participants as the Compensation Committee (Committee) determines. The Committee is authorized to grant any type of award to a participant that is consistent with the provisions of the 2003 Plan. Awards may consist of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, performance units, performance shares or any combination of these awards. The Committee determines the provisions, terms and conditions of each award. The restricted shares vest at the end of five years of continuous employment. Holders of restricted shares receive dividends and may vote the shares. The restricted shares are recorded at fair market value (on the date granted) as a separate component of stockholders equity. The cost of these shares are being amortized against earnings using the straight-line method over five years. The options shares granted under the 2003 plan vest at a rate of 20% per year. The restricted shares granted under the 2003 Plan vest after five years.

The fair value of options granted is estimated on the date of the grant using an option-pricing model with the following weighted-average assumptions:

<b>December 31</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Dividend yields	2.14%	1.87%	2.04%
Volatility factors of expected market price of common stock	18.10%	19.97%	23.37%
Risk-free interest rates	5.20%	4.37%	4.44%
Expected life of options	9 years	9 years	9 years

A summary of option activity under the 2003 Plan as of December 31, 2006, and changes during the year then ended, is presented below:

	<b>Shares</b>	<b>Weighted-Average Exercise Price</b>	<b>Weighted-Average Remaining Contractual Term</b>	<b>Aggregate Intrinsic Value</b>
Outstanding, beginning of year	24,000	\$ 24.43		
Granted	10,000	26.04		
Exercised	(400)	23.56		
Forfeited or expired	(600)	23.56		
Outstanding, end of year	33,000	\$ 24.96	\$ 8.34	\$ 83
Exercisable, end of year	8,200	\$ 24.07	\$ 7.73	\$ 28





**Table of Contents****Horizon Bancorp and Subsidiaries****Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

The weighted average grant-date fair value of options granted during the years 2006, 2005 and 2004 was \$7.12, \$7.66 and \$6.97, respectively. The total intrinsic value of options exercised during the year ended December 31, 2006 was \$956. No options granted under the 2003 Plan were exercised in 2005 or 2004.

A summary of the status of Horizon's nonvested, restricted shares as of December 31, 2006 and 2005, is presented below:

	2006		2005	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Nonvested, end of year	45,000	\$ 23.56	45,000	\$ 23.56

There were no shares granted, vested or forfeited during 2006. These restricted shares all vest on August 2, 2009.

Total compensation cost recognized in the income statement for option-based payment arrangements during 2006 was \$40,000 and the related tax benefit recognized was \$16,000. No cost was recognized for the years 2005 and 2004.

Total compensation cost recognized in the income statement for restricted share based payment arrangements during 2006, 2005 and 2004 was \$212,000, \$212,000 and \$88,000, respectively. The recognized tax benefit related thereto was \$84,000, \$84,000 and \$35,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

Cash received from option exercise under all share-based payment arrangements for the years ended December 31, 2006, 2005 and 2004 was \$735,000, \$946,000 and \$445,000, respectively. The actual tax benefit realized for the tax deductions from option exercise of the share-based payment arrangements totaled \$723,000, \$1,139,000 and \$308,000, respectively, for the years ended December 31, 2006, 2005 and 2004.

As of December 31, 2006, there was \$706,000 of total unrecognized compensation cost related to all nonvested share-based compensation arrangements granted under all of the plans. That cost is expected to be recognized over a weighted-average period of 2.8 years.

**Note 20 FDIC One-Time Assessment Credit**

Effective November 17, 2006, the FDIC implemented a one-time credit of \$4.7 billion to eligible institutions. The purpose of the credit is to recognize contributions made by certain institutions to capitalize the Bank Insurance Fund and Savings Association Insurance Fund, which have now been merged into the Deposit Insurance Fund. The Bank is an eligible institution and has received notice from the FDIC that its share of the credit is \$458,184. This amount is not reflected in the accompanying financial statements as it represents contingent future credits against future insurance assessment payments. As such, the timing and ultimate recoverability of the one-time credit may change.

**Table of Contents****Horizon Bancorp and Subsidiaries****Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

**Note 21 Fair Values of Financial Instruments**

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

The estimated fair values of financial instruments, as shown below, are not intended to reflect the estimated liquidation or market value of Horizon taken as a whole. The disclosed fair value estimates are limited to Horizon's significant financial instruments at December 31, 2006 and 2005. These include financial instruments recognized as assets and liabilities on the consolidated balance sheet as well as certain off-balance sheet financial instruments. The estimated fair values shown below do not include any valuation of assets and liabilities which are not financial instruments as defined by SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*.

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

**Cash and Cash Equivalents** The carrying amounts approximate fair value.

**Interest-Bearing Deposits** The carrying amounts approximate fair value.

**Investment Securities** For debt and marketable equity securities available for sale and held to maturity, fair values are based on quoted market prices or dealer quotes. For those securities where a quoted market price is not available, carrying amount is a reasonable estimate of fair value based upon comparison with similar securities.

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

**Interest Receivable/Payable** The carrying amounts approximate fair value.

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

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

**Short-Term Borrowings** The carrying amounts approximate fair value.

**Long-Term Borrowings** Rates currently available to Horizon for debt with similar terms and remaining maturities are used to estimate fair values of existing long-term borrowings.

**Table of Contents****Horizon Bancorp and Subsidiaries****Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

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

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

The estimated fair values of Horizon's financial instruments are as follows:

December 31	2006		2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Assets</b>				
Cash and cash equivalents	\$ 52,312	\$ 52,312	\$ 39,250	\$ 39,250
Interest-bearing deposits	898	898	15,735	15,735
Investment securities available for sale	243,078	243,078	275,177	275,177
Loans including loans held for sale, net	848,199	855,468	726,806	720,747
Interest receivable	6,094	6,094	5,813	5,813
Stock in FHLB and FRB	12,136	12,136	12,983	12,983
<b>Liabilities</b>				
Noninterest-bearing deposits	81,949	81,949	148,127	148,127
Interest-bearing deposits	832,024	821,701	707,439	678,304
Short-term borrowings	83,842	83,842	50,024	50,024
Long-term debt	115,951	131,258	133,609	132,204
Subordinated debentures	40,209	44,032	27,837	27,906
Interest payable	1,771	1,771	1,663	1,663

**Table of Contents****Horizon Bancorp and Subsidiaries****Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

**Note 22 Condensed Financial Information (Parent Company Only)**

Presented below is condensed financial information as to financial position, results of operations and cash flows of Horizon Bancorp:

**Condensed Balance Sheets**

<b>December 31</b>	<b>2006</b>	<b>2005</b>
<b>Assets</b>		
Total cash and cash equivalents	\$ 481	\$ 611
Investment securities, available for sale	12,024	
Investment in Bank	87,307	82,452
Other assets	8,295	6,176
<b>Total assets</b>	<b>\$ 108,107</b>	<b>\$ 89,239</b>
<b>Liabilities</b>		
Short-term borrowings	\$ 5,200	\$ 7,200
Subordinated debentures	40,209	27,837
Other liabilities	821	672
<b>Stockholders Equity</b>	<b>61,877</b>	<b>53,530</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 108,107</b>	<b>\$ 89,239</b>

**Condensed Statements of Income**

<b>Years Ended December 31</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>Operating Income (Expense)</b>			
Dividend income from Bank	\$ 5,900	\$ 9,900	\$ 4,800
Investment income	91	48	19
Other Income	4		
Interest expense	(2,675)	(1,800)	(825)
Employee benefit expense	(433)	(412)	(338)
Other expense	(155)	(153)	(94)
<b>Income Before Undistributed Income of Subsidiaries</b>	<b>2,732</b>	<b>7,583</b>	<b>3,562</b>
<b>Undistributed Income (Loss) of Subsidiaries</b>	<b>3,497</b>	<b>(1,435)</b>	<b>2,873</b>
<b>Income Before Tax</b>	<b>6,229</b>	<b>6,148</b>	<b>6,435</b>

<b>Income Tax Benefit</b>	1,255	943	500
<b>Net Income</b>	\$ 7,484	\$ 7,091	\$ 6,935

**Table of Contents****Horizon Bancorp and Subsidiaries****Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

**Condensed Statements of Cash Flows**

<b>Years Ended December 31</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>Operating Activities</b>			
Net income	\$ 7,484	\$ 7,091	\$ 6,935
Items not requiring (providing) cash Distributions in excess (equity in undistributed) net income of Bank	(3,497)	1,435	(2,860)
Equity in undistributed net income of Insurance Company			(13)
Change in			
Income taxes receivable	(1,745)		703
Dividends receivable from Bank	(100)	(1,600)	
Other assets	298	(1,348)	(1,166)
Other liabilities	149	(785)	127
Net cash provided by operating activities	2,589	4,793	3,726
<b>Investing Activities</b>			
Purchases of securities available for sale	(12,024)		
Investment in Insurance Company			563
Investment in Bank		(8,764)	(7,500)
Investment in Statutory Trusts	(372)		(310)
Acquisition, net of cash acquired		(2,901)	
Net cash used in investing activities	(12,396)	(11,665)	(7,247)
<b>Financing Activities</b>			
Dividends paid	(1,811)	(1,660)	(1,481)
Change in short-term borrowings	(2,000)	7,200	(5,000)
Issuance of stock	1,244	1,853	696
Proceeds from issuance of trust preferred securities	12,372		10,310
Purchase of treasury stock	(128)	(651)	(848)
Net cash provided by financing activities	9,677	6,742	3,677
<b>Net Change in Cash and Cash Equivalents</b>	<b>(130)</b>	<b>(130)</b>	<b>156</b>
<b>Cash and Cash Equivalents at Beginning of Year</b>	<b>611</b>	<b>741</b>	<b>585</b>
<b>Cash and Cash Equivalents at End of Year</b>	<b>\$ 481</b>	<b>\$ 611</b>	<b>\$ 741</b>





**Table of Contents****Horizon Bancorp and Subsidiaries**  
**Notes to Consolidated Financial Statements**

(Table Dollar Amounts in Thousands)

**Note 23 Quarterly Results of Operations (Unaudited)**

The following is a summary of the quarterly consolidated results of operations:

<b>Three Months Ended 2006</b>	<b>March 31</b>	<b>June 30</b>	<b>September 30</b>	<b>December 31</b>
Interest income	\$ 15,663	\$ 16,650	\$ 17,758	\$ 18,609
Interest expense	7,853	8,814	9,946	10,522
Net interest income	7,810	7,836	7,812	8,087
Loss on sale of securities available for sale	158	91	515	
Provision for loan losses	380	225	120	180
Net income	1,449	1,834	1,968	2,233
Earnings per share				
Basic	\$ .46	\$ .58	\$ .62	\$ .70
Diluted	\$ .45	\$ .57	\$ .61	\$ .69
Average shares outstanding				
Basic	3,142,219	3,183,870	3,189,004	3,193,306
Diluted	3,203,206	3,209,294	3,211,777	3,238,648
<b>Three Months Ended 2005</b>	<b>March 31</b>	<b>June 30</b>	<b>September 30</b>	<b>December 31</b>
Interest income	\$ 11,795	\$ 13,235	\$ 15,741	\$ 16,022
Interest expense	5,022	5,956	7,193	7,749
Net interest income	6,773	7,279	8,548	8,273
Provision for loan losses	330	381	360	450
Net income	1,303	1,680	2,028	2,080
Earnings per share				
Basic	\$ .43	\$ .55	\$ .66	\$ .67
Diluted	\$ .42	\$ .53	\$ .64	\$ .65

Average shares outstanding				
Basic	3,016,609	3,066,512	3,074,705	3,111,583
Diluted	3,140,322	3,157,731	3,165,847	3,186,780
	70			

---

**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

Audit Committee, Board of Directors and Stockholders

Horizon Bancorp

Michigan City, Indiana

We have audited the accompanying consolidated balance sheets of Horizon Bancorp as of December 31, 2006 and 2005, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 Horizon Bancorp as of December 31, 2006 and 2005, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America.

**BKD, llp**

Fort Wayne, Indiana

March 13, 2007

**Table of Contents**

**Horizon Bancorp**  
**Management's Report on Financial Statements**

Management is responsible for the preparation and presentation of the consolidated financial statements and related notes on the preceding pages. The statements have been prepared in conformity with accounting principles generally accepted in the United States of America appropriate in the circumstances and include amounts that are based on management's best estimates and judgments. Financial information elsewhere in the Annual Report is consistent with that in the consolidated financial statements.

In meeting its responsibility for the accuracy of the consolidated financial statements, management relies on Horizon's system of internal accounting controls. This system is designed to provide reasonable assurance that assets are safeguarded and transactions are properly recorded to permit the preparation of appropriate financial information. The system of internal controls is supplemented by a program of internal audits to independently evaluate the adequacy and application of financial and operating controls and compliance with Company policies and procedures.

The Audit Committee of the Board of Directors meets periodically with management, the independent accountants and the internal auditors to ensure that each is properly discharging its responsibilities with regard to the consolidated financial statements and internal accounting controls. The independent accountants have full and free access to the Audit Committee and meet with it to discuss auditing and financial reporting matters.

The consolidated financial statements in the Annual Report have been audited by **BKD, llp**, independent registered public accounting firm, for 2006, 2005 and 2004. Their audits were conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States) and included consideration of internal accounting controls, tests of accounting records and other audit procedures to the extent necessary to allow them to express their opinion on the fairness of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America.

**Table of Contents**

**Horizon Bancorp**  
**Summary of Selected Financial Data**

(Dollar Amounts In Thousands Except Per Share Data and Ratios)

	2006	2005	2004	2003	2002
<b>Earnings</b>					
Net interest income	\$ 31,545	\$ 30,873	\$ 25,422	\$ 24,151	\$ 23,153
Provision for loan losses	905	1,521	990	1,350	1,625
Total noninterest income	10,137	9,813	10,669	11,140	10,249
Total noninterest expense	30,455	29,129	25,672	24,771	23,403
Provision for income taxes	2,838	2,945	2,494	2,636	2,778
Net income from continuing operations	7,484	7,091	6,935	6,534	5,596
Cumulative effective of change in accounting for goodwill, net of tax					(97)
Net income	\$ 7,484	\$ 7,091	\$ 6,935	\$ 6,534	\$ 5,499
Cash dividend declared	\$ 1,811	\$ 1,660	\$ 1,481	\$ 1,311	\$ 1,211
<b>Per Share Data</b>					
Net income basic	\$ 2.36	\$ 2.31	\$ 2.32	\$ 2.19	\$ 1.85
Net income diluted	2.33	2.24	2.22	2.10	1.83
Cash dividends declared	.56	.53	.49	.44	.41
Book value at period end	19.11	17.01	16.56	15.48	13.93
Weighted average shares outstanding					
Basic	3,177,272	3,067,632	2,993,696	2,978,161	2,975,394
Diluted	3,217,050	3,162,950	3,123,325	3,108,178	3,003,381
<b>Period End Totals</b>					
Loans, net of deferred loan fees and unearned income	\$ 843,834	\$ 732,734	\$ 564,042	\$ 447,718	\$ 535,793
Allowance for loan losses	8,738	8,368	7,193	6,909	6,255
Total assets	1,222,430	1,127,875	913,831	757,443	720,502
Total deposits	913,973	855,566	612,217	546,168	489,259
Total borrowings	240,002	211,470	244,668	158,585	183,893

**Table of Contents**

**Horizon Bancorp**  
**Summary of Selected Financial Data**  
(Dollar Amounts In Thousands Except Per Share Data and Ratios)  
(Continued)

	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
<b>Ratios</b>					
Loan to deposit	93.76%	85.64%	92.76%	81.97%	109.51%
Loan to total funding	76.73	68.67	65.67	63.53	79.59
Return on average assets	.67	.71	.85	.88	.86
Average stockholders' equity to average total assets	5.14	5.19	5.90	6.01	6.06
Return on average stockholders' equity	13.03	13.67	14.38	14.65	14.21
Dividend payout ratio (dividends divided by net income)	24.20	21.21	21.36	20.06	22.02
Price to book value ratio	143.53	166.42	162.74	184.40	126.85
Price to earnings ratio	11.77	12.24	12.14	13.12	9.64

All share and per share amounts have been adjusted for the 3-for-1 stock split declared October 16, 2001, and the 3-for-2 stock split declared on October 21, 2003.

**Table of Contents****Horizon Bancorp****Horizon's Common Stock and Related Stockholders Matters**

Horizon common stock is traded on the NASDAQ Global Market under the symbol HBNC. The following table sets forth, for the periods indicated, the high and low prices per share. Also summarized below are the cash dividends declared by quarter for 2006 and 2005.

	<b>2006</b>		<b>Dividends Declared Per Share</b>
	<b>Common Stock Prices</b>		
	<b>High</b>	<b>Low</b>	
First Quarter	\$ 32.23	\$ 26.30	\$ .14
Second Quarter	31.00	25.16	.14
Third Quarter	26.93	25.50	.14
Fourth Quarter	27.89	25.92	.14

	<b>2005</b>		<b>Dividends Declared Per Share</b>
	<b>Common Stock Prices</b>		
	<b>High</b>	<b>Low</b>	
First Quarter	\$ 31.51	\$ 27.00	\$ .13
Second Quarter	30.00	24.20	.13
Third Quarter	28.26	26.55	.13
Fourth Quarter	27.93	24.95	.14

There can be no assurance as to the amount of future dividends on Horizon common stock since future dividends are subject to the discretion of the Board of Directors, cash needs, general business conditions and dividends from the bank subsidiary.

The approximate number of holders of outstanding common stock, based upon the number of record holders as of December 31, 2006, is 572.

**Table of Contents**

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

None

**ITEM 9A. CONTROLS AND PROCEDURES**

**Disclosure Controls and Procedures**

Under the supervision of and with the participation of its management, including the Chief Executive Officer and Chief Financial Officer, Horizon has evaluated the effectiveness of the design and operation of its disclosure controls (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934 (the Exchange Act )) as of the end of the period covered by this report. Based on such evaluation, such officers have concluded that, as of the evaluation date, Horizon's disclosure controls and procedures are effective to ensure that the information required to be disclosed by Horizon in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and are designed to ensure that information required to be disclosed in those reports is accumulated and communicated to management as appropriate to allow timely decisions regarding disclosure.

**Internal Control Over Financial Reporting**

Horizon's management, including its Chief Executive Officer and Chief Financial Officer, also have concluded that during the fiscal quarter ended December 31, 2006, there were no changes in Horizon's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect Horizon's internal control over financial reporting.

**ITEM 9B. OTHER INFORMATION**

Not applicable.

**PART III**

This information is omitted from this report pursuant to General Instruction G. (3) of Form 10-K as Horizon intends to file with the Commission its definitive Proxy Statement for its 2007 Annual Meeting of Shareholders (the Proxy Statement ) pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, not later than 120 days after December 31, 2006.

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information relating to Horizon's directors required by this item is found in the Proxy Statement under Proposal I Election of Directors and is incorporated into this report by reference. The information relating to the Audit Committee of the Board of Directors required by this item is found in the Proxy Statement under Corporate Governance The Audit Committee and is incorporated into this report by reference.

The information relating to Horizon's executive officers required by this item is included in Part I of this Form 10-K under Special Item: Executive Officers and is incorporated into this item by reference.

The information relating to certain filing obligations of directors and executive officers required by this item is found in the Proxy Statement under Section 16(a) Beneficial Ownership Reporting Compliance and is incorporated into this report by reference.

Horizon has a code of ethics that applies to its directors, chief executive officer and chief



**Table of Contents**

financial officer. The code is available on Horizon's website at [www.accesshorizon.com](http://www.accesshorizon.com).

**ITEM 11. EXECUTIVE COMPENSATION**

The information on executive and director compensation and compensation committee matters required by this item can be found in the Proxy Statement under Corporate Governance, Compensation Committee Report, Compensation Discussion and Analysis, Executive Compensation and Compensation of Directors and is incorporated into this report by reference.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT****Equity Compensation Plan Information**

The following table presents information regarding grants under all equity compensation plans of Horizon through December 31, 2006.

<b>Plan Category</b>	<b>Number of securities to be issued upon exercise of outstanding options, warrants and rights</b>	<b>Weighted-average exercise price of outstanding options, warrants and rights</b>	<b>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in the first column)</b>
Equity compensation plans approved by security holders (1)	68,520	\$15.87	144,602
Equity compensation plans not approved by security holders	0	0	0
<b>Total</b>	<b>68,520</b>	<b>\$15.87</b>	<b>144,602</b>

(1) Represents options granted or available under the 1997 Key Employees Stock Option and Stock Appreciation Rights Plan of Horizon Bancorp and the Horizon Bancorp 2003 Omnibus Equity Incentive Plan.

The remaining information required by this item can be found in the Proxy Statement under Common Stock Ownership by Directors and Executive Officers and Stock Ownership of Certain Beneficial Owners and is incorporated by reference into this report.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS; AND DIRECTOR INDEPENDENCE**

The information required by this item is found in the Proxy Statement under Corporate Governance and Certain Business Relationships and Transactions and is incorporated by reference into this report.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by this item is incorporated by reference from the Proxy Statement section captioned Accountant Fees and Services.

**Table of Contents**

**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

(a) Documents Filed As Part of This Annual Report on Form 10-K:

1. Financial Statement

See the Financial Statements included in Item 8.

2. Financial Statement Schedules

Financial statement schedules are omitted for the reason that they are not required or are not applicable, or the required information is included in the financial statements.

3. Exhibits

The exhibits filed as part of this Annual Report on Form 10-K are identified in the Exhibit Index, which Exhibit Index specifically identifies those exhibits that describe or evidence all management contracts and compensation plans or arrangements required to be filed as exhibits to this Report. Such Exhibit Index is incorporated herein by reference.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized

**Horizon Bancorp**

Registrant

Date: March 13, 2007

By: /s/ Craig M. Dwight

Craig M. Dwight  
President and Chief Executive Officer (Principal  
Executive Officer)

Date: March 13, 2007

By /s/ James H. Foglesong  
:

James H. Foglesong  
Chief Financial Officer (Principal Financial Officer  
and Principal Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Date	Signature and Title
March 13, 2007	/s/ Robert C. Dabagia  Robert C. Dabagia, Chairman of the Board and Director
March 13, 2007	/s/ Craig M. Dwight  Craig M. Dwight, President and Chief Executive Officer and Director
March 13, 2007	/s/ Susan D. Aaron  Susan D. Aaron, Director
March 13, 2007	/s/ James B. Dworkin  James B. Dworkin, Director
March 13, 2007	/s/ Charley E. Gillispie  Charley E. Gillispie, Director
March 13, 2007	/s/ Daniel F. Hopp

Daniel F. Hopp, Director

79

---

**Table of Contents**

Date	Signature and Title
March 13, 2007	Robert E. McBride, Director  /s/ Peter L. Pairitz
March 13, 2007	Peter L. Pairitz, Director  /s/ Larry N. Middleton
March 13, 2007	Larry N. Middleton, Director  /s/ Bruce E. Ramage
March 13, 2007	Bruce E. Ramage, Director  /s/ Robert E. Swinehart
March 13, 2007	Robert E. Swinehart, Director  /s/ Spero W. Valavanis
	Spero W. Valavanis, Director 80

---

**Table of Contents****EXHIBIT INDEX**

The following exhibits are included in this Form 10-K or are incorporated by reference as noted in the following table:

Exhibit Number	Description	Incorporated by Reference/Attached
1.1	Placement Agreement, dated December 15, 2006, among Horizon Bancorp, Horizon Capital Trust III and J.P. Morgan Securities Inc.	Incorporated by Reference to Exhibit 1.1 to Registrant's Form 8-K filed December 21, 2006
2.1	Agreement of Merger and Plan of Reorganization for Horizon Bancorp and Alliance Financial Corporation	Incorporated by Reference to Exhibit 2.1 to Registrant's Form 8-K filed March 1, 2005
2.2	Amendment to Agreement of Merger and Plan of Reorganization for Horizon Bancorp and Alliance Financial Corporation	Incorporated by Reference to Exhibit 2.1 to Registrant's Form 8-K filed March 24, 2005
3.1	Articles of Incorporation of Horizon Bancorp, as amended	Incorporated by Reference to Exhibit 3.1 to Registrant's Form 10-Q for the Quarter Ended September 30, 2003
3.2	Amended and Restated Bylaws of Horizon Bancorp (as adopted January 21, 2003)	Incorporated by Reference to Exhibit 3.2 to Registrant's Form 10-K for the Year Ended December 31, 2002
4.1	Indenture, dated as of October 21, 2004, between Horizon Bancorp and Wilmington Trust Company related to the issuance of Trust Preferred Securities	Incorporated by Reference to Exhibit 4.1 to Registrant's Form 8-K filed October 27, 2004
4.2	Amended and Restated Declaration of Trust of Horizon Bancorp Capital Trust II, dated as of October 21, 2004, related to the issuance of Trust Preferred Securities	Incorporated by Reference to Exhibit 4.2 to Registrant's Form 8-K filed October 27, 2004
4.3	Junior Subordinated Indenture, dated as of December 15, 2006, between Horizon Bancorp and Wilmington Trust Company.	Incorporated by Reference to Exhibit 4.1 to Registrant's Form 8-K filed December 21, 2006
4.4	Amended and Restated Trust Agreement of Horizon Bancorp Capital Trust III, dated as of December 15, 2006	Incorporated by Reference to Exhibit 4.2 to Registrant's Form 8-K filed December 21, 2006
10.1*	1987 Stock Option and Stock Appreciation Rights Plan of Horizon Bancorp, as amended	Incorporated by Reference to Exhibit 10.1 to Registrant's Form 10-K for the Year Ended December 31, 2001.

Edgar Filing: HORIZON BANCORP /IN/ - Form 10-K

10.2*	Nonqualified Stock Option and Stock Appreciation Rights Agreement between Horizon Bancorp and Craig M. Dwight	Incorporated by Reference to Exhibit 10.2 to Registrant's Form 10-K for the Year Ended December 31, 2001
10.3*	Supplemental Employee Retirement Plan, as amended	Incorporated by Reference to Exhibit 10.3 to Registrant's Form 10-K for the Year Ended December 31, 2001



**Table of Contents**

Exhibit Number	Description	Incorporated by Reference/Attached
10.4*	1997 Key Employees Stock Option and Stock Appreciation Rights Plan	Incorporated by Reference to Exhibit 10.4 to Registrant's Form 10-K for the Year Ended December 31, 2001
10.5*	Form of Amendment No. 1 to Horizon Bancorp Stock Option and Stock Appreciation Rights Agreement and Schedule Identifying Material Details of Individual Amendments	Incorporated by Reference to Exhibit 10.1 to Registrant's Form 10-Q for the Quarter Ended September 30, 2002
10.6*	Horizon Bancorp 2003 Omnibus Equity Incentive Plan	Incorporated by Reference to Appendix B to the Registrant's Proxy Statement for the Annual Meeting of Shareholders Held on May 8, 2003
10.7*	Agreement dated October 18, 1999, between Horizon Bank, N.A., and James D. Neff	Incorporated by Reference to Exhibit 10.11 to Registrant's Form 10-K for the year ended December 31, 2003
10.8*	Directors Deferred Compensation Plan	Incorporated by Reference to Exhibit 10.8 to Registrant's Form 10-K for the year ended December 31, 2004
10.9*	Form of Change of Control Agreement for certain executive officers	Incorporated by Reference to Exhibit 10.9 to Registrant's Form 10-K for the year ended December 31, 2004
10.10*	Form of Restricted Stock Award Agreement under 2003 Omnibus Plan	Incorporated by Reference to Exhibit 10.10 to Registrant's Form 10-K for the year ended December 31, 2004
10.11*	Form of Option Grant Agreement under 2003 Omnibus Plan	Incorporated by Reference to Exhibit 10.11 to Registrant's Form 10-K for the year ended December 31, 2004
10.12*	Description of Executive Officer Bonus Plan	Incorporated by Reference to Exhibit 10.12 to Registrant's Form 10-K for the year ended December 31, 2004
10.13	Guarantee Agreement of Horizon Bancorp, dated as of October 21, 2004, related to the issuance of Trust Preferred Securities	Incorporated by Reference to Exhibit 10.1 to Registrant's Form 8-K filed October 27, 2004
10.14*	Horizon Bancorp 2005 Supplemental Executive Retirement Plan	Attached

Edgar Filing: HORIZON BANCORP /IN/ - Form 10-K

10.15*	Employment Agreement, dated July 19, 2006, among Horizon Trust & Management, N.A., Horizon Bank, Horizon Bancorp and Lawrence J. Mazur	Incorporated by Reference to Exhibit 10.1 to Registrant's Form 8-K filed July 21, 2006
10.16*	Amendment to Horizon Bancorp Restricted Stock Award Agreement, dated July 19, 2006	Incorporated by Reference to Exhibit 10.2 to Registrant's Form 8-K filed July 21, 2006
10.17*	Employment Agreement, dated December 1, 2006, among Horizon Bancorp, Horizon	Incorporated by Reference to Exhibit 10.1 to Registrant's Form 8-K filed December 6,

**Table of Contents**

Exhibit Number	Description	Incorporated by Reference/Attached
	Bank, N.A. and Craig M. Dwight	2006
10.18*	Letter Agreement, dated December 1, 2006, between Horizon Bank, N.A. and Craig M. Dwight	Incorporated by Reference to Exhibit 10.2 to Registrant's Form 8-K filed December 6, 2006
10.19*	Guarantee Agreement of Horizon Bancorp, dated as of December 15, 2006	Incorporated by Reference to Exhibit 10.1 to Registrant's Form 8-K filed December 21, 2006
21	Subsidiaries of Horizon	Attached
23	Consent of <b>BKD, llp</b>	Attached
31.1	Certification of Craig M. Dwight pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Attached
31.2	Certification of James H. Foglesong pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Attached
32.1	Certification of Craig M. Dwight Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Attached
32.2	Certification of James H. Foglesong Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Attached

\* Indicates exhibits that describe or evidence management contracts or compensatory plans or arrangements required to be filed as exhibits to this Form 10-K.

