SOFTECH INC
Form 10-Q
April 14, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended February 29, 2016

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

For the transition period from _________________ to ___________________

0-10665
Commission File Number

SOFTECH, INC.
(Exact name of the Registrant as specified in its charter)

Massachusetts	**04-2453033**
(State or other jurisdiction of incorporation or organization)	(I.R.S Employer Identification No.)

650 Suffolk Street, Suite 415, Lowell, MA 01854
(Address of principal executive offices and zip code)

Telephone (978) 513-2700

(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer .	Accelerated filer .
Non-accelerated filer . (Do not check if a smaller reporting company)	Smaller reporting company X .

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

The number of shares outstanding of registrant s common stock at April 10, 2016 was 903,724 shares.

SOFTECH, INC.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

SOFTECH, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except for share data)

	February 29, 2016 (Unaudited)	May 31, 2015
ASSETS		
Cash	$ 73	$ 310
Accounts receivable (less allowance for uncollectible accounts of $18 as of February 29, 2016 and May 31, 2015)	726	587
Earn-out payments from CADRA sale, current portion	200	243
Prepaid and other assets	278	315
Total current assets	1,277	1,455
Property and equipment, net	77	57
Goodwill	948	948
Capitalized software development costs, net	722	422
Capitalized patent costs	114	109
Earn-out payments from CADRA sale, net of current portion	146	133
Related party note receivable	134	134
Other assets	35	35
TOTAL ASSETS	$ 3,453	$ 3,293

LIABILITIES, REDEEMABLE COMMON STOCK AND SHAREHOLDERS DEFICIT

Liabilities:

Accounts payable	$	281	$	137
Accrued expenses		360		283
Deferred revenue		1,558		1,732
Capital lease, current		24		19
Current maturities of long-term debt		900		446
Total current liabilities		3,123		2,617
Capital lease, net of current portion		45		30
Other accrued liabilities		1		10
Total liabilities		3,169		2,657
Commitments and contingencies				
Redeemable Common Stock and Shareholders Deficit:				
Redeemable common stock, $0.10 par value, 180,000 and 170,000 shares issued and outstanding at February 29, 2016 and May 31, 2015, respectively.		1,260		1,190
Shareholders deficit:				
Common stock, $0.10 par value 20,000,000 shares authorized, 723,724 issued and outstanding at February 29, 2016 and May 31, 2015		73		73
Additional paid in capital		27,114		27,056
Accumulated deficit		(27,905)		(27,400)
Accumulated other comprehensive loss		(258)		(283)
Total shareholders deficit		(976)		(554)
TOTAL LIABILITIES AND SHAREHOLDERS DEFICIT	$	3,453	$	3,293

See accompanying notes to consolidated financial statements

SOFTECH, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	(in thousands, except for share and per share data)	
	For the Three Months Ended	
	February 29, 2016	**February 28, 2015**
Revenue:		
Products	$ 67	$ 184
Services	845	741
Total revenue	912	925
Cost of revenue:		
Products	18	38
Services	335	392
Total cost of revenue	353	430
Gross margin	559	495
Research and development expenses	204	183
Selling, general and administrative expenses	668	592
Change in fair value of earn-out payments	(21)	(10)
Operating loss	(292)	(270)
Interest expense	30	31
Other (income) expense	(12)	55
Net loss	$ (310)	$ (356)
Basic and diluted net loss per share:	$ (0.34)	$ (0.40)
Weighted average common and redeemable shares outstanding-basic and diluted	903,724	893,724

See accompanying notes to unaudited consolidated financial statements

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SOFTECH, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	(in thousands, except for share and per share data) For the Nine Months Ended	
	February 29, 2016	**February 28, 2015**
Revenue:		
Products	$ 475	$ 454
Services	2,722	2,362
Total revenue	3,197	2,816
Cost of revenue:		
Products	64	124
Services	1,138	1,183
Total cost of revenue	1,202	1,307
Gross margin	1,995	1,509
Research and development expenses	495	677
Selling, general and administrative expenses	1,900	1,953
Change in fair value of earn-out payments and holdback payment	30	(70)
Operating loss	(430)	(1,051)
Interest expense	71	158
Other expense	4	98
Net loss	$ (505)	$ (1,307)
Basic and diluted net loss per share:	$ (0.56)	$ (1.47)
Weighted average common and redeemable shares outstanding-basic and diluted	898,833	888,906

See accompanying notes to unaudited consolidated financial statements

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SOFTECH, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF

COMPREHENSIVE INCOME (LOSS) (UNAUDITED)

	(in thousands) For the Three Months Ended			
	February 29, 2016		**February 28, 2015**	
Net loss	$	(310)	$	(356)
Other comprehensive income:				
Foreign currency translation adjustment		(30)		113
Comprehensive loss	$	(340)	$	(243)

See accompanying notes to unaudited consolidated financial statements

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SOFTECH, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF

COMPREHENSIVE INCOME (LOSS) (UNAUDITED)

	(in thousands) For the Nine Months Ended	
	February 29, 2016	**February 28, 2015**
Net loss	$ (505)	$ (1,307)
Other comprehensive income:		
Foreign currency translation adjustment	25	198
Comprehensive loss	$ (480)	$ (1,109)

See accompanying notes to unaudited consolidated financial statements

SOFTECH, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	(in thousands) For the Nine Months Ended February 29, 2016	For the Nine Months Ended February 28, 2015
Cash flows from operating activities:		
Net loss	$ (505)	$ (1,307)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization expense	64	253
Stock-based compensation	86	85
Non-cash loss on foreign currency transactions	4	98
Non-cash interest expense	-	27
Change in fair value of earn-out payments and holdback payment	30	(70)
Change in current assets and liabilities:		
Accounts receivable	(139)	125
Prepaid expenses and other assets	37	(31)
Accounts payable and accrued expenses	204	(617)
Deferred revenue	(174)	228
Net cash used in operating activities	(393)	(1,209)
Cash flows from investing activities:		
Capital expenditures	(17)	(2)
Proceeds from holdback agreement	-	320
Capitalized software development costs	(335)	(101)
Capitalized patent costs	(5)	(2)
Net cash provided by (used in) investing activities	(357)	215
Cash flows from financing activities:		
Cost of repurchase of common stock	-	(37)
Cost of repurchase of redeemable common stock	-	(275)
Borrowing under debt agreements	578	750
Proceeds from issuance of common stock	50	820
Repayments under debt agreements	(124)	(1,020)
Repayments under capital lease	(12)	(10)
Net cash provided by financing activities	492	228
Effect of exchange rates on cash	21	95
Decrease in cash and cash equivalents	(237)	(671)
Cash and cash equivalents, beginning of period	310	1,209

Cash and cash equivalents, end of period	$	73	$	538
Supplemental disclosures of cash flow information:				
Interest paid	$	47	$	105
Income taxes paid	$	2	$	2
Noncash investing and financing activities:				
Accretion of redeemable common stock	$	29	$	370
Purchase of property and equipment under capital lease	$	32	$	-

See accompanying notes to unaudited consolidated financial statements

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SOFTECH, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

A. DESCRIPTION OF THE BUSINESS AND BASIS OF PRESENTATION

SofTech, Inc. (the Company) was formed in Massachusetts on June 10, 1969. The Company is primarily engaged in the development, marketing, distribution and support of computer software solutions that serve the Product Lifecycle Management (PLM) industry. In addition to the products offered to the PLM industry, in 2012, the Company filed a patent application describing an information management system for the residential property market. During fiscal years 2015 and 2016 the Company invested a substantial amount of time in, among other things, researching this market, reviewing various business models, creating specifications for the technology and developing the technology. In January 2016, the product, HomeView , was introduced to the market and a free version of the app was made available on iTunes. The Company s operations are organized geographically with offices in the U.S. and in Italy. The Company also has resellers in Asia and Europe.

The Company has been actively engaged in acquiring and filing new U.S. patents, evaluating alternatives for monetizing its existing patents and investigating the acquisition of specific patents already awarded that might enhance shareholder value.

The unaudited consolidated financial statements of the Company include the accounts of SofTech, Inc. and its wholly-owned subsidiaries, Information Decisions, Inc., Workgroup Technology Corporation, HomeView, Inc., SofTech, GmbH and SofTech, Srl. All significant intercompany accounts and transactions have been eliminated in consolidation.

Our unaudited consolidated financial statements presented herein have been prepared pursuant to the rules of the Securities and Exchange Commission (the SEC) for quarterly reports on Form 10-Q and do not include all of the information and footnote disclosures required by generally accepted accounting principles in the United States of America (GAAP). These statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended May 31, 2015 included in our Annual Report on Form 10-K (Annual Report), which was filed with the SEC on August 31, 2015. In the opinion of management, the consolidated financial statements include all adjustments necessary for the fair presentation of the consolidated financial position, results of operations, and cash flows of the Company as of and for these interim periods.

The Company has sustained net operating losses and negative cash flow from operations for fiscal year 2014, 2015 and the first nine months of fiscal 2016 as detailed in the table below (000 s):

	Nine Months Ended February 29, 2016	Fiscal Years Ended May 31, 2015	Fiscal Years Ended May 31, 2014
Net loss	$ (505)	$ (1,319)	$ (748)
Net cash used in operating activities	$ (393)	$ (1,287)	$ (516)

The majority of the net losses and net cash used in operating activities during fiscal year 2015 and the first nine months of fiscal 2016 related to our Italian subsidiary and expenses we have incurred in launching our HomeView technology.

Our Italian subsidiary was primarily focused on marketing and supporting the CADRA technology prior to the sale of that product line in fiscal 2014. Since that time, it has been offering CADRA under a Distributorship Agreement while developing new revenue streams. The losses diminished significantly in fiscal 2016 as compared to 2015 as a result of these new initiatives.

With regard to HomeView, we are continuing to develop the technology and expect multiple new releases for the foreseeable future. We began introducing this product to the market during the three months ended February 29, 2016. The Company expects that additional capital will be required to continue to introduce HomeView into the market effectively.

The Company has been investigating various alternatives for raising this needed capital. While debt is one of those alternatives, the Company believes that some form of equity infusion is more appropriate given that the new product has not yet demonstrated market acceptance or proven its revenue model. There can be no assurance that we can raise the necessary capital on reasonable terms. If the Company is unable to raise the necessary capital, its plans for maximizing the return on the capital invested in the HomeView product and for establishing a new revenue source may be materially negatively impacted.

Another possible alternative to selling additional shares of common stock or incurring debt may be to raise the necessary capital through the sale of one or more of the Company s existing revenue producing product lines. At this time, we do not know what alternatives will be available to us and no final decision has been made on the best alternative available. However, we are continuously evaluating this situation.

The consolidated financial statements have been prepared on a basis that contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. The Company s long-term viability is dependent on its ability to generate sufficient product revenue, net income and cash flows from operations to support its business as well as its ability to obtain additional capital.

The Company had a cash balance of approximately $73,000 as of February 29, 2016. Management s plans also include reducing operating costs and delaying certain expenditures, if necessary, to maintain the Company s liquidity. Management believes that with its available cash and current operating plan that projects cash generation from future operations it will have sufficient cash to meet the Company s working capital and capital expenditure requirements through at least the next twelve months. There can be no assurance, however, that the Company will not require additional financing in the future if funds from future operations or estimated expenses differ materially from those amounts estimated by management. If we were required to obtain additional financing in the future, there can be no assurance that sources of capital would be available on terms favorable to us, if at all.

HOMEVIEW, INC.

The Company established a wholly-owned subsidiary, HomeView, Inc. on April 7, 2015 in Massachusetts. HomeView , a technology being developed by HomeView, Inc., is a secure, intelligent home asset management and maintenance system. HomeView allows homeowners to create a virtual home manual that logs, manages and tracks personal assets and attributes about the property. Home ownership is made easier by managing user manuals, warranty periods, service records, maintenance reminders and other projects with HomeView. We are currently offering this technology to consumers as a hosted solution, with the software residing on our servers.

CADRA SALE

On October 18, 2013, the Company sold substantially all of the assets of its CADRA product line, including all intellectual property related to that technology but specifically excluding cash, billed accounts receivable and liabilities other than the deferred maintenance liability associated with CADRA customer maintenance contracts for support services (the CADRA Sale), to Mentor Graphics Corporation (Mentor), pursuant to an Asset Purchase Agreement dated August 30, 2013 (the Asset Purchase Agreement). The aggregate consideration for the CADRA Sale is up to $3.95 million. Through February 29, 2016 the Company has received a total of approximately $3.5 million from Mentor. On April 1, 2016, the Company received an additional payment of approximately $200,000 in contingent payments and could receive up to an additional $223,000 based upon the CADRA revenue generated by Mentor for the period from February 1, 2016 through October 31, 2016. In accordance with the terms of the Asset Purchase Agreement the final payment would be received on or before April 1, 2017.

In conjunction with completing the CADRA Sale, the Company entered into a one-year, exclusive Distributorship Agreement with Mentor allowing us to market and support the CADRA technology as a reseller throughout Europe (except Germany) at a thirty percent (30%) gross margin. In March 2016 that arrangement was extended through March 24, 2017 on a non-exclusive basis. Under the new arrangement, gross margin on software remained at 30% and the gross margin on support contracts is 35%.

RECLASSIFICATIONS

Certain accounts in the financial statements for the three and nine month period ended February 28, 2015 have been reclassified for presentation purposes and had no impact on net loss.

B. SIGNIFICANT ACCOUNTING POLICIES

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 revenues and expenses during the reporting period. The most significant estimates included in the financial statements pertain to revenue recognition, the allowance for doubtful accounts receivable, the fair value estimate of the Holdback Payment and Earn-Out Payments and the valuation of long term assets including goodwill, capitalized patent costs, capitalized software development costs and deferred tax assets. Actual results could differ from those estimates.

SOFTWARE DEVELOPMENT COSTS

The Company accounts for its software development costs in accordance with Accounting Standards Codification (ASC) *985-20, Software-Costs of Computer Software to Be Sold, Leased or Marketed* and *ASC 350-40, Intangibles-Goodwill and Other- Internal Use-Software.* ASC 985-20 is applicable to costs incurred to develop or purchase software to be sold, leased or otherwise marketed as a separate product or as part of a product or process. ASC 350-40 is applicable to costs incurred to develop or obtain software solely to meet an entity s internal needs and for which no substantive plan exists or is being developed to externally market the software. ASC 350-40 also covers technology that would be offered as a hosted solution.

Under ASC 985-20, costs that are incurred in researching and developing a computer software product are charged to expense until technological feasibility has been established for the product. Once technological feasibility is established, software development costs are capitalized until the product is available for general release to customers.

Under ASC 350-40 there are three distinct stages associated with development software which include 1) preliminary project; 2) application development; and 3) post implementation-operation. Costs should be capitalized after each of the following has occurred:

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The preliminary project stage has been completed;

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Management with the relevant authority authorizes the project;

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Management with the relevant authority commits to fund the project;

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It is probable that the project will be completed; and

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It is probable that the software will be used for the intended purpose.

Capitalization stops after the software is substantially complete.

Capitalized costs are amortized using the straight-line method over the estimated economic life of the product, generally three years. The Company evaluates the realizability of the assets and the related periods of amortization on a regular basis. Judgment is required in determining when costs should begin to be capitalized under both standards as well as the technology s economic life.

During both the three and nine months ended February 28, 2015, the Company capitalized software development costs of approximately $101,000. During the three and nine months ended February 29, 2016, the Company capitalized approximately $104,000 and $335,000 of its software development costs, respectively. Amortization expense related to capitalized software development costs for the three and nine months ended February 29, 2016 was approximately $7,000 and $35,000, respectively, as compared to approximately $28,000 and $84,000 for the comparable periods in the prior fiscal year.

<u>INCOME TAXES</u>

The provision for income taxes is based on the earnings or losses reported in the consolidated financial statements. The Company recognizes deferred tax liabilities and assets for the expected future tax consequences of events that have been recognized in the Company s financial statements or tax returns. Deferred tax liabilities and assets are determined based on the difference between the financial statement carrying amounts and tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. The Company provides a valuation allowance against deferred tax assets if it is more likely than not that some or all of the deferred tax assets will not be realized.

REVENUE RECOGNITION

The Company follows the provisions of ASC 985-605, *Software Revenue Recognition,* for transactions involving the licensing of software and software support services. Revenue from software license sales is recognized when persuasive evidence of an arrangement exists, delivery of the product has been made, there is a fixed fee and collectability is reasonably assured. The Company does not provide for a right of return. For multiple element arrangements, total fees are allocated to each of the undelivered elements based upon vendor specific objective evidence (VSOE) of their fair values, with the residual amount recognized as revenue for the delivered elements, using the residual method set forth in ASC 985-605. Revenue from customer maintenance support agreements is deferred and recognized ratably over the term of the agreements, typically one year. Revenue from engineering, consulting and training services is recognized as those services are rendered using a proportional performance model.

ACCOUNTING FOR GOODWILL

The Company accounts for goodwill pursuant to ASC 350, *Intangibles Goodwill and Other*. This requires that goodwill be reviewed annually, or more frequently as a result of an event or change in circumstances, for possible impairment with impaired assets written down to fair value. Additionally, existing goodwill and intangible assets must be assessed and classified within the standard s criteria.

As of May 31, 2015, the Company conducted its annual impairment test of goodwill by comparing the fair value of the reporting unit to the carrying amount of the underlying assets and liabilities of its single reporting unit. The Company determined that the fair value of the reporting unit exceeded the carrying amount of the assets and liabilities, therefore no impairment existed as of the testing date. The Company concluded that no facts or circumstances arose during the three and nine months ended February 29, 2016 to warrant an interim impairment test.

CAPITALIZED PATENT COSTS

Costs related to patent applications are capitalized as incurred and are amortized once the patent application is accepted or are expensed if the application is finally rejected. Patent costs are amortized over their estimated economic lives under the straight-line method, and are evaluated for impairment when events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable through the estimated undiscounted future cash flows from the use of the associated patent. Capitalized patent costs totaled approximately $5,000 for both the three and nine month periods ended February 29, 2016, respectively, as compared to $2,000 for both the three and nine month periods ended February 28, 2015.

LONG-LIVED ASSETS

The Company periodically reviews the carrying value of all intangible and other long-lived assets. If indicators of impairment exist, the Company compares the undiscounted cash flows estimated to be generated by those assets over their estimated economic life to the related carrying value of those assets to determine if the assets are impaired. If the carrying value of the asset is greater than the estimated undiscounted cash flows, the carrying value of the assets would be decreased to their fair value through a charge to operations. As of February 29, 2016, the Company does not have any long-lived assets it considers to be impaired.

FINANCIAL INSTRUMENTS

The Company s financial instruments consist of cash, accounts receivable, Earn-Out Payments, related party notes receivable, accounts payable, accrued expenses, long-term debt and capital lease obligations. The Company s estimate of the fair value of these financial instruments approximates their carrying value due to the short term maturity of the assets and liabilities at February 29, 2016.

FAIR VALUE OF FINANCIAL INSTRUMENTS

Accounting guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Under this guidance, the Company is required to classify certain assets based on the fair value hierarchy, which groups fair value-measured assets based upon the following levels of inputs:

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Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

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Level 2 Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability;

.

Level 3 Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e. supported by little or no market activity).

The assets maintained by the Company that are required to be measured at fair value on a recurring basis are the Earn-Out Payments associated with the Company s sale of the CADRA product line. As of February 29, 2016, the maximum amount that could be received by the Company under the Asset Purchase Agreement totaled $423,000. On April 1, 2016, the Company received an Earn-Out Payment of approximately $200,000 for the CADRA revenue generated by Mentor for the twelve month period ended January 31, 2016 thereby reducing the maximum amount that could be collected in the final Earn-Out Payment due on April 1, 2017 to $223,000. The final Earn-Out Payment will be based on the CADRA revenue generated for the nine month period ended October 31, 2016. The average quarterly CADRA revenue for Mentor s most recent fiscal year was approximately $500,000.

The following table summarizes the valuation of the Company's assets and liabilities measured at fair value on a recurring basis as of February 29, 2016:

			(in thousands)	
	Total	**Quoted prices in active markets (Level 1)**	**Significant other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**
Assets:				
Earn-Out Payments	$ 346	$ -	$ -	$ 346
Total assets at fair value	$ 346	$ -	$ -	$ 346

The following table summarizes the valuation of the Company's assets and liabilities measured at fair value on a recurring basis as of May 31, 2015:

			(in thousands)	
	Total	**Quoted prices in active markets (Level 1)**	**Significant other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**
Assets:				
Earn-Out Payments	$ 376	$ -	$ -	$ 376
Total assets at fair value	$ 376	$ -	$ -	$ 376

The table below provides a summary of the changes in fair value of the Level 3 classified Holdback Payment and Earn-Out Payments asset from May 31, 2014 through February 29, 2016.

		(in thousands)
Fair value at May 31, 2014	$	895
Payments received		(604)
Change in fair value		85
Fair value at May 31, 2015		376
Change in fair value		(30)
Fair value at February 29, 2016	$	346

The fair value of the Earn-Out Payments expected to be collected within twelve months of the balance sheet date have been classified as current assets and the remainder as non-current assets in the accompanying consolidated balance sheets. The Company has estimated the fair value of the Earn-Out Payments using a discounted cash flow approach. This valuation is based upon several factors including; i) management s estimate of the amount and timing of future CADRA revenues, ii) the timing of receipt of payments from Mentor, and iii) a discount rate of 7%.

A change in any of these unobservable inputs can significantly change the fair value of the asset. The change in fair value of the Earn-Out Payments recognized in the Consolidated Statements of Operations for the three and nine months ended February 29, 2016 resulted in a gain (loss) of approximately $21,000 and ($30,000), respectively. The change in fair value of the Earn-Out Payments recognized in the Consolidated Statements of Operations for the three and nine months ended February 28, 2015 resulted in income of approximately $10,000 and $70,000, respectively.

FOREIGN CURRENCY TRANSLATION

The functional currency of the Company s foreign operations is the Euro. As a result, assets and liabilities are translated at period-end exchange rates and revenues and expenses are translated at the average exchange rates. Adjustments resulting from translation of such financial statements are classified in accumulated other comprehensive loss. Foreign currency gains and losses arising from transactions were included in the statements of operations. For the three and nine month periods ended February 29, 2016, the Company recorded a net (gain) loss from foreign currency related transactions of approximately ($12,000), and $4,000, respectively, as compared to approximately $55,000 and $98,000, respectively, for the comparable periods in the prior fiscal year, to Other (income) expense in the unaudited Consolidated Statements of Operations.

NET (LOSS) INCOME PER COMMON SHARE

For the three and nine month periods ended February 29, 2016, 3,989 and 3,192, respectively, options to purchase shares of common stock were anti-dilutive and were excluded from the basic and diluted earnings per share calculation. For the three and nine month periods ended February 28, 2015, 1,991 and 995, respectively, options to purchase shares of common stock were anti-dilutive and were excluded from the basic and diluted earnings per share calculation.

STOCK-BASED COMPENSATION

Stock-based compensation expense for all stock-based payment awards made to employees and directors is measured based on the grant-date fair value of the award. The Company estimated the fair value of each share-based award using the Black-Scholes option valuation model. The Black-Scholes option valuation model incorporates assumptions as to stock price volatility, the expected life of options, a risk-free interest rate and dividend yield. The Company recognizes stock-based compensation expense on a straight-line basis over the requisite service period of the award.

In May 2011, the 2011 Equity Incentive Plan (the 2011 Plan) was approved by the Company s shareholders, pursuant to which 150,000 shares of our common stocks are reserved for issuance. Any shares subject to any award under the 2011 Plan that expires, is terminated unexercised or is forfeited will be available for awards under the 2011 Plan. The Company may grant stock options, restricted stock, restricted stock units, stock equivalents and awards of shares of common stock that are not subject to restrictions or forfeiture under the 2011 Plan. As of February 29, 2016, 149,500 options were outstanding.

The following table summarizes option activity under the 2011 Stock Option Plan:

	Number of Options	Weighted Average Exercise Price Per Share	Weighted-Average Remaining Life (in years)	Aggregate Intrinsic Value
Outstanding options at May 31, 2014	129,500	1.88	9.74	20,825
Granted	30,000	1.84	10.00	-
Exercised	-	-	-	-
Forfeited or expired	(12,500)	1.11	-	-
Outstanding options at May 31, 2015	147,000	1.77	8.54	2,625
Granted	2,500	1.00	10.00	-
Exercised	-	-	-	-
Forfeited or expired	-	-	-	-
Outstanding options at February 29, 2016	149,500	$ 1.75	7.82	$ 4,975
Exercisable at February 29, 2016	131,598	$ 1.77	7.74	$ 4,722

The Company determined the volatility for options granted using the historical volatility of the Company s common stock. The expected life of options has been determined utilizing the simplified method as prescribed in ASC 718, *Compensation, Stock Compensation*. The expected life represents an estimate of the time options are expected to remain outstanding. The risk-free interest rate is based on a treasury instrument whose term is consistent with the expected life of the stock options. The Company has not paid, and does not anticipate paying, cash dividends on its common stock; therefore, the expected dividend yield is assumed to be zero.

For the three and nine month periods ended February 29, 2016, the Company expensed approximately $28,000 and $86,000 of stock-based compensation, respectively, as compared to approximately $25,000 and $85,000 in the comparable prior periods.

REDEEMABLE COMMON STOCK

During the year ended May 31, 2013, the Company issued 50,000 shares of common stock, $0.10 par value (the Common Stock), at a purchase price of $5.00 per share to accredited investors (collectively, the Investors) in separate private placement transactions for total proceeds of $250,000. These transactions were completed pursuant to a Securities Purchase Agreement (the Agreement) which the Company entered into with each of the respective Investors. In lieu of registration rights, each $25,000 investment entitled the Investors to a fee of $6,000 (the Fee) to be paid in six equal quarterly installments during the eighteen month period following the investment. The Agreement also provided the Investors with the right to require the Company to redeem the Common Stock held by such Investors (the Put Option) for $5.50 per share in cash for a 30 day period ending between June 1, 2014 and June 30, 2014. Each of the Investors exercised their Put Option and the Common Stock was repurchased by the Company at the agreed upon Put Option price of $5.50 per share for a total of $275,000 during the first quarter of fiscal 2015.

During the fiscal quarter ended August 31, 2014, in a transaction structured in a similar fashion to the above described Agreement, the Company issued 110,000 shares of the Common Stock at a purchase price of $5.00 per share to Joseph P. Daly, an accredited investor and existing Company shareholder, in a private placement transaction for total proceeds of $550,000. This transaction was completed pursuant to a securities purchase agreement whereby Mr. Daly shall have the right to require the Company to repurchase some or all of the shares at $7.00 per share during the ninety (90) day period immediately following the three-year anniversary of the transaction. Upon completion of the transaction, the 110,000 shares of Common Stock issued pursuant to the security purchase agreement were recorded as redeemable common stock at its redemption value of $770,000 and accretion of $220,000 was recorded to additional paid in capital.

During the fiscal quarter ended November 30, 2014, the Company issued an additional 60,000 shares of the Common Stock at a purchase price of $5.00 per share to four accredited investors (collectively, the New Investors) in private placement transactions for total proceeds of $300,000. These transactions were completed pursuant to Securities Purchase Agreements (the New Agreements) entered into with each of the respective New Investors. In lieu of registration rights, each $50,000 investment entitles the New Investors to a fee (the New Investors Fees) of $5,000 to be paid in eight equal quarterly installments during the twenty-four month period (the Payment Period) following the investment. The New Agreements also provide the New Investors with the right to require the Company to redeem the Common Stock held by such New Investors for $7.00 per share in cash for a 30 day period following the Payment Period. Upon completion of these transactions, the 60,000 shares of Common Stock issued pursuant to the New Agreements were recorded as redeemable common stock at its redemption value of $420,000 and accretion of

$120,000 was recorded to additional paid in capital.

During the fiscal quarter ended November 30, 2015, the Company issued an additional 10,000 shares of the Common Stock at a purchase price of $5.00 per share to an accredited investor in private placement transactions for total proceeds of $50,000. This transaction was completed pursuant to a Securities Purchase Agreement entered into with the investor. In lieu of registration rights, the investor is entitled to a fee of $5,000 to be paid in eight equal quarterly installments during the twenty-four month period (the Payment Period) following the investment. The Securities Purchase Agreement also provides the investor with the right to require the Company to redeem the Common Stock held by such investor for $7.00 per share in cash for a 30 day period following the Payment Period. Upon completion of this transaction, the 10,000 shares of Common Stock issued pursuant to the Securities Purchase Agreement was recorded as redeemable common stock at its redemption value of $70,000 and accretion of $20,000 was recorded to additional paid in capital.

As of February 29, 2016, the redeemable common stockholders of the Company have the right to redeem shares with an aggregate redemption value of $420,000 within twelve months of the balance sheet date.

The Company first assessed the redeemable Common Stock to determine whether each of these instruments should be accounted for as a liability in accordance with ASC 480, *Distinguishing Liabilities from Equity*. In that the put option is optionally redeemable by the holder, the Common Stock was not required to be accounted for as a liability. Next, the Company assessed each put option within the redeemable Common Stock as a potential embedded derivative pursuant to the provisions of ASC 815, *Derivatives and Hedging,* and concluded that the put option did not meet the net settlement criteria within the definition of a derivative. Therefore, the Company has accounted for the redeemable Common Stock in accordance with ASC 480-10-S99, *Classification and Measurement of Redeemable Securities*, which provides that securities that are optionally redeemable by the holder for cash or other assets are classified outside of permanent equity in temporary equity.

RECENT ACCOUNTING PRONOUNCEMENTS

In May 2015, the FASB issued ASU No. 2015-08, "Business Combinations (Topic 805): Pushdown Accounting Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115." The amendments in this ASU amend various SEC paragraphs pursuant to the issuance of Staff Accounting Bulletin No. 115, Topic 5: Miscellaneous Accounting, regarding various pushdown accounting issues, and did not have a material impact on the Company's consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-05, "Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement." The amendments in this ASU provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The amendments do not change the accounting for a customer's accounting for service contracts. As a result of the amendments, all software licenses within the scope of Subtopic 350-40 will be accounted for consistent with other licenses of intangible assets. The amendments in this ASU are effective for public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted. An entity can elect to adopt the amendments either: (1) prospectively to all arrangements entered into or materially modified after the effective date; or (2) retrospectively. The Company is currently assessing the impact that ASU 2015-05 will have on its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, "Interest Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs." The amendments in this ASU are intended to simplify the presentation of debt issuance costs. These amendments require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. The amendments in this ASU are effective for public business entities for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted for financial statements that have not been previously issued. The Company does not expect the adoption of ASU 2015-03 to have a material impact on its consolidated financial statements.

In February 2015, the FASB issued ASU No. 2015-02, "Consolidation (Topic 810): Amendments to the Consolidation Analysis." The amendments in this ASU are intended to improve targeted areas of consolidation guidance for legal entities such as limited partnerships, limited liability corporations, and securitization structures (collateralized debt obligations, collateralized loan obligations, and mortgage-backed security transactions). In addition to reducing the number of consolidation models from four to two, the new standard simplifies the FASB Accounting Standards

Codification and improves current GAAP by placing more emphasis on risk of loss when determining a controlling financial interest, reducing the frequency of the application of related-party guidance when determining a controlling financial interest in a variable interest entity ("VIE"), and changing consolidation conclusions for public and private companies in several industries that typically make use of limited partnerships or VIEs. The amendments in this ASU are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. ASU 2015-02 may be applied retrospectively in previously issued financial statements for one or more years with a cumulative-effect adjustment to retained earnings as of the beginning of the first year restated. The Company does not expect the adoption of ASU 2015-02 to have a material impact on its consolidated financial statements.

Accounting Standards Update (ASU) 2014-16, Derivatives and Hedging (Topic 815) Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity was issued by the FASB in November 2014. The primary purpose of the ASU is to eliminate the use of different methods in practice and thereby reduce existing diversity under GAAP in the accounting for hybrid financial instruments issued in the form of a share. ASU 2014-16 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The Company does not believe that this guidance will have a material impact on its consolidated results of operations or financial position or disclosures.

Accounting Standards Update (ASU) 2014-15, Presentation of Financial Statements-Going Concern (Subtopic 205-40) Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern was issued by the FASB in August 2014. The primary purpose of the ASU is to provide guidance in GAAP about management s responsibility to evaluate whether there is substantial doubt about an entity s ability to continue as a going concern and to provide related footnote disclosures. The amendments should reduce diversity in the timing and content of footnote disclosure. ASU 2014-15 is effective for the annual period ending after December 15, 2016, and for the annual periods and interim periods thereafter. Early adoption is permitted. The Company is in the process of evaluating if this guidance will have a material impact on its consolidated results of operations or financial position or disclosures.

ASU 2014-12, Compensation-Stock Compensation (Topic 718) Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period was issued by the FASB in June 2014. ASU 2014-12 requires that compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. ASU 2014-12 is effective for public business entities for annual periods and interim periods within the annual periods beginning after December 15, 2015. Early adoption is permitted. The Company does not believe this guidance will have a material impact on its consolidated results of operations or financial position.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, (Topic 606). The ASU is the result of a joint project by the FASB and the International Accounting Standards Board (IASB) to clarify the principles for recognizing revenue and to develop a common revenue standard for GAAP and International Financial Reporting Standards (IFRS) that would: remove inconsistencies and weaknesses, provide a more robust framework for addressing revenue issues, improve comparability of revenue recognition practices across entities, jurisdictions, industries, and capital markets, improve disclosure requirements and resulting financial statements, and simplify the presentation of financial statements. The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU is effective for annual and interim reporting periods beginning after December 15, 2017, based on ASU 2015-14. Early application is permitted but not before the original effective date of December 15, 2016. The Company is currently assessing the impact of this guidance.

C. GEOGRAPHICAL INFORMATION

The Company operates in one reportable segment and is engaged in the development, marketing, distribution and support of computer aided design and product data management and collaboration computer solutions. The Company s operations are organized geographically with offices in the U.S. and Italy. Components of revenue and long-lived assets (consisting primarily of intangible assets, capitalized software and property, plant and equipment) by geographic location, are as follows (in thousands):

	Three Month Periods Ended	
Revenue:	**February 29, 2016**	**February 28, 2015**
North America	$ 746	$ 809
Europe	193	146
Asia	3	-
Eliminations	(30)	(30)

Consolidated Total	$	912	$	925

	Nine Month Periods Ended			
	February 29, 2016		February 28, 2015	
Revenue:				
North America	$	2,564	$	2,350
Europe		675		512
Asia		9		-
Eliminations		(51)		(46)
Consolidated Total	$	3,197	$	2,816

	As of February 29, 2016		As of May 31, 2015	
Long Lived Assets:				
North America	$	2,136	$	1,797
Europe		40		41
Consolidated Total	$	2,176	$	1,838

D. DEBT

ESSIGPR

On June 20, 2014, the Company entered into a promissory note agreement (the Note) with EssigPR, Inc. (EssigPR), a Puerto Rico corporation and related party of the Company. The Note is a three (3) year borrowing arrangement with EssigPR as the lender. The Note is a $750,000 term loan maturing on April 1, 2017, that accrues interest at a 9.5% interest rate, paid quarterly in arrears. The principal on the Note was to be paid from the deferred payments (Holdback Payment and Earn-Out Payments) due over the next three years from Mentor in connection with their purchase of the CADRA product line.

On October 1, 2014, the Company entered into an additional short term borrowing arrangement with EssigPR (Short Term Note) whereby it was agreed that the Company would retain $300,000 of the Holdback Payment due from Mentor in October 2014 rather than utilize those monies to pay down the above described Note. The interest rate on the Short Term Note is 9.5%, payable quarterly in arrears. The Short Term Note can be repaid at any time without penalty and was due in full on April 10, 2015. EssigPR was awarded 5,000 fully vested stock options to purchase SofTech common stock at $1.00 per share. The stock options will expire on October 1, 2024 if not exercised. The Short Term Note arrangement did not increase the total principal amount of debt owed to EssigPR. Rather, the arrangement had the effect of establishing new payoff terms for that portion of the debt owed to EssigPR under the Note.

On April 2, 2015, the Short Term Note was amended to extend the due date by three months from April 10, 2015 to July 10, 2015. EssigPR was awarded 2,500 fully vested stock options to purchase SofTech common stock at $1.00 per share. The stock options will expire on April 2, 2025 if not exercised.

During the three months ended August 31, 2015, the Short Term Note was amended to extend the due date to October 10, 2015 and to increase the borrowings by $200,000 in exchange for 2,500 fully vested stock options to purchase SofTech common stock at $1.00 per share. The stock options will expire on July 15, 2025 if not exercised.

During the three months ended November 30, 2015, the Short Term Note was amended to extend the due date to January 10, 2016 and to increase the borrowings by $254,000.

On January 8, 2016, the Short Term Note was amended to extend the due date to April 10, 2016.

On April 11, 2016, the Short Term Note was amended to extend the due date to July 10, 2016.

On the occurrence and continuance of an event of default under the Note that is not cured after written notice from EssigPR, all or any part of the indebtedness under the Note may become immediately due at the option of EssigPR. Under the Note, events of default are (1) a default in the payment of any money owed by the Company to EssigPR under the Note or in any other transaction or (2) a default in the Company s performance of any obligation to EssigPR under the Note or any other agreement between the two parties, whether such agreement is presently existing or entered into in the future. If the Company dissolves, becomes insolvent, or makes an assignment for the benefit of creditors, all such indebtedness under the Note shall become automatically due and payable.

EssigPR is owned by Joseph P. Daly, a related party of the Company whose beneficial ownership was approximately 19.6% of the Company s outstanding common stock as of February 29, 2016.

SHORT TERM ADVANCES FROM RELATED PARTIES

Robert Anthonyson, an Officer, Director and beneficial owner of 19.5% of the Company s outstanding common stock as of February 29, 2016, loaned the Company $50,000 on July 29, 2015 which was repaid to Mr. Anthonyson during the second quarter of fiscal year 2016. Joseph Mullaney, an Officer, Director and beneficial owner of 11.2% of the Company s outstanding common stock as of February 29, 2016, loaned the Company $19,300 on September 1, 2015 which was repaid during the second quarter of fiscal year 2016.

BLUEVINE

In September 2015, the Company arranged for a credit line of up to $80,000 with BlueVine Capital, Inc. (BlueVine). The borrowing arrangement with BlueVine as the lender allows the Company to receive an advance of 85% of the total value of specified invoices. During the three and nine month periods ended February 29, 2016, the Company received advances totaling approximately $23,000 and $55,000 against seven invoices from one customer. As of February 29, 2016 there were no outstanding borrowings under this debt facility.

E. NOTE RECEIVABLE, RELATED PARTY

Joseph Mullaney, the Company s CEO, was extended a non-interest bearing note in the amount of $134,000 related to a stock transaction in May, 1998. The note is partially secured by the Company stock acquired in that transaction. The Company does not expect repayment within the next twelve months.

F. STOCK PURCHASE AGREEMENT

In June 2013, the Company purchased 170,000 shares of common stock from Greenleaf, The Ronda E. Stryker and William D. Johnston Foundation, and The L. Lee Stryker 1974 Irrevocable Trust fbo Ronda E. Stryker, for a purchase price of $62,900 or $0.37 per share as detailed in Note K to the consolidated financial statements as of May 31, 2013. On August 8, 2014 the Company repurchased Greenleaf s remaining 101,411 shares at $0.37 per share for a total of approximately $37,000.

G. SUBSEQUENT EVENTS

The Company has evaluated all events and transactions that occurred after the balance sheet and through the date that the financial statements were issued.

On March 25, 2016, the Company s wholly-owned subsidiary in Italy renewed its Distributorship Agreement with Mentor allowing us to market and support the CADRA technology as a reseller throughout Europe (except Germany) through March 24, 2017 on a non-exclusive basis.

On April 11, 2016 the Short Term Note by and among SofTech, Inc., EssigPR and Joe Daly was extended for an additional three months to July 10, 2016.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

This report includes forward-looking statements that relate to, among other matters, our business operations and plans and strategy for the future; our future financial performance and results of operations; and demand for our products and services. These forward-looking statements are often identified by words such as may, will, should, could, w expect, intend, plan, anticipate, believe, estimate, project, predict, potential and similar expressions are only predictions and involve estimates, assumptions and uncertainties that could cause actual results to differ materially from those expressed. You should not place any undue reliance on these forward-looking statements.

You should be aware that our actual results could differ materially from those contained in the forward-looking statements due to a number of factors, including our ability to:

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generate sufficient cash flow from our operations or other sources to fund our working capital needs and growth initiatives;

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maintain good relationships with our lenders;

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comply with the covenant requirements and payment terms under our loan agreements;

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successfully introduce and attain market acceptance of any new products and/or enhancements of existing products;

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attract and retain qualified personnel;

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prevent obsolescence of our technologies;

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identify strategic initiatives and opportunities that are consistent with our strategic goals;

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maintain agreements with our critical software vendors;

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secure renewals of existing software maintenance contracts, as well as contracts with new maintenance customers; and

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secure new business, both from existing and new customers.

These and other additional factors that may cause our actual results to differ materially from those contained in the forward-looking statements are set forth more fully under Item 1A Risk Factors of this report and the other reports we file from time to time with the SEC.

The forward-looking statements speak only as of the date on which they are made, and, except to the extent required by federal securities laws, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. References in this report to the Company, we, our, and us refer to the registrant, SofTech, Inc., and its wholly ow subsidiaries.

The following discussion and results of operations should be read in conjunction with the consolidated financial statements and the notes to those statements included in the previously filed Form 10-K. This discussion includes forward-looking statements that involve risk and uncertainties.

Overview

We operate in one reportable segment and are engaged in the development, marketing, distribution and support of computer software solutions that enable companies to manage the entire lifecycle of their products from conception through design and manufacture, to service and disposal, all of which is known in the industry as Product Lifecycle Management (PLM). These solutions include software technology offerings for Computer Aided Design (CAD), which we describe below as the *CADRA* product offering and Product Data Management (PDM) and collaboration technologies, which we describe below as our *ProductCenter* and *Connector* technologies. The CADRA technology is marketed by the Company in Europe (other than Germany) under the terms of a distribution agreement (the

Distributorship Agreement) with Mentor Graphics Corporation (Mentor), which acquired that technology from us in October 2013. In addition, we offer a technology platform that allows for data exchange between various third party technology offerings which we describe as our *Connector* offering. We deliver these enterprise level PLM solutions, with comprehensive out-of-the-box capabilities, to meet the needs of manufacturers of all sizes quickly and cost-effectively. Our operations are organized geographically in the U.S. and Europe. We have sales and customer support offices in the U.S. and Italy. We also operate through resellers in North America, Europe and Asia. For geographical information about our operating revenues and assets, see Note E to the consolidated financial statements included in the Company s Form 10-K for the fiscal year ended May 31, 2015.

The Company has been actively engaged in acquiring and filing new patent applications, evaluating alternatives for monetizing its existing patents and investigating the acquisition of specific patents already awarded that might enhance our value. It is expected that this kind of activity will become an increasing area of focus and investment over the coming years.

Developing HomeView Technology

One such patent filed in 2012 described an information management system for the residential property market. During fiscal 2015 and 2016 we have invested a substantial amount of time in, among other things, researching this market, reviewing various business models, creating specifications for the technology and developing the technology. We are marketing this technology under the name HomeView . By the end of the second quarter of fiscal 2015 we had completed the preliminary project stage and met the other conditions for capitalizing development costs under ASC 350-40. While this technology is aimed at the needs of the residential property market, the skillsets of our PLM engineers are very similar to the requirements for this technology.

In December 2015, the mobile version of HomeView was approved on iTunes and is now available for download at no charge. HomeView is offered as a hosted solution wherein the software resides on our servers. We are continuing to develop the technology and expect multiple new releases for the foreseeable future. We began introducing this product to the market in the third quarter of fiscal 2016, through attendance and participation at multiple trade events as well as conducting other market outreach activities. Specifically, we attended the Computer Electronics Show and the National Association of Home Builders Show in Las Vegas, Nevada in January 2016. We also exhibited at Inman Connect, a gathering focused on Realtors and Brokers, in New York City in February 2016. In March and April 2016 we have exhibited at multiple Home Shows throughout Massachusetts. We expect this market outreach to continue and possibly increase for the foreseeable future.

ProductCenter

From fiscal years 2006 through 2014 our ProductCenter technology experienced year over year revenue declines. We identified multiple causes for this historical negative revenue trend including, among other things: (i) an increased number of competitive offerings in the marketplace, (ii) elongation of purchase decisions by customers of a technology that already had a long sales cycle, and (iii) uncertain economic conditions. ProductCenter revenue increased in fiscal 2015 by 14.6% as compared to the prior fiscal year. For the first nine months of fiscal 2016, the revenue from the ProductCenter technology increased 5.8% as compared to the same period in fiscal 2015, although this growth has been uneven through the fiscal quarters of fiscal 2016 as detailed herein.

Connector

The Connector technology is offered only as an annual subscription. This product was launched in fiscal 2014 and has been growing steadily. Our revenue for the first nine months of fiscal 2016 was about $137,000 as compared to about $79,000 for the same period in fiscal 2015. During the first nine months of fiscal 2016 we had ten new subscribers compared to seven new subscribers during the same period in fiscal 2015.

CADRA Sale

CADRA is a drafting and design software package for the professional mechanical engineer.

On October 18, 2013, the Company sold substantially all of the assets of its CADRA product line, including all intellectual property related to that technology but specifically excluding cash, billed accounts receivable and liabilities other than the deferred maintenance liability associated with CADRA customer maintenance contracts for support services (the CADRA Sale), to Mentor pursuant to an Asset Purchase Agreement dated August 30, 2013 (the Asset Purchase Agreement). The aggregate consideration for the CADRA Sale is up to $3.95 million, which is comprised of (i) $3.2 million, $2.88 million of which was paid on the closing date and $320,000 (representing a 10% holdback) payable on the one year anniversary of the closing date subject to any indemnification claims, (the Holdback Payment), and (ii) earn-out payments of up to an aggregate $750,000 over the three-year period subsequent to the closing date (the Earn-Out Payments), based on 10% of the net revenue generated by the CADRA business, subject to the terms of the Earn-Out Agreement dated August 30, 2013 (the Earn-Out Agreement). The Holdback Payment of $320,000 was received on October 20, 2014. No indemnification claims against the Company were made by Mentor during the period of indemnification which has now expired. As of April 1, 2016, Mentor has paid the Company $528,000 of the maximum $750,000 of Earn-Out Payments related to CADRA revenue generated by Mentor from the transaction date to January 31, 2016. The final Earn-Out Payment is due on April 1, 2017 based on CADRA revenue generated by Mentor for the nine months ended October 31, 2016.

In conjunction with completing the CADRA Sale, the Company entered into a one-year, exclusive Distributorship Agreement with Mentor allowing us to market and support the CADRA technology as a reseller throughout Europe (except Germany). Since then, the arrangement has been amended, extended and renewed multiple times. On March 25, 2016, the Distributorship Agreement between SofTech Srl and Mentor was renewed allowing us to market and support the CADRA technology throughout Europe (except Germany) through March 24, 2017 on a non-exclusive basis. Under this arrangement gross margin on software is 30% and the gross margin on support contracts is 35%, consistent with the prior year s Distributorship Agreement.

We are in the process of restructuring our business subsequent to the CADRA Sale to enable us to successfully operate as a significantly smaller company and to seek new sources of revenue and possible new strategic initiatives. We currently contemplate pursuing the activities described below and other strategic initiatives that the board of directors may subsequently determine are in the best interests of the shareholders.

Activities following the CADRA Sale

PLM Business

Subsequent to the completion of the CADRA Sale, we have continued to offer our ProductCenter and Connector technologies to design and manufacturing companies. Our ProductCenter technology manages the engineering data and electronic files of discrete parts designed in third party proprietary design technologies offered primarily by SolidWorks, PTC and Autodesk. The Connector platform is a technology that allows for a direct interface between Aras Innovator, a third-party PLM solution which features modern, web-based technology, and various well-established CAD technologies. The Aras technology is offered under a subscription revenue model as is our Connector technology. We entered into a partnership agreement with Aras in 2012, pursuant to which we provide distribution and consulting services, as further described below. For a description of the risks related to our PLM business, see Risk Factors Risks Related to Our Business in our Form 10-K for fiscal year 2015.

Distribution Activity

In connection with the CADRA Sale, we entered into a Distributorship Agreement with Mentor to market and support the CADRA technology throughout Europe (except Germany), for a minimum of one year following the sale, through our wholly-owned subsidiary in Italy, SofTech, Srl. The margin to be earned by SofTech for this distribution activity pursuant to the existing Distributorship Agreement was consistent with the margin earned by distributors in the industry. In addition, we will continue to market and distribute third party technologies from Aras as we have since 2012.

Consulting

SofTech has been engaged in the PLM market since 1993. Our consulting group is composed of deeply experienced, long tenured experts solving very complex problems relating to data migration, customization, data control, access, version control, connectivity between proprietary systems and a myriad of other problems encountered by our customers.

Exploring Strategic Initiatives

A core tenet of the management team s strategy during the past several years has been to actively consider ways to monetize some or all of SofTech s assets and to pursue new strategic initiatives, such as potential business combinations, sale transactions or strategic partnerships.

Developing Remaining Patent Estate. The Company has filed three provisional patents and purchased the rights to one provisional patent since March 2011. These patents remain in process at the United States Patent and Trademark Office, and the Company intends to continue to pursue the resolution to these filings. These patents generally relate to methods of accumulating buyers information in a database in ways that allow the information to be shared with sellers so as to allow the sellers to make targeted, relevant offers to the buyers. While these patents, which could generally be considered eCommerce related, pertain to technologies that are not directly related to our historical revenue producing business activities, we believe they may have applications in those areas.

Analyzing the potential of the technologies described in these patents and the business case for us to invest in efforts to commercialize any of them is part of an ongoing evaluation. While many of these businesses would be new to us, we believe that we possess underlying competencies from our existing businesses, such as strong engineering and software capabilities especially in database technologies, and other attributes, such as numerous long-term client relationships with technology companies that may be complementary to developing new businesses around these technologies. However, any investment by us to attempt to commercialize the technologies described in these patents could be costly and prove to be unsuccessful.

As detailed above, under the caption Overview *Developing HomeView Technology*, during fiscal year 2015 and 2016 we have invested a substantial amount of time in pursuing a data management offering for the residential property market. The product idea was detailed in a patent filing in 2012 that has yet to be awarded. During the third quarter of fiscal 2016, we made the HomeView technology available on iTunes. In addition, we attended a half dozen technology, trade and home shows to begin to introduce the offering. The feedback has been positive to date and we expect this kind of marketing outreach to continue for the foreseeable future.

Strategic Transactions. We will continue to evaluate business combinations and other sale opportunities. We believe that, in addition to our remaining businesses and prospects described above, our status as a publicly traded company and tax attributes could make us an attractive strategic partner. As of May 31, 2015, SofTech had approximately $21 million in federal tax attributes and approximately $4 million in state tax attributes. We will continue to seek strategic transactions for the benefit of our shareholders, but there can be no assurances in this regard.

Other

Deferred CADRA Purchase Price. The sale of the CADRA assets includes contingent Earn-Out Payments equal to 10% of Mentor s revenue derived from the CADRA technology up to a maximum of $750,000 over the three year period following completion of the transaction (ending October 31, 2016). Therefore, SofTech has a direct financial interest in the continued success of the CADRA technology subsequent to the sale. For the period from October 16, 2013 through January 31, 2016, Mentor has reported Earn-Out Payments of approximately $528,000, all of which have been paid in accordance with the Earn-Out Agreement. The CADRA revenue over the more recent quarters has been trending down ft:3.00em; text-indent:-1.00em">Federal agency collateralized mortgage obligations

95,337	1,533	(39)	96,831

Federal agency mortgage-backed pools

152,372	6,847	(15)	159,204

Private labeled mortgage-backed pools

1,960	71		2,031

Corporate notes

32	19		51

Total available for sale investment securities	$463,306	$19,663	$(168)	$482,801

Based on evaluation of available evidence, including recent changes in market interest rates, credit rating information, and information obtained from regulatory filings, management believes the declines in fair value for these securities are temporary. While these securities are held in the available for sale portfolio, Horizon intends, and has the ability, to hold them until the earlier of a recovery in fair value or maturity.

Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other-than-temporary impairment is identified. At March 31, 2013, no individual investment security had an unrealized loss that was determined to be other-than-temporary.

The unrealized losses on the Company s investments in securities of state and municipal governmental agencies, and federal agency mortgage-backed pools were caused by interest rate volatility and not a decline in credit quality. The contractual terms of those investments do not permit the issuer to settle the securities at a

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HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

price less than the amortized cost basis of the investments. The Company expects to recover the amortized cost basis over the term of the securities. Because the Company does not intend to sell the investments and it is not likely that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be at maturity, the Company did not consider those investments to be other-than-temporarily impaired at March 31, 2013.

The amortized cost and fair value of securities available for sale and held to maturity at March 31, 2013 and December 31, 2012, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	March 31, 2013		December 31, 2012	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for sale				
Within one year	$ 4,102	$ 4,116	$ 4,358	$ 4,368
One to five years	53,522	54,656	49,415	50,673
Five to ten years	91,240	96,738	98,551	104,258
After ten years	57,966	61,245	61,313	65,436
	206,830	216,755	213,637	224,735
Federal agency collateralized mortgage obligations	109,727	111,235	95,337	96,831
Federal agency mortgage-backed pools	144,300	150,230	152,372	159,204
Private labeled mortgage-backed pools	1,695	1,756	1,960	2,031
Total available for sale investment securities	$ 462,552	$ 479,976	$ 463,306	$ 482,801
Held to maturity				
Within one year	$ 2,110	$ 2,110	$	$
One to five years				
Total held to maturity investment securities	$ 2,110	$ 2,110	$	$

The following table shows the gross unrealized losses and the fair value of the Company s investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position.

	Less than 12 Months		12 Months or More		Total	
March 31, 2013	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and federal agencies	$ 15,552	$ (38)	$	$	$ 15,552	$ (38)
State and municipal	16,027	(199)			16,027	(199)
Federal agency collateralized mortgage obligations	31,845	(83)			31,845	(83)
Federal agency mortgage-backed pools	15,241	(26)			15,241	(26)

Total temporarily impaired securities	$ 78,665	$	(346)	$	$		$ 78,665	$	(346)

	Less than 12 Months			12 Months or More		Total		
December 31, 2012	**Fair Value**		**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**		**Unrealized Losses**
U.S. Treasury and federal agencies	$ 13,064	$	(30)	$	$	$ 13,064	$	(30)
State and municipal	11,928		(84)			11,928		(84)
Federal agency collateralized mortgage obligations	12,719		(39)			12,719		(39)
Federal agency mortgage-backed pools	4,126		(15)			4,126		(15)
Total temporarily impaired securities	$ 41,837	$	(168)	$	$	$ 41,837	$	(168)

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	Three months ended March 31 2013	2012
Sales of securities available for sale (Unaudited)		
Proceeds	**$ 23,485**	$
Gross gains	**376**	
Gross losses	**(8)**	

Note 4 Loans

	March 31 2013	December 31 2012
Commercial		
Working capital and equipment	**$ 207,901**	$ 198,805
Real estate, including agriculture	**251,470**	247,108
Tax exempt	**4,467**	4,579
Other	**9,264**	9,979
Total	**473,102**	460,471
Real estate		
1 4 family	**187,692**	185,940
Other	**3,655**	3,774
Total	**191,347**	189,714
Consumer		
Auto	**139,785**	142,149
Recreation	**4,908**	5,163
Real estate/home improvement	**29,599**	29,989
Home equity	**101,261**	104,974
Unsecured	**3,759**	4,194
Other	**2,398**	2,615
Total	**281,710**	289,084
Mortgage warehouse	**143,609**	251,448
Total loans	**1,089,768**	1,190,717
Allowance for loan losses	**(19,565)**	(18,270)
Loans, net	**$ 1,070,203**	$ 1,172,447

Commercial

Commercial loans are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected, and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial real estate loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves larger loan principal amounts and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely

HORIZON BANCORP AND SUBSIDIARIES

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affected by conditions in the real estate markets or in the general economy. The properties securing the Company s commercial real estate portfolio are diverse in terms of property type, and are monitored for concentrations of credit. Management monitors and evaluates commercial real estate loans based on collateral, cash flow and risk grade criteria. As a general rule, the Company avoids financing single purpose projects unless other underwriting factors are present to help mitigate risk. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans.

Real Estate and Consumer

With respect to residential loans that are secured by 1-4 family residences and are generally owner occupied, the Company generally establishes a maximum loan-to-value ratio and requires private mortgage insurance if that ratio is exceeded. Home equity loans are typically secured by a subordinate interest in 1-4 family residences, and consumer loans are secured by consumer assets such as automobiles or recreational vehicles. Some consumer loans are unsecured such as small installment loans and certain lines of credit. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Repayment can also be impacted by changes in property values on residential properties. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

Mortgage Warehousing

Horizon s mortgage warehouse lending has specific mortgage companies as customers of Horizon Bank. Individual mortgage loans originated by these mortgage companies are funded as a secured borrowing with a pledge of collateral under Horizon s agreement with the mortgage company. Each individual mortgage is assigned to Horizon until the loan is sold to the secondary market by the mortgage company. In addition, Horizon takes possession of each original note and forwards such note to the end investor once the mortgage company has sold the loan. At the time a loan is transferred to the secondary market, the mortgage company repurchases the loan under its option within the agreement. Due to the repurchase feature contained in the agreement, the transaction does not qualify as a sale and therefore is accounted for as a secured borrowing with a pledge of collateral pursuant to the agreement with the mortgage company. When the individual loan is sold to the end investor by the mortgage company, the proceeds from the sale of the loan are received by Horizon and used to pay off the loan balance with Horizon along with any accrued interest and any related fees. The remaining balance from the sale is forwarded to the mortgage company. These individual loans typically are sold by the mortgage company within 30 days and are seldom held more than 90 days. Interest income is accrued during this period and collected at the time each loan is sold. Fee income for each loan sold is collected when the loan is sold, and no costs are deferred due to the term between each loan funding and related payoff, which is typically less than 30 days.

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

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

March 31, 2013	Loan Balance	Interest Due	Deferred Fees / (Costs)	Recorded Investment
Owner occupied real estate	$ 157,076	$ 287	$ 363	$ 157,726
Non owner occupied real estate	217,220	197	349	217,766
Residential spec homes	248			248
Development & spec land loans	10,975	22	21	11,018
Commercial and industrial	86,729	815	121	87,665
Total commercial	472,248	1,321	854	474,423
Residential mortgage	184,589	599	506	185,694
Residential construction	6,252	8		6,260
Mortgage warehouse	143,609	480		144,089
Total real estate	334,450	1,087	506	336,043
Direct installment	27,396	108	(208)	27,296
Direct installment purchased	382			382
Indirect installment	131,293	361	(71)	131,583
Home equity	122,176	585	742	123,503
Total consumer	281,247	1,054	463	282,764
Total loans	1,087,945	3,462	1,823	1,093,230
Allowance for loan losses	(19,565)			(19,565)
Net loans	$ 1,068,380	$ 3,462	$ 1,823	$ 1,073,665

December 31, 2012	Loan Balance	Interest Due	Deferred Fees / (Costs)	Recorded Investment
Owner occupied real estate	$ 162,694	$ 503	$ 485	$ 163,682
Non owner occupied real estate	201,763	467	276	202,506
Residential spec homes	1,056	8		1,064
Development & spec land loans	6,963	11		6,974
Commercial and industrial	87,082	380	152	87,614
Total commercial	459,558	1,369	913	461,840
Residential mortgage	181,450	565	583	182,598
Residential construction	7,681	13		7,694
Mortgage warehouse	251,448	480		251,928

Total real estate	440,579	1,058	583	442,220
Direct installment	27,831	115	(204)	27,742
Direct installment purchased	429			429
Indirect installment	133,481	370		133,851
Home equity	126,588	605	959	128,152
Total consumer	288,329	1,090	755	290,174
Total loans	1,188,466	3,517	2,251	1,194,234
Allowance for loan losses	(18,270)			(18,270)
Net loans	$ 1,170,196	$ 3,517	$ 2,251	$ 1,175,964

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Note 5 Allowance for Loan Losses

The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company over the prior one to five years. Management believes the five-year historical loss experience methodology is appropriate in the current economic environment, as it captures loss rates that are comparable to the current period being analyzed. The actual allowance for loan loss activity is provided below.

	Three Months Ended March 31	
	2013	**2012**
Balance at beginning of the period	$ 18,270	$ 18,882
Loans charged-off:		
Commercial		
Owner occupied real estate	132	
Non owner occupied real estate	146	
Residential development		
Development & Spec Land Loans		
Commercial and industrial	139	
Total commercial	417	
Real estate		
Residential mortgage	143	89
Residential construction		
Mortgage warehouse		
Total real estate	143	89
Consumer		
Direct Installment	107	113
Direct Installment Purchased		
Indirect Installment	353	338
Home Equity	438	133
Total consumer	898	584
Total loans charged-off	1,458	673
Recoveries of loans previously charged-off:		
Commercial		
Owner occupied real estate	32	300
Non owner occupied real estate	2	7
Residential development		
Development & Spec Land Loans		
Commercial and industrial	36	25
Total commercial	70	332
Real estate		

Residential mortgage	3	30
Residential construction		
Mortgage warehouse		
Total real estate	3	30
Consumer		
Direct Installment	394	15
Direct Installment Purchased		
Indirect Installment	170	201
Home Equity	32	66
Total consumer	596	282
Total loan recoveries	669	644
Net loans charged-off	789	29
Provision charged to operating expense		
Commercial	1,738	86
Real estate	312	611
Consumer	34	(138)
Total provision charged to operating expense	2,084	559
Balance at the end of the period	$ 19,565	$ 19,412

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Certain loans are individually evaluated for impairment, and the Company s general practice is to proactively charge down impaired loans to the fair value of the underlying collateral.

Consistent with regulatory guidance, charge-offs on all loan segments are taken when specific loans, or portions thereof, are considered uncollectible. The Company s policy is to promptly charge these loans off in the period the uncollectible loss is reasonably determined.

For all loan portfolio segments except 1-4 family residential properties and consumer, the Company promptly charges-off loans, or portions thereof, when available information confirms that specific loans are uncollectible based on information that includes, but is not limited to, (1) the deteriorating financial condition of the borrower, (2) declining collateral values, and/or (3) legal action, including bankruptcy, that impairs the borrower s ability to adequately meet its obligations. For impaired loans that are considered to be solely collateral dependent, a partial charge-off is recorded when a loss has been confirmed by an updated appraisal or other appropriate valuation of the collateral.

The Company charges-off 1-4 family residential and consumer loans, or portions thereof, when the Company reasonably determines the amount of the loss. The Company adheres to timeframes established by applicable regulatory guidance which provides for the charge-down or specific allocation of 1-4 family first and junior lien mortgages to the net realizable value less costs to sell when the value is known but no later than when a loan is 180 days past due. Pursuant to such guidelines, the Company also charges-off unsecured open-end loans when the loan is 90 days past due, and charges down to the net realizable value other secured loans when they are 90 days past due. Loans at these respective delinquency thresholds for which the Company can clearly document that the loan is both well-secured and in the process of collection, such that collection in full will occur regardless of delinquency status, are not charged off.

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment analysis:

March 31, 2013	**Commercial**	**Real Estate**	**Mortgage Warehousing**	**Consumer**	**Total**
Allowance For Loan Losses					
Ending allowance balance attributable to loans:					
Individually evaluated for impairment	$ 1,945	$	$	$	$ 1,945
Collectively evaluated for impairment	7,221	3,477	1,603	5,319	17,620
Total ending allowance balance	$ 9,166	$ 3,477	$ 1,603	$ 5,319	$ 19,565
Loans:					
Individually evaluated for impairment	$ 10,054	$	$	$	$ 10,054
Collectively evaluated for impairment	464,369	191,954	144,089	282,764	1,083,176
Total ending loans balance	$ 474,423	$ 191,954	$ 144,089	$ 282,764	$ 1,093,230

December 31, 2012	**Commercial**	**Real Estate**	**Mortgage Warehousing**	**Consumer**	**Total**
Allowance For Loan Losses					
Ending allowance balance attributable to loans:					
Individually evaluated for impairment	$ 1,945	$	$	$	$ 1,945
Collectively evaluated for impairment	5,826	3,204	1,705	5,590	16,325

Total ending allowance balance	$ 7,771	$ 3,204	$ 1,705	$ 5,590	$ 18,270
Loans:					
Individually evaluated for impairment	$ 10,597	$	$	$	$ 10,597
Collectively evaluated for impairment	451,243	190,292	251,928	290,174	1,183,637
Total ending loans balance	$ 461,840	$ 190,292	$ 251,928	$ 290,174	$ 1,194,234

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Note 6 Non-performing Loans and Impaired Loans

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

March 31, 2013	Nonaccrual	Loans Past Due Over 90 Days Still Accruing	Non Performing TDR s	Performing TDR s	Total Non-Performing Loans
Commercial					
Owner occupied real estate	$ 1,299	$	$ 1,190	$ 823	$ 3,312
Non owner occupied real estate	2,219		1,674	447	4,340
Residential development					
Development & Spec Land Loans	699				699
Commercial and industrial	912		792		1,704
Total commercial	5,129		3,656	1,270	10,055
Real estate					
Residential mortgage	4,057	2	2,691	1,907	8,657
Residential construction			290		290
Mortgage warehouse					
Total real estate	4,057	2	2,981	1,907	8,947
Consumer					
Direct Installment	273				273
Direct Installment Purchased					
Indirect Installment	930				930
Home Equity	1,904		147	1,460	3,511
Total Consumer	3,107		147	1,460	4,714
Total	$ 12,293	$ 2	$ 6,784	$ 4,637	$ 23,716

December 31, 2012	Nonaccrual	Loans Past Due Over 90 Days Still Accruing	Non Performing TDR s	Performing TDR s	Total Non-Performing Loans
Commercial					
Owner occupied real estate	$ 2,800	$	$ 1,272	$ 819	$ 4,891
Non owner occupied real estate	1,705		1,605	446	3,756
Residential development					
Development & Spec Land Loans	705				705

Commercial and industrial	544		797		1,341
Total commercial	5,754		3,674	1,265	10,693
Real estate					
Residential mortgage	4,565	2	2,536	1,761	8,864
Residential construction			291		291
Mortgage warehouse					
Total real estate	4,565	2	2,827	1,761	9,155
Consumer					
Direct Installment	138	26			164
Direct Installment Purchased					
Indirect Installment	866	26			892
Home Equity	2,051		148	676	2,875
Total Consumer	3,055	52	148	676	3,931
Total	$ 13,374	$ 54	$ 6,649	$ 3,702	$ 23,779

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Included in the $12.3 million of non-accrual loans and the $6.8 million of non-performing TDR s at March 31, 2013 were $3.0 million and $3.5 million, respectively, of loans acquired for which accretable yield was recognized.

From time to time, the Bank obtains information that may lead management to believe that the collection of payments may be doubtful on a particular loan. In recognition of this, it is management s policy to convert the loan from an earning asset to a non-accruing loan. The entire balance of a loan is considered delinquent if the minimum payment contractually required to be made is not received by the specified due date. Further, it is management s policy to place a loan on a non-accrual status when the payment is delinquent in excess of 90 days or the loan has had the accrual of interest discontinued by management. The officer responsible for the loan and the Chief Operating Officer or the senior collection officer must review all loans placed on non-accrual status. Subsequent payments on non-accrual loans are recorded as a reduction of principal, and interest income is recorded only after principal recovery is reasonably assured. Nonaccrual loans are returned to accrual status when, in the opinion of management, the financial position of the borrower indicates there is no longer any reasonable doubt as to the timely collection of interest or principal in accordance with the loan terms. The Company requires a period of satisfactory performance of not less than six months before returning a nonaccrual loan to accrual status.

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

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

Loans for which it is probable that the Company will not collect all principal and interest due according to contractual terms, including TDRs, are measured for impairment. Allowable methods for determining the amount of impairment include estimating fair value using the fair value of the collateral for collateral-dependent loans.

The Company s TDRs are considered impaired loans and included in the allowance methodology using the guidance for impaired loans. At March 31, 2013, the type of concessions the Company has made on restructured loans has been temporary rate reductions and/or reductions in monthly payments and there have been no restructured loans with modified recorded balances. Any modification to a loan that is a concession and is not in the normal course of lending is considered a restructured loan. A restructured loan is returned to accruing status after six consecutive payments but is still reported as TDR unless the loan bears interest at a market rate. As of March 31, 2013, the Company had $11.4 million in TDRs and $4.6 million were performing according to the restructured terms and no TDR s were returned to accrual status in the first three months of 2013. There was $1.7 million of specific reserves allocated to TDRs at March 31, 2013 based on the collateral deficiencies.

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Loans transferred and classified as troubled debt restructuring during the three months ended March 31, 2013 and 2012, segregated by class, are shown in the table below.

	March 31, 2013		March 31, 2012	
	Number of Defaults	Unpaid Principal Balance	Number of Defaults	Unpaid Principal Balance
Commercial				
Owner occupied real estate	**2**	**$ 76**		$
Non owner occupied real estate	**1**	**70**		
Residential development				
Development & Spec Land Loans				
Commercial and industrial				
Total commercial	**3**	**146**		
Real estate				
Residential mortgage	**3**	**390**	1	121
Residential construction				
Mortgage warehouse				
Total real estate	**3**	**390**	1	121
Consumer				
Direct Installment				
Direct Installment Purchased				
Indirect Installment				
Home Equity	**2**	**791**	1	53
Total Consumer	**2**	**791**	1	53
Total	**8**	**$ 1,327**	2	$ 174

Troubled debt restructured loans which had payment defaults during the three months ended March 31, 2013 and 2012, segregated by class, are shown in the table below. Default occurs when a loan is 90 days or more past due or has been transferred to nonaccrual.

	March 31, 2013		March 31, 2012	
	Number of Defaults	Unpaid Principal Balance	Number of Defaults	Unpaid Principal Balance
Commercial				
Owner occupied real estate	**2**	**$ 76**		$
Non owner occupied real estate	**1**	**70**		
Residential development				
Development & Spec Land Loans				

Commercial and industrial						
Total commercial	**3**		**146**			
Real estate						
Residential mortgage	**1**		**234**	2		232
Residential construction						
Mortgage warehouse						
Total real estate	**1**		**234**	2		232
Consumer						
Direct Installment						
Direct Installment Purchased						
Indirect Installment						
Home Equity				1		53
Total Consumer				1		53
Total	**4**	**$**	**380**	3	$	285

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The following table presents commercial loans individually evaluated for impairment by class of loan:

March 31, 2013	Unpaid Principal Balance	Recorded Investment	Allowance For Loan Loss Allocated	Three Months Ending Average Balance in Impaired Loans	Three Months Ending Cash/Accrual Interest Income Recognized
With no recorded allowance					
Commercial					
Owner occupied real estate	$ 3,310	$ 3,317	$	$ 4,906	14
Non owner occupied real estate	2,578	2,579		3,793	11
Residential development					
Development & Spec Land Loans	135	135		166	
Commercial and industrial	912	928		1,877	
Total commercial	6,935	6,959		10,742	25
With an allowance recorded					
Commercial					
Owner occupied real estate					
Non owner occupied real estate	1,763	1,763	1,080	1,774	
Residential development					
Development & Spec Land Loans	564	564	600	569	
Commercial and industrial	792	792	265	794	
Total commercial	3,119	3,119	1,945	3,137	
Total	$ 10,054	$ 10,078	$ 1,945	$ 13,879	$ 25

March 31, 2012	Unpaid Principal Balance	Recorded Investment	Allowance For Loan Loss Allocated	Three Months Ending Average Balance in Impaired Loans	Three Months Ending Cash/Accrual Interest Income Recognized
With no recorded allowance					
Commercial					
Owner occupied real estate	$ 723	$ 723	$	$ 503	$ 3
Non owner occupied real estate	972	974		973	
Residential development					
Development & Spec Land Loans	90	90		90	
Commercial and industrial	338	338		240	1
Total commercial	2,123	2,125		1,806	4
With an allowance recorded					
Commercial					

Owner occupied real estate	1,636	1,636	595	1,783	1
Non owner occupied real estate	3,213	3,213	1,105	3,186	2
Residential development					
Development & Spec Land Loans	715	715	470	237	6
Commercial and industrial	1,348	1,348	663	1,130	4
Total commercial	6,912	6,912	2,833	6,336	13
Total	$ 9,035	$ 9,037	$ 2,833	$ 8,142	$ 17

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

March 31, 2013	30 -59 Days Past Due	60 -89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial						
Owner occupied real estate	$ 568	$ 17	$	$ 585	$ 156,491	$ 157,076
Non owner occupied real estate	636	183		819	216,401	217,220
Residential development					248	248
Development & Spec Land Loans		39		39	10,936	10,975
Commercial and industrial	203	99		302	86,427	86,729
Total commercial	1,407	338		1,745	470,503	472,248
Real estate						
Residential mortgage	44	84	2	130	184,459	184,589
Residential construction					6,252	6,252
Mortgage warehouse					143,609	143,609
Total real estate	44	84	2	130	334,320	334,450
Consumer						
Direct Installment	80	200		280	27,116	27,396
Direct Installment Purchased					382	382
Indirect Installment	949	96		1,045	130,248	131,293
Home Equity	1,428	1,091		2,519	119,657	122,176
Total consumer	2,457	1,387		3,844	277,403	281,247
Total	$ 3,908	$ 1,809	$ 2	$ 5,719	$ 1,082,226	$ 1,087,945
Percentage of total loans	0.36%	0.17%	0.00%	0.53%	99.47%	

December 31, 2012	30 -59 Days Past Due	60 -89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial						
Owner occupied real estate	$ 2,207	$ 19	$	$ 2,226	$ 160,468	$ 162,694
Non owner occupied real estate	669	147		816	200,947	201,763
Residential development					1,056	1,056
Development & Spec Land Loans					6,963	6,963
Commercial and industrial	538	16		554	86,528	87,082
Total commercial	3,414	182		3,596	455,962	459,558
Real estate						
Residential mortgage	167		2	169	181,281	181,450

Residential construction					7,681	7,681
Mortgage warehouse					251,448	251,448
Total real estate	167		2	169	440,410	440,579
Consumer						
Direct Installment	240	64	26	330	27,501	27,831
Direct Installment Purchased					429	429
Indirect Installment	1,105	177	26	1,308	132,173	133,481
Home Equity	1,072	321		1,393	125,195	126,588
Total consumer	2,417	562	52	3,031	285,298	288,329
Total	$ 5,998	$ 744	$ 54	$ 6,796	$ 1,181,670	$ 1,188,466
Percentage of total loans	0.50%	0.06%	0.00%	0.57%	99.43%	

The entire balance of a loan is considered delinquent if the minimum payment contractually required to be made is not received by the specified due date.

Horizon Bank s processes for determining credit quality differ slightly depending on whether a new loan or a renewed loan is being underwritten, or whether an existing loan is being re-evaluated for credit quality. The latter usually occurs upon receipt of current financial information or other pertinent data that would trigger a change in the loan grade.

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For new and renewed commercial loans, the Bank s Credit Department, which acts independently of the loan officer, assigns the credit quality grade to the loan. Loan grades for loans with an aggregate credit exposure of $500,000 or greater are validated by the Loan Committee, which is chaired by the Chief Operating Officer (COO).

Commercial loan officers are responsible for reviewing their loan portfolios and report any adverse material change to the COO or Loan Committee. When circumstances warrant a change in the credit quality grade, loan officers are required to notify the COO and the Credit Department of the change in the loan grade. Downgrades are accepted immediately by the COO however, lenders must present their factual information to either the Loan Committee or the COO when recommending an upgrade.

The COO meets weekly with loan officers to discuss the status of past-due loans and classified loans. These meetings are also designed to give the loan officers an opportunity to identify an existing loan that should be downgraded to a classified grade.

Monthly, senior management meets with the Watch Committee, which reviews all of the past due, classified, and impaired loans and the relative trends of these assets. This committee also reviews the actions taken by management regarding foreclosure mitigation, loan extensions, troubled debt restructures, and collateral repossessions. The information reviewed in this meeting act as a precursor for developing management s analysis of the adequacy of the Allowance for Loan and Lease Losses.

For real estate and consumer loans, Horizon uses a grading system based on delinquency. Loans that are 90 days or more past due, on non-accrual, or are classified as a TDR are graded Substandard. After being 90 days delinquent a loan is charged off unless it is well secured and in the process of collection. If the latter case exists, the loan is placed on non-accrual. Occasionally a mortgage loan may be graded as Special Mention. When this situation arises, it is because the characteristics of the loan and the borrower fit the definition of a Risk Grade 5 described below, which is normally used for grading commercial loans. Loans not graded Substandard are considered Pass.

Horizon Bank employs an eight-grade rating system to determine the credit quality of commercial loans. The first four grades represent acceptable quality, and the last four grades mirror the criticized and classified grades used by the bank regulatory agencies (special mention, substandard, doubtful, and loss). The loan grade definitions are detailed below.

Risk Grade 1: Excellent (Pass)

Loans secured by liquid collateral, such as certificates of deposit, reputable bank letters of credit, or other cash equivalents; loans that are guaranteed or otherwise backed by the full faith and credit of the United States government or an agency thereof, such as the Small Business Administration; or loans to any publicly held company with a current long-term debt rating of A or better.

Risk Grade 2: Good (Pass)

Loans to businesses that have strong financial statements containing an unqualified opinion from a CPA firm and at least three consecutive years of profits; loans supported by unaudited financial statements containing strong balance sheets, five consecutive years of profits, a five-year satisfactory relationship with the Bank, and key balance sheet and income statement trends that are either stable or positive; loans secured by publicly traded marketable securities where there is no impediment to liquidation; loans to individuals backed by liquid personal assets and unblemished credit history; or loans to publicly held companies with current long-term debt ratings of Baa or better.

Risk Grade 3: Satisfactory (Pass)

Loans supported by financial statements (audited or unaudited) that indicate average or slightly below average risk and having some deficiency or vulnerability to changing economic conditions; loans with some weakness but offsetting features of other support are readily available; loans that are meeting the terms of repayment, but which may be susceptible to deterioration if adverse factors are encountered.

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

At inception, the loan was properly underwritten, did not possess an unwarranted level of credit risk, and the loan met the above criteria for a risk grade of Excellent, Good, or Satisfactory;

At inception, the loan was secured with collateral possessing a loan value adequate to protect the Bank from loss.

The loan has exhibited two or more years of satisfactory repayment with a reasonable reduction of the principal balance.

During the period that the loan has been outstanding, there has been no evidence of any credit weakness. Some examples of weakness include slow payment, lack of cooperation by the borrower, breach of loan covenants, or the borrower is in an industry known to be experiencing problems. If any of these credit weaknesses is observed, a lower risk grade may be warranted.

Risk Grade 4: Satisfactory/Monitored (Pass)

Loans in this category are considered to be of acceptable credit quality, but contain greater credit risk than Satisfactory loans due to weak balance sheets, marginal earnings or cash flow, lack of financial information, weakening markets, insufficient or questionable collateral coverage or other uncertainties. These loans warrant a higher than average level of monitoring to ensure that weaknesses do not advance. The level of risk in a Satisfactory/Monitored loan is within acceptable underwriting guidelines so long as the loan is given the proper level of management supervision. Loans that normally fall into this grade include construction of commercial real estate buildings, land development and subdivisions, and rental properties that have not attained stabilization.

Risk Grade 5: Special Mention

Loans which possess some credit deficiency or potential weakness which deserves close attention. Such loans pose an unwarranted financial risk that, if not corrected, could weaken the loan by adversely impacting the future repayment ability of the borrower. The key distinctions of a Special Mention classification are that (1) it is indicative of an unwarranted level of risk and (2) weaknesses are considered potential, not defined, impairments to the primary source of repayment. These loans may be to borrowers with adverse trends in financial performance, collateral value and/or marketability, or balance sheet strength.

Risk Grade 6: Substandard

One or more of the following characteristics may be exhibited in loans classified Substandard:

Loans which possess a defined credit weakness. The likelihood that a loan will be paid from the primary source of repayment is uncertain. Financial deterioration is under way and very close attention is warranted to ensure that the loan is collected without loss.

Loans are inadequately protected by the current net worth and paying capacity of the obligor.

The primary source of repayment is gone, and the Bank is forced to rely on a secondary source of repayment, such as collateral liquidation or guarantees.

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

Unusual courses of action are needed to maintain a high probability of repayment.

The borrower is not generating enough cash flow to repay loan principal; however, it continues to make interest payments.

The lender is forced into a subordinated or unsecured position due to flaws in documentation.

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Loans have been restructured so that payment schedules, terms, and collateral represent concessions to the borrower when compared to the normal loan terms.

The lender is seriously contemplating foreclosure or legal action due to the apparent deterioration in the loan.

There is a significant deterioration in market conditions to which the borrower is highly vulnerable.

Risk Grade 7: Doubtful

One or more of the following characteristics may be present in loans classified Doubtful:

Loans have all of the weaknesses of those classified as Substandard. However, based on existing conditions, these weaknesses make full collection of principal highly improbable.

The primary source of repayment is gone, and there is considerable doubt as to the quality of the secondary source of repayment.

The possibility of loss is high but because of certain important pending factors which may strengthen the loan, loss classification is deferred until the exact status of repayment is known.

Risk Grade 8: Loss

Loans are considered uncollectible and of such little value that continuing to carry them as assets is not feasible. Loans will be classified Loss when it is neither practical nor desirable to defer writing off or reserving all or a portion of a basically worthless asset, even though partial recovery may be possible at some time in the future.

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The following table presents loans by credit grades.

March 31, 2013	Pass	Special Mention	Substandard	Doubtful	Total
Commercial					
Owner occupied real estate	$ 139,631	$ 4,062	$ 13,383	$	$ 157,076
Non owner occupied real estate	189,876	10,806	16,538		217,220
Residential development	248				248
Development & Spec Land Loans	7,108	99	3,768		10,975
Commercial and industrial	78,882	1,993	5,854		86,729
Total commercial	415,745	16,960	39,543		472,248
Real estate					
Residential mortgage	175,933		8,656		184,589
Residential construction	5,962		290		6,252
Mortgage warehouse	143,609				143,609
Total real estate	325,504		8,946		334,450
Consumer					
Direct Installment	27,123		273		27,396
Direct Installment Purchased	382				382
Indirect Installment	130,363		930		131,293
Home Equity	118,665		3,511		122,176
Total Consumer	276,533		4,714		281,247
Total	$ 1,017,782	$ 16,960	$ 53,203	$	$ 1,087,945
Percentage of total loans	93.55%	1.56%	4.89%	0.00%	

December 31, 2012	Pass	Special Mention	Substandard	Doubtful	Total
Commercial					
Owner occupied real estate	$ 137,664	$ 6,407	$ 17,029	$ 1,594	$ 162,694
Non owner occupied real estate	171,319	19,440	10,717	287	201,763
Residential development	405		651		1,056
Development & Spec Land Loans	3,171	178	3,614		6,963
Commercial and industrial	78,810	3,136	5,136		87,082
Total commercial	391,369	29,161	37,147	1,881	459,558
Real estate					
Residential mortgage	172,586		8,864		181,450
Residential construction	7,390		291		7,681

Mortgage warehouse	251,448				251,448
Total real estate	431,424		9,155		440,579
Consumer					
Direct Installment	27,667		164		27,831
Direct Installment Purchased	429				429
Indirect Installment	132,589		892		133,481
Home Equity	123,713		2,875		126,588
Total Consumer	284,398		3,931		288,329
Total	$ 1,107,191	$ 29,161	$ 50,233	$ 1,881	$ 1,188,466
Percentage of total loans	93.16%	2.45%	4.23%	0.16%	

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Note 7 Derivative financial instruments

Cash Flow Hedges

As a strategy to maintain acceptable levels of exposure to the risk of changes in future cash flow due to interest rate fluctuations, the Company entered into interest rate swap agreements for a portion of its floating rate debt. The agreements provide for the Company to receive interest from the counterparty at three month LIBOR and to pay interest to the counterparty at a weighted average fixed rate of 6.14% on a notional amount of $30.5 million at March 31, 2013 and $30.5 million at December 31, 2012. Under the agreements, the Company pays or receives the net interest amount monthly, with the monthly settlements included in interest expense.

Management has designated the interest rate swap agreement as a cash flow hedging instrument. For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings. At March 31, 2013 the Company s cash flow hedge was effective and is not expected to have a significant impact on the Company s net income over the next 12 months.

Fair Value Hedges

Fair value hedges are intended to reduce the interest rate risk associated with the underlying hedged item. The Company enters into fixed rate loan agreements as part of its lending policy. To mitigate the risk of changes in fair value based on fluctuations in interest rates, the Company has entered into interest rate swap agreements on individual loans, converting the fixed rate loans to a variable rate. For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative as well as the offsetting gain or loss on the hedged item attributable to the hedged risk are recognized in current earnings. At March 31, 2013 the Company s fair value hedges were effective and are not expected to have a significant impact on the Company s net income over the next 12 months.

The change in fair value of both the hedge instruments and the underlying loan agreements are recorded as gains or losses in interest income. The fair value hedges are considered to be highly effective and any hedge ineffectiveness was deemed not material. The notional amounts of the loan agreements being hedged were $75.6 million at March 31, 2013 and $81.0 million at December 31, 2012.

Other Derivative Instruments

The Company enters into non-hedging derivatives in the form of mortgage loan forward sale commitments with investors and commitments to originate mortgage loans as part of its mortgage banking business. At March 31, 2013, the Company s fair value of these derivatives were recorded and over the next 12 months are not expected to have a significant impact on the Company s net income.

The change in fair value of both the forward sale commitments and commitments to originate mortgage loans were recorded and the net gains or losses included in the Company s gain on sale of loans.

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

	Asset Derivative March 31, 2013		Liability Derivatives March 31, 2013	
Derivatives designated as hedging instruments (Unaudited)	**Balance Sheet Location**	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Interest rate contracts	Loans	$ 89	Other liabilities	$ 1,813
Interest rate contracts	Other Assets	1,724	Other liabilities	5,055
Total derivatives designated as hedging instruments		1,813		6,868
Derivatives not designated as hedging instruments				
Mortgage loan contracts	Other assets	846	Other liabilities	
Total derivatives not designated as hedging instruments		846		
Total derivatives		$ 2,659		$ 6,868

	Asset Derivative December 31, 2012		Liability Derivatives December 31, 2012	
Derivatives designated as hedging instruments (Unaudited)	**Balance Sheet Location**	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Interest rate contracts	Loans	$ 279	Other liabilities	$ 2,214
Interest rate contracts	Other Assets	1,935	Other liabilities	5,493
Total derivatives designated as hedging instruments		2,214		7,707
Derivatives not designated as hedging instruments				
Mortgage loan contracts	Other assets	858	Other liabilities	
Total derivatives not designated as hedging instruments		858		
Total derivatives		$ 3,072		$ 7,707

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

Comprehensive Income on Derivative (Effective Portion)

Derivative in cash flow hedging relationship	Three Months Ended March 31 2013 (Unaudited)	2012 (Unaudited)
Interest rate contracts	$ 285	$ 367

FASB Accounting Standards Codification (ASC) Topic 820-10-20 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Topic 820-10-55 establishes a fair value hierarchy that emphasizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value.

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Derivative in fair value hedging relationship	Location of gain (loss) recognized on derivative	Amount of Gain (Loss) Recognized on Derivative Three Months Ended March 31 2013 (Unaudited)	2012 (Unaudited)
Interest rate contracts	Interest income - loans	$ (401)	$ (74)
Interest rate contracts	Interest income - loans	401	74
Total		$	$

Derivative not designated as hedging relationship	Location of gain (loss) recognized on derivative	Amount of Gain (Loss) Recognized on Derivative Three Months Ended March 31 2013 (Unaudited)	2012 (Unaudited)
Mortgage contracts	Other income - gain on sale of loans	$ (12)	$ (223)

Note 8 Disclosures about fair value of assets and liabilities

The Fair Value Measurements topic of the FASB ASC defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. There are three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying condensed consolidated financial statements, as well as the general classification of such instruments pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the period ended March 31, 2013. For assets classified within Level 3 of the fair value hierarchy, the process used to develop the reported fair value is described below.

Available for sale securities

When quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities include U.S. Treasury and federal agency securities, state and municipal securities, federal agency mortgage obligations and mortgage-backed pools, private-label mortgage-backed pools and corporate notes. Level 2 securities are valued by a third party pricing service commonly used in the banking industry utilizing observable inputs. Observable inputs include dealer quotes, market spreads, cash flow analysis, the U.S. Treasury yield curve, trade execution data, market consensus prepayment spreads and available credit information and the bond s terms and conditions. The pricing provider utilizes evaluated pricing models that vary based on asset class. These models incorporate available market information including quoted prices of securities with similar characteristics and, because many fixed-income securities do not trade on a daily basis, apply available information through processes such as benchmark curves, benchmarking of like securities, sector grouping, and matrix pricing. In addition, model processes, such as an option adjusted spread model is used to develop prepayment and interest rate scenarios for securities with prepayment features.

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Hedged loans

Certain fixed rate loans have been converted to variable rate loans by entering into interest rate swap agreements. The fair value of those fixed rate loans is based on discounting the estimated cash flows using interest rates determined by the respective interest rate swap agreement. Loans are classified within Level 2 of the valuation hierarchy based on the unobservable inputs used.

Interest rate swap agreements

The fair value of the Company s interest rate swap agreements is estimated by a third party using inputs that are primarily unobservable including a yield curve, adjusted for liquidity and credit risk, contracted terms and discounted cash flow analysis, therefore, are classified within Level 2 of the valuation hierarchy.

The following table presents the fair value measurements of assets and liabilities recognized in the accompanying financial statements measured at fair value on a recurring basis and the level within the FASB ASC fair value hierarchy in which the fair value measurements fall at the following:

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
March 31, 2013				
Available-for-sale securities				
U.S. Treasury and federal agencies	$ 46,217	$	$ 46,217	$
State and municipal	170,489		170,489	
Federal agency collateralized mortgage obligations	111,235		111,235	
Federal agency mortgage-backed pools	150,230		150,230	
Private labeled mortgage-backed pools	1,756		1,756	
Corporate notes	49		49	
Total available-for-sale securities	479,976		479,976	
Hedged loans	75,601		75,601	
Forward sale commitments	846		846	
Interest rate swap agreements	(6,868)		(6,868)	
Commitments to originate loans				
December 31, 2012				
Available-for-sale securities				
U.S. Treasury and federal agencies	$ 51,779	$	$ 51,779	$
State and municipal	172,905		172,905	
Federal agency collateralized mortgage obligations	96,831		96,831	
Federal agency mortgage-backed pools	159,204		159,204	
Private labeled mortgage-backed pools	2,031		2,031	
Corporate notes	51		51	

Total available-for-sale securities	482,801	482,801
Hedged loans	81,018	81,018
Forward sale commitments	858	858
Interest rate swap agreements	(7,707)	(7,707)
Commitments to originate loans		

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Transfers between levels

Transfers between Levels 1, 2 and 3 and the reasons for those transfers are as follows:

December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Reason for Transfer
Transfers to level:				
Hedged loans	$	$ 59,911	$	(a)
Forward sale commitments		510		(b)
Interest rate swap agreements		(6,464)		(a)
Commitments to originate loans		(71)		(b)
Total transfers to level	$	$ 53,886	$	

(a) - Valuation determined by widely accepted techniques including discounted cash flow analysis on expected cash flows of each derivative and observable market rate inputs such as yield curves and contractual terms on each instrument.

(b) - Valuation determined by quoted prices for similar loans in the secondary market with an expected fallout rate (interest rate locked pipeline loans not expected to close). Fallout rate is not considered a significant input to the fair value in its entirety.

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the accompanying condensed consolidated balance sheet using significant unobservable (Level 3) inputs:

	Hedged Loans	Forward Sale Commitments	Interest Rate Swaps	Commitments to Originate Loans
Beginning balance December 31, 2011	$ 54,362	$ 662	$ (7,101)	$
Total realized and unrealized gains and losses				
Included in net income	(74)	(152)	74	(71)
Included in other comprehensive income, gross			563	
Purchases, issuances, and settlements	6,114			
Principal payments	(491)			
Transfers out to Level 2	(59,911)	(510)	6,464	71

Ending balance December 31, 2012	$	$	$	$

Realized gains and losses included in net income for the periods are reported in the condensed consolidated statements of income as follows:

	Three Months Ended March 31	
Non Interest Income	**2013 (Unaudited)**	**2012 (Unaudited)**
Total gains and losses from:		
Hedged loans	$ (401)	$ (74)
Fair value interest rate swap agreements	401	74
Derivative loan commitments	(12)	(223)
	$ (12)	$ (223)

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Certain other assets are measured at fair value on a nonrecurring basis in the ordinary course of business and are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
March 31, 2013				
Impaired loans	$ 8,109	$	$	$ 8,109
Mortgage servicing rights	5,461			5,461
December 31, 2012				
Impaired loans	$ 8,652	$	$	$ 8,652
Mortgage servicing rights	5,145			5,145

Impaired (collateral dependent): Loans for which it is probable that the Company will not collect all principal and interest due according to contractual terms are measured for impairment. Allowable methods for determining the amount of impairment include estimating fair value using the fair value of the collateral for collateral-dependent loans.

If the impaired loan is identified as collateral dependent, then the fair value method of measuring the amount of impairment is utilized. This method requires obtaining a current independent appraisal of the collateral and applying a discount factor to the value.

Impaired loans that are collateral dependent are classified within Level 3 of the fair value hierarchy when impairment is determined using the fair value method. Fair value adjustments on impaired loans were $1.9 million at March 31, 2013 and $1.9 million at December 31, 2012.

Mortgage Servicing Rights (MSRs): MSRs do not trade in an active market with readily observable prices. Accordingly, the fair value of these assets is classified as Level 3. The Company determines the fair value of MSRs using an income approach model based upon the Company s month-end interest rate curve and prepayment assumptions. The model utilizes assumptions to estimate future net servicing income cash flows, including estimates of time decay, payoffs and changes in valuation inputs and assumptions. The Company reviews the valuation assumptions against this market data for reasonableness and adjusts the assumptions if deemed appropriate. The carrying amount of the MSR s were increased by $33,000 in during the first three months of 2013 and reduced by $1.0 million in 2012 for the fair value.

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The following table presents qualitative information about unobservable inputs used in recurring and nonrecurring Level 3 fair value measurements, other than goodwill.

	Fair Value at March 31, 2013	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Impaired loans	$ 8,109	Collateral based measurement	Discount to reflect current market conditions and ultimate collectability	10% - 15% (12%)
Mortgage servicing rights	$ 5,461	Discounted cashflows	Discount rate, Constant prepayment rate, Probably of default	10% -15% (12%), 4% -7% (4.6%), 1% - 10% (4.5%)

	Fair Value at December 31, 2012	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Impaired loans	$ 8,652	Collateral based measurement	Discount to reflect current market conditions and ultimate collectability	10% - 15% (12%)
Mortgage servicing rights	$ 5,145	Discounted cashflows	Discount rate, Constant prepayment rate, Probably of default	10% - 15% (12%), 4% -7% (4.6%), 1% - 10% (4.5%)

Note 9 Fair Value of Financial Instruments

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

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, 2012 and December 31, 2011. 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 the FASB ASC fair value hierarchy.

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

Cash and Due from Banks The carrying amounts approximate fair value.

Held-to-Maturity Securities For debt securities held to maturity, fair values are based on quoted market prices or dealer quotes. For those securities where a quoted market price is not available, carrying amount is a reasonable estimate of fair value based upon comparison with similar securities.

Loans Held for Sale The carrying amounts approximate fair value.

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

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

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

Interest Receivable/Payable The carrying amounts approximate fair value.

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

Borrowings Rates currently available to Horizon for debt with similar terms and remaining maturities are used to estimate fair values of existing borrowings.

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

Commitments to Extend Credit and Standby 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 following table presents estimated fair values of the Company s financial instruments and the level within the fair value hierarchy in which the fair value measurements fall (unaudited).

	March 31, 2013			
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash and due from banks	$ 27,053	$ 27,053	$	$
Loans held for sale	9,105			9,105
Loans excluding loan level hedges, net	992,789			1,018,701
Stock in FHLB and FRB	13,333		13,333	
Interest receivable	7,549		7,549	
Liabilities				
Non-interest bearing deposits	$ 217,197	$ 217,197	$	$
Interest-bearing deposits	1,097,866		1,099,495	
Borrowings	208,899		215,402	
Subordinated debentures	32,370		32,345	
Interest payable	552		552	

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

	December 31, 2012			
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash and due from banks	$ 30,735	$ 30,735	$	$
Loans held for sale	13,744			13,744
Loans excluding loan level hedges, net	1,089,215			1,118,255
Stock in FHLB and FRB	13,333		13,333	
Interest receivable	7,716		7,716	
Liabilities				
Non-interest bearing deposits	$ 209,200	$ 209,200	$	$
Interest-bearing deposits	1,084,953		1,092,184	
Borrowings	345,764		352,891	
Subordinated debentures	32,331		32,268	
Interest payable	560		560	

Note 10 Other Comprehensive Income

	Accumulated Other Comprehensive Income [1]		
Unaudited	Unrealized Gains (Losses) on Securities Available-for-Sale	Unrealized Gains (Losses) on Derivative Instruments	Total
Balance at December 31, 2012	$ 12,672	$ (3,570)	$ 9,101
Other comprehensive income before reclassifications	(1,107)	285	(822)
Amounts reclassified from other comprehensive income	(239)		(239)
Period change	(1,346)	285	(1,061)
Balance at March 31, 2013	$ 11,326	$ (3,285)	$ 8,040
Balance at December 31, 2011	$ 11,036	$ (3,194)	$ 7,842
Other comprehensive income before reclassifications	564	367	931
Amounts reclassified from other comprehensive income			
Period change	564	367	931
Balance at March 31, 2012	$ 11,600	$ (2,827)	$ 8,773

(1) All amounts are net of tax. Related income tax expense or benefit is calculated using a combined Federal and State income tax rate approximating 35%.

Details About Accumulated Other Comprehensive Income Components Unaudited	**Amount Reclassified from Accumulated Other Comprehensive Income For the Three Months Ended March 31, 2013**	**2012**	**Affected Line Items in the Statement of Net Income**
Securities available-for-sale [1]			
Net securities gains reclassified into earnings	$ 368	$	Gain on sale of investment securities
Related income tax expense	(129)		Income tax expense
Net effect on accumulated other comprehensive income for the period	239		Net of tax
Total reclassifications for the period	$ 239	$	Net of tax

(1) For additional detail related to unrealized gains on securities and related amounts reclassified from accumulated other comprehensive income see Note 3, Securities

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Note 11 Future accounting matters

ASU 2011-11 Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities. The ASU amends Topic 210 by requiring additional improved information to be disclosed regarding financial instruments and derivative instruments that are offset in accordance with the conditions under ASC 210-20-45 or ASC 810-10-45 or subject to an enforceable master netting arrangement or similar agreement. The amendments are effective for annual and interim reporting periods beginning on or after January 1, 2013. The disclosures required by the amendments were applied retrospectively for all comparative periods presented (See Note 7). The amendments did not have a material impact on the Company s Condensed Consolidated Financial Statements.

ASU 2013-01 Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. The ASU amends Update 2011-11 to clarify that the scope applies to derivatives, repurchase and reverse repurchase agreements, and securities borrowing and lending transactions that are either offset in accordance with Section 210-20-45 or Section 815-10-45 or subject to master netting or similar arrangements. Other types of financial assets and liabilities subject to master netting or similar arrangements are not subject to the disclosure requirements in Update 2011-11. The amendments are effective for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods (See Note 7). The amendments did not have a material impact on the Company s Condensed Consolidated Financial Statements.

ASU 2013-02 Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. The ASU requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. The amendments are effective prospectively for reporting periods beginning after December 15, 2012. The amendments did not have a material impact on the Company s Condensed Consolidated Financial Statements.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward Looking Statements

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, with respect to Horizon Bancorp (Horizon or the Company) and Horizon Bank, N.A. (the Bank). Horizon intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Reform Act of 1995, and is including this statement for the purposes of these safe harbor provisions. Statements in this report should be considered in conjunction with the other information available about Horizon, including the information in the other filings we make with the Securities and Exchange Commission. The forward-looking statements are based on management s expectations and are subject to a number of risks and uncertainties. We have tried, wherever possible, to identify such statements by using words such as anticipate, expect, estimate, project, intend, plan, believe, could, will and similar expressions in connecti discussion of future operating or financial performance. Although management believes that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from those expressed or implied in such statements.

Actual results may differ materially, and adversely or positively, from the expectations of the Company that are expressed or implied by any forward-looking statement. Risks, uncertainties, and factors that could cause the Company s actual results to vary materially from those expressed or implied by any forward-looking statement include but not limited to:

- economic conditions and their impact on Horizon and its customers;
- changes in the level and volatility of interest rates, spreads on earning assets and interest-bearing liabilities, and interest rate sensitivity;
- estimates of fair value of certain of Horizon s assets and liabilities;
- volatility and disruption in financial markets;
- prepayment speeds, loan originations, credit losses and market values, collateral securing loans and other assets;
- sources of liquidity;
- potential risk of environmental liability related to lending activities;
- changes in the competitive environment in Horizon s market areas and among other financial service providers;

legislation and/or regulation affecting the financial services industry as a whole, and Horizon and its subsidiaries in particular, including the effects resulting from the reforms enacted by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) and the adoption of regulations by regulatory bodies under the Dodd-Frank Act;

changes in regulatory supervision and oversight, including monetary policy and capital requirements;

changes in accounting policies or procedures as may be adopted and required by regulatory agencies;

rapid technological developments and changes;

containing costs and expenses;

the slowing or failure of economic recovery;

the ability of the U.S. federal government to manage federal debt limits; and

the risks of expansion through mergers and acquisitions, including unexpected credit quality problems with acquired loans, difficulty integrating acquired operations and material differences in the actual financial results of such transactions compared with Horizon s initial expectations, including the full realization of anticipated cost savings.

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Because such forward-looking statements are subject to risks and uncertainties, actual results may differ materially from those expressed or implied by such statements. The foregoing list of important factors is not exclusive, and you are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this document or, in the case of documents incorporated by reference, the dates of those documents. We do not undertake to update any forward-looking statements, whether written or oral, that may be made from time to time by or on behalf of us. For a detailed discussion of the risks and uncertainties that may cause our actual results or performance to differ materially from the results or performance expressed or implied by forward-looking statements, see Risk Factors in Item 1A of Part I of our 2012 Annual Report on Form 10-K and in the subsequent reports we file with the SEC.

Overview

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

Horizon continues to operate in a challenging economic and banking environment. Within the Company s primary market areas of Northwest and Central Indiana and Southwest Michigan, unemployment rates increased during 2009 and have remained elevated through the first three months of 2013. This rise in unemployment has been driven by multiple factors including slowdowns in commercial industries as well as a continued lower activity in the housing and construction industries. The Company s higher than historical levels of non-performing loans at March 31, 2013 and over the past two years can be attributed to the continued slow economy worldwide and continued high local unemployment, which have resulted in lower business revenues. The acquisition of Heartland on July 17, 2012, further added to the non-performing credits. Despite these economic factors and events, Horizon has continued to post record results through the first three months of 2013.

On July 17, 2012, Horizon completed the acquisition of Heartland Bancshares, Inc. and its wholly owned subsidiary, Heartland Community Bank, which was merged into Horizon Bank. Under the final terms of the acquisition, the exchange ratio was 0.81 shares of Horizon s common stock for each outstanding share of Heartland common stock. Heartland shares outstanding at the closing were 1,442,449, and the shares of Horizon common stock issued to Heartland shareholders totaled 1,168,383. Horizon s stock price was $16.83 per share at the close of business on July 17, 2012. Based upon these numbers, the total value of the consideration, including the retirement of TARP, for the acquisition was $26.9 million.

Following are some highlights of Horizon s financial performance through the first three months of 2013:

- First quarter 2013 net income was $5.3 million or $.58 diluted earnings per share, the highest quarterly net income in the Company s history.

- Net interest income, before provisions for loan losses, for the first three months of 2013 was $16.0 million compared with $13.2 million for the same period in the prior year.

Non-interest income rose to $7.5 million in first quarter of 2013 compared with $5.1 million in first quarter of 2012, primarily reflecting a significant increase in gain on sale of loans with increases also in service charges and fees, fiduciary activities and other income.

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Return on average assets was 1.23% for the first quarter of 2013.

Return on average common equity was 14.11% for the first quarter of 2013.

Total loans decreased $100.9 million during the quarter to $1.1 billion at March 31, 2013 as mortgage warehouse loans decreased $107.8 million during the same period.

Total deposits increased $20.9 million during the quarter to $1.3 billion at March 31, 2013.

Total borrowings decreased $136.9 million during the quarter to $208.9 million as the short-term funding needed for mortgage warehouse loans declined and deposits increased.

Horizon s tangible book value per share rose to $14.64 at March 31, 2013, compared to $14.24 at March 31, 2012.

Horizon Bank s capital ratios, including Tier 1 Capital to Average Assets of 8.80% and Total Capital to Risk Weighted Assets of 13.99% as of March 31, 2013, continue to be well above the regulatory standards for well-capitalized banks.

Critical Accounting Policies

The notes to the consolidated financial statements included in Item 8 of the Company s Annual Report on Form 10-K for 2012 contain a summary of the Company s significant accounting policies. Certain of these policies are important to the portrayal of the Company s financial condition, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Management has identified as critical accounting policies the allowance for loan losses, intangible assets, mortgage servicing rights, hedge accounting and valuation measurements.

Allowance for Loan Losses

An allowance for loan losses is maintained to absorb probable incurred loan losses inherent in the loan portfolio. The determination of the allowance for loan losses is a critical accounting policy that involves management s ongoing quarterly assessments of the probable incurred losses inherent in the loan portfolio. The identification of loans that have probable incurred losses is subjective; therefore, a general reserve is maintained to cover all probable losses within the entire loan portfolio. Horizon utilizes a loan grading system that helps identify, monitor and address asset quality problems in an adequate and timely manner. Each quarter, various factors affecting the quality of the loan portfolio are reviewed. Large credits are reviewed on an individual basis for loss potential. Other loans are reviewed as a group based upon previous trends of loss experience. Horizon also reviews the current and anticipated economic conditions of its lending market as well as transaction risk to determine the effect they may have on the loss experience of the loan portfolio.

Goodwill and Intangible Assets

Management believes that the accounting for goodwill and other intangible assets also involves a higher degree of judgment than most other significant accounting policies. FASB ASC 350-10 establishes standards for the amortization of acquired intangible assets and impairment assessment of goodwill. At March 31, 2013, Horizon had core deposit intangibles of $3.9 million subject to amortization and $19.7 million of goodwill, which is not subject to amortization. Goodwill arising from business combinations represents the value attributable to unidentifiable intangible assets in the business acquired. Horizon s goodwill relates to the value inherent in the banking industry and that value is dependent upon the ability of Horizon to provide quality, cost effective banking services in a competitive marketplace. The goodwill value is supported by revenue that is in part driven by the volume of business transacted. A decrease in earnings resulting from a decline in the customer base or the inability to deliver cost effective services over sustained periods can lead to impairment of goodwill that could adversely affect earnings in future periods. FASB ASC 350-10 requires an annual evaluation of goodwill for impairment. The evaluation of goodwill for impairment requires the use of estimates and assumptions. Market price at the close of business on March 31, 2013 was $20.21 per share compared to a book value of $17.38 per common share. Horizon reported record earnings for the thirteenth consecutive year in 2012, and the first three months of 2013 were the highest quarterly net income in the Company s history.

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

Mortgage Servicing Rights

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

Generally, when market interest rates decline and other factors favorable to prepayments occur, there is a corresponding increase in prepayments as customers refinance existing mortgages under more favorable interest rate terms. When a mortgage loan is prepaid, the anticipated cash flows associated with servicing that loan are terminated, resulting in a reduction of the fair value of the capitalized mortgage servicing rights. To the extent that actual borrower prepayments do not react as anticipated by the prepayment model (i.e., the historical data observed in the model does not correspond to actual market activity), it is possible that the prepayment model could fail to accurately predict mortgage prepayments and could result in significant earnings volatility. To estimate prepayment speeds, Horizon utilizes a third-party prepayment model, which is based upon statistically derived data linked to certain key principal indicators involving historical borrower prepayment activity associated with mortgage loans in the secondary market, current market interest rates and other factors, including Horizon s own historical prepayment experience. For purposes of model valuation, estimates are made for each product type within the mortgage servicing rights portfolio on a monthly basis. In addition, on a quarterly basis Horizon engages a third party to independently test the value of its servicing asset.

Derivative Instruments

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

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Horizon s accounting policies related to derivatives reflect the guidance in FASB ASC 815-10. Derivatives that qualify for the hedge accounting treatment are designated as either: a hedge of the fair value of the recognized asset or liability or of an unrecognized firm commitment (a fair value hedge) or a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability (a cash flow hedge). For fair value hedges, the cumulative change in fair value of both the hedge instruments and the underlying loans is recorded in non-interest income. For cash flow hedges, changes in the fair values of the derivative instruments are reported in OCI to the extent the hedge is effective. The gains and losses on derivative instruments that are reported in OCI are reflected in the consolidated income statement in the periods in which the results of operations are impacted by the variability of the cash flows of the hedged item. Generally, net interest income is increased or decreased by amounts receivable or payable with respect to the derivatives, which qualify for hedge accounting. At inception of the hedge, Horizon establishes the method it uses for assessing the effectiveness of the hedging derivative and the measurement approach for determining the ineffective aspect of the hedge. The ineffective portion of the hedge, if any, is recognized currently in the consolidated statements of income. Horizon excludes the time value expiration of the hedge when measuring ineffectiveness.

Valuation Measurements

Valuation methodologies often involve a significant degree of judgment, particularly when there are no observable active markets for the items being valued. Investment securities, residential mortgage loans held for sale and derivatives are carried at fair value, as defined in FASB ASC 820, which requires key judgments affecting how fair value for such assets and liabilities is determined. In addition, the outcomes of valuations have a direct bearing on the carrying amounts of goodwill, mortgage servicing rights, and pension and other post-retirement benefit obligations. To determine the values of these assets and liabilities, as well as the extent, to which related assets may be impaired, management makes assumptions and estimates related to discount rates, asset returns, prepayment speeds and other factors. The use of different discount rates or other valuation assumptions could produce significantly different results, which could affect Horizon s results of operations.

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Financial Condition

On March 31, 2013, Horizon s total assets were $1.7 billion, a decrease of approximately $114.0 million compared to December 31, 2012. This decrease was primarily due to the reduction of $107.8 million in mortgage warehouse loans, partially offset by an increase in commercial loans of $12.6 million and residential mortgage loans of $1.6 million.

Investment securities were comprised of the following as of:

	March 31, 2013		December 31, 2012	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for sale				
U.S. Treasury and federal agencies	$ 45,974	$ 46,217	$ 51,458	$ 51,779
State and municipal	160,824	170,489	162,147	172,905
Federal agency collateralized mortgage obligations	109,727	111,235	95,337	96,831
Federal agency mortgage-backed pools	144,300	150,230	152,372	159,204
Private labeled mortgage-backed pools	1,695	1,756	1,960	2,031
Corporate notes	32	49	32	51
Total available for sale investment securities	$ 462,552	$ 479,976	$ 463,306	$ 482,801
Held to maturity, State and Municipal	$ 2,110	$ 2,110	$	$

Total investment securities decreased by approximately $715,000 at March 31, 2013 compared to December 31, 2012.

Net loans decreased $102.2 million since December 31, 2012. This decrease was primarily the result of a reduction in mortgage warehouse loans of $107.8 million and consumer loans of $7.4 million, partially offset by increases in commercial and residential mortgage loans of $12.6 million and $1.6 million, respectively. The decrease in the Company s mortgage warehousing business reflects interest rate movements, seasonality and the decline in the demand for mortgage refinance business. The decrease in consumer loans resulted from loan payments and payoffs outpacing the origination volume in the first quarter. The increase in commercial loans is the direct result of increased calling efforts to increase Horizon s market share within the Company s footprint and market expansion.

Total deposits increased $20.9 million during the first three months of 2013. This increase was the result of non-interest bearing deposit accounts increasing by $8.0 million due to increased calling and marketing efforts, interest bearing deposit accounts increasing by $8.2 million primarily due to increased consumer deposits, and time deposits increasing by $4.8 million during the first three months of 2013.

The Company s borrowings decreased $136.9 million from December 31, 2012 as the short-term funding needed for mortgage warehouse loans declined and deposits increased. At March 31, 2013, the Company had no short-term funds borrowed compared to $157.0 million at December 31, 2012. The Company reduces short-term borrowings to offset decreases in mortgage warehouse lending when it is determined that the loan demand will decrease as a result of refinancing activity. In addition, the Company s current balance sheet strategy is to utilize a reasonable level of short-term borrowings during extended low rate environments in addition to what is needed for the fluctuations in mortgage warehouse lending.

Stockholders equity totaled $162.3 million at March 31, 2013 compared to $159.0 million at December 31, 2012. The increase in stockholders equity during the period was the result of the generation of net income partially offset by a decrease in accumulated other comprehensive income and dividends declared. At March 31, 2013, the ratio of average stockholders equity to average assets was 9.16% compared to 8.71% for December 31, 2012. Book value per common share at March 31, 2013 increased to $17.38 compared to $17.00 at December 31, 2012.

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Results of Operations

Overview

Consolidated net income for the three-month period ended March 31, 2013 was $5.3 million, an increase of 15.1% from the $4.6 million for the same period in 2012. Earnings per common share for the three months ended March 31, 2013 were $0.60 basic and $0.58 diluted, compared to $0.60 basic and $0.59 diluted for the same three-month period in 2012. Diluted earnings per share decreased by $.01 compared with the same three-month period in 2012 due to an increase in dilutive shares and additional shares issued in the Heartland acquisition. Growth in commercial loans and realizing the synergies from the Heartland transaction contributed to the record earnings in the first quarter of 2013 as mortgage warehousing balances decreased.

Net Interest Income

The largest component of net income is net interest income. Net interest income is the difference between interest income, principally from loans and investment securities, and interest expense, principally on deposits and borrowings. Changes in the net interest income are the result of changes in volume and the net interest spread, which affects the net interest margin. Volume refers to the average dollar levels of interest-earning assets and interest-bearing liabilities. Net interest spread refers to the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities. Net interest margin refers to net interest income divided by average interest-earning assets and is influenced by the level and relative mix of interest-earning assets and interest-bearing liabilities.

The reduction in interest rates has influenced the cost of the Company s interest bearing liabilities more significantly than the reduction in the yields received on the Company s interest earning assets, resulting in an increase of the net interest margin. Management does not expect a significant rise in interest rates in the short term, but an increase in rates is expected at some time in the future due to the current historically low interest rate environment.

Net interest income during the three months ended March 31, 2013 was $16.0 million, an increase of $2.8 million over the $13.2 million earned during the same period in 2012. Yields on the Company s interest-earning assets increased by 4 basis points to 4.95% from 4.91% for the three months ended March 31, 2013 and 2012, respectively. Interest income increased $2.6 million from $16.8 million for the three months ended March 31, 2012 to $19.4 million for the same period in 2013. This increase was primarily due to an increase in interest earning assets and the recognition of approximately $2.0 million of interest income from Heartland loan discounts being accreted and loans paying off before their scheduled maturity. In addition, the asset yields on loans receivable has not declined at the same pace as some market indices partially due to interest rate floors that are in place on approximately $332.2 million of the Company s $497.0 million of adjustable rate loans.

Rates paid on interest-bearing liabilities decreased by 17 basis points for the three months ended March 31, 2013 compared to the same period in 2012 due to the lower interest rate environment. Interest expense decreased $209,000 from $3.6 million for the three months ended March 31, 2012 to $3.4 million for the same period in 2013. This decrease was due to the lower rates being paid on the Company s interest bearing liabilities. The net interest margin increased 23 basis points from 3.87% for the three months ended March 31, 2012 to 4.10% for the same period in 2013. The increase in the margin for the three-months ended March 31, 2013 compared to the same period in 2012 was due to the recognition of approximately $2.0 million of interest income from Heartland loan discounts being accreted and loans paying off before their scheduled maturity, along with a reduction in the rate paid on interest bearing liabilities. Excluding the interest income recognized from the loan discounts, the margin would have been 3.60% for the three-month period ending March 31, 2013.

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The following are the average balance sheets for the three months ending:

	Three Months Ended March 31, 2013			Three Months Ended March 31, 2012		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
ASSETS						
Interest-earning assets						
Federal funds sold	$ 12,639	$ 8	0.26%	$ 4,782	$ 3	0.25%
Interest-earning deposits	7,423	2	0.11%	1,971	1	0.20%
Investment securities - taxable	371,311	2,012	2.20%	344,144	2,310	2.70%
Investment securities - non-taxable (1)	120,652	967	4.33%	107,892	980	5.07%
Loans receivable (2)(3)(4)	1,105,843	16,440	6.03%	952,236	13,532	5.72%
Total interest-earning assets (1)	1,617,868	19,429	4.95%	1,411,025	16,826	4.91%
Noninterest-earning assets						
Cash and due from banks	23,745			15,785		
Allowance for loan losses	(18,425)			(19,427)		
Other assets	134,623			96,543		
	$ 1,757,811			$ 1,503,926		
LIABILITIES AND SHAREHOLDERS EQUITY						
Interest-bearing liabilities						
Interest-bearing deposits	$ 1,102,599	$ 1,480	0.54%	$ 909,314	$ 1,639	0.72%
Borrowings	241,383	1,448	2.43%	292,616	1,519	2.09%
Subordinated debentures	32,370	491	6.15%	31,446	470	6.01%
Total interest-bearing liabilities	1,376,352	3,419	1.01%	1,233,376	3,628	1.18%
Noninterest-bearing liabilities						
Demand deposits	202,403			131,778		
Accrued interest payable and other liabilities	18,082			13,510		
Shareholders equity	160,974			125,262		
	$ 1,757,811			$ 1,503,926		
Net interest income/spread		$ 16,010	3.95%		$ 13,198	3.73%
Net interest income as a percent of average interest earning assets (1)			4.10%			3.87%

(1) Securities balances represent daily average balances for the fair value of securities. The average rate is calculated based on the daily average balance for the amortized cost of securities. Interest rate is presented on a tax equivalent basis.
(2) Includes fees on loans. The inclusion of loan fees does not have a material effect on the average interest rate.
(3) Non-accruing loans for the purpose of the computations above are included in the daily average loan amounts outstanding. Loan totals are shown net of unearned income and deferred loans fees.
(4) Loan fees and late fees included in interest on loans.

Provision for Loan Losses

Horizon assesses the adequacy of its Allowance for Loan and Lease Losses (ALLL) by regularly reviewing the performance of its loan portfolios. During the three-months ended March 31, 2013, a provision for loan losses of $2.1 million was required to adequately fund the ALLL compared to a provision of $559,000 for the same period of 2012. Commercial loan net charge-offs during the first quarter of 2013 were $347,000, residential mortgage loan net charge-offs were $140,000, and consumer loan net charge-offs were $302,000.

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The higher provision for loan losses during the three months ended March 31, 2013 was related to organic growth in the Company s loan portfolio and $1.4 million of additional loan loss provision expense related to credit losses from certain Heartland loans that exceeded the loan discounts recorded at the time of the acquisition. The ALLL balance at March 31, 2013 was $19.6 million or 1.78% of total loans. This compares to an ALLL balance of $18.3 million at December 31, 2012 or 1.52% of total loans and $19.4 million at March 31, 2012 or 1.94% of total loans. The increase in the ratio at March 31, 2013 compared to December 31, 2012 was primarily due an increase in the ALLL balance for commercial loans of $1.4 million and a decrease in total loans of $100.9 million. The decrease in the ratio at March 31, 2013 compared to March 31, 2012 was primarily due to the increase in total loans resulting from the Heartland acquisition in which loans were recorded at fair value with no allowance allocated to them at March 31, 2013.

No assurance can be given that Horizon will not, in any particular period, sustain loan losses that are significant in relation to the amount reserved, or that subsequent evaluations of the loan portfolio, in light of factors then prevailing, including economic conditions and management s ongoing quarterly assessments of the portfolio, will not require increases in the allowance for loan losses. Horizon considers the allowance for loan losses to be appropriate to cover probable incurred losses in the loan portfolio as of March 31, 2013.

Non-performing loans totaled $23.7 million on March 31, 2013, down slightly from $23.8 million on December 31, 2012, and up from $21.1 million on March 31, 2012. The increase from March 31, 2012 was due to the Heartland acquisition. Excluding Heartland loans, non-performing loans decreased to $17.3 million at March 31, 2013 from $21.1 million at March 31, 2012. As a percentage of total loans, non-performing loans were 2.16% on March 31, 2013, up from 1.97% on December 31, 2012, and 2.11% on March 31, 2012.

At March 31, 2013, loans acquired in the Heartland acquisition represented $6.4 million in non-performing, $17.7 million in substandard and $793,000 in delinquent loans, which compares to $7.3 million in non-performing, $18.1 million in substandard and $3.4 million in delinquent loans at December 31, 2012.

Other Real Estate Owned (OREO) totaled $1.8 million on March 31, 2013, down from $2.6 million on December 31, 2012 and up from $889,000 on March 31, 2012.

Other Income

The following is a summary of changes in other income:

	Three Months Ended			
	March 31 2013	**March 31 2012**	**Amount Change**	**Percent Change**
Other income				
Service charges on deposit accounts	**$ 913**	$ 712	$ 201	28.2%
Wire transfer fees	**190**	182	8	4.4%
Interchange fees	**866**	628	238	37.9%
Fiduciary activities	**1,140**	975	165	16.9%
Gain on sale of securities	**368**		368	100.0%
Gain on sale of mortgage loans	**3,106**	2,274	832	36.6%
Mortgage servicing net of impairment	**163**	90	73	81.1%
Increase in cash surrender value of bank owned life insurance	**252**	225	27	12.0%
Other income	**462**	56	406	725.0%

Total other income	**$ 7,460**	$ 5,142	$ 2,318	45.1%

Service charges on deposit accounts were $201,000 higher and interchange fees were $238,000 higher during the first quarter of 2013 compared to the same period in 2012 primarily due to an increase in transaction

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accounts and volume. Fiduciary activities increased $165,000 during the first quarter compared to the same period in 2012 due to customer and market value growth. In addition, Horizon incurred a gain on the sale of securities of $368,000 during the first quarter as the result of an analysis that determined that market conditions provided the opportunity to add gains to capital without negatively impacting long-term earnings. The residential mortgage loan activity during the first quarter of 2013 generated $3.1 million of income from the gain on sale of mortgage loans, up $832,000 from the same period in 2012. This increase was due to more favorable pricing on loans sold and additional volume. Loans originated for sale during the first quarter of 2013 were $95.0 million compared to $80.3 million for the same period in 2012. Other income increased $406,000 primarily due to $238,000 of gains on the sale of other real estate owned and $87,000 of recoveries from loans that had been charged off by Heartland prior to the acquisition.

Other Expense

The following is a summary of changes in other expense:

	Three Months Ended			
	March 31 2013	**March 31 2012**	**Amount Change**	**Percent Change**
Other expense				
Salaries	**$ 5,179**	$ 3,934	$ 1,245	31.6%
Commission and bonuses	**1,039**	846	193	22.8%
Employee benefits	**1,286**	1,183	103	8.7%
Net occupancy expenses	**1,311**	1,054	257	24.4%
Data processing	**600**	526	74	14.1%
Professional fees	**499**	534	(35)	-6.6%
Outside services and consultants	**712**	471	241	51.2%
Loan expense	**1,114**	702	412	58.7%
FDIC deposit insurance	**283**	257	26	10.1%
Other losses	**(72)**	30	(102)	-340.0%
Other expenses	**2,028**	1,623	405	25.0%
Total other expense	**$ 13,979**	$ 11,160	$ 2,819	25.3%

Total other expenses were $2.8 million higher in the first quarter of 2013 compared to the first quarter of 2012. Salaries, commissions and employee benefits increased $1.5 million compared to the same quarter in 2012 primarily due to changes to annual merit pay, employee benefits costs, commissions earned and bonus accruals. In addition, compensation and net occupancy expenses were higher due to the Heartland acquisition and directly related to Horizon s investment in growth markets. The increase in the first quarter of 2013 in outside services and consultants of $241,000 compared to the same quarter in the prior year was due to growth and increased products and services provided by the Company. The increase in loan expense during the first quarter of 2013 compared to the prior year was related to an increase in loan origination, collection and workout costs. Other losses improved $102,000 year over year due to the reversal of a previously required reserve for potential repurchases of sold loans that were resolved without a loss. Other expenses increased $405,000 in the first quarter of 2013 compares to the same period in 2012 primarily due to the Company s growth and expansion efforts.

Income Taxes

Income tax expense for the first quarter of 2013 was $2.1 million compared to $2.0 million of tax expense for same period of 2012. The effective tax rate for the first quarter of 2013 was 28.3% compared to 30.3% in the same period of 2012. The decrease in the effective tax rate is primarily due to tax planning strategies implemented in the first quarter of 2013 including a captive real estate investment trust subsidiary (REIT) and a captive insurance subsidiary reducing both the federal and state tax liabilities.

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Liquidity

The Bank maintains a stable base of core deposits provided by long-standing relationships with individuals and local businesses. These deposits are the principal source of liquidity for Horizon. Other sources of liquidity for Horizon include earnings, loan repayment, investment security sales and maturities, proceeds from the sale of residential mortgage loans, and borrowing relationships with correspondent banks, including the FHLB. During the three months ended March 31, 2013, cash and cash equivalents decreased by approximately $3.7 million. At March 31, 2013, in addition to liquidity available from the normal operating, funding, and investing activities of Horizon, the Bank had approximately $435.5 million in unused credit lines with various money center banks, including the FHLB and the FRB Discount Window compared to $349.6 million at December 31, 2012 and $333.4 million at March 31, 2012.

Capital Resources

The capital resources of Horizon and the Bank exceeded regulatory capital ratios for well capitalized banks at March 31, 2013. Stockholders equity totaled $162.3 million as of March 31, 2013, compared to $159.0 million as of December 31, 2012. For the three months ended March 31, 2013, the ratio of average stockholders equity to average assets was 9.16% compared to 8.71% for the three months ended December 31, 2012. The increase in stockholders equity during the period was the result of the generation of net income partially offset by a decrease in accumulated other comprehensive income, net of dividends declared.

The Company currently intends to continue its participation in the Small Business Lending Fund, pursuant to which it issued preferred stock to the US Treasury, since the growth in the Company s small business lending has reduced the dividend cost. For the three months ending March 31, 2013, the dividend cost was approximately $146,000, or 4.7% annualized. For the second quarter of 2013, the dividend cost will be approximately $141,000 or 4.5% annualized and for the third quarter of 2013, the dividend cost will be approximately $62,500 or 2.0% annualized. The Company plans to reserve cash for the ability to redeem this preferred stock if and when the cost of this capital exceeds other forms of capital.

Horizon declared common stock dividends in the amount of $0.10 per share during the first three months of 2013 compared to $0.09 for the same period of 2012. The dividend payout ratio (dividends as a percent of basic earnings per share) was 16.7% and 14.5% for the first three months of 2013 and 2012, respectively. For additional information regarding dividends, see Horizon s Annual Report on Form 10-K for 2012.

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Quantitative and Qualitative Disclosures About Market Risk

For the Three Months Ended March 31, 2013

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Refer to Horizon s 2012 Annual Report on Form 10-K for analysis of its interest rate sensitivity. Horizon believes there have been no significant changes in its interest rate sensitivity since it was reported in its 2012 Annual Report on Form 10-K.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation Of Disclosure Controls And Procedures

Based on an evaluation of disclosure controls and procedures as of March 31, 2013, Horizon s Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of Horizon s disclosure controls (as defined in Exchange Act Rule 13a-15(e) of the Securities Exchange Act of 1934 (the Exchange Act)). Based on such evaluation, such officers have concluded that, as of the evaluation date, Horizon s disclosure controls and procedures are effective to ensure that the information required to be disclosed by Horizon in the reports it files under the Exchange Act is recorded, processed, summarized and reported within the time specified in Securities and Exchange Commission rules and forms and are designed to ensure that information required to be disclosed in those reports is accumulated and communicated to management as appropriate to allow timely decisions regarding disclosure.

Changes In Internal 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 March 31, 2013, there have been no changes in Horizon s internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, Horizon s internal control over financial reporting.

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Part II Other Information

For the Three Months Ended March 31, 2013

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

There have been no material changes from the factors previously disclosed under Item 1A of Horizon s Annual Report on Form 10-K for 2012.

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

Not Applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable

ITEM 5. OTHER INFORMATION

Not Applicable

HORIZON BANCORP AND SUBSIDIARIES

Part II Other Information

For the Three Months Ended March 31, 2013

ITEM 6. EXHIBITS
(a) Exhibits

Exhibit No.	Description
3	Amended and Restated Bylaws, as amended through April 16, 2013
31.1	Certification of Craig M. Dwight
31.2	Certification of Mark E. Secor
32	Certification of Chief Executive and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	Interactive Data Files*

* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files in Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

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SIGNATURES

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

	HORIZON BANCORP
Dated: May 8, 2013	/s/ Craig M. Dwight Craig M. Dwight Chief Executive Officer
Dated: May 8, 2013	/s/ Mark E. Secor Mark E. Secor Chief Financial Officer

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INDEX TO EXHIBITS

Exhibit No.	Description	Location
3	Amended and Restated Bylaws, as amended through April 16, 2013	Incorporated by reference to Exhibit 3.1 to the Registrant s Form 8-K filed on April 18, 2013
Exhibit 31.1	Certification of Craig M. Dwight	Attached
Exhibit 31.2	Certification of Mark E. Secor	Attached
Exhibit 32	Certification of Chief Executive and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Attached
Exhibit 101	Interactive Data Files*	Attached

* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files in Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.