FIRST CAPITAL INC
Form 10-Q
November 13, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2012

OR

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

For the transition period from to

Commission File No. 0-25023

First Capital, Inc.

(Exact name of registrant as specified in its charter)

Indiana	**35-2056949**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification Number)**

220 Federal Drive NW, Corydon, Indiana 47112

(Address of principal executive offices) (Zip Code)

Registrant s telephone number including area code 1-812-738-2198

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

(Check one):	Large Accelerated Filer	¨	Accelerated Filer	¨
	Non-accelerated Filer	¨	Smaller Reporting Company	x

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 2,785,001 shares of common stock were outstanding as of October 31, 2012.

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FIRST CAPITAL, INC.

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PART I FINANCIAL INFORMATION

FIRST CAPITAL, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

(Unaudited)

	September 30, 2012	December 31, 2011
	(In thousands)	
ASSETS		
Cash and due from banks	$ 8,290	$ 10,794
Interest bearing deposits with banks	2,316	525
Federal funds sold	12,089	7,604
Total cash and cash equivalents	22,695	18,923
Securities available for sale, at fair value	123,375	111,440
Securities-held to maturity	14	16
Loans, net	280,967	276,047
Loans held for sale	2,306	2,909
Federal Home Loan Bank stock, at cost	2,820	2,820
Foreclosed real estate	420	661
Premises and equipment	10,593	10,721
Accrued interest receivable	1,782	1,801
Cash value of life insurance	6,129	5,991
Goodwill	5,386	5,386
Core deposit intangibles	0	32
Other assets	1,865	2,139
Total Assets	$ 458,352	$ 438,886
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 61,548	$ 47,313
Interest-bearing	322,519	317,061
Total deposits	384,067	364,374
Retail repurchase agreements	9,112	9,125
Advances from Federal Home Loan Bank	10,100	12,350
Accrued interest payable	320	413
Accrued expenses and other liabilities	2,525	1,571
Total liabilities	406,124	387,833
EQUITY		
First Capital, Inc. stockholders equity:		
Preferred stock of $.01 par value per share Authorized 1,000,000 shares; none issued	0	0
Common stock of $.01 par value per share Authorized 5,000,000 shares; issued 3,164,420 shares	32	32
Additional paid-in capital	24,313	24,313
Retained earnings-substantially restricted	33,381	32,297
Accumulated other comprehensive income	1,720	1,612
Less treasury stock, at cost - 379,419 shares (378,727 shares in 2011)	(7,326)	(7,312)

Total First Capital, Inc. stockholders equity	52,120	50,942
Noncontrolling interest in subsidiary	108	111
Total equity	52,228	51,053
Total Liabilities and Equity	$ 458,352	$ 438,886

See accompanying notes to consolidated financial statements.

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PART I FINANCIAL INFORMATION

FIRST CAPITAL, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(In thousands, except per share data)			
INTEREST INCOME				
Loans, including fees	$ 4,020	$ 4,300	$ 12,028	$ 12,990
Securities:				
Taxable	425	520	1,280	1,471
Tax-exempt	245	254	708	796
Federal Home Loan Bank dividends	21	20	66	66
Federal funds sold and interest bearing deposits with banks	11	7	37	27
Total interest income	4,722	5,101	14,119	15,350
INTEREST EXPENSE				
Deposits	469	739	1,594	2,447
Retail repurchase agreements	8	14	29	48
Advances from Federal Home Loan Bank	98	144	305	460
Total interest expense	575	897	1,928	2,955
Net interest income	4,147	4,204	12,191	12,395
Provision for loan losses	350	400	1,125	1,325
Net interest income after provision for loan losses	3,797	3,804	11,066	11,070
NONINTEREST INCOME				
Service charges on deposit accounts	756	750	2,187	2,157
Commission income	63	61	143	143
Gain (loss) on sale of securities	29	11	29	(8)
Gain on sale of mortgage loans	207	169	712	394
Mortgage brokerage fees	3	9	22	39
Increase in cash surrender value of life insurance	43	50	138	154
Other income	25	24	70	73
Total noninterest income	1,126	1,074	3,301	2,952
NONINTEREST EXPENSE				
Compensation and benefits	2,471	1,883	6,171	5,594
Occupancy and equipment	321	312	932	952
Data processing	336	297	993	878
Professional fees	150	151	462	464
Advertising	68	72	180	185
Other operating expenses	637	616	1,938	1,881
Total noninterest expense	3,983	3,331	10,676	9,954
Income before income taxes	940	1,547	3,691	4,068
Income tax expense	218	451	1,008	1,128

Net Income	$ 722	$ 1,096	$ 2,683	$ 2,940
Less: net income attributable to noncontrolling interest in subsidiary	3	3	10	10
Net Income Attributable to First Capital, Inc.	$ 719	$ 1,093	$ 2,673	$ 2,930
Earnings per common share attributable to First Capital, Inc.				
Basic	$ 0.26	$ 0.39	$ 0.96	$ 1.05
Diluted	$ 0.26	$ 0.39	$ 0.96	$ 1.05
Dividends per share	$ 0.19	$ 0.19	$ 0.57	$ 0.57

See accompanying notes to consolidated financial statements.

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PART I FINANCIAL INFORMATION

FIRST CAPITAL, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	**2011**	**2012**	**2011**
	(In thousands)			
Net Income	$ 722	$ 1,096	$ 2,683	$ 2,940
OTHER COMPREHENSIVE INCOME				
Unrealized gains on securities available for sale:				
Unrealized holding gains arising during the period	128	711	207	2,148
Income tax expense	(51)	(282)	(82)	(851)
Net of tax amount	77	429	125	1,297
Less: reclassification adjustment for realized (gains) losses included in net income	(29)	(11)	(29)	8
Income tax (expense) benefit	12	4	12	(3)
Net of tax amount	(17)	(7)	(17)	5
Other Comprehensive Income, net of tax	60	422	108	1,302
Comprehensive Income	$ 782	$ 1,518	$ 2,791	$ 4,242

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PART I FINANCIAL INFORMATION

FIRST CAPITAL, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(Unaudited)

(In thousands, except share data)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Noncontrolling Interest	Total
Balances at January 1, 2011	$ 32	$ 24,313	$ 30,442	$ 391	$ (7,285)	$ 111	$ 48,004
Net income	0	0	2,930	0	0	10	2,940
Change in unrealized gain on securities available for sale,net of reclassification adjustments and tax effect	0	0	0	1,302	0	0	1,302
Cash dividends	0	0	(1,588)	0	0	(13)	(1,601)
Purchase of 1,608 treasury shares	0	0	0	0	(27)	0	(27)
Balances at September 30, 2011	$ 32	$ 24,313	$ 31,784	$ 1,693	$ (7,312)	$ 108	$ 50,618
Balances at January 1, 2012	$ 32	$ 24,313	$ 32,297	$ 1,612	$ (7,312)	$ 111	$ 51,053
Net income	0	0	2,673	0	0	10	2,683
Change in unrealized gain on securities available for sale, net of reclassification adjustments and tax effect	0	0	0	108	0	0	108
Cash dividends	0	0	(1,589)	0	0	(13)	(1,602)
Purchase of 692 treasury shares	0	0	0	0	(14)	0	(14)
Balances at September 30, 2012	$ 32	$ 24,313	$ 33,381	$ 1,720	$ (7,326)	$ 108	$ 52,228

See accompanying notes to consolidated financial statements.

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PART I FINANCIAL INFORMATION

FIRST CAPITAL, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 2,683	$ 2,940
Adjustments to reconcile net income to net cash and cash equivalents provided by operating activities:		
Amortization of premiums and accretion of discounts on securities, net	721	695
Depreciation and amortization expense	576	608
Deferred income taxes	(508)	(54)
Increase in cash value of life insurance	(138)	(154)
Provision for loan losses	1,125	1,325
(Gain) loss on sale of securities	(29)	8
Proceeds from sales of loans	29,144	18,343
Loans originated for sale	(27,829)	(14,270)
Gain on sale of loans	(712)	(394)
(Increase) decrease in accrued interest receivable	19	(47)
Decrease in accrued interest payable	(93)	(195)
Net change in other assets/liabilities	1,668	499
Net Cash Provided By Operating Activities	6,627	9,304
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of securities available for sale	(54,833)	(27,542)
Proceeds from maturities of securities available for sale	27,825	14,355
Proceeds from maturities of securities held to maturity	0	14
Proceeds from sales of securities available for sale	2,927	1,399
Principal collected on mortgage-backed obligations	11,632	7,124
Net (increase) decrease in loans receivable	(6,693)	7,389
Proceeds from sale of foreclosed real estate	889	559
Proceeds from redemption of Federal Home Loan Bank stock	0	374
Purchase of premises and equipment	(416)	(323)
Net Cash Provided By (Used In) Investing Activities	(18,669)	3,349
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in deposits	19,693	(15,878)
Net increase (decrease) in advances from Federal Home Loan Bank	(2,250)	496
Net decrease in retail repurchase agreements	(13)	(2,379)
Purchase of treasury stock	(14)	(27)
Dividends paid	(1,602)	(1,602)
Net Cash Provided By (Used In) Financing Activities	15,814	(19,390)
Net Increase (Decrease) in Cash and Cash Equivalents	3,772	(6,737)
Cash and cash equivalents at beginning of period	18,923	21,575

Cash and Cash Equivalents at End of Period	$ 22,695	$ 14,838

See accompanying notes to consolidated financial statements.

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Presentation of Interim Information

First Capital, Inc. (Company) is the savings and loan holding company for First Harrison Bank (Bank). The information presented in this report relates primarily to the Bank s operations. First Harrison Investments, Inc. and First Harrison Holdings, Inc. are wholly-owned Nevada corporate subsidiaries of the Bank that jointly own First Harrison, LLC, a Nevada limited liability corporation that holds and manages an investment portfolio. First Harrison REIT, Inc. (REIT) was incorporated as a wholly-owned subsidiary of First Harrison Holdings, Inc. to hold a portion of the Bank s real estate mortgage loan portfolio. On January 21, 2009, the REIT issued 105 shares of 12.5% redeemable cumulative preferred stock with an aggregate liquidation value of $105,000 in a private placement offering in order to satisfy certain ownership requirements to qualify as a real estate investment trust. At September 30, 2012, this noncontrolling interest represented 0.2% ownership of the REIT.

In the opinion of management, the unaudited consolidated financial statements include all normal adjustments considered necessary to present fairly the financial position as of September 30, 2012, and the results of operations for the three and nine months ended September 30, 2012 and cash flows for the nine months ended September 30, 2012 and 2011. All of these adjustments are of a normal, recurring nature. Such adjustments are the only adjustments included in the unaudited consolidated financial statements. Interim results are not necessarily indicative of results for a full year.

The accompanying unaudited consolidated financial statements and notes have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial statements and are presented as permitted by the instructions to Form 10-Q. Accordingly, they do not contain certain information included in the Company s annual audited consolidated financial statements and related footnotes for the year ended December 31, 2011 included in the Form 10-K.

The unaudited consolidated financial statements include the accounts of the Company and its subsidiaries. All material intercompany balances and transactions have been eliminated in consolidation.

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

2. Investment Securities

Debt and equity securities have been classified in the consolidated balance sheets according to management s intent. Investment securities at September 30, 2012 and December 31, 2011 are summarized as follows:

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2012				
Securities available for sale:				
Agency mortgage-backed securities	$ 22,022	$ 538	$ 9	$ 22,551
Agency CMO	24,278	169	90	24,357
Privately-issued CMO	666	19	28	657
Other debt securities:				
Agency notes and bonds	42,119	330	1	42,448
Municipal obligations	28,331	1,750	20	30,061
Subtotal debt securities	117,416	2,806	148	120,074
Mutual funds	3,263	56	18	3,301
Total securities available for sale	$ 120,679	$ 2,862	$ 166	$ 123,375
Securities held to maturity:				
Agency mortgage-backed securities	$ 14	$ 0	$ 0	$ 14
Total securities held to maturity	$ 14	$ 0	$ 0	$ 14
December 31, 2011				
Securities available for sale:				
Agency mortgage-backed securities	$ 11,689	$ 542	$ 11	$ 12,220
Agency CMO	23,196	152	60	23,288
Privately-issued CMO	896	16	32	880
Other debt securities:				
Agency notes and bonds	41,971	395	3	42,363
Municipal obligations	25,800	1,501	0	27,301
Subtotal debt securities	103,552	2,606	106	106,052
Mutual funds	5,369	52	33	5,388
Total securities available for sale	$ 108,921	$ 2,658	$ 139	$ 111,440
Securities held to maturity:				
Agency mortgage-backed securities	$ 16	$ 0	$ 0	$ 16

Total securities held to maturity	$ 16	$ 0	$ 0	$ 16

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(2 continued)

Agency notes and bonds, agency mortgage-backed securities and agency collateralized mortgage obligations (CMO) include securities issued by the Government National Mortgage Association (GNMA), a U.S. government agency, and the Federal National Mortgage Association (FNMA), the Federal Home Loan Mortgage Corporation (FHLMC) and the Federal Home Loan Bank (FHLB), which are government-sponsored enterprises. Privately-issued CMOs are issued by special-purpose entities that are generally collateralized by first position residential mortgage loans and first position residential home equity loans.

The amortized cost and fair value of debt securities as of September 30, 2012, by contractual maturity, are shown below. Expected maturities of mortgage-backed securities may differ from contractual maturities because the mortgages underlying the obligations may be prepaid without penalty.

	Securities Available for Sale		Securities Held to Maturity	
	Amortized Cost	**Fair Value**	**Amortized Cost**	**Fair Value**
(In thousands)				
Due in one year or less	$ 832	$ 835	$ 0	$ 0
Due after one year through five years	6,537	6,669	0	0
Due after five years through ten years	19,406	19,859		
Due after ten years	43,675	45,146	0	0
	70,450	72,509	0	0
Mortgage-backed securities and CMO	46,966	47,565	14	14
	$ 117,416	$ 120,074	$ 14	$ 14

Information pertaining to investment securities available for sale with gross unrealized losses at September 30, 2012, aggregated by investment category and the length of time that individual investment securities have been in a continuous position, follows:

(Dollars in thousands)	**Number of Investment Positions**	**Fair Value**	**Gross Unrealized Losses**
Continuous loss position less than twelve months:			
Agency notes and bonds	3	$ 3,049	$ 1
Agency CMO	10	9,798	86
Agency mortgage-backed securities	1	2,075	9
Muncipal obligations	5	1,638	20
Total less than twelve months	19	16,560	116

Continuous loss position more than twelve months:			
Privately-issued CMO	1	202	28
Agency CMO	2	1,105	4
Mutual fund	1	374	18
Total more than twelve months	4	1,681	50
Total securities available for sale	23	$ 18,241	$ 166

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(2 continued)

Management evaluates securities for other-than-temporary impairment at least quarterly, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recover in fair value.

At September 30, 2012, the 21 U.S. government agency debt securities, including agency notes and bonds, mortgage-backed securities and CMO, and municipal obligations in a loss position had depreciated approximately 0.7% from the amortized cost basis. All of the U.S. government agency securities and municipal obligations are issued by U.S. government agencies, government-sponsored enterprises and municipal governments, or are secured by first mortgage loans and municipal project revenues. These unrealized losses related principally to current interest rates for similar types of securities. In analyzing an issuer s financial condition, management considers whether the securities are issued by the federal government, its agencies or other governments, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer s financial condition. As the Company has the ability to hold the debt securities until maturity, or the foreseeable future if classified as available for sale, no declines are deemed to be other-than-temporary.

At September 30, 2012, the privately-issued CMO in a loss position had depreciated approximately 12.2% from the amortized cost basis. The Company evaluates the existence of a potential credit loss component related to the decline in fair values of the privately-issued CMO portfolio each quarter using an independent third party analysis. At September 30, 2012, the privately-issued CMO in a loss position had an amortized cost of $230,000 and a fair value of $202,000, and had been downgraded to a substandard regulatory classification in 2009 due to a downgrade of the security s credit quality by various rating agencies. Based on the independent third party analysis performed in September 2012, the Company did not recognize an other-than-temporary impairment loss during the quarter ended September 30, 2012. While management did not anticipate a credit-related impairment loss at September 30, 2012, any future deterioration in market and economic conditions may have an adverse impact on the credit quality in future periods.

3. Loans and Allowance for Loan Losses

The Company s loan and allowance for loan loss policies are as follows:

Loans are stated at unpaid principal balances, less net deferred loan fees and the allowance for loan losses. The Company grants real estate mortgage, commercial business and consumer loans. A substantial portion of the loan portfolio is represented by mortgage loans to customers in southern Indiana. The ability of the Company s customers to honor their loan agreements is dependent upon the real estate and general economic conditions in this area.

Loan origination and commitment fees, as well as certain direct costs of underwriting and closing loans, are deferred and amortized as a yield adjustment to interest income over the lives of the related loans using the interest method. Amortization of net deferred loan fees is discontinued when a loan is placed on nonaccrual status.

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

The recognition of income on a loan is discontinued and previously accrued interest is reversed, when interest or principal payments become ninety (90) days past due unless, in the opinion of management, the outstanding interest remains collectible. Past due status is determined based on contractual terms. Generally, by applying the cash receipts method, interest income is subsequently recognized only as received until the loan is returned to accrual status. The cash receipts method is used when the likelihood of further loss on the loan is remote. Otherwise, the Company applies the cost recovery method and applies all payments as a reduction of the unpaid principal balance until the loan qualifies for return to accrual status. Interest income on impaired loans is recognized using the cost recovery method, unless the likelihood of further loss on the loan is remote.

A loan is restored to accrual status when all principal and interest payments are brought current and the borrower has demonstrated the ability to make future payments of principal and interest as scheduled, which generally requires that the borrower demonstrate a period of performance of at least six consecutive months.

The Company s practice is to charge-off any loan or portion of a loan when the loan is determined by management to be uncollectible due to the borrower s failure to meet repayment terms, the borrower s deteriorating or deteriorated financial condition, the depreciation of the underlying collateral, the loan s classification as a loss by regulatory examiners, or for other reasons. A partial charge-off is recorded on a loan when the uncollectibility of a portion of the loan has been confirmed, such as when a loan is discharged in bankruptcy, the collateral is liquidated, a loan is restructured at a reduced principal balance, or other identifiable events that lead management to determine the full principal balance of the loan will not be repaid. A specific reserve is recognized as a component of the allowance for estimated losses on loans individually evaluated for impairment. Partial charge-offs on nonperforming and impaired loans are included in the Company s historical loss experience used to estimate the general component of the allowance for loan losses as discussed below. Specific reserves are not considered charge-offs in management s analysis of the allowance for loan losses because they are estimates and the outcome of the loan relationship is undetermined. At September 30, 2012, the Company had six loans on which partial charge-offs of $371,000 had been recorded.

Installment loans are typically charged off at 90 days past due, or earlier if deemed uncollectible, unless the loans are in the process of collection. Overdrafts are charged off after 45 days past due. Charge-offs are typically recorded on loans secured by real estate when the property is foreclosed upon.

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management s periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower s ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

The allowance consists of specific and general components. The specific component relates to loans that are classified as doubtful, substandard, or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors, as discussed below.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan s effective interest rate, the loan s obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Values for collateral dependent loans are generally based on appraisals obtained from independent licensed real estate appraisers, with adjustments applied for estimated costs to sell the property, costs to complete unfinished or repair damaged property and other known defects. New appraisals are generally obtained for all significant properties when a loan is identified as impaired. Generally, a property is considered significant if the value of the property is estimated to exceed $200,000. Subsequent appraisals are obtained as needed or if management believes there has been a significant change in the market value of the property. In instances where it is not deemed necessary to obtain a new appraisal, management would base its impairment and allowance for loan loss analysis on the original appraisal with adjustments for current conditions based on management s assessment of market factors and management s inspection of the property.

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

The following table provides the components of the Company s recorded investment in loans for each portfolio segment at September 30, 2012:

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity & 2nd Mtg	Other Consumer	Total
				(In thousands)				
Recorded Investment in Loans:								
Principal loan balance	$ 111,594	$ 9,663	$ 11,878	$ 63,944	$ 19,146	$ 37,348	$ 31,796	$ 285,369
Accrued interest receivable	447	42	31	170	56	142	180	1,068
Net deferred loan origination fees and costs	64	2	(13)	(8)	(10)	154	0	189
Recorded investment in loans	$ 112,105	$ 9,707	$ 11,896	$ 64,106	$ 19,192	$ 37,644	$ 31,976	$ 286,626
Recorded Investment in Loans as Evaluated for Impairment:								
Individually evaluated for impairment	$ 2,698	$ 4	$ 394	$ 2,986	$ 1,809	$ 101	$ 0	$ 7,992
Collectively evaluated for impairment	109,407	9,703	11,502	61,120	17,383	37,543	31,976	278,634
Acquired with deteriorated credit quality	0	0	0	0	0	0	0	0
Ending balance	$ 112,105	$ 9,707	$ 11,896	$ 64,106	$ 19,192	$ 37,644	$ 31,976	$ 286,626

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

The following table provides the components of the Company s recorded investment in loans for each portfolio segment at December 31, 2011:

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity & 2nd Mtg	Other Consumer	Total
				(In thousands)				
Recorded Investment in Loans:								
Principal loan balance	$ 116,338	$ 9,910	$ 6,963	$ 57,680	$ 20,722	$ 38,641	$ 29,832	$ 280,086
Accrued interest receivable	463	60	16	160	64	162	202	1,127
Net deferred loan origination fees and costs	67	2	0	0	(10)	84	0	143
Recorded investment in loans	$ 116,868	$ 9,972	$ 6,979	$ 57,840	$ 20,776	$ 38,887	$ 30,034	$ 281,356
Recorded Investment in Loans as Evaluated for Impairment:								
Individually evaluated for impairment	$ 2,281	$ 5	$ 247	$ 2,853	$ 1,928	$ 87	$ 0	$ 7,401
Collectively evaluated for impairment	114,587	9,967	6,732	54,987	18,848	38,800	30,034	273,955
Acquired with deteriorated credit quality	0	0	0	0	0	0	0	0
Ending balance	$ 116,868	$ 9,972	$ 6,979	$ 57,840	$ 20,776	$ 38,887	$ 30,034	$ 281,356

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

An analysis of the allowance for loan losses as of September 30, 2012 is as follows:

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity & 2nd Mtg	Other Consumer	Total
				(In thousands)				
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	$ 267	$ 0	$ 0	$ 441	$ 914	$ 29	$ 0	$ 1,651
Collectively evaluated for impairment	943	102	60	520	185	824	306	2,940
Acquired with deteriorated credit quality	0	0	0	0	0	0	0	0
Ending balance	$ 1,210	$ 102	$ 60	$ 961	$ 1,099	$ 853	$ 306	$ 4,591

An analysis of the allowance for loan losses as of December 31, 2011 is as follows:

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity & 2nd Mtg	Other Consumer	Total
				(In thousands)				
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	$ 183	$ 0	$ 0	$ 539	$ 936	$ 0	$ 0	$ 1,658
Collectively evaluated for impairment	645	93	33	730	224	400	399	2,524
Acquired with deteriorated credit quality	0	0	0	0	0	0	0	0
Ending balance	$ 828	$ 93	$ 33	$ 1,269	$ 1,160	$ 400	$ 399	$ 4,182

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

An analysis of the changes in the allowance for loan losses for the three months and nine months ended September 30, 2012 is as follows:

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity & 2nd Mtg	Other Consumer	Total
				(In thousands)				
Allowance for loan losses:								
Changes in Allowance for Loan Losses for the three-months ended September 30, 2012								
Beginning balance	$ 1,173	$ 102	$ 40	$ 826	$ 1,154	$ 840	$ 297	$ 4,432
Provisions for loan losses	51	0	20	135	(60)	158	46	350
Charge-offs	(15)	0	0	0	0	(154)	(90)	(259)
Recoveries	1	0	0	0	5	9	53	68
Ending balance	$ 1,210	$ 102	$ 60	$ 961	$ 1,099	$ 853	$ 306	$ 4,591
Changes in Allowance for Loan Losses for the nine-months ended September 30, 2012								
Beginning balance	$ 828	$ 93	$ 33	$ 1,269	$ 1,160	$ 400	$ 399	$ 4,182
Provisions for loan losses	697	12	27	(308)	(70)	765	2	1,125
Charge-offs	(327)	(4)	0	0	0	(330)	(236)	(897)
Recoveries	12	1	0	0	9	18	141	181
Ending balance	$ 1,210	$ 102	$ 60	$ 961	$ 1,099	$ 853	$ 306	$ 4,591

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

An analysis of the changes in the allowance for loan losses for the three months and nine months ended September 30, 2011 is as follows:

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity & 2nd Mtg	Other Consumer	Total
				(In thousands)				
Allowance for loan losses:								
Changes in Allowance for Loan Losses for the three-months ended September 30, 2011								
Beginning balance	$ 1,217	$ 59	$ 26	$ 1,271	$ 1,020	$ 562	$ 406	$ 4,561
Provisions for loan losses	146	2	2	114	130	3	3	400
Charge-offs	(80)	0	0	0	0	(250)	(73)	(403)
Recoveries	5	0	3	0	36	16	45	105
Ending balance	$ 1,288	$ 61	$ 31	$ 1,385	$ 1,186	$ 331	$ 381	$ 4,663
Changes in Allowance for Loan Losses for the nine-months ended September 30, 2011								
Beginning balance	$ 1,024	$ 55	$ 21	$ 1,051	$ 1,251	$ 606	$ 465	$ 4,473
Provisions for loan losses	601	6	7	402	199	136	(26)	1,325
Charge-offs	(346)	0	0	(68)	(305)	(458)	(211)	(1,388)
Recoveries	9	0	3	0	41	47	153	253
Ending balance	$ 1,288	$ 61	$ 31	$ 1,385	$ 1,186	$ 331	$ 381	$ 4,663

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

At September 30, 2012 and December 31, 2011, for each loan portfolio segment management applied an overall qualitative factor of 1.15 to the Company s historical loss factors based on the most recent calendar quarters. The overall qualitative factor is derived from management s analysis of changes and trends in the following qualitative factors:

Underwriting Standards Management reviews the findings of periodic internal audit loan reviews, independent outsourced loan reviews and loan reviews performed by the banking regulators to evaluate the risk associated with changes in underwriting standards. At September 30, 2012 and December 31, 2011, management assessed the risk associated with this component as neutral, requiring no adjustment to the historical loss factors.

Economic Conditions Management analyzes trends in housing and unemployment data in the Harrison, Floyd and Clark counties of Indiana, the Company s primary market area, to evaluate the risk associated with economic conditions. Due to a decrease in new home construction and an increase in unemployment in the Company s primary market area, management assigned a risk factor of 1.20 for this component at September 30 2012 and December 31, 2011.

Past Due Loans Management analyzes trends in past due loans for the Company to evaluate the risk associated with delinquent loans. In general, past due loan ratios have remained at elevated levels compared to historical amounts since 2007, and management assigned a risk factor of 1.20 for this component at September 30, 2012 and December 31, 2011.

Other Internal and External Factors This component includes management s consideration of other qualitative factors such as loan portfolio composition. The Company has focused on the origination of commercial business and real estate loans in an effort to convert the Company s balance sheet from that of a traditional thrift institution to a commercial bank. In addition, the Company has increased its investment in mortgage loans in which it does not hold a first lien position. Commercial loans and second mortgage loans generally entail greater credit risk than residential mortgage loans secured by a first lien. As a result of changes in the loan portfolio composition, management assigned a risk factor of 1.20 for this component at September 30, 2012 and December 31, 2011.

Each of the four factors above was assigned an equal weight to arrive at an average for the overall qualitative factor of 1.15 at September 30, 2012 and December 31, 2011. The effect of the overall qualitative factor was to increase the estimated allowance for loan losses by $306,000 and $317,000 at September 30, 2012 and December 31, 2011, respectively.

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

The following table summarizes the Company s impaired loans by class of loans as of September 30, 2012 and for the three months and nine months ended September 30, 2012:

	At September 30, 2012			Three Months Ended September 30, 2012			Nine Months Ended September 30, 2012		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Interest Recognized - Cash Method	Average Recorded Investment	Interest Income Recognized	Interest Recognized - Cash Method
					(In thousands)				
Loans with no related allowance recorded:									
Residential	$ 1,259	$ 1,531	$ 0	$ 1,152	$ 1	$ 1	$ 1,203	$ 2	$ 2
Land	4	5	0	23	0	0	23	0	1
Construction	394	402	0	330	0	0	293	0	0
Commercial real estate	1,220	1,511	0	1,229	0	0	1,231	0	0
Commercial business	0	0	0	0	0	0	0	0	0
Home Equity/2nd mortgage	0	0	0	43	0	0	64	2	1
Other consumer	0	0	0	0	1	0	0	1	0
	2,877	3,449	0	2,777	2	1	2,814	5	4
Loans with an allowance recorded:									
Residential	1,439	1,524	267	1,382	0	1	1,151	0	1
Land	0	0	0	0	0	0	0	0	0
Construction	0	0	0	0	0	0	0	0	0
Commercial real estate	1,766	1,845	441	1,630	0	0	1,602	0	0
Commercial business	1,809	1,909	914	1,826	0	0	1,877	0	0
Home Equity/2nd mortgage	101	102	29	128	0	0	111	0	0
Other consumer	0	0	0	0	0	0	0	0	0
	5,115	5,380	1,651	4,966	0	1	4,741	0	1
Total:									
Residential	2,698	3,055	267	2,534	1	2	2,354	2	3
Land	4	5	0	23	0	0	23	0	1
Construction	394	402	0	330	0	0	293	0	0
Commercial real estate									