

HORIZON BANCORP /IN/
Form 10-Q
November 09, 2016
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HORIZON BANCORP

FORM 10-Q

United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

QUARTERLY REPORT UNDER SECTION 13 OR 15 (d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2016

Commission file number 0-10792

HORIZON BANCORP

(Exact name of registrant as specified in its charter)

Indiana
(State or other jurisdiction of
incorporation or organization)

35-1562417
(I.R.S. Employer
Identification No.)

515 Franklin Square, Michigan City, Indiana
(Address of principal executive offices)

46360
(Zip Code)

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

Former name, former address and former fiscal year, if changed since last report: N/A

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 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check One):

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer Do not check if smaller reporting company

Smaller Reporting Company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 22,172,103 shares of Common Stock, no par value, at November 9, 2016.

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HORIZON BANCORP

FORM 10-Q

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Table of Contents**PART 1 FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****HORIZON BANCORP AND SUBSIDIARIES****Condensed Consolidated Balance Sheets**

(Dollar Amounts in Thousands)

	September 30 2016 (Unaudited)	December 31 2015
Assets		
Cash and due from banks	\$ 83,721	\$ 48,650
Investment securities, available for sale	557,213	444,982
Investment securities, held to maturity (fair value of \$194,294 and \$193,703)	187,027	187,629
Loans held for sale	7,369	7,917
Loans, net of allowance for loan losses of \$14,524 and \$14,534	2,175,995	1,734,597
Premises and equipment, net	67,265	60,798
Federal Reserve and Federal Home Loan Bank stock	20,877	13,823
Goodwill	74,308	49,600
Other intangible assets	9,583	7,371
Interest receivable	12,702	10,535
Cash value of life insurance	73,661	54,504
Other assets	55,929	31,995
Total assets	\$ 3,325,650	\$ 2,652,401
Liabilities		
Deposits		
Non-interest bearing	\$ 479,771	\$ 335,955
Interest bearing	1,856,391	1,544,198
Total deposits	2,336,162	1,880,153
Borrowings	569,908	449,347
Subordinated debentures	37,418	32,797
Interest payable	1,015	507
Other liabilities	35,411	22,765
Total liabilities	2,979,914	2,385,569
Commitments and contingent liabilities		
Stockholders Equity		
Preferred stock, Authorized, 1,000,000 shares Series B shares \$.01 par value, \$1,000 liquidation value Issued 0 and 12,500 shares		12,500

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Common stock, no par value Authorized, 66,000,000 shares (Restated - See Note 1) Issued, 22,172,103 and 17,992,986 shares (Restated - See Note 1) Outstanding, 22,143,228 and 17,909,831 shares (Restated - See Note 1)

Additional paid-in capital	181,901	106,370
Retained earnings	161,026	148,685
Accumulated other comprehensive income (loss)	2,809	(723)
Total stockholders' equity	345,736	266,832
Total liabilities and stockholders' equity	\$ 3,325,650	\$ 2,652,401

See notes to condensed consolidated financial statements

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Condensed Consolidated Statements of Income**

(Dollar Amounts in Thousands, Except Per Share Data)

	Three Months Ended September 30		Nine Months Ended September 30	
	2016	2015	2016	2015
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Interest Income				
Loans receivable	\$ 25,313	\$ 20,297	\$ 65,854	\$ 55,140
Investment securities				
Taxable	2,498	2,156	7,703	6,377
Tax exempt	1,151	1,125	3,583	3,281
Total interest income	28,962	23,578	77,140	64,798
Interest Expense				
Deposits	1,875	1,566	4,923	4,035
Borrowed funds	2,128	1,729	5,608	4,747
Subordinated debentures	549	507	1,556	1,504
Total interest expense	4,552	3,802	12,087	10,286
Net Interest Income	24,410	19,776	65,053	54,512
Provision for loan losses	455	300	1,219	2,820
Net Interest Income after Provision for Loan Losses	23,955	19,476	63,834	51,692
Non-interest Income				
Service charges on deposit accounts	1,483	1,359	4,056	3,443
Wire transfer fees	292	160	588	493
Interchange fees	2,016	1,625	5,137	4,093
Fiduciary activities	1,653	1,520	4,753	4,033
Gain on sale of investment securities (includes \$0 for the three months ended and \$875 for the nine months ended September 30, 2016 and \$0 for the three months ended and \$124 for the nine months ended September 30, 2015, related to accumulated other comprehensive earnings reclassifications)			875	124
Gain on sale of mortgage loans	3,528	2,794	9,171	7,815
Mortgage servicing income net of impairment	409	246	1,356	725
Increase in cash value of bank owned life insurance	449	374	1,145	889
Death benefit on bank owned life insurance				145
Other income	226	322	708	892

Total non-interest income	10,056	8,400	27,789	22,652
Non-interest Expense				
Salaries and employee benefits	12,210	10,652	32,592	27,541
Net occupancy expenses	2,174	1,723	6,011	4,649
Data processing	1,616	1,281	3,855	3,170
Professional fees	612	409	2,190	1,596
Outside services and consultants	2,686	3,209	5,983	4,753
Loan expense	1,482	1,351	4,086	3,975
FDIC insurance expense	465	423	1,279	1,099
Other losses	107	246	510	351
Other expense	3,468	2,941	9,616	7,819
Total non-interest expense	24,820	22,235	66,122	54,953
Income Before Income Tax	9,191	5,641	25,501	19,391
Income tax expense (includes \$0 for the three months ended and \$306 for the nine months ended September 30, 2016 and \$0 for the three months ended and \$43 for the nine months ended September 30, 2015, related to income tax expense from reclassification items)	2,589	1,353	7,192	5,017
Net Income	6,602	4,288	18,309	14,374
Preferred stock dividend		(31)	(42)	(94)
Net Income Available to Common Shareholders	\$ 6,602	\$ 4,257	\$ 18,267	\$ 14,280
Basic Earnings Per Share (Restated - See Note 1)	\$ 0.31	\$ 0.24	\$ 0.95	\$ 0.95
Diluted Earnings Per Share (Restated - See Note 1)	0.30	0.24	0.94	0.92
See notes to condensed consolidated financial statements				

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Condensed Consolidated Statements of Comprehensive Income**

(Dollar Amounts in Thousands)

	Three Months Ended September 30		Nine Months Ended September 30	
	2016	2015	2016	2015
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Net Income	\$ 6,602	\$ 4,288	\$ 18,309	\$ 14,374
Other Comprehensive Income (Loss)				
Change in fair value of derivative instruments:				
Change in fair value of derivative instruments for the period	803	(516)	158	(334)
Income tax effect	(281)	181	(55)	117
Changes from derivative instruments	522	(335)	103	(217)
Change in securities:				
Unrealized appreciation (depreciation) for the period on AFS securities	(1,927)	1,781	6,712	1,379
Amortization from transfer of securities from available-for-sale to held-to-maturity securities	(83)	(203)	(560)	(475)
Reclassification adjustment for securities gains realized in income			(875)	(124)
Income tax effect	704	(552)	(1,848)	(273)
Unrealized gains (losses) on securities	(1,306)	1,026	3,429	507
Other Comprehensive Income (Loss), Net of Tax	(784)	691	3,532	290
Comprehensive Income	\$ 5,818	\$ 4,979	\$ 21,841	\$ 14,664

See notes to condensed consolidated financial statements

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HORIZON BANCORP AND SUBSIDIARIES

Condensed Consolidated Statement of Stockholders' Equity

(Unaudited)

(Dollar Amounts in Thousands, Except Per Share Data)

	Preferred	Additional	Retained	Accumulated	Total
	Stock	Paid-in	Earnings	Other	
		Capital		Comprehensive	
				Income	
				(Loss)	
Balances, January 1, 2016	\$ 12,500	\$ 106,370	\$ 148,685	\$ (723)	\$ 266,832
Net income			18,309		18,309
Other comprehensive income, net of tax				3,532	3,532
Redemption of preferred stock	(12,500)				(12,500)
Amortization of unearned compensation		222			222
Stock option expense		247			247
Stock issued stock plans		286			286
Stock issued in KFI acquisition		14,470			14,470
Stock issued in LPSB acquisition		60,306			60,306
Cash dividends on preferred stock (1.00%)			(42)		(42)
Cash dividends on common stock (\$.30 per share)			(5,926)		(5,926)
Balances, September 30, 2016	\$	\$ 181,901	\$ 161,026	\$ 2,809	\$ 345,736

See notes to condensed consolidated financial statements

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Condensed Consolidated Statements of Cash Flows**

(Dollar Amounts in Thousands)

	Nine Months Ended September 30	
	2016	2015
	(Unaudited)	(Unaudited)
Operating Activities		
Net income	\$ 18,309	\$ 14,374
Items not requiring (providing) cash		
Provision for loan losses	1,219	2,820
Depreciation and amortization	3,790	3,020
Share based compensation	247	216
Mortgage servicing rights net impairment	840	389
Premium amortization on securities available for sale, net	4,389	2,192
Gain on sale of investment securities	(875)	(124)
Gain on sale of mortgage loans	(9,171)	(7,815)
Proceeds from sales of loans	246,435	247,512
Loans originated for sale	(236,719)	(239,137)
Change in cash value of life insurance	(1,145)	(868)
Gain (Loss) on sale of other real estate owned	118	(214)
Net change in		
Interest receivable	(687)	(1,337)
Interest payable	275	(28)
Other assets	(16,641)	(61)
Other liabilities	1,015	1,020
Net cash provided by operating activities	11,399	21,959
Investing Activities		
Purchases of securities available for sale	(152,283)	(170,391)
Proceeds from sales, maturities, calls, and principal repayments of securities available for sale	88,330	61,785
Purchases of securities held to maturity	(35,598)	(26,128)
Proceeds from maturities of securities held to maturity	14,654	7,155
Change in FHLB stock	(2,443)	268
Net change in loans	(26,920)	(123,326)
Proceeds on the sale of OREO and repossessed assets	1,524	2,425
Change in premises and equipment, net	(1,719)	(4,757)
Acquisition of Peoples, net of cash received		182,413
Acquisition of Kosciusko, net of cash received	30,437	
Acquisition of LaPorte, net of cash received	116,521	
Net cash provided by (used in) investing activities	32,503	(70,556)

Financing Activities

Net change in		
Deposits	(37,495)	79,669
Borrowings	46,846	(26,064)
Redemption of preferred stock	(12,500)	
Proceeds from issuance of stock	286	4,178
Dividends paid on common shares	(5,926)	(4,413)
Dividends paid on preferred shares	(42)	(94)
Net cash provided by (used in) financing activities	(8,831)	53,276
Net Change in Cash and Cash Equivalents	35,071	4,679
Cash and Cash Equivalents, Beginning of Period	48,650	43,476
Cash and Cash Equivalents, End of Period	\$ 83,721	\$ 48,155

Additional Supplemental Information

Interest paid	\$ 11,579	\$ 10,292
Income taxes paid	7,310	4,900
Transfer of loans to other real estate owned	3,035	2,825

The Company purchased all of the capital stock of Kosciusko for \$22,983 on June 1, 2016 and Peoples for \$78,147 on July 1, 2015. In conjunction with the acquisition, liabilities were assumed as follows:

Fair value of assets acquired	155,873	485,077
Less: common stock issued	14,470	22,641
Cash paid for the capital stock	8,513	55,506
Liabilities assumed	132,890	406,930

The Company purchased all of the capital stock of LaPorte Bancorp for \$98,634 on July 18, 2016. In conjunction with the acquisition, liabilities were assumed as follows:

Fair value of assets acquired	546,770	
Less: common stock issued	60,306	
Cash paid for the capital stock	38,328	
Liabilities assumed	448,136	

See notes to condensed consolidated financial statements

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements**

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

Note 1 - Accounting Policies

The accompanying unaudited condensed consolidated financial statements include the accounts of Horizon Bancorp (Horizon or the Company) and its wholly-owned subsidiaries, including Horizon Bank, N.A. (Bank). All inter-company balances and transactions have been eliminated. The results of operations for the periods ended September 30, 2016 and September 30, 2015 are not necessarily indicative of the operating results for the full year of 2016 or 2015. The accompanying unaudited condensed consolidated financial statements reflect all adjustments that are, in the opinion of Horizon s management, necessary to fairly present the financial position, results of operations and cash flows of Horizon for the periods presented. Those adjustments consist only of normal recurring adjustments.

Certain information and note disclosures normally included in Horizon s annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in Horizon s Annual Report on Form 10-K for 2015 filed with the Securities and Exchange Commission on February 29, 2016. The condensed consolidated balance sheet of Horizon as of December 31, 2015 has been derived from the audited balance sheet as of that date.

On October 18, 2016, the Board of Directors of the Company approved a three-for-two stock split of the Company s authorized common stock, no par value. All share and per share amounts in the condensed consolidated financial statements and notes thereto have been retroactively adjusted, where necessary, to reflect this three-for-two stock split. The effect of the three-for-two stock split on the outstanding common shares is that shareholders of record as of the close of business on October 31, 2016, the record date, will receive an additional half share of common stock held, with shareholders receiving cash in lieu of any fractional shares. The additional shares issued in the stock split are expected to be payable and issued on November 14, 2016, and that the common shares will begin trading on a split-adjusted basis on or about November 15, 2016.

Basic earnings per share is computed by dividing net income available to common shareholders (net income less dividend requirements for preferred stock and accretion of preferred stock discount) by the weighted-average number of common shares outstanding. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. The following table shows computation of basic and diluted earnings per share.

	Three Months Ended September 30		Nine Months Ended September 30	
	2016	2015	2016	2015
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Basic earnings per share				
Net income	\$ 6,602	\$ 4,288	\$ 18,309	\$ 14,374
Less: Preferred stock dividends		31	42	94

Net income available to common shareholders	\$	6,602	\$	4,257	\$	18,267	\$	14,280
Weighted average common shares outstanding ⁽¹⁾		21,538,752		17,408,964		19,252,295		15,044,129
Basic earnings per share	\$	0.31	\$	0.24	\$	0.95	\$	0.95
Diluted earnings per share								
Net income available to common shareholders	\$	6,602	\$	4,257	\$	18,267	\$	14,280
Weighted average common shares outstanding ⁽¹⁾		21,538,752		17,408,964		19,252,295		15,044,129
Effect of dilutive securities:								
Warrants				321,888				436,044
Restricted stock		33,650		50,207		27,590		46,092
Stock options		79,551		58,823		66,491		54,446
Weighted average shares outstanding		21,651,953		17,839,882		19,346,376		15,580,711
Diluted earnings per share	\$	0.30	\$	0.24	\$	0.94	\$	0.92

⁽¹⁾ Adjusted for 3:2 stock split on November 14, 2016

There were no shares for both the three and nine months ended September 30, 2016, respectively, and 3,750 for both the three and nine months ended September 30, 2015 which were not included in the computation of diluted earnings per share because they were non-dilutive.

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

Horizon has share-based employee compensation plans, which are described in the notes to the financial statements included in the December 31, 2015 Annual Report on Form 10-K.

Note 2 Acquisitions

On July 1, 2015, Horizon completed the acquisition of Peoples Bancorp, an Indiana corporation (Peoples) and Horizon Bank N.A.'s acquisition of Peoples Federal Savings Bank of DeKalb County (Peoples FSB), through mergers effective July 1, 2015. Under the terms of the acquisition, the exchange ratio was 1.425 shares of Horizon common stock (the Exchange Ratio) and \$9.75 in cash for each outstanding share of Peoples common stock. Peoples shareholders owning fewer than 100 shares of common stock received \$33.14 in cash for each common share. Peoples shares outstanding at the closing were 2,311,858, and the shares of Horizon common stock issued to Peoples shareholders totaled 3,288,303. Horizon's stock price was \$16.88 per share at the close of business on July 1, 2015. Based upon these numbers, the total value of the consideration for the acquisition was \$78.1 million. The Company had approximately \$4.9 million in costs related to the acquisition as of December 31, 2015. These expenses were classified in the non-interest expense section of the income statement and primarily located in the salaries and employee benefits, professional services and other expense line items. As a result of the acquisition, the Company increased its deposit base and reduced transaction costs. The Company also expects to reduce cost through economies of scale.

Under the purchase method of accounting, the total estimated purchase price is allocated to Peoples net tangible and intangible assets based on their current estimated fair values on the date of the acquisition. Based on management's preliminary valuation of the fair value of tangible and intangible assets acquired and liabilities assumed, which are based on estimates and assumptions that are subject to change, the final purchase price for the Peoples acquisition is allocated as follows:

ASSETS	
Cash and due from banks	\$ 205,054
Investment securities, held to maturity	2,038
Commercial	67,435
Residential mortgage	137,331
Consumer	19,593
Total loans	224,359
Premises and equipment, net	5,524
FRB and FHLB stock	2,743
Goodwill	21,424
Core deposit intangible	4,394

Interest receivable	1,279
Cash value of life insurance	13,898
Other assets	4,364
Total assets purchased	\$ 485,077
Common shares issued	\$ 55,506
Cash paid	22,641
Total estimated purchase price	\$ 78,147
LIABILITIES	
Deposits	
Non-interest bearing	\$ 28,251
NOW accounts	65,771
Savings and money market	125,176
Certificates of deposits	131,889
Total deposits	351,087
Borrowings	48,884
Interest payable	21
Other liabilities	6,938
Total liabilities assumed	\$ 406,930

Of the total purchase price of \$78.1 million, \$4.4 million has been allocated to core deposit intangible. Additionally, \$21.0 million has been allocated to goodwill and none of the purchase price is deductible. The core deposit intangible will be amortized over seven years on a straight line basis.

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

The Company acquired the \$228.6 million loan portfolio at a fair value discount of \$4.8 million. The performing portion of the portfolio, \$223.4 million, had an estimated fair value of \$220.0 million. The excess of expected cash flows above the fair value of the performing portion of loans will be accreted to interest income over the remaining lives of the loans in accordance with ASC 310-20.

The Company acquired certain loans in the acquisition and the transferred loans had evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected.

The loans purchased with evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected are considered to be credit impaired. Evidence of credit quality deterioration as of the purchase date may include information such as past-due and non-accrual status, borrower credit scores and recent loan-to-value percentages. Purchased credit-impaired loans are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality (ASC 310-30) and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loan. Accordingly, an allowance for credit losses related to these loans is not carried over and recorded at the acquisition date. Management estimated the cash flows expected to be collected at acquisition using our internal risk models, which incorporate the estimate of current key assumptions, such as default rates, severity and prepayment speeds.

Loans with specific credit-related deterioration, since origination, are recorded at fair value, reflecting the present value of the amounts expected to be collected. Income recognition of these loans is based on reasonable expectation about the timing and amount of cash flows to be collected.

The following table details the acquired loans that are accounted for in accordance with ASC 310-30 as of July 1, 2015.

Contractually required principal and interest at acquisition	\$ 5,730
Contractual cash flows not expected to be collected (nonaccretable differences)	715
Expected cash flows at acquisition	5,015
Interest component of expected cash flows (accretable discount)	647
Fair value of acquired loans accounted for under ASC 310-30	\$ 4,368

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements**

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

The results of operations of Peoples and Peoples FSB have been included in the Company's consolidated financial statements since the acquisition dates. The following schedule includes pro forma results for the periods ended September 30, 2016 and 2015 as if the Peoples and Peoples FSB acquisitions had occurred as of the beginning of the comparable prior reporting period.

	Three Months Ended		Nine Months Ended	
	September 30	September 30	September 30	September 30
	2016	2015	2016	2015
Summary of Operations:				
Net Interest Income	\$ 24,410	\$ 19,776	\$ 65,053	\$ 60,466
Provision for Loan Losses	455	300	1,219	2,880
Net Interest Income after Provision for Loan Losses	23,955	19,476	63,834	57,586
Non-interest Income	10,056	8,400	27,789	24,545
Non-Interest Expense	24,820	22,235	66,122	61,192
Income before Income Taxes	9,191	5,641	25,501	20,939
Income Tax Expense	2,589	1,353	7,192	5,164
Net Income	6,602	4,288	18,309	15,776
Net Income Available to Common Shareholders	\$ 6,602	\$ 4,257	\$ 18,267	\$ 15,682
Basic Earnings Per Share	\$ 0.31	\$ 0.24	\$ 0.95	\$ 0.91
Diluted Earnings Per Share	\$ 0.30	\$ 0.24	\$ 0.94	\$ 0.89

The pro forma information includes adjustments for interest income on loans, amortization of intangibles arising from the transaction, interest expense on deposits acquired, premises expense for the banking centers acquired and the related income tax effects.

The pro forma financial information is presented for information purposes only and is not indicative of the results of operations that actually would have been achieved had the acquisition been consummated as of that time, nor is it intended to be a projection of future results.

On June 1, 2016, Horizon completed the acquisition of Kosciusko Financial, Inc., an Indiana corporation (Kosciusko) and Horizon Bank's acquisition of Farmers State Bank, a state-chartered bank and wholly owned subsidiary of Kosciusko, through mergers effective June 1, 2016. Under the terms of the Merger Agreement, shareholders of Kosciusko had the option to receive \$81.75 per share in cash or 4.5183 shares of Horizon common stock for each share of Kosciusko's common stock, subject to allocation provisions to assure that in aggregate, Kosciusko shareholders received total consideration that consisted of 65% stock and 35% cash. Kosciusko shareholders owning fewer than 100 shares of common stock received \$81.75 in cash for each common share. As a result of Kosciusko stockholder stock and cash elections and the related proration provisions of the Merger Agreement, Horizon issued

873,430 shares of its common stock in the merger. Based upon the June 1, 2016 closing price of \$16.57 per share of Horizon common stock, the transaction has an implied valuation of approximately \$23.0 million. The Company has had approximately \$1.6 million in costs related to the acquisition. These expenses are classified in the non-interest expense section of the income statement and primarily located in the salaries and employee benefits, professional services and other expense line items. As a result of the acquisition, the Company will have an opportunity to increase its deposit base and reduce transaction costs. The Company also expects to reduce cost through economies of scale.

Under the acquisition method of accounting, the total purchase price is allocated to net tangible and intangible assets based on their current estimated fair values on the date of the acquisition. Based on preliminary valuations of the fair value of tangible and intangible assets acquired and liabilities assumed, which are based on assumptions that are subject to change, the purchase price for the Kosciusko acquisition is detailed in the following table. The final valuation numbers were received in September 2016 which changed the goodwill estimate from \$6.9 million to \$6.4 million.

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

ASSETS	
Cash and due from banks	\$ 38,950
Investment securities, held to maturity	1,191
Commercial	70,006
Residential mortgage	26,244
Consumer	6,319
Total loans	102,569
Premises and equipment, net	1,466
FRB and FHLB stock	582
Goodwill	6,443
Core deposit intangible	526
Interest receivable	636
Cash value of life insurance	2,745
Other assets	765
Total assets purchased	\$ 155,873
Common shares issued	\$ 14,470
Cash paid	8,513
Total estimated purchase price	\$ 22,983
LIABILITIES	
Deposits	
Non-interest bearing	\$ 27,871
NOW accounts	35,213
Savings and money market	26,953
Certificates of deposits	32,771
Total deposits	122,808
Borrowings	9,038
Interest payable	55
Other liabilities	989
Total liabilities assumed	\$ 132,890

Of the total estimated purchase price of \$23.0 million, \$526,000 has been allocated to core deposit intangible. Additionally, \$6.4 million has been allocated to goodwill and none of the purchase price is deductible. The core deposit intangible will be amortized over seven years on a straight line basis.

The Company acquired loans in the acquisition and the transferred loans had evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected.

Loans purchased with evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected are considered to be credit impaired. Evidence of credit quality deterioration as of the purchase date may include information such as past-due and non-accrual status, borrower credit scores and recent loan-to-value percentages. Purchased credit-impaired loans are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality (ASC 310-30) and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loan. Accordingly, an allowance for credit losses related to these loans is not carried over and recorded at the acquisition date. Management estimated the cash flows expected to be collected at acquisition using our internal risk models, which incorporate the estimate of current key assumptions, such as default rates, severity and prepayment speeds.

Loans with specific credit-related deterioration, since origination, are recorded at fair value, reflecting the present value of the amounts expected to be collected. Income recognition of these loans is based on reasonable expectation about the timing and amount of cash flows to be collected.

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements**

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

The following table details the acquired loans that are accounted for in accordance with ASC 310-30 as of June 1, 2016.

Contractually required principal and interest at acquisition	\$ 2,682
Contractual cash flows not expected to be collected (nonaccretable differences)	25
Expected cash flows at acquisition	2,657
Interest component of expected cash flows (accretable discount)	634
Fair value of acquired loans accounted for under ASC 310-30	\$ 2,023

Final estimates of certain loans, those for which specific credit-related deterioration, since origination, are recorded at fair value, reflecting the present value of the amounts expected to be collected. Income recognition of these loans is based on reasonable expectation about the timing and amount of cash flows to be collected.

Pro-forma statements were not presented due to the immateriality of the transaction.

On July 18, 2016, Horizon completed the acquisition of LaPorte Bancorp, Inc., a Maryland corporation (LaPorte Bancorp) and Horizon Bank's acquisition of The LaPorte Savings Bank, a state-chartered savings bank and wholly owned subsidiary of LaPorte Bancorp, through mergers effective July 18, 2016. Under the terms of the Merger Agreement, shareholders of LaPorte Bancorp had the option to receive \$17.50 per share in cash or 0.9435 shares of Horizon common stock for each share of LaPorte Bancorp's common stock, subject to allocation provisions to assure that in aggregate, LaPorte Bancorp shareholders received total consideration that consisted of 65% stock and 35% cash. As a result of LaPorte Bancorp stockholder stock and cash elections and the related proration provisions of the Merger Agreement, Horizon issued 3,421,488 shares of its common stock in the merger. Based upon the July 18, 2016 closing price of \$18.36 per share of Horizon common stock, less the consideration used to pay off LaPorte's ESOP loan receivable, the transaction has an implied valuation of approximately \$98.6 million.

Under the acquisition method of accounting, the total purchase price is allocated to net tangible and intangible assets based on their current estimated fair values on the date of the acquisition. Based on preliminary valuations of the fair value of tangible and intangible assets acquired and liabilities assumed, which are based on assumptions that are subject to change, the purchase price for the LaPorte Bancorp acquisition is detailed in the following table. Final estimates of fair value on the date of acquisition have not been received yet. Prior to the end of the one year measurement period for finalizing the purchase price allocation, if information becomes available which would indicate adjustments are required to the purchase price allocation, such adjustments will be included in the purchase price allocation prospectively. If any adjustments are made to the preliminary assumptions (provisional amounts), disclosures will be made in the notes to the financial statements of the amounts recorded in the current period earnings

by line item that have been recorded in previous reporting periods if the adjustments to the provisional amounts had been recognized as of the acquisition date.

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements**

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

ASSETS	
Cash and due from banks	\$ 154,849
Investment securities, held to maturity	23,779
Commercial	154,223
Residential mortgage	42,603
Consumer	16,801
Mortgage Warehousing	99,752
Total loans	313,379
Premises and equipment, net	6,022
FHLB stock	4,029
Goodwill	18,265
Core deposit intangible	2,514
Interest receivable	844
Cash value of life insurance	15,267
Other assets	7,822
Total assets purchased	\$ 546,770
Common shares issued	\$ 60,306
Cash paid	38,328
Total estimated purchase price	\$ 98,634
LIABILITIES	
Deposits	
Non-interest bearing	\$ 66,733
NOW accounts	99,346
Savings and money market	117,688
Certificates of deposits	86,929
Total deposits	370,696
Borrowings	64,793
Interest payable	178
Subordinated debt	4,504
Other liabilities	7,965
Total liabilities assumed	\$ 448,136

Of the total estimated purchase price of \$98.6 million, \$2.5 million has been allocated to core deposit intangible. Additionally, \$18.3 million has been allocated to goodwill and none of the purchase price is deductible. The core deposit intangible will be amortized over seven years on a straight line basis.

The Company acquired loans in the acquisition and the transferred loans had evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected.

Loans purchased with evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected are considered to be credit impaired. Evidence of credit quality deterioration as of the purchase date may include information such as past-due and non-accrual status, borrower credit scores and recent loan-to-value percentages. Purchased credit-impaired loans are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality (ASC 310-30) and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loan. Accordingly, an allowance for credit losses related to these loans is not carried over and recorded at the acquisition date. Management estimated the cash flows expected to be collected at acquisition using our internal risk models, which incorporate the estimate of current key assumptions, such as default rates, severity and prepayment speeds.

Loans with specific credit-related deterioration, since origination, are recorded at fair value, reflecting the present value of the amounts expected to be collected. Income recognition of these loans is based on reasonable expectation about the timing and amount of cash flows to be collected.

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements**

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

The following table details an estimate of the acquired loans that are accounted for in accordance with ASC 310-30 as of July 18, 2016. Final valuation estimates have not yet been determined for acquired loans as of September 30, 2016. If information becomes available which would indicate adjustments to the purchase price allocation, such adjustments would be made prospectively.

Contractually required principal and interest at acquisition	\$ 12,551
Contractual cash flows not expected to be collected (nonaccretable differences)	3,411
Expected cash flows at acquisition	9,140
Interest component of expected cash flows (accretable discount)	1,736
Fair value of acquired loans accounted for under ASC 310-30	\$ 7,404

Estimates of certain loans, those for which specific credit-related deterioration, since origination, are recorded at fair value, reflecting the present value of the amounts expected to be collected. Income recognition of these loans is based on reasonable expectation about the timing and amount of cash flows to be collected.

The results of operations of LaPorte Bancorp and The LaPorte Savings Bank have been included in the Company's consolidated financial statements since the acquisition dates. The following schedule includes pro forma results for the periods ended September 30, 2016 and 2015 as if the LaPorte Bancorp and The LaPorte Savings Bank acquisitions had occurred as of the beginning of the comparable prior reporting periods.

	Three Months Ended		Nine Months Ended	
	September 30	September 30	September 30	September 30
	2016	2015	2016	2015
Summary of Operations:				
Net Interest Income	\$ 25,044	\$ 23,981	\$ 74,512	\$ 67,243
Provision for Loan Losses	455	400	1,219	3,075
Net Interest Income after Provision for Loan Losses	24,589	23,581	73,293	64,168
Non-interest Income	11,056	9,099	33,052	24,767
Non-Interest Expense	31,611	25,541	80,937	64,956
Income before Income Taxes	4,034	7,139	25,408	23,979
Income Tax Expense	1,855	1,670	8,070	5,932

Net Income	2,179	5,469	17,338	18,047
Net Income Available to Common Shareholders	\$ 2,179	\$ 5,438	\$ 17,296	\$ 17,953
Basic Earnings Per Share	\$ 0.10	\$ 0.31	\$ 0.90	\$ 1.19
Diluted Earnings Per Share	\$ 0.10	\$ 0.30	\$ 0.89	\$ 1.15

The pro forma information includes adjustments for interest income on loans, amortization of intangibles arising from the transaction, interest expense on deposits acquired, premises expense for the banking centers acquired and the related income tax effects.

The pro forma financial information is presented for information purposes only and is not indicative of the results of operations that actually would have been achieved had the acquisition been consummated as of that time, nor is it intended to be a projection of future results.

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements**

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

Note 3 Securities

The fair value of securities is as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2016				
Available for sale				
U.S. Treasury and federal agencies	\$ 27,383	\$ 54	\$ (15)	\$ 27,422
State and municipal	62,825	1,321	(107)	64,039
Federal agency collateralized mortgage obligations	188,072	1,894	(282)	189,684
Federal agency mortgage-backed pools	272,144	4,240	(411)	275,973
Corporate notes	32	63		95
Total available for sale investment securities	\$ 550,456	\$ 7,572	\$ (815)	\$ 557,213
Held to maturity				
State and municipal	\$ 158,543	\$ 6,718	\$ (761)	\$ 164,500
Federal agency collateralized mortgage obligations	6,828	144		6,972
Federal agency mortgage-backed pools	21,656	1,166		22,822
Total held to maturity investment securities	\$ 187,027	\$ 8,028	\$ (761)	\$ 194,294
December 31, 2015				
Available for sale				
U.S. Treasury and federal agencies	\$ 5,940	\$ 3	\$ (17)	\$ 5,926
State and municipal	73,829	1,299	(33)	75,095
Federal agency collateralized mortgage obligations	157,291	567	(1,655)	156,203
Federal agency mortgage-backed pools	206,970	2,080	(1,346)	207,704
Corporate notes	32	22		54

Total available for sale investment securities	\$ 444,062	\$ 3,971	\$ (3,051)	\$ 444,982
Held to maturity				
U.S. Treasury and federal agencies	\$ 5,859	\$ 93	\$	\$ 5,952
State and municipal	146,331	5,375	(253)	151,453
Federal agency collateralized mortgage obligations	9,051	27	(124)	8,954
Federal agency mortgage-backed pools	26,388	1,141	(185)	27,344
Total held to maturity investment securities	\$ 187,629	\$ 6,636	\$ (562)	\$ 193,703

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 and held-to-maturity, 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 September 30, 2016, 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, U.S. Treasury and federal agencies, federal agency collateralized mortgage obligations, 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 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 September 30, 2016.

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements**

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

The amortized cost and fair value of securities available for sale and held to maturity at September 30, 2016 and December 31, 2015, 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.

	September 30, 2016		December 31, 2015	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for sale				
Within one year	\$ 6,921	\$ 6,953	\$ 7,192	\$ 7,232
One to five years	52,105	52,482	38,197	38,894
Five to ten years	12,934	13,325	16,807	17,152
After ten years	18,280	18,796	17,605	17,797
	90,240	91,556	79,801	81,075
Federal agency collateralized mortgage obligations	188,072	189,684	157,291	156,203
Federal agency mortgage-backed pools	272,144	275,973	206,970	207,704
Total available for sale investment securities	\$ 550,456	\$ 557,213	\$ 444,062	\$ 444,982
Held to maturity				
Within one year	\$	\$	\$	\$
One to five years	22,801	23,965	17,815	18,403
Five to ten years	88,924	93,501	106,167	110,026
After ten years	46,818	47,034	28,208	28,976
	158,543	164,500	152,190	157,405
Federal agency collateralized mortgage obligations	6,828	6,972	9,051	8,954
Federal agency mortgage-backed pools	21,656	22,822	26,388	27,344
Total held to maturity investment securities	\$ 187,027	\$ 194,294	\$ 187,629	\$ 193,703

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.

September 30, 2016	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and federal agencies	\$ 6,594	\$ (15)	\$	\$	\$ 6,594	\$ (15)
State and municipal	26,360	(868)			26,360	(868)
Federal agency collateralized mortgage obligations	48,837	(184)	12,304	(98)	61,141	(282)
Federal agency mortgage-backed pools	47,054	(365)	6,779	(46)	53,833	(411)
Total temporarily impaired securities	\$ 128,845	\$ (1,432)	\$ 19,083	\$ (144)	\$ 147,928	\$ (1,576)

December 31, 2015	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and federal agencies	\$ 5,468	\$ (17)	\$	\$	\$ 5,468	\$ (17)
State and municipal	17,353	(280)	446	(6)	17,799	(286)
Federal agency collateralized mortgage obligations	89,459	(1,124)	25,428	(655)	114,887	(1,779)
Federal agency mortgage-backed pools	113,244	(1,212)	16,506	(319)	129,750	(1,531)
Total temporarily impaired securities	\$ 225,524	\$ (2,633)	\$ 42,380	\$ (980)	\$ 267,904	\$ (3,613)

Three Months Ended September 30, 2016 **Three Months Ended September 30, 2015**

	2016	2015	2016	2015
Sales of securities available for sale (Unaudited)				
Proceeds	\$	\$	\$ 25,077	\$ 13,332
Gross gains			1,060	147
Gross losses			(185)	(23)

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements**

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

Note 4 Loans

	September 30 2016	December 31 2015
Commercial		
Working capital and equipment	\$ 440,599	\$ 381,245
Real estate, including agriculture	564,602	391,668
Tax exempt	12,621	8,674
Other	29,628	23,408
Total	1,047,450	804,995
Real estate		
1-4 family	523,721	433,015
Other	6,441	4,129
Total	530,162	437,144
Consumer		
Auto	167,541	168,397
Recreation	5,458	5,365
Real estate/home improvement	55,505	47,015
Home equity	140,156	127,113
Unsecured	4,230	4,120
Other	13,141	10,290
Total	386,031	362,300
Mortgage warehouse	226,876	144,692
Total loans	2,190,519	1,749,131
Allowance for loan losses	(14,524)	(14,534)
Loans, net	\$ 2,175,995	\$ 1,734,597

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 affected by conditions in the real estate markets, the general economy or fluctuations in interest rates. 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.

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HORIZON BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

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 and the related mortgagee are underwritten by Horizon to the end investor guidelines and 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 reacquires the loan under its option within the agreement. Due to the reacquire 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 reacquire from Horizon its 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 reacquire 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 reacquire its loan on an individual mortgage, Horizon would be able to exercise its rights under the agreement.

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

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

September 30, 2016	Loan Balance	Interest Due	Deferred Fees / (Costs)	Recorded Investment
Owner occupied real estate	\$ 321,762	\$ 1,151	\$ 1,192	\$ 324,105
Non owner occupied real estate	457,555	627	529	458,711
Residential spec homes	7,949	20	6	7,975
Development & spec land loans	39,798	79	74	39,951
Commercial and industrial	218,414	1,992	171	220,577
Total commercial	1,045,478	3,869	1,972	1,051,319
Residential mortgage	506,545	1,599	2,556	510,700
Residential construction	21,061	38		21,099
Mortgage warehouse	226,876	498		227,374
Total real estate	754,482	2,135	2,556	759,173
Direct installment	66,495	178	(439)	66,234
Direct installment purchased	124			124
Indirect installment	147,829	296		148,125
Home equity	172,905	665	(883)	172,687
Total consumer	387,353	1,139	(1,322)	387,170
Total loans	2,187,313	7,143	3,206	2,197,662
Allowance for loan losses	(14,524)			(14,524)
Net loans	\$ 2,172,789	\$ 7,143	\$ 3,206	\$ 2,183,138
December 31, 2015	Loan Balance	Interest Due	Deferred Fees / (Costs)	Recorded Investment
Owner occupied real estate	\$ 268,281	\$ 613	\$ 1,328	\$ 270,222
Non owner occupied real estate	326,399	306	497	327,202
Residential spec homes	5,018	9	17	5,044
Development & spec land loans	18,183	33	26	18,242
Commercial and industrial	184,911	1,246	335	186,492

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Total commercial	802,792	2,207	2,203	807,202
Residential mortgage	414,924	1,275	2,470	418,669
Residential construction	19,751	34		19,785
Mortgage warehouse	144,692	480		145,172
Total real estate	579,367	1,789	2,470	583,626
Direct installment	54,341	168	(359)	54,150
Direct installment purchased	153			153
Indirect installment	151,523	323		151,846
Home equity	157,164	628	(522)	157,270
Total consumer	363,181	1,119	(881)	363,419
Total loans	1,745,340	5,115	3,792	1,754,247
Allowance for loan losses	(14,534)			(14,534)
Net loans	\$ 1,730,806	\$ 5,115	\$ 3,792	\$ 1,739,713

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements**

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

Note 5 Accounting for Certain Loans Acquired in a Transfer

The Company acquired loans in acquisitions and the transferred loans had evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected.

Loans purchased with evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected are considered to be credit impaired. Evidence of credit quality deterioration as of the purchase date may include information such as past-due and non-accrual status, borrower credit scores and recent loan-to-value percentages. Purchased credit-impaired loans are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality (ASC 310-30) and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loan. Accordingly, an allowance for credit losses related to these loans is not carried over and recorded at the acquisition date.

Management estimated the cash flows expected to be collected at acquisition using our internal risk models, which incorporate the estimate of current key assumptions, such as default rates, severity and prepayment speeds. Amounts for LaPorte were estimated as of September 30, 2016 as the final analysis of loans with deterioration was not completed.

The carrying amounts of those loans included in the balance sheet amounts of loans receivable are as follows:

	September 30 2016	September 30 2016	September 30 2016	September 30 2016	September 30 2016	September 30 2016
	Heartland	Summit	Peoples	Kosciusko	LaPorte	Total
Commercial	\$ 867	\$ 5,323	\$ 724	\$ 1,667	\$ 5,731	\$ 14,312
Real estate	605	989	204	492	1,673	3,963
Consumer	2	9				11
Outstanding balance	\$ 1,474	\$ 6,321	\$ 928	\$ 2,159	\$ 7,404	\$ 18,286
Carrying amount, net of allowance of \$0						\$ 18,286

	December 31 2015	December 31 2015	December 31 2015	December 31 2015	December 31 2015	December 31 2015
	Heartland	Summit	Peoples	Kosciusko	LaPorte	Total
Commercial	\$ 1,633	\$ 5,567	\$ 1,061	\$	\$	\$ 8,261
Real estate	693	1,216	179			2,088
Consumer	6	35				41

Outstanding balance	\$ 2,332	\$ 6,818	\$ 1,240	\$	\$	\$ 10,390
Carrying amount, net of allowance of \$63						\$ 10,327

Accretable yield, or income expected to be collected for the nine months ended September 30, is as follows:

	Nine Months Ended September 30, 2016					
	Heartland	Summit	Peoples	Kosciusko	LaPorte	Total
Balance at January 1	\$ 795	\$ 708	\$ 555	\$	\$	\$ 2,058
Additions				634	1,736	2,370
Accretion	(127)	(139)	(92)	(38)		(396)
Reclassification from nonaccretable difference						
Disposals	(74)	(35)	(59)	(23)		(191)
Balance at September 30	\$ 594	\$ 534	\$ 404	\$ 573	\$ 1,736	\$ 3,841

	Nine Months Ended September 30, 2015					
	Heartland	Summit	Peoples	Kosciusko	LaPorte	Total
Balance at January 1	\$ 2,400	\$ 1,268	\$	\$	\$	\$ 3,668
Additions			647			647
Accretion	(272)	(254)				(526)
Reclassification from nonaccretable difference						
Disposals	(1,210)	(237)				(1,447)
Balance at September 30	\$ 918	\$ 777	\$ 647	\$	\$	\$ 2,342

During the nine months ended September 30, 2016 and 2015, the Company decreased the allowance for loan losses on purchased loans by a recovery to the income statement of \$0 and \$87,000, respectively.

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

Note 6 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 September 30		Nine Months Ended September 30	
	2016	2015	2016	2015
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Balance at beginning of the period	\$ 14,226	\$ 16,421	\$ 14,534	\$ 16,501
Loans charged-off:				
Commercial				
Owner occupied real estate	4	56	182	1,478
Non owner occupied real estate	(1)		471	16
Residential development				
Development & Spec Land Loans				
Commercial and industrial	8	38	47	291
Total commercial	11	94	700	1,785
Real estate				
Residential mortgage	12	101	127	287
Residential construction				
Mortgage warehouse				
Total real estate	12	101	127	287
Consumer				
Direct Installment	55	51	159	206
Direct Installment Purchased				
Indirect Installment	296	218	851	783
Home Equity	32	262	271	766
Total consumer	383	531	1,281	1,755
Total loans charged-off	406	726	2,108	3,827

Recoveries of loans previously charged-off:

Commercial				
Owner occupied real estate	2	8	31	94
Non owner occupied real estate	1	1	55	1
Residential development	2		6	
Development & Spec Land Loans				
Commercial and industrial	12	8	107	41
Total commercial	17	17	199	136
Real estate				
Residential mortgage	12	5	75	10
Residential construction				
Mortgage warehouse				
Total real estate	12	5	75	10
Consumer				
Direct Installment	26	15	70	91
Direct Installment Purchased				
Indirect Installment	160	112	400	347
Home Equity	34	24	135	90
Total consumer	220	151	605	528
Total loan recoveries	249	173	879	674
Net loans charged-off (recovered)	157	553	1,229	3,153
Provision charged to operating expense				
Commercial	165	532	(471)	2,580
Real estate	102	(955)	(147)	(51)
Consumer	188	723	1,837	291
Total provision charged to operating expense	455	300	1,219	2,820
Balance at the end of the period	\$ 14,524	\$ 16,168	\$ 14,524	\$ 16,168

Certain loans are individually evaluated for impairment, and the Company's general practice is to proactively charge down impaired loans to the fair value, which is the appraised value less estimated selling costs, of the underlying collateral.

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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:

September 30, 2016	Commercial	Real Estate	Mortgage Warehousing	Consumer	Total
Allowance For Loan Losses					
Ending allowance balance attributable to loans:					
Individually evaluated for impairment	\$	\$	\$	\$	\$
Collectively evaluated for impairment	6,222	1,947	1,337	5,018	14,524
Loans acquired with deteriorated credit quality					
Total ending allowance balance	\$ 6,222	\$ 1,947	\$ 1,337	\$ 5,018	\$ 14,524

Loans:										
Individually evaluated for impairment	\$	5,855	\$	\$	\$	5,855				
Collectively evaluated for impairment		1,045,464		531,799	227,374	387,170	2,191,807			
Loans acquired with deteriorated credit quality										
Total ending loans balance	\$	1,051,319	\$	531,799	\$	227,374	\$	387,170	\$	2,197,662

December 31, 2015	Commercial	Real Estate	Mortgage Warehousing	Consumer	Total					
Allowance For Loan Losses										
Ending allowance balance attributable to loans:										
Individually evaluated for impairment	\$	202	\$	\$	\$	202				
Collectively evaluated for impairment		6,739		2,476	1,007	3,856	14,078			
Loans acquired with deteriorated credit quality		254					254			
Total ending allowance balance	\$	7,195	\$	2,476	\$	1,007	\$	3,856	\$	14,534

Loans:										
Individually evaluated for impairment	\$	7,019	\$	\$	\$	7,019				
Collectively evaluated for impairment		798,454		438,454	145,172	363,419	1,745,499			
Loans acquired with deteriorated credit quality		1,729					1,729			
Total ending loans balance	\$	807,202	\$	438,454	\$	145,172	\$	363,419	\$	1,754,247

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

Note 7 Non-performing Loans and Impaired Loans

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

September 30, 2016	Non-accrual	Loans Past Due Over 90 Days Still Accruing	Non-Performing TDRs	Performing TDRs	Total Non-Performing Loans
Commercial					
Owner occupied real estate	\$ 566	\$	\$	\$	\$ 566
Non owner occupied real estate	2,734		240	60	3,034
Residential development					
Development & Spec Land Loans	137				137
Commercial and industrial	1,740				1,740
Total commercial	5,177		240	60	5,477
Real estate					
Residential mortgage	1,094	44	870	863	2,871
Residential construction			238		238
Mortgage warehouse					
Total real estate	1,094	44	1,108	863	3,109
Consumer					
Direct Installment	1,505				1,505
Direct Installment Purchased					
Indirect Installment	970	15			985
Home Equity	1,345		175	241	1,761
Total Consumer	3,820	15	175	241	4,251
Total	\$ 10,091	\$ 59	\$ 1,523	\$ 1,164	\$ 12,837
December 31, 2015	Non-accrual	Loans Past Due Over 90	Non-Performing TDRs	Performing TDRs	Total Non-Performing Loans

**Days
Still
Accruing**

Commercial					
Owner occupied real estate	\$ 1,749	\$	\$	\$	\$ 1,749
Non owner occupied real estate	3,034		1,915	60	5,009
Residential development					
Development & Spec Land Loans	71				71
Commercial and industrial	176				176
Total commercial	5,030		1,915	60	7,005
Real estate					
Residential mortgage	4,354	1	824	808	5,987
Residential construction			250		250
Mortgage warehouse					
Total real estate	4,354	1	1,074	808	6,237
Consumer					
Direct Installment	541				541
Direct Installment Purchased					
Indirect Installment	601	27			628
Home Equity	1,736		183	350	2,269
Total Consumer	2,878	27	183	350	3,438
Total	\$ 12,262	\$ 28	\$ 3,172	\$ 1,218	\$ 16,680

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Included in the \$10.1 million of non-accrual loans and the \$1.5 million of non-performing TDRs at September 30, 2016 were \$1.2 million and \$238,000, 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 generally 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 Operations 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. Non-accrual 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 non-accrual 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 September 30, 2016, 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 September 30, 2016, the Company had \$2.7 million in TDRs and \$1.5 million were performing according to the restructured terms and zero TDRs were returned to accrual status during the first nine months of 2016. There was \$84,000 of specific reserves allocated to TDRs at September 30, 2016 based on the discounted cash flows or when appropriate the fair value of the collateral.

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

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

	Unpaid Principal Balance		Recorded Investment	Allowance for Loan Loss Allocated	Three Months Ending Average Cash/ Accrual Balance in Impaired Loans	Interest Income Recognized	Nine Months Ending Average Cash/ Accrual Balance in Impaired Loans	Interest Income Recognized
September 30, 2016								
With no recorded allowance								
Commercial								
Owner occupied real estate	\$ 994	\$ 995	\$	\$	\$ 1,029	\$	\$ 1,062	\$
Non owner occupied real estate	3,106	3,120			3,150	1	3,776	3
Residential development								
Development & Spec Land Loans								
Commercial and industrial	1,740	1,740			1,984		878	
Total commercial	5,840	5,855			6,163	1	5,716	3
With an allowance recorded								
Commercial								
Owner occupied real estate								
Non owner occupied real estate								
Residential development								
Development & Spec Land Loans								
Commercial and industrial								
Total commercial								
Total	\$ 5,840	\$ 5,855	\$	\$	\$ 6,163	\$ 1	\$ 5,716	\$ 3

	Unpaid Principal Balance		Recorded Investment	Allowance for Loan Loss Allocated	Three Months Ending Average Cash/ Accrual Balance in Impaired Loans	Interest Income Recognized	Nine Months Ending Average Cash/ Accrual Balance in Impaired Loans	Interest Income Recognized
September 30, 2015								
With no recorded allowance								

Commercial

Owner occupied real estate	\$ 1,235	\$ 1,238	\$	\$ 1,262	\$ 1	\$ 1,041	\$ 10
Non owner occupied real estate	2,798	2,801		2,815	1	2,846	4
Residential development							
Development & Spec Land Loans							
Commercial and industrial	239	239		583	4	415	4
Total commercial	4,272	4,278		4,660	6	4,302	18

With an allowance recorded**Commercial**

Owner occupied real estate	2,967	2,966	598	2,968		2,191	55
Non owner occupied real estate	2,817	2,828	550	2,858		2,942	
Residential development							
Development & Spec Land Loans							
Commercial and industrial	776	776	451	776		836	
Total commercial	6,560	6,570	1,599	6,602		5,969	55
Total	\$ 10,832	\$ 10,848	\$ 1,599	\$ 11,262	\$ 6	\$ 10,271	\$ 73

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

September 30, 2016	Greater than 90			Total Past Due	Loans Not Past Due	Total
	30 - 59 Days Past Due	60 - 89 Days Past Due	Days Past Due			
Commercial						
Owner occupied real estate	\$ 282	\$ 17	\$	\$ 299	\$ 321,463	\$ 321,762
Non owner occupied real estate	180	103		283	457,272	457,555
Residential development					7,949	7,949
Development & Spec Land Loans	32			32	39,766	39,798
Commercial and industrial	361	267		628	217,786	218,414
Total commercial	855	387		1,242	1,044,236	1,045,478
Real estate						
Residential mortgage	982	210	43	1,235	505,310	506,545
Residential construction					21,061	21,061
Mortgage warehouse					226,876	226,876
Total real estate	982	210	43	1,235	753,247	754,482
Consumer						
Direct Installment	42	30		72	66,423	66,495
Direct Installment Purchased					124	124
Indirect Installment	805	49	15	869	146,960	147,829
Home Equity	436	26		462	172,443	172,905
Total consumer	1,283	105	15	1,403	385,950	387,353
Total	\$ 3,120	\$ 702	\$ 58	\$ 3,880	\$ 2,183,433	\$ 2,187,313
Percentage of total loans	0.14%	0.03%	0.00%	0.18%	99.82%	
December 31, 2015	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days	Total Past Due	Loans Not Past Due	Total

Past Due

Commercial						
Owner occupied real estate	\$ 481	\$ 18	\$	\$ 499	\$ 267,782	\$ 268,281
Non owner occupied real estate	49			49	326,350	326,399
Residential development					5,018	5,018
Development & Spec Land						
Loans					18,183	18,183
Commercial and industrial	32			32	184,879	184,911
Total commercial	562	18		580	802,212	802,792
Real estate						
Residential mortgage	1,121	344	1	1,466	413,458	414,924
Residential construction					19,751	19,751
Mortgage warehouse					144,692	144,692
Total real estate	1,121	344	1	1,466	577,901	579,367
Consumer						
Direct Installment	106	10		116	54,225	54,341
Direct Installment Purchased					153	153
Indirect Installment	1,186	268	27	1,481	150,042	151,523
Home Equity	1,193	203		1,396	155,768	157,164
Total consumer	2,485	481	27	2,993	360,188	363,181
Total	\$ 4,168	\$ 843	\$ 28	\$ 5,039	\$ 1,740,301	\$ 1,745,340

Percentage of total loans 0.24% 0.05% 0.00% 0.29% 99.71%

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 that exceeds the authorities in the respective markets (ranging from \$1,000,000 to \$2,500,000) are validated by the Loan Committee, which is chaired by the Chief Credit Officer (CCO).

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

The CCO, or his designee, 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, other real estate owned and personal property repossessions. The information reviewed in this meeting acts as a precursor for developing management's analysis of the adequacy of the Allowance for Loan and Lease Losses.

For residential 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 to 120 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 a nine-grade rating system to determine the credit quality of commercial loans. The first five 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:

Loans in this category are considered to be of acceptable credit quality, but contain greater credit risk than Satisfactory loans. Borrower displays acceptable liquidity, leverage, and earnings performance within the Bank's minimum underwriting guidelines. The level of risk is acceptable but conditioned on the proper level of loan officer supervision. Loans that normally fall into this grade include acquisition, construction and development loans and income producing properties that have not reached stabilization.

Risk Grade 4W Management Watch:

Loans in this category are considered to be of acceptable quality, but with above normal risk. Borrower displays potential indicators of weakness in the primary source of repayment resulting in a higher reliance on secondary sources of repayment. Balance sheet may exhibit weak liquidity and/or high leverage. There is inconsistent earnings performance without the ability to sustain adverse economic conditions. Borrower may be operating in a declining industry or the property type, as for a commercial real estate loan, may be high risk or in decline. These loans require an increased level of loan officer supervision and monitoring to assure that any deterioration is addressed in a timely fashion.

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.

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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.

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

The following table presents loans by credit grades.

September 30, 2016	Pass	Special Mention	Substandard	Doubtful	Total
Commercial					
Owner occupied real estate	\$ 305,849	\$ 5,258	\$ 10,655	\$	\$ 321,762
Non owner occupied real estate	450,811	344	6,400		457,555
Residential development	7,949				7,949
Development & Spec Land Loans	39,571		227		39,798
Commercial and industrial	207,998	1,419	8,997		218,414
Total commercial	1,012,178	7,021	26,279		1,045,478
Real estate					
Residential mortgage	503,821		2,724		506,545
Residential construction	20,823		238		21,061
Mortgage warehouse	226,876				226,876
Total real estate	751,520		2,962		754,482
Consumer					
Direct Installment	64,990		1,505		66,495
Direct Installment Purchased	124				124
Indirect Installment	146,844		985		147,829
Home Equity	171,152		1,753		172,905
Total Consumer	383,110		4,243		387,353
Total	\$ 2,146,808	\$ 7,021	\$ 33,484	\$	\$ 2,187,313
Percentage of total loans	98.15%	0.32%	1.53%	0.00%	

December 31, 2015	Pass	Special Mention	Substandard	Doubtful	Total
Commercial					
Owner occupied real estate	\$ 257,181	\$ 4,954	\$ 6,146	\$	\$ 268,281
Non owner occupied real estate	320,216	585	5,598		326,399
Residential development	5,018				5,018
Development & Spec Land Loans	18,112		71		18,183

Commercial and industrial	180,581	693	3,637	184,911
Total commercial	781,108	6,232	15,452	802,792
Real estate				
Residential mortgage	408,937		5,987	414,924
Residential construction	19,501		250	19,751
Mortgage warehouse	144,692			144,692
Total real estate	573,130		6,237	579,367
Consumer				
Direct Installment	53,800		541	54,341
Direct Installment Purchased	153			153
Indirect Installment	150,895		628	151,523
Home Equity	154,895		2,269	157,164
Total Consumer	359,743		3,438	363,181
Total	\$ 1,713,981	\$ 6,232	\$ 25,127	\$ 1,745,340
Percentage of total loans	98.20%	0.36%	1.44%	0.00%

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

Note 8 Repurchase Agreements

The Company transfers various securities to customers in exchange for cash at the end of each business day and agrees to acquire the securities at the end of the next business day for the cash exchanged plus interest. The process is repeated at the end of each business day until the agreement is terminated. The securities underlying the agreement remained under the Bank's control.

The following table shows repurchase agreements accounted for as secured borrowings (in thousands):

September 30, 2016	Remaining Contractual Maturity of the Agreements						Total
	Overnight and Continuous	Up to one year	One to three years	Three to five years	Five to ten years	Beyond ten years	
Repurchase Agreements and repurchase-to-maturity transactions							
Repurchase Agreements	\$ 62,703	\$ 35,000	\$ 50,000	\$ 10,000	\$	\$	\$ 157,703
Securities lending transactions							
U.S. Treasury and federal agencies	4,025						4,025
Federal agency collateralized mortgage obligations	50,255		316	258	21,514	30,621	102,964
Federal agency mortgage-backed pools	14,501		89	2,146	20,778	29,388	66,902
Total	68,781		405	2,404	42,292	60,009	173,891
Total borrowings	\$ (6,078)	\$ 35,000	\$ 49,595	\$ 7,596	\$ (42,292)	\$ (60,009)	\$ (16,188)
Gross amount of recognized liabilities for repurchase agreements and securities lending							\$ 157,703

Note 9 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 September 30, 2016 and December 31, 2015. 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 September 30, 2016, 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 September 30, 2016, 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.

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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 \$118.1 million at September 30, 2016 and \$117.3 million at December 31, 2015.

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 September 30, 2016, 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.

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

Derivatives designated as hedging instruments (Unaudited)	Asset Derivatives September 30, 2016		Liability Derivatives September 30, 2016	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Interest rate contracts	Loans	\$	Other liabilities	\$ 4,563
Interest rate contracts	Other Assets	4,563	Other liabilities	3,002
Total derivatives designated as hedging instruments		4,563		7,565
Derivatives not designated as hedging instruments				
Mortgage loan contracts	Other assets	787	Other liabilities	
Total derivatives not designated as hedging instruments		787		
Total derivatives		\$ 5,350		\$ 7,565

	Asset Derivatives December 31, 2015		Liability Derivatives December 31, 2015	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments (Unaudited)				
Interest rate contracts	Loans	\$	Other liabilities	\$ 1,782
Interest rate contracts	Other Assets	1,782	Other liabilities	3,141
Total derivatives designated as hedging instruments		1,782		4,923
Derivatives not designated as hedging instruments				
Mortgage loan contracts	Other assets	642	Other liabilities	
Total derivatives not designated as hedging instruments		642		
Total derivatives		\$ 2,424		\$ 4,923

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

The effect of the derivative instruments on the condensed consolidated statements of income for the three and nine month periods ending September 30 is as follows:

	Comprehensive Income on Derivative		Comprehensive Income on Derivative	
	(Effective Portion)		(Effective Portion)	
	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2016	2015	2016	2015
Derivative in cash flow hedging relationship	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Interest rate contracts	\$ 522	\$ (335)	\$ 103	\$ (217)

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.

	Location of gain (loss)	Amount of Gain (Loss) Recognized on Derivative		Amount of Gain (Loss) Recognized on Derivative	
		Three Months Ended		Nine Months Ended	
		September 30		September 30	
		2016	2015	2016	2015
Derivative in fair value hedging relationship	recognized on derivative	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Interest rate contracts	Interest income - loans	\$ (830)	\$ 765	\$ 2,781	\$ 579
Interest rate contracts	Interest income - loans	830	(765)	(2,781)	(579)
Total		\$	\$	\$	\$

	Location of gain (loss)	Amount of Gain (Loss) Recognized on Derivative		Amount of Gain (Loss) Recognized on Derivative	
		Three Months Ended		Nine Months Ended	
		September 30		September 30	
		2016	2015	2016	2015
Derivative not designated		(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)

as hedging relationship	recognized on derivative				
Mortgage contracts	Other income - gain on sale of loans	\$ (324)	\$ (77)	\$ 145	\$ 196

Note 10 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

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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 September 30, 2016. 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 collateralized mortgage obligations and 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.

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, and therefore, are classified within Level 2 of the valuation hierarchy.

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The following table presents the fair value measurements of assets and liabilities recognized in the accompanying condensed consolidated 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)
September 30, 2016				
Available-for-sale securities				
U.S. Treasury and federal agencies	\$ 27,422	\$	\$ 27,422	\$
State and municipal	64,039		64,039	
Federal agency collateralized mortgage obligations	189,684		189,684	
Federal agency mortgage-backed pools	275,973		275,973	
Corporate notes	95		95	
Total available-for-sale securities	557,213		557,213	
Hedged loans	113,558		113,558	
Forward sale commitments	787		787	
Interest rate swap agreements	(7,870)		(7,870)	
Commitments to originate loans				
December 31, 2015				
Available-for-sale securities				
U.S. Treasury and federal agencies	\$ 5,926	\$	\$ 5,926	\$
State and municipal	75,095		75,095	
Federal agency collateralized mortgage obligations	156,203		156,203	
Federal agency mortgage-backed pools	207,704		207,704	
Corporate notes	54		54	
Total available-for-sale securities	444,982		444,982	
Hedged loans	115,472		115,472	
Forward sale commitments	642		642	
Interest rate swap agreements	(4,923)		(4,923)	

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

Non Interest Income Total gains and losses from:	Three Months Ended September 30		Nine Months Ended September 30	
	2016 (Unaudited)	2015 (Unaudited)	2016 (Unaudited)	2015 (Unaudited)
Hedged loans	\$ (830)	\$ 765	\$ 2,781	\$ 579
Fair value interest rate swap agreements	830	(765)	(2,781)	(579)
Derivative loan commitments	(324)	(77)	145	196
	\$ (324)	\$ (77)	\$ 145	\$ 196

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)
September 30, 2016				
Impaired loans	\$ 5,840	\$	\$	\$ 5,840
Mortgage servicing rights	10,269			10,269
December 31, 2015				
Impaired loans	\$ 6,803	\$	\$	\$ 6,803
Mortgage servicing rights	8,874			8,874

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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.

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 MSRs' fair value due to impairment decreased by \$193,000 during the first nine months of 2016 and decreased by \$51,000 during the first nine months of 2015.

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 September 30, 2016	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Impaired loans	\$ 5,840	Collateral based measurement	Discount to reflect current market conditions and ultimate collectability	10% - 15% (12%)
Mortgage servicing rights	\$ 10,269	Discounted cashflows	Discount rate, Constant prepayment rate, Probability of default	10% - 15% (12%), 4% - 7% (4.6%), 1% - 10% (4.5%)
	Fair Value at	Valuation Technique	Unobservable Inputs	Range (Weighted Average)

**December
31, 2015**

Impaired loans			Discount to reflect current market conditions and ultimate collectability	10% - 15% (12%)
	\$ 6,803	Collateral based measurement		
Mortgage servicing rights		Discounted cashflows	Discount rate, Constant prepayment rate, Probability of default	10% - 15% (12%), 4% - 7% (4.6%), 1% - 10% (4.5%)
	\$ 8,874			

Note 11 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.

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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 September 30, 2016 and December 31, 2015. These include financial instruments recognized as assets and liabilities on the condensed 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.

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 Letters 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.

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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).

	September 30, 2016			
	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	\$ 83,721	\$ 83,721	\$	\$
Investment securities, held to maturity	187,027		194,294	
Loans held for sale	7,369			7,369
Loans excluding loan level hedges, net	2,062,437			2,046,807
Stock in FHLB and FRB	20,877		20,877	
Interest receivable	12,702		12,702	
Liabilities				
Non-interest bearing deposits	\$ 479,771	\$ 479,771	\$	\$
Interest-bearing deposits	1,856,391		1,873,377	
Borrowings	569,908		566,880	
Subordinated debentures	37,418		36,491	
Interest payable	1,015		1,015	

	December 31, 2015			
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				

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Cash and due from banks	\$ 48,650	\$ 48,650	\$	\$
Investment securities, held to maturity	187,629		193,703	
Loans held for sale	7,917			7,917
Loans excluding loan level hedges, net	1,619,125			1,703,506
Stock in FHLB and FRB	13,823		13,823	
Interest receivable	10,535		10,535	
Liabilities				
Non-interest bearing deposits	\$ 335,955	\$ 335,955	\$	\$
Interest-bearing deposits	1,544,198		1,461,314	
Borrowings	449,347		441,547	
Subordinated debentures	32,797		32,996	
Interest payable	507		507	

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Note 12 Accumulated Other Comprehensive Income

	September 30 2016	December 31 2015
Unrealized gain on securities available for sale	\$ 6,757	\$ 920
Unamortized gain on securities held to maturity, previously transferred from AFS	548	1,109
Unrealized loss on derivative instruments	(3,002)	(3,142)
Tax effect	(1,494)	390
Total accumulated other comprehensive income (loss)	\$ 2,809	\$ (723)

Note 13 Regulatory Capital

Horizon and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies and are assigned to a capital category. Failure to meet the minimum regulatory capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators, which if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective actions, the Bank must meet specific capital guidelines involving quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined), or leverage ratio. For September 30, 2016, Basel III rules require the Bank to maintain minimum amounts and ratios of common equity Tier I capital (as defined in the regulation) to risk-weighted assets (as defined). Additionally, under Basel III rules, the decision was made to opt-out of including accumulated other comprehensive income in regulatory capital.

To be categorized as well capitalized, the Bank must maintain minimum Total risk-based, Tier I risk-based, common equity Tier I risk-based (September 30, 2016) and Tier I leverage ratios as set forth in the table below. As of September 30, 2016 and December 31, 2015, the Bank met all capital adequacy requirements to be considered well capitalized. There have been no conditions or events since the end of the third quarter of 2016 that management believes have changed the Bank's classification as well capitalized. There is no threshold for well-capitalized status for bank holding companies.

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Horizon and the Bank's actual and required capital ratios as of September 30, 2016 and December 31, 2015 were as follows:

	Actual		Required For Capital ¹		Well Capitalized Under Prompt ¹	
	Amount	Ratio	Adequacy Purposes Amount	Ratio	Corrective Action Provisions Amount	Ratio
As of September 30, 2016						
Total capital ¹ (to risk-weighted assets)						
Consolidated	\$ 317,012	13.39%	\$ 204,318	8.63%	N/A	N/A
Bank	315,040	13.34%	203,808	8.63%	\$ 236,162	10.00%
Tier 1 capital ¹ (to risk-weighted assets)						
Consolidated	302,488	12.78%	156,925	6.63%	N/A	N/A
Bank	300,516	12.73%	156,514	6.63%	188,855	8.00%
Common equity tier 1 capital ¹ (to risk-weighted assets)						
Consolidated	302,488	11.16%	121,395	5.13%	N/A	N/A
Bank	300,516	12.73%	121,103	5.13%	153,445	6.50%
Tier 1 capital ¹ (to average assets)						
Consolidated	302,488	9.69%	124,866	4.00%	N/A	N/A
Bank	300,516	9.65%	124,566	4.00%	155,708	5.00%
As of December 31, 2015						
Total capital ¹ (to risk-weighted assets)						
Consolidated	\$ 264,452	13.99%	\$ 151,223	8.00%	N/A	N/A
Bank	237,348	12.57%	151,057	8.00%	\$ 188,821	10.00%
Tier 1 capital ¹ (to risk-weighted assets)						
Consolidated	249,918	13.22%	113,427	6.00%	N/A	N/A
Bank	222,814	11.80%	113,295	6.00%	151,060	8.00%
Common equity tier 1 capital ¹ (to risk-weighted assets)						

Consolidated	204,350	10.81%	85,067	4.50%	N/A	N/A
Bank	222,814	11.80%	84,971	4.50%	122,737	6.50%
Tier 1 capital ¹ (to average assets)						
Consolidated	249,918	9.82%	101,800	4.00%	N/A	N/A
Bank	222,814	8.77%	101,626	4.00%	127,032	5.00%

¹ As defined by regulatory agencies

Note 14 Preferred Stock Redemption

On February 1, 2016, Horizon completed the redemption (the Redemption) of all 12,500 outstanding shares of Senior Non-Cumulative Perpetual Preferred Stock, Series B (the SBLF Preferred Stock) which were held by the U.S. Department of Treasury and issued pursuant to its Small Business Lending Fund (SBLF). The SBLF Preferred Stock was redeemed at its liquidation value of \$1,000 per share, plus accrued dividends, for a total Redemption price of \$12,510,416.67. Horizon funded the Redemption using cash on hand without borrowing and without a special dividend from the Bank. Following the Redemption, Horizon does not have any shares of its Senior Non-Cumulative Perpetual Preferred Stock, Series B outstanding. The Redemption terminates Horizon's participation in the SBLF.

Note 15 Subsequent Events

On July 12, 2016, Horizon announced the acquisition of CNB Bancorp, parent company of The Central National Bank and Trust Company (Central National Bank & Trust). Under the terms of the Merger Agreement, stockholders of CNB Bancorp will receive cash consideration consisting of a special dividend calculated as capital in excess of 8% of CNB Bancorp's total assets, less certain after tax transaction costs, and an amount to be paid by Horizon equal to 120% of remaining capital. These amounts will be determined as of the end of the month prior to the closing of the merger. These amounts are dependent on CNB Bancorp's earnings and other factors, but if the cash consideration for the stockholders were calculated based on the

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March 31, 2016 financial information available at the time of signing the Merger Agreement, the stockholders would receive, in the aggregate, a \$6.7 million special dividend and a \$5.3 million payment from Horizon. As of September 30, 2016, CNB Bancorp had total assets of approximately \$56.4 million. Horizon anticipates closing the acquisition in early November 2016.

On October 4, 2016, Horizon announced the signing of a definitive agreement to purchase certain loans and substantially all of the deposits of a single branch located at 42 S. State Road 135, Bargersville, Indiana and owned by First Farmers Bank & Trust Co., an Indiana state chartered bank (First Farmers) and wholly owned subsidiary of First Farmers Financial Corporation, headquartered in Converse, Indiana. Under the terms of the agreement, Horizon anticipates purchasing approximately \$5.0 million dollars in loans and assuming approximately \$15 million in deposits. The loans to be purchased are subject to review and acceptance by Horizon prior to closing. Horizon will not be purchasing fixed assets or assuming the underlying lease for the First Farmers branch.

Note 16 Future Accounting Matters

In February 2016, the Financial Accounting Standards Board (FASB) issued **Accounting Standards Update (ASU) 2016-02, Leases (Topic 842)**. Topic 842 establishes a right of use model that requires a lessee to record a right of use asset and a lease liability for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. For lessors, the guidance modifies the classification criteria and the accounting for sales-type and direct financing leases. A lease will be treated as a sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as a financing. If the lessor does not convey risks and rewards or control, an operating lease results.

The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years for public business entities. Entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements, with certain practical expedients available. Early adoption is permitted. The Company continues to assess the impact of Topic 842 on its accounting and disclosures.

In March 2016, the FASB issued **ASU 2016-07, Investments - Equity Method and Joint Ventures: Simplifying the Transition to the Equity Method of Accounting**. The amendments affect all entities that have an investment that becomes qualified for the equity method of accounting as a result of an increase in the level of ownership interest or degree of influence. The amendments eliminate the requirement that when an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest or degree of influence, an investor must adjust the investment, results of operations, and retained earnings retroactively on a step-by-step basis as if the equity method had been in effect during all previous periods that the investment had been held. The amendments require that the equity method investor add the cost of acquiring the additional interest in the investee to the current basis of the investor's previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting. Therefore, upon qualifying for the equity method of accounting, no

retroactive adjustment of the investment is required.

The amendments require that an entity that has an available-for-sale equity security that becomes qualified for the equity method of accounting recognize through earnings the unrealized holding gain or loss in accumulated other comprehensive income at the date the investment becomes qualified for use of the equity method.

The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. The amendments should be applied prospectively upon their effective date to increases in the level of ownership interest or degree of influence that result in the adoption of the equity method. Earlier application is permitted.

In March 2016, the FASB issued **ASU 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting**. ASU 2016-09 requires all income tax effects of awards to be recognized in the income statement when the awards vest or are settled. It also allows an employer to repurchase more of an employee's shares than it can today for tax withholding purposes without triggering liability accounting and to make a policy election for forfeitures as they occur.

The guidance is effective for public business entities for fiscal years beginning after December 15, 2016, and interim periods within those years. Early adoption is permitted. The Company continues to assess ASU 2016-09 but does not expect a significant impact on its accounting and disclosures.

In June 2016, the FASB issued **ASU 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Statements**. Topic 326 amends guidance on reporting credit losses for assets held at amortized cost basis and available for sale debt securities. The ASU is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The ASU requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates.

Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. The ASU requires enhanced disclosures to help investors and other financial statement users better understand

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Notes to Condensed Consolidated Financial Statements

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

significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration.

The ASU is effective for SEC filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019 (i.e., January 1, 2020, for calendar year entities). Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018.

In August 2016, the FASB issued **ASU 2016-15, Statement of Cash Flows (Topic 230)-Classification of Certain Cash Receipts and Cash Payments**. ASU 2016-15 provides cash flow statement classification guidance for certain transactions including how the predominance principle should be applied when cash receipts and cash payments have aspects of more than one class of cash flows.

The guidance is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years and should be applied retrospectively. Early adoption is permitted, including adoption in an interim period. The Company is assessing ASU 2016-15 but does not expect a significant impact on its accounting and disclosures.

Note 17 General Litigation

The Company is subject to claims and lawsuits that arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the consolidated financial position, results of operation and cash flows of the Company.

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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 connection with any discussion of 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, 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 are 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;

rising interest rates and their impact on mortgage loan volumes and the outflow of deposits;

loss of key Horizon personnel;

increases in disintermediation, as new technologies allow consumers to complete financial transactions without the assistance of banks;

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;

the impact of the new Basel III capital rules;

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;

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the risks presented by cyber terrorism and data security breaches;

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.

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 2015 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 Northern and Central Indiana and Southwestern and Central 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 Select Market under the symbol HBNC. The Bank was chartered as a national banking association in 1873 and has operated continuously since that time. The Bank is a full-service commercial bank offering commercial and retail banking services, corporate and individual trust and agency services, and other services incident to banking.

On July 18, 2016, Horizon completed the acquisition of LaPorte Bancorp, Inc., a Maryland corporation ("LaPorte Bancorp") and Horizon Bank's acquisition of The LaPorte Savings Bank, a state-chartered savings bank and wholly owned subsidiary of LaPorte Bancorp, through mergers effective July 18, 2016. Under the terms of the Merger Agreement, shareholders of LaPorte Bancorp had the option to receive \$17.50 per share in cash or 0.9435 shares of

Horizon common stock for each share of LaPorte Bancorp's common stock, subject to allocation provisions to assure that in aggregate, LaPorte Bancorp shareholders received total consideration that consisted of 65% stock and 35% cash. As a result of LaPorte stockholder stock and cash elections and the related proration provisions of the Merger Agreement, Horizon issued 3,421,488 shares of its common stock in the merger. Based upon the July 18, 2016 closing price of \$18.36 per share of Horizon common stock, the transaction has an implied valuation of approximately \$98.6 million.

On June 1, 2016, Horizon completed the acquisition of Kosciusko Financial, Inc., an Indiana corporation (Kosciusko) and Horizon Bank's acquisition of Farmers State Bank, a state-chartered bank and wholly owned subsidiary of Kosciusko, through mergers effective June 1, 2016. Under the terms of the Merger Agreement, shareholders of Kosciusko had the option to receive \$81.75 per share in cash or 4.5183 shares of Horizon common stock, or a combination of both, for each share of Kosciusko's common stock, subject to allocation provisions to assure that in aggregate, Kosciusko shareholders received total consideration that consisted of 65% stock and 35% cash. Kosciusko shareholders owning fewer than 100 shares of common stock received \$81.75 in cash for each common share. As a result of Kosciusko stockholder stock and cash elections and the related proration provisions of the Merger Agreement, Horizon issued 873,430 shares of its common stock in the merger. Based upon the June 1, 2016 closing price of \$16.57 per share of Horizon common stock, the transaction has an implied valuation of approximately \$23.0 million.

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On July 1, 2015, Horizon completed the acquisition of Peoples Bancorp, an Indiana corporation (Peoples) and Horizon Bank's acquisition of Peoples Federal Savings Bank of DeKalb County, a federally-chartered stock savings bank and wholly owned subsidiary of Peoples, through mergers effective July 1, 2015. Under the terms of the acquisition, the exchange ratio was 1.425 shares of Horizon common stock (the Exchange Ratio) and \$9.75 in cash for each outstanding share of Peoples common stock. Peoples shareholders owning fewer than 100 shares of common stock received \$33.14 in cash for each common share. Peoples shares outstanding at the closing were 2,311,858, and the shares of Horizon common stock issued to Peoples shareholders totaled 3,288,303. Horizon's stock price was \$16.88 per share at the close of business on July 1, 2015. Based upon these numbers, the total value of the consideration for the acquisition was \$78.1 million.

Following are some highlights of Horizon's financial performance through the third quarter of 2016:

Net income for the third quarter of 2016 was \$6.6 million or \$.30 diluted earnings per share compared to \$4.3 million or \$.24 diluted earnings per share for the third quarter of 2015.

Excluding acquisition-related expenses and purchase accounting adjustments, net income for the third quarter of 2016 increased 29.6% compared to the same period of 2015 to \$8.4 million or \$.39 diluted earnings per share.

Net income for the first nine months of 2016 was \$18.3 million or \$.94 diluted earnings per share compared to \$14.4 million or \$.92 diluted earnings per share for the first nine months of 2015.

Excluding acquisition-related expenses and purchase accounting adjustments, gain on sale of investment securities and the death benefit on bank owned life insurance, net income for the first nine months of 2016 increased 32.1% compared to the same period of 2015 to \$20.7 million or \$1.07 diluted earnings per share.

Excluding the LaPorte Bancorp, Inc. (LaPorte Bancorp) acquisition, mortgage warehouse loans and loans held for sale, loans increased 4.1% on an annualized basis during the third quarter of 2016.

Net interest income for the first nine months of 2016 increased 19.3% or \$10.5 million compared to the same period in 2015.

Net interest margin, excluding the impact of acquisitions (core net interest margin), was 3.31% for the third quarter of 2016 compared to 3.42% for the prior quarter and 3.44% for the same period in 2015.

Non-interest income for the first nine months of 2016 increased 22.7% or \$5.1 million compared to the same period in 2015.

Horizon's tangible book value per share rose to \$11.83 at September 30, 2016, compared to \$11.02 at December 31, 2015 and \$10.89 at September 30, 2015.

Horizon opened its first commercial office in Fort Wayne, Indiana on September 14, 2016. The new location will offer commercial loans and cash management services and will be led by Greg Haney, Horizon's Fort Wayne Market President.

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 2015 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

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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 September 30, 2016, Horizon had core deposit intangibles of \$9.6 million subject to amortization and \$74.3 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 September 30, 2016 was \$19.59 per share compared to a book value of \$15.55 per common share.

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

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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.

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.

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Management's Discussion and Analysis of Financial Condition****And Results of Operations****For the Three and Nine Months ended September 30, 2016****Financial Condition**

On September 30, 2016, Horizon's total assets were \$3.3 billion, an increase of approximately \$673.2 million compared to December 31, 2015. The increase was primarily in net loans of \$441.4 million, investment securities available for sale of \$112.2 million, cash of \$35.1 million, goodwill of \$24.7 million, other assets of \$23.9 million and cash value of life insurance of \$19.2 million.

Investment securities were comprised of the following as of (dollars in thousands):

	September 30, 2016		December 31, 2015	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for sale				
U.S. Treasury and federal agencies	\$ 27,383	\$ 27,422	\$ 5,940	\$ 5,926
State and municipal	62,825	64,039	73,829	75,095
Federal agency collateralized mortgage obligations	188,072	189,684	157,291	156,203
Federal agency mortgage-backed pools	272,144	275,973	206,970	207,704
Corporate notes	32	95	32	54
Total available for sale investment securities	\$ 550,456	\$ 557,213	\$ 444,062	\$ 444,982
Held to maturity				
U.S. Treasury and federal agencies	\$	\$	\$ 5,859	\$ 5,952
State and municipal	158,543	164,500	146,331	151,453
Federal agency collateralized mortgage obligations	6,828	6,972	9,051	8,954
Federal agency mortgage-backed pools	21,656	22,822	26,388	27,344
Total held to maturity investment securities	\$ 187,027	\$ 194,294	\$ 187,629	\$ 193,703

Total investment securities increased by approximately \$111.6 million at September 30, 2016 compared to December 31, 2015, primarily due to the investing of cash from the closing of the LaPorte Bancorp acquisition.

Total loans increased \$441.4 million since December 31, 2015 to \$2.2 billion as of September 30, 2016. This increase was the result of an increase in commercial loans of \$242.5 million, mortgage warehouse loans of \$82.2 million, residential mortgage loans of \$93.0 million and consumer loans of \$23.7 million. The growth in total loans during the

nine months ended September 30, 2016 is the direct result of increased calling efforts to increase Horizon's market share within the Company's footprint and market expansion as well as the loans added through the Kosciusko and LaPorte Bancorp acquisitions.

Total deposits increased \$456.0 million since December 31, 2015 to \$2.3 billion as of September 30, 2016. Non-interest bearing deposit accounts increased by \$143.8 million, interest-bearing transaction accounts increased by \$189.6 million and time deposits increased by \$122.6 million during the nine months ended September 30, 2016.

The Company's borrowings increased \$120.6 million from December 31, 2015 to \$569.9 million as of September 30, 2016. At September 30, 2016, the Company had \$307.9 million in short-term funds borrowed compared to \$206.0 million at December 31, 2015. The Company has a debt reduction plan either through cash flow or possible early redemption.

Stockholders' equity totaled \$345.7 million at September 30, 2016 compared to \$266.8 million at December 31, 2015. The increase in stockholders' equity during the period was the result of the generation of net

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income, net of dividends declared, as well as the stock issued in the Kosciusko and LaPorte Bancorp acquisitions. At September 30, 2016, the ratio of average stockholders' equity to average assets was 10.18% compared to 10.32% at December 31, 2015. Book value per common share at September 30, 2016 increased to \$15.61 compared to \$14.20 at December 31, 2015.

Results of Operations

Overview

Consolidated net income for the three-month period ended September 30, 2016 was \$6.6 million compared to \$4.3 million for the same period in 2015. Earnings per common share for the three months ended September 30, 2016 were \$0.31 basic and \$0.30 diluted, compared to \$0.24 basic and \$0.24 diluted for the same three-month period in the previous year. The increase in net income and earnings per share from the previous year reflects an increase in net interest income and non-interest income of \$4.6 million and \$1.7 million, respectively, partially offset by increases in non-interest expense of \$2.6 million, income tax expense of \$1.2 million and the diluted shares outstanding primarily due to the stock issued in the Kosciusko and LaPorte Bancorp acquisitions. Non-interest expenses increased primarily due to an increase in salaries, employee benefits, net occupancy expenses, data processing expense, professional fees, loan expenses and other expense. Excluding acquisition-related expenses and purchase accounting adjustments, net income for the third quarter of 2016 was \$8.4 million or \$0.39 diluted earnings per share compared to \$6.5 million or \$0.36 diluted earnings per share in the same period of 2015.

Consolidated net income for the nine-month period ended September 30, 2016 was \$18.3 million compared to \$14.3 million for the same period in 2015. Earnings per common share for the nine months ended September 30, 2016 were \$0.95 basic and \$0.94 diluted, compared to \$0.95 basic and \$0.92 diluted for the same period of 2015. The increase in net income from the previous year reflects an increase in net interest income and non-interest income of \$10.5 million and \$5.1 million, respectively, and a decrease in the provision for loan losses of \$1.6 million, partially offset by increases in non-interest expense of \$11.2 million and income tax expense of \$2.2 million and the diluted shares outstanding primarily due to the stock issued in the Kosciusko and LaPorte Bancorp acquisitions. Non-interest expenses increased primarily due to an increase in salaries, employee benefits, net occupancy expenses, data processing expense, professional fees, outside services and consultants' expense, loan expense, FDIC deposit insurance, other losses and other expense. Excluding acquisition-related expenses and purchase accounting adjustments, gain on sale of investment securities and the death benefit on bank owned life insurance, net income for the nine months ended September 30, 2016 was \$20.7 million or \$1.07 diluted earnings per share compared to \$15.7 million or \$0.99 diluted earnings per share in the same period of 2015.

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.

Net interest income during the three months ended September 30, 2016 was \$24.4 million, an increase of \$4.6 million from the \$19.8 million earned during the same period in 2015. Yields on the Company's interest-earning assets decreased by 19 basis points to 3.98% for the three months ending September 30, 2016 from 4.17% for the three months ended September 30, 2015. Interest income increased \$5.4 million from \$23.6 million for the three months ended September 30, 2015 to \$29.0 million for the same period in 2016. This

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increase was due to an increase in interest-earning assets, partially offset by lower yields on loans and investment securities. Interest income from acquisition-related purchase accounting adjustments was \$459,000 for the three months ending September 30, 2016 compared to \$402,000 for the same period of 2015.

Rates paid on interest-bearing liabilities decreased by 5 basis points for the three-month period ended September 30, 2016 compared to the same period in 2015 due to the continued low interest rate environment and shift in mix on interest-bearing liabilities. Interest expense increased \$750,000 compared to the three-month period ended September 30, 2015 to \$4.6 million for the same period in 2016. This increase was due to higher average balances of interest-bearing deposits and borrowings, partially offset by lower rates paid on interest-bearing deposits and borrowings. The net interest margin decreased 14 basis points from 3.51% for the three-month period ended September 30, 2015 to 3.37% for the same period in 2016. The decrease in the margin for the three-month period ended September 30, 2016 compared to the same period in 2015 was due to a reduction in the yield on interest-earning assets. Excluding the interest income recognized from the acquisition-related purchase accounting adjustments, the margin would have been 3.31% for the three-month period ending September 30, 2016 compared to 3.44% for the same period in 2015.

The following are the average balance sheets for the three months ending (dollars in thousands):

	Three Months Ended			Three Months Ended		
	September 30, 2016			September 30, 2015		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
ASSETS						
Interest-earning assets						
Federal funds sold	\$ 35,492	\$ 20	0.22%	\$ 23,086	\$ 2	0.03%
Interest-earning deposits	55,047	32	0.23%	16,340	5	0.12%
Investment securities - taxable	530,228	2,446	1.84%	401,702	2,149	2.12%
Investment securities - non-taxable (1)	186,074	1,151	3.73%	154,050	1,125	4.39%
Loans receivable (2)(3)	2,151,103	25,313	4.69%	1,709,337	20,297	4.72%
Total interest-earning assets (1)	2,957,944	28,962	3.98%	2,304,515	23,578	4.17%
Non-interest-earning assets						
Cash and due from banks	39,875			31,384		
Allowance for loan losses	(14,301)			(16,427)		

Other assets	290,100	206,545
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	\$ 3,273,618	\$ 2,526,017
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LIABILITIES AND SHAREHOLDERS EQUITY

Interest-bearing liabilities

Interest-bearing deposits	\$ 1,896,156	\$ 1,875	0.39%	\$ 1,568,777	\$ 1,566	0.40%
Borrowings	510,738	2,128	1.66%	303,521	1,729	2.26%
Subordinated debentures	37,092	549	5.89%	32,737	507	6.14%

Total interest-bearing liabilities	2,443,986	4,552	0.74%	1,905,035	3,802	0.79%
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Non-interest-bearing liabilities

Demand deposits	462,253	343,780
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Accrued interest payable and other liabilities	34,144	14,891
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Stockholders equity	333,235	262,311
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	\$ 3,273,618	\$ 2,526,017
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Net interest income/spread	\$ 24,410	3.24%	\$ 19,776	3.38%
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Net interest income as a percent of average interest earning assets (1)	3.37%	3.51%
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HORIZON BANCORP AND SUBSIDIARIES

Management's Discussion and Analysis of Financial Condition

And Results of Operations

For the Three and Nine Months ended September 30, 2016

- (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 loan fees and late fees. The inclusion of these 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.

Net interest income during the nine months ended September 30, 2016 was \$65.1 million, an increase of \$10.5 million from the \$54.5 million earned during the same period in 2015. Yields on the Company's interest-earning assets decreased by 20 basis points to 4.05% for the nine months ending September 30, 2016 compared to 4.25% for the same period of 2015. Interest income increased \$12.3 million from \$64.8 million for the nine months ended September 30, 2015 to \$77.1 million for the same period in 2016. This increase was due to an increase in interest-earning assets, partially offset by lower yields on loans and investment securities and a decrease in interest income from acquisition-related purchase accounting adjustments from \$2.3 million for the nine months ending September 30, 2015 to \$1.4 million for the same period of 2016.

Rates paid on interest-bearing liabilities decreased by 5 basis points for the nine-month period ended September 30, 2016 compared to the same period in 2015 due to the continued low interest rate environment and shift in mix on interest-bearing liabilities. Interest expense increased \$1.8 million compared to the nine-month period ended September 30, 2015 to \$12.1 million for the same period in 2016. This increase was due to higher average balances of interest-bearing deposits and borrowings, partially offset by lower rates paid on interest-bearing deposits and borrowings. The net interest margin decreased 16 basis points from 3.59% for the nine-month period ended September 30, 2015 to 3.43% for the same period in 2016. The decrease in the margin for the nine-month period ended September 30, 2016 compared to the same period in 2015 was due to a reduction in the yield on interest-earning assets and a decrease of approximately \$878,000 of interest income from acquisition-related purchase accounting adjustments. Excluding the interest income recognized from the acquisition-related purchase accounting adjustments, the margin would have been 3.36% for the nine-month period ending September 30, 2016 compared to 3.44% for the same period in 2015.

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The following are the average balance sheets for the nine months ending (dollars in thousands):

	Nine Months Ended			Nine Months Ended		
	September 30, 2016			September 30, 2015		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
ASSETS						
Interest-earning assets						
Federal funds sold	\$ 13,812	\$ 23	0.22%	\$ 10,563	\$ 11	0.14%
Interest-earning deposits	34,624	59	0.23%	11,927	10	0.11%
Investment securities - taxable	486,374	7,621	2.09%	375,548	6,356	2.26%
Investment securities - non-taxable (1)	183,142	3,583	3.63%	145,576	3,281	3.96%
Loans receivable (2)(3)	1,873,614	65,854	4.70%	1,528,662	55,140	4.83%
Total interest-earning assets (1)	2,591,566	77,140	4.05%	2,072,276	64,798	4.25%
Non-interest-earning assets						
Cash and due from banks	36,220			30,729		
Allowance for loan losses	(14,334)			(16,557)		
Other assets	243,021			174,363		
	\$ 2,856,473			\$ 2,260,811		

LIABILITIES AND SHAREHOLDERS' EQUITY

Interest-bearing liabilities						
Interest-bearing deposits	\$ 1,680,560	\$ 4,923	0.39%	\$ 1,347,882	\$ 4,035	0.40%
Borrowings	438,324	5,608	1.71%	340,593	4,747	1.86%
Subordinated debentures	34,144	1,556	6.09%	32,698	1,504	6.15%
Total interest-bearing liabilities	2,153,028	12,087	0.75%	1,721,173	10,286	0.80%
Non-interest-bearing liabilities						
Demand deposits	387,768			303,309		
Accrued interest payable and other liabilities	26,397			14,582		

Stockholders equity	289,280		221,747	
	\$ 2,856,473		\$ 2,260,811	
Net interest income/spread	\$ 65,053	3.30%	\$ 54,512	3.45%
Net interest income as a percent of average interest earning assets (1)		3.43%		3.59%

- (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 loan fees and late fees. The inclusion of these 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.

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 portfolio. During the three-month period ended September 30, 2016, a provision of \$455,000 was required to adequately fund the ALLL compared to \$300,000 for the same period of 2015. Commercial loan net charge-offs during the three-month period ended September 30, 2016 were negative \$6,000, there were no residential mortgage loan net charge-offs and consumer loan net charge-offs were \$163,000. The increase in the provision for loan losses in the third quarter of 2016 compared to the same period of 2015 was due to loan growth. The ALLL balance at September 30, 2016 was \$14.5 million or 0.66% of total loans. This compares to an ALLL balance of \$14.5 million at December 31, 2015 or 0.83% of total loans. The decrease in the ratio at September 30, 2016 compared to December 31, 2015 was due to an increase in total loans of \$441.4 million from the Kosciusko and LaPorte Bancorp mergers and improving credit trends.

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For the nine-month period ended September 30, 2016, the provision for loan losses totaled \$1.2 million compared to \$2.8 million in the same period of 2015. The lower provision for loan losses in the third quarter of 2016 compared to the same period of 2015 was due to the improvement of non-performing loans and the charge-off of one commercial credit of \$1.3 million in the first nine months of 2015.

Horizon's loan loss reserve ratio, excluding loans with credit-related purchase accounting adjustments, stood at 0.87% as of September 30, 2016. Loan loss reserves and credit-related loan discounts on acquired loans as a percentage of total loans was 1.40% as of September 30, 2016. The table below illustrates Horizon's loan loss reserve ratio composition as of September 30, 2016.

Non-GAAP Allowance for Loan and Lease Loss Detail**As of September 30, 2016**

(Dollars in Thousands, Unaudited)

	Horizon Legacy	Heartland	Summit	Peoples	Kosciusko	LaPorte	Total
Pre-discount loan balance	\$ 1,673,722	\$ 15,719	\$ 57,214	\$ 155,318	\$ 89,490	\$ 215,531	\$ 2,206,994
Allowance for loan losses (ALLL)	14,524						14,524
Loan discount	N/A	1,067	2,645	3,545	1,132	8,086	16,475
ALLL+loan discount	14,524	1,067	2,645	3,545	1,132	8,086	30,999
Loans, net	\$ 1,659,198	\$ 14,652	\$ 54,569	\$ 151,773	\$ 88,358	\$ 207,445	\$ 2,175,995
ALLL/ pre-discount loan balance	0.87%	0.00%	0.00%	0.00%	0.00%	0.00%	0.66%
Loan discount/ pre-discount loan balance	N/A	6.79%	4.62%	2.28%	1.26%	3.75%	0.75%
ALLL+loan discount/	0.87%	6.79%	4.62%	2.28%	1.26%	3.75%	1.40%

pre-discount loan
balance

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 September 30, 2016.

Non-performing loans totaled \$12.8 million as of September 30, 2016, down from \$16.7 million as of December 31, 2015. Compared to December 31, 2015, non-performing commercial and real estate loans decreased by \$1.5 million and \$3.1 million, respectively, and non-performing consumer loans increased by \$813,000.

Other Real Estate Owned (OREO) totaled \$3.7 million at September 30, 2016 compared to \$3.2 million on December 31, 2015 and \$1.3 million on September 30, 2015.

Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Management's Discussion and Analysis of Financial Condition****And Results of Operations****For the Three and Nine Months ended September 30, 2016**Non-interest Income

The following is a summary of changes in non-interest income (three and nine month table dollar amounts in thousands):

	Three Months Ended			
	September 30	September 30	Amount	Percent
	2016	2015	Change	Change
Non-interest Income				
Service charges on deposit accounts	\$ 1,483	\$ 1,359	\$ 124	9.1%
Wire transfer fees	292	160	132	82.5%
Interchange fees	2,016	1,625	391	24.1%
Fiduciary activities	1,653	1,520	133	8.8%
Gain on sale of mortgage loans	3,528	2,794	734	26.3%
Mortgage servicing net of impairment	409	246	163	66.3%
Increase in cash surrender value of bank owned life insurance	449	374	75	20.1%
Other income	226	322	(96)	-29.8%
Total non-interest income	\$ 10,056	\$ 8,400	\$ 1,656	19.7%

Total non-interest income was \$1.7 million higher in the third quarter of 2016 compared to the same period of 2015. Service charges on deposit accounts increased \$124,000, wire transfer fees increased \$132,000, interchange fees increased by \$391,000, and fiduciary activities increased \$133,000 primarily due to overall company growth and increased volume. Residential mortgage loan activity during the third quarter of 2016 generated \$3.5 million of income from the gain on sale of mortgage loans, up \$734,000 from the same period in 2015. The increase in the gain on sale of mortgage loans was due to an increase in the percentage earned on the sale of these loans from 3.30% in the third quarter of 2015 to 3.91% in the same period of 2016. Mortgage servicing net of impairment increased by \$163,000 during the third quarter of 2016 compared to the same period of 2015 primarily due to a larger portfolio of mortgage loans serviced.

	Nine Months Ended			
	September 30	September 30	Amount	Percent
	2016	2015	Change	Change

Non-interest Income				
Service charges on deposit accounts	\$ 4,056	\$ 3,443	\$ 613	17.8%
Wire transfer fees	588	493	95	19.3%
Interchange fees	5,137	4,093	1,044	25.5%
Fiduciary activities	4,753	4,033	720	17.9%
Gain on sale of investment securities	875	124	751	605.6%
Gain on sale of mortgage loans	9,171	7,815	1,356	17.4%
Mortgage servicing net of impairment	1,356	725	631	87.0%
Increase in cash surrender value of bank owned life insurance	1,145	889	256	28.8%
Death benefit on officer life insurance		145	(145)	100.0%
Other income	708	892	(184)	-20.6%
Total non-interest income	\$ 27,789	\$ 22,652	\$ 5,137	22.7%

Total non-interest income was \$5.1 million higher in the first nine months of 2016 compared to the same period of 2015. Service charges on deposit accounts increased \$613,000, interchange fees increased by \$1.0 million and fiduciary activities increased \$720,000, primarily due to overall company growth and increased volume. Gain on sale of securities increased \$751,000 due to gains realized in the first nine months of 2016 as the result of an analysis that determined market conditions provided the opportunity to add gains to capital without negatively impacting long-term earnings. Residential mortgage loan activity during the first nine months of 2016 generated \$9.2 million of income from the gain on sale of mortgage loans, up \$1.4 million from the same period in 2015. The increase in the gain on sale of mortgage loans was due to an increase in the percentage earned on the sale of these loans from 3.19% during the first nine months of 2015 to 3.81% in the same period of 2016, partially offset by a decrease in total loans sold of \$2.4 million from \$239.1 million

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during the first nine months of 2015 to \$236.7 million in the same period of 2016. Mortgage servicing net of impairment increased by \$631,000 during the first nine months of 2016 compared to the same period of 2015 primarily due to a larger portfolio of mortgage loans serviced. The cash surrender value of bank owned life insurance increased by \$256,000 in the first nine months of 2016 compared to the same period in 2015 due to the addition of bank owned life insurance policies as a result of the Kosciusko and LaPorte Bancorp acquisitions. The death benefit on bank owned life insurance decreased by \$145,000 compared to the previous year due to a \$145,000 death benefit on officer life insurance realized during the first nine months of 2015.

Non-interest Expense

The following is a summary of changes in non-interest expense (three and nine month table dollar amounts in thousands):

	Three Months Ended			
	September 30	September 30	Amount	Percent
	2016	2015	Change	Change
Non-interest expense				
Salaries	\$ 8,349	\$ 6,896	\$ 1,453	21.1%
Commission and bonuses	1,799	1,958	(159)	-8.1%
Employee benefits	2,062	1,798	264	14.7%
Net occupancy expenses	2,174	1,723	451	26.2%
Data processing	1,616	1,281	335	26.2%
Professional fees	612	409	203	49.6%
Outside services and consultants	2,686	3,209	(523)	-16.3%
Loan expense	1,482	1,351	131	9.7%
FDIC deposit insurance	465	423	42	9.9%
Other losses	107	246	(139)	-56.5%
Other expense	3,468	2,941	527	17.9%
Total non-interest expense	\$ 24,820	\$ 22,235	\$ 2,585	11.6%

Total non-interest expense was \$2.6 million higher in the third quarter of 2016 compared to the same period of 2015. Salaries increased by \$1.5 million and employee benefits increased by \$264,000 due to a larger employee base. Net occupancy expense increased \$451,000 due to Horizon's investment in growth markets and the Peoples, Kosciusko and LaPorte Bancorp acquisitions. Data processing expenses increased \$335,000, professional fees increased \$203,000 and loan expenses increased \$131,000 primarily due to company growth. Other expenses increased by \$527,000

primarily due to company growth and one-time merger-related expenses. Outside services and consultants expense decreased by \$523,000 due to the one-time fees associated with the Peoples acquisition in the third quarter of 2015. One-time non-interest expense related to the Kosciusko, LaPorte Bancorp and CNB Bancorp acquisitions in the third quarter of 2016 totaled \$2.9 million compared to \$3.6 million in one-time fees associated with the Peoples acquisition in the same period of 2015.

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	Nine Months Ended			
	September 30	September 30	Amount	Percent
	2016	2015	Change	Change
Non-interest expense				
Salaries	\$ 22,485	\$ 18,522	\$ 3,963	21.4%
Commission and bonuses	4,064	4,325	(261)	-6.0%
Employee benefits	6,043	4,694	1,349	28.7%
Net occupancy expenses	6,011	4,649	1,362	29.3%
Data processing	3,855	3,170	685	21.6%
Professional fees	2,190	1,596	594	37.2%
Outside services and consultants	5,983	4,753	1,230	25.9%
Loan expense	4,086	3,975	111	2.8%
FDIC deposit insurance	1,279	1,099	180	16.4%
Other losses	510	351	159	45.3%
Other expense	9,616	7,819	1,797	23.0%
Total non-interest expense	\$ 66,122	\$ 54,953	\$ 11,169	20.3%

Total non-interest expenses were \$11.2 million higher in the first nine months of 2016 compared to the same period of 2015. Salaries increased by \$4.0 million and employee benefits increased by \$1.3 million due to a larger employee base. Net occupancy expense increased \$1.4 million due to Horizon's investment in growth markets and the Peoples, Kosciusko and LaPorte Bancorp acquisitions. Data processing expenses increased \$685,000, loan expense increased \$111,000 and FDIC deposit insurance increased by \$180,000 primarily due to company growth. Other losses increased by \$159,000 primarily due to higher debit card losses and a trust settlement. Other expenses increased by \$1.8 million primarily due to company growth and one-time merger-related expenses. Commission and bonuses decreased by \$261,000 due to a decrease in loan volume and incentive pay. Outside services and consultants expense increased by \$1.2 million due to the one-time fees associated with Kosciusko, LaPorte Bancorp and CNB Bancorp acquisitions. One-time non-interest expense related to the Kosciusko, LaPorte Bancorp and CNB Bancorp acquisitions totaled \$5.5 million in the first nine months of 2016 compared to \$4.4 million in one-time fees associated with the Peoples acquisition in the same period of 2015.

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 nine months ended September 30, 2016, cash and cash equivalents increased by approximately \$35.1 million. At September 30,

2016, in addition to liquidity available from the normal operating, funding, and investing activities of Horizon, the Bank had approximately \$278.2 million in unused credit lines with various money center banks, including the FHLB and the FRB Discount Window compared to \$253.2 million at December 31, 2015 and \$328.0 million at September 30, 2015.

Capital Resources

The capital resources of Horizon and the Bank exceeded regulatory capital ratios for well capitalized banks at September 30, 2016. Stockholders' equity totaled \$345.7 million as of September 30, 2016, compared to \$266.8 million as of December 31, 2015. For the three months ended September 30, 2016, the ratio of average stockholders' equity to average assets was 10.18% compared to 10.32% for the three months ended December 31, 2015. The increase in stockholders' equity during the period was the result of the generation of net income, net of dividends declared, as well as the stock issued in the Kosciusko and LaPorte Bancorp acquisitions.

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On February 1, 2016, the Company paid off the \$12.5 million in funds received through the Small Business Lending Fund with cash from the holding company, thereby ending its participation in the program, pursuant to which it issued preferred stock to the US Treasury. The funds were paid off due to an increase in the dividend cost that would have gone in effect at the end of February 2016. For the nine months ending September 30, 2016, the dividend cost was \$42,000 or 1.0% annualized and included the acceleration of interest due to the payoff.

Horizon declared common stock dividends in the amount of \$0.30 per share during the first nine months of 2016 compared to \$0.29 per share for the same period of 2015. The dividend payout ratio (dividends as a percent of basic earnings per share) was 31.6% and 30.2% for the first nine months of 2016 and 2015, respectively. For additional information regarding dividends, see Horizon's Annual Report on Form 10-K for 2015.

Use of Non-GAAP Financial Measures

Certain information set forth in this quarterly report on Form 10-Q refers to financial measures determined by methods other than in accordance with GAAP. Specifically, we have included non-GAAP financial measures of the net interest margin and the allowance for loan and lease losses excluding the impact of acquisition-related purchase accounting adjustments and net income and diluted earnings per share excluding the impact of one-time costs related to acquisitions, acquisition-related purchase accounting adjustments and other events that are considered to be non-recurring. Horizon believes that these non-GAAP financial measures are helpful to investors and provide a greater understanding of our business without giving effect to the purchase accounting impacts and one-time costs of acquisitions and non-core items, although these measures are not necessarily comparable to similar measures that may be presented by other companies and should not be considered in isolation or as a substitute for the related GAAP measure.

Non-GAAP Reconciliation of Net Interest Margin

(Dollars in Thousands, Unaudited)

	Three Months Ended			Nine Months Ended	
	September 30 2016	June 30 2016	September 30 2015	September 30 2016	September 30 2015
<u>Net Interest Margin As Reported</u>					
Net interest income	\$ 24,410	\$ 20,869	\$ 19,776	\$ 65,053	\$ 54,512
Average interest-earning assets	2,957,944	2,471,354	2,304,515	2,591,566	2,072,276
Net interest income as a percent of average interest-earning assets (Net	3.37%	3.48%	3.51%	3.43%	3.59%

Interest Margin)

Impact of Acquisitions

Interest income from acquisition-related purchase accounting adjustments	\$ (459)	\$ (397)	\$ (402)	\$ (1,404)	\$ (2,282)
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Excluding Impact of Acquisitions

Net interest income	\$ 23,951	\$ 20,472	\$ 19,374	\$ 63,649	\$ 52,230
Average interest-earning assets	2,957,944	2,471,354	2,304,515	2,591,566	2,072,276
Core Net Interest Margin	3.31%	3.42%	3.44%	3.36%	3.44%

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Table of Contents**HORIZON BANCORP AND SUBSIDIARIES****Management's Discussion and Analysis of Financial Condition****And Results of Operations****For the Three and Nine Months ended September 30, 2016****Non-GAAP Reconciliation of Net Income and Diluted Earnings per Share**

(Dollars in Thousands Except per Share Data, Unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
	2016	2015	2016	2015
<u>Non-GAAP Reconciliation of Net Income</u>				
Net income as reported	\$ 6,602	\$ 4,288	\$ 18,309	\$ 14,374
Merger expenses	2,953	3,648	5,472	4,364
Tax effect	(886)	(1,219)	(1,582)	(1,402)
Net income excluding merger expenses	8,669	6,717	22,199	17,336
Gain on sale of investment securities			(875)	(124)
Tax effect			306	43
Net income excluding gain on sale of investment securities	8,669	6,717	21,630	17,255
Death benefit on bank owned life insurance (BOLI)				(145)
Tax effect				51
Net income excluding death benefit on BOLI	8,669	6,717	21,630	17,161
Acquisition-related purchase accounting adjustments (PAUs)	(459)	(402)	(1,404)	(2,282)
Tax effect	161	141	491	799
Net income excluding PAUs	\$ 8,371	\$ 6,456	\$ 20,717	\$ 15,678
<u>Non-GAAP Reconciliation of Diluted Earnings per Share</u>				
Diluted earnings per share as reported	\$ 0.30	\$ 0.24	\$ 0.94	\$ 0.92
Merger expenses	0.14	0.20	0.28	0.28
Tax effect	(0.04)	(0.07)	(0.08)	(0.09)

Diluted earnings per share excluding merger expenses	0.40	0.37	1.14	1.11
Gain on sale of investment securities			(0.05)	(0.01)
Tax effect			0.02	0.00
Net income excluding gain on sale of investment securities	0.40	0.37	1.11	1.10
Death benefit on BOLI				(0.01)
Tax effect				0.00
Net income excluding death benefit on BOLI	0.40	0.37	1.11	1.09
Acquisition-related PAUs	(0.02)	(0.02)	(0.07)	(0.15)
Tax effect	0.01	0.01	0.03	0.05
Diluted earnings per share excluding PAUs	\$ 0.39	\$ 0.36	\$ 1.07	\$ 0.99

Non-GAAP Reconciliation of Tangible Stockholders Equity and Tangible Book Value per Share

(Dollars in Thousands Except per Share Data)

	September 30 2016 (Unaudited)	June 30 2016 (Unaudited)	March 31 2016 (Unaudited)	December 31 2015	September 30 2015 (Unaudited)
Total stockholders equity	\$ 345,736	\$ 281,002	\$ 261,417	\$ 266,832	\$ 264,738
Less: Preferred stock				12,500	12,500
Less: Intangible assets	83,891	65,144	56,695	56,971	57,248
Total tangible stockholders equity	\$ 261,845	\$ 215,858	\$ 204,722	\$ 197,361	\$ 194,990
Common shares outstanding	22,143,228	18,857,301	17,974,970	17,909,831	17,897,981
Tangible book value per common share	\$ 11.83	\$ 11.45	\$ 11.39	\$ 11.02	\$ 10.89

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HORIZON BANCORP AND SUBSIDIARIES

Quantitative and Qualitative Disclosures About Market Risk

For the Three and Nine Months ended September 30, 2016

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We refer you to Horizon's 2015 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 2015 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 September 30, 2016, 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 September 30, 2016, 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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HORIZON BANCORP AND SUBSIDIARIES

Part II – Other Information

For the Three and Nine Months ended September 30, 2016

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 2015.

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

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HORIZON BANCORP AND SUBSIDIARIES

Part II – Other Information

For the Three and Nine Months ended September 30, 2016

ITEM 6. EXHIBITS

(a) Exhibits

Exhibit No.	Description
3.1	Amended and Restated Articles of Incorporation of Horizon Bancorp, with October 19, 2016 Amendment (incorporated by reference to Exhibit 3.1 to Registrant's Form 8-K filed October 19, 2016)
10.1	Agreement between Horizon Bank, N.A. and Kathie A. DeRuiter (incorporated by reference to Exhibit 10.1 to Registrant's Form 8-K filed September 21, 2016)
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

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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: November 9, 2016

/s/ Craig M. Dwight
Craig M. Dwight
Chief Executive Officer

Dated: November 9, 2016

/s/ Mark E. Secor
Mark E. Secor
Chief Financial Officer

Table of Contents**INDEX TO EXHIBITS**

Exhibit No.	Description	Location
Exhibit 3.1	Amended and Restated Articles of Incorporation of Horizon Bancorp, with October 19, 2016 Amendment	Incorporated by reference to Exhibit 3.1 to Registrant's Form 8-K filed October 19, 2016
Exhibit 10.1	Agreement between Horizon Bank, N.A. and Kathie A. DeRuiter	Incorporated by reference to Exhibit 10.1 to Registrant's Form 8-K filed September 21, 2016
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