FIRST CAPITAL INC
Form 10-Q
November 13, 2013
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2013

OR

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

For the transition period from __________ to __________

Commission File No. 0-25023

First Capital, Inc.

(Exact name of registrant as specified in its charter)

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

220 Federal Drive NW, Corydon, Indiana 47112

(Address of principal executive offices) (Zip Code)

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

Not applicable

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

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

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

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 2,784,415 shares of common stock were outstanding as of October 31, 2013.

Table of Contents

FIRST CAPITAL, INC.

INDEX

Table of Contents

PART I - FINANCIAL INFORMATION

FIRST CAPITAL, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

(Unaudited)

	September 30, 2013	December 31, 2012
	(In thousands)	
ASSETS		
Cash and due from banks	$ 8,414	$ 11,277
Interest bearing deposits with banks	2,712	1,975
Federal funds sold	5,682	9,959
Total cash and cash equivalents	16,808	23,211
Securities available for sale, at fair value	112,289	122,973
Securities-held to maturity	10	12
Loans, net	288,937	280,407
Loans held for sale	700	3,609
Federal Home Loan Bank stock, at cost	2,820	2,820
Foreclosed real estate	364	295
Premises and equipment	10,462	10,757
Accrued interest receivable	1,675	1,757
Cash value of life insurance	6,294	6,172
Goodwill	5,386	5,386
Other assets	1,958	1,733
Total Assets	$ 447,703	$ 459,132
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 60,769	$ 56,715
Interest-bearing	316,238	327,628
Total deposits	377,007	384,343
Retail repurchase agreements	10,437	14,092
Advances from Federal Home Loan Bank	5,000	5,100
Accrued interest payable	225	290
Accrued expenses and other liabilities	2,147	2,371
Total liabilities	394,816	406,196
EQUITY		
First Capital, Inc. stockholders equity:		

Preferred stock of $.01 par value per share Authorized 1,000,000 shares; none issued	0	0
Common stock of $.01 par value per share Authorized 5,000,000 shares; issued 3,164,416 shares; outstanding 2,784,515 and 2,784,997 shares in 2013 and 2012, respectively	32	32
Additional paid-in capital	24,313	24,313
Retained earnings-substantially restricted	36,261	34,101
Accumulated other comprehensive income (loss)	(491)	1,704
Less treasury stock, at cost - 379,901 shares (379,419 shares in 2012)	(7,336)	(7,326)
Total First Capital, Inc. stockholders equity	52,779	52,824
Noncontrolling interest in subsidiary	108	112
Total equity	52,887	52,936
Total Liabilities and Equity	$ 447,703	$ 459,132

See accompanying notes to consolidated financial statements.

Table of Contents

PART I - FINANCIAL INFORMATION

FIRST CAPITAL, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In thousands, except per share data)			
INTEREST INCOME				
Loans, including fees	$ 4,011	$ 4,020	$ 11,860	$ 12,028
Securities:				
Taxable	307	425	970	1,280
Tax-exempt	287	245	821	708
Federal Home Loan Bank dividends	25	21	74	66
Federal funds sold and interest bearing deposits with banks	19	11	54	37
Total interest income	4,649	4,722	13,779	14,119
INTEREST EXPENSE				
Deposits	355	469	1,145	1,594
Retail repurchase agreements	7	8	22	29
Advances from Federal Home Loan Bank	46	98	139	305
Total interest expense	408	575	1,306	1,928
Net interest income	4,241	4,147	12,473	12,191
Provision for loan losses	100	350	575	1,125
Net interest income after provision for loan losses	4,141	3,797	11,898	11,066
NONINTEREST INCOME				
Service charges on deposit accounts	823	756	2,327	2,187
Commission income	102	63	297	143
Gain on sale of securities	8	29	29	29
Gain on sale of mortgage loans	194	207	675	712
Mortgage brokerage fees	20	3	37	22
Increase in cash surrender value of life insurance	38	43	122	138
Other income	26	25	74	70
Total noninterest income	1,211	1,126	3,561	3,301
NONINTEREST EXPENSE				
Compensation and benefits	1,757	2,471	5,232	6,171
Occupancy and equipment	281	321	880	932

Data processing	373	336	1,084	993
Professional fees	164	150	534	462
Advertising	80	68	189	180
Other operating expenses	615	637	1,979	1,938
Total noninterest expense	3,270	3,983	9,898	10,676
Income before income taxes	2,082	940	5,561	3,691
Income tax expense	653	218	1,721	1,008
Net Income	$ 1,429	$ 722	$ 3,840	$ 2,683
Less: net income attributable to noncontrolling interest in subsidiary	3	3	10	10
Net Income Attributable to First Capital, Inc.	$ 1,426	$ 719	$ 3,830	$ 2,673
Earnings per common share attributable to First Capital, Inc.				
Basic	$ 0.51	$ 0.26	$ 1.38	$ 0.96
Diluted	$ 0.51	$ 0.26	$ 1.38	$ 0.96
Dividends per share	$ 0.20	$ 0.19	$ 0.60	$ 0.57

See accompanying notes to consolidated financial statements.

Table of Contents

PART I - FINANCIAL INFORMATION

FIRST CAPITAL, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
	(In thousands)		*(In thousands)*	
Net Income	$ 1,429	$ 722	$ 3,840	$ 2,683
OTHER COMPREHENSIVE INCOME (LOSS)				
Unrealized gains (losses) on securities available for sale:				
Unrealized holding gains (losses) arising during the period	(781)	128	(3,605)	207
Income tax (expense) benefit	309	(51)	1,428	(82)
Net of tax amount	(472)	77	(2,177)	125
Less: reclassification adjustment for realized gains included in net income	(7)	(29)	(29)	(29)
Income tax expense	3	12	11	12
Net of tax amount	(4)	(17)	(18)	(17)
Other Comprehensive Income (Loss), net of tax	(476)	60	(2,195)	108
Comprehensive Income	953	782	1,645	2,791
Less: comprehensive income attributable to the noncontrolling interest in subsidiary	3	3	10	10
Comprehensive Income Attributable to First Capital, Inc.	$ 950	$ 779	$ 1,635	$ 2,781

See accompanying notes to consolidated financial statements.

Table of Contents

PART I - FINANCIAL INFORMATION

FIRST CAPITAL, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(Unaudited)

(In thousands, except share and per share data)	**Common Stock**	**Additional Paid-in Capital**	**Retained Earnings**	**Accumulated Other Comprehensive Income (Loss)**	**Treasury Stock**	**Noncontrolling Interest**	**Total**
Balances at January 1, 2012	$ 32	$ 24,313	$ 32,297	$ 1,612	$ (7,312)	$ 111	$ 51,053
Net income	0	0	2,673	0	0	10	2,683
Other comprehensive income	0	0	0	108	0	0	108
Cash dividends	0	0	(1,589)	0	0	(13)	(1,602)
Purchase of treasury shares	0	0	0	0	(14)	0	(14)
Balances at September 30, 2012	$ 32	$ 24,313	$ 33,381	$ 1,720	$ (7,326)	$ 108	$ 52,228
Balances at January 1, 2013	$ 32	$ 24,313	$ 34,101	$ 1,704	$ (7,326)	$ 112	52,936
Net income	0	0	3,830	0	0	10	3,840
Other comprehensive loss	0	0	0	(2,195)	0	0	(2,195)
Cash dividends	0	0	(1,670)	0	0	(14)	(1,684)
Purchase of treasury shares	0	0	0	0	(10)	0	(10)
Balances at September 30, 2013	$ 32	$ 24,313	$ 36,261	$ (491)	$ (7,336)	$ 108	$ 52,887

See accompanying notes to consolidated financial statements.

Table of Contents

PART I - FINANCIAL INFORMATION

FIRST CAPITAL, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 3,840	$ 2,683
Adjustments to reconcile net income to net cash and cash equivalents provided by operating activities:		
Amortization of premiums and accretion of discounts on securities, net	712	721
Depreciation and amortization expense	533	576
Deferred income taxes	87	(508)
Increase in cash value of life insurance	(122)	(138)
Gain on sale of securities	(29)	(29)
Provision for loan losses	575	1,125
Proceeds from sales of loans	32,090	29,144
Loans originated for sale	(28,506)	(27,829)
Gain on sale of loans	(675)	(712)
Decrease in accrued interest receivable	82	19
Decrease in accrued interest payable	(65)	(93)
Net change in other assets/liabilities	722	1,668
Net Cash Provided By Operating Activities	9,244	6,627
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of securities available for sale	(23,460)	(54,833)
Proceeds from maturities of securities available for sale	19,047	27,825
Proceeds from sales of securities available for sale	517	2,927
Principal collected on mortgage-backed obligations	10,446	11,632
Net increase in loans receivable	(9,473)	(6,693)
Proceeds from sale of foreclosed real estate	299	889
Purchase of premises and equipment	(238)	(416)
Net Cash Used In Investing Activities	(2,862)	(18,669)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in deposits	(7,336)	19,693
Net decrease in advances from Federal Home Loan Bank	(100)	(2,250)
Net decrease in retail repurchase agreements	(3,655)	(13)

Purchase of treasury stock	(10)	(14)
Dividends paid	(1,684)	(1,602)
Net Cash Provided By (Used In) Financing Activities	(12,785)	15,814
Net Increase (Decrease) in Cash and Cash Equivalents	(6,403)	3,772
Cash and cash equivalents at beginning of period	23,211	18,923
Cash and Cash Equivalents at End of Period	$ 16,808	$ 22,695

See accompanying notes to consolidated financial statements.

Table of Contents

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Presentation of Interim Information

First Capital, Inc. (Company) is the savings and loan holding company for First Harrison Bank (Bank). The information presented in this report relates primarily to the Bank s operations. First Harrison Investments, Inc. and First Harrison Holdings, Inc. are wholly-owned Nevada corporate subsidiaries of the Bank that jointly own First Harrison, LLC, a Nevada limited liability corporation that holds and manages an investment portfolio. First Harrison REIT, Inc. (REIT) was incorporated as a wholly-owned subsidiary of First Harrison Holdings, Inc. to hold a portion of the Bank s real estate mortgage loan portfolio. On January 21, 2009, the REIT issued 105 shares of 12.5% redeemable cumulative preferred stock with an aggregate liquidation value of $105,000 in a private placement offering in order to satisfy certain ownership requirements to qualify as a real estate investment trust. At September 30, 2013, this noncontrolling interest represented 0.2% ownership of the REIT.

In the opinion of management, the unaudited consolidated financial statements include all adjustments considered necessary to present fairly the financial position as of September 30, 2013, and the results of operations for the three months and nine months ended September 30, 2013 and 2012 and the cash flows for the nine months ended September 30, 2013 and 2012. All of these adjustments are of a normal, recurring nature. Such adjustments are the only adjustments included in the unaudited consolidated financial statements. Interim results are not necessarily indicative of results for a full year or any other period.

The accompanying unaudited consolidated financial statements and notes have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial statements and are presented as permitted by the instructions to Form 10-Q. Accordingly, they do not contain certain information included in the Company s annual audited consolidated financial statements and related footnotes for the year ended December 31, 2012 included in the Company s Annual Report on Form 10-K.

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

Table of Contents

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

2. Investment Securities

Debt and equity securities have been classified in the consolidated balance sheets according to management s intent. Investment securities at September 30, 2013 and December 31, 2012 are summarized as follows:

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2013				
Securities available for sale:				
Agency mortgage-backed securities	$ 18,377	$ 205	$ 235	$ 18,347
Agency CMO	21,714	115	307	21,522
Other debt securities:				
Agency notes and bonds	34,754	82	557	34,279
Municipal obligations	35,757	874	943	35,688
Subtotal - debt securities	110,602	1,276	2,042	109,836
Mutual funds	2,477	0	24	2,453
Total securities available for sale	$ 113,079	$ 1,276	$ 2,066	$ 112,289
Securities held to maturity:				
Agency mortgage-backed securities	$ 10	$ 0	$ 0	$ 10
Total securities held to maturity	$ 10	$ 0	$ 0	$ 10
December 31, 2012				
Securities available for sale:				
Agency mortgage-backed securities	$ 22,762	$ 456	$ 12	$ 23,206
Agency CMO	22,458	225	23	22,660
Other debt securities:				
Agency notes and bonds	38,273	290	10	38,553
Municipal obligations	32,605	1,800	88	34,317
Subtotal - debt securities	116,098	2,771	133	118,736
Mutual funds	4,213	40	16	4,237

Total securities available for sale	$	120,311	$	2,811	$	149	$	122,973
Securities held to maturity:								
Agency mortgage-backed securities	$	12	$	0	$	0	$	12
Total securities held to maturity	$	12	$	0	$	0	$	12

Table of Contents

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(2 continued)

Agency notes and bonds, agency mortgage-backed securities and agency collateralized mortgage obligations (CMO) include securities issued by the Government National Mortgage Association (GNMA), a U.S. government agency, and the Federal National Mortgage Association (FNMA), the Federal Home Loan Mortgage Corporation (FHLMC) and the Federal Home Loan Bank (FHLB), which are government-sponsored enterprises.

The amortized cost and fair value of debt securities as of September 30, 2013, by contractual maturity, are shown below. Expected maturities of mortgage-backed securities may differ from contractual maturities because the mortgages underlying the obligations may be prepaid without penalty.

	Securities Available for Sale		Securities Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
(In thousands)				
Due in one year or less	$ 0	$ 0	$ 0	$ 0
Due after one year through five years	9,310	9,305	0	0
Due after five years through ten years	30,540	30,485		
Due after ten years	30,661	30,177	0	0
	70,511	69,967	0	0
Mortgage-backed securities and CMO	40,091	39,869	10	10
	$ 110,602	$ 109,836	$ 10	$ 10

Information pertaining to investment securities available for sale with gross unrealized losses at September 30, 2013, aggregated by investment category and the length of time that individual investment securities have been in a continuous position, follows:

	Number of Investment Positions	Fair Value	Gross Unrealized Losses

(Dollars in thousands)

Continuous loss position less than twelve months:			
Agency notes and bonds	20	$ 22,248	$ 557
Agency CMO	11	10,542	291
Agency mortgage-backed securities	17	14,413	235
Muncipal obligations	31	13,405	918
Mutual fund	1	1,544	9
Total less than twelve months	80	62,152	2,010
Continuous loss position more than twelve months:			
Muncipal obligations	2	589	25
Agency CMO	1	775	16
Mutual fund	1	393	15
Total more than twelve months	4	1,757	56
Total securities available for sale	84	$ 63,909	$ 2,066

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(2 continued)

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

At September 30, 2013, the 82 U.S. government agency debt securities, including agency notes and bonds, mortgage-backed securities and CMO, and municipal obligations in a loss position had depreciated approximately 3.2% from the amortized cost basis. All of the U.S. government agency securities and municipal obligations are issued by U.S. government agencies, government-sponsored enterprises and municipal governments, or are secured by first mortgage loans and municipal project revenues. These unrealized losses related principally to current interest rates for similar types of securities. In analyzing an issuer s financial condition, management considers whether the securities are issued by the federal government, its agencies or other governments, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer s financial condition. As the Company has the ability to hold the debt securities until maturity, or the foreseeable future if classified as available for sale, no declines are deemed to be other-than-temporary.

During the nine months ended September 30, 2013, the Company realized gross gains on sales of available for sale municipal securities and U.S. government agency debt securities of $21,000 and $8,000, respectively. The Company realized gross gains on sales of available for sale U.S. government agency debt securities of $8,000 during the three months ended September 30, 2013. During the three and nine months ended September 30, 2012, the Company realized gross gains on sales of available for sale U.S. government agency mortgage-backed securities and agency bonds of $35,000 and $2,000, respectively, and gross losses on sales of available for sale agency CMOs of $8,000.

3. Loans and Allowance for Loan Losses

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

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

Loan origination and commitment fees, as well as certain direct costs of underwriting and closing loans, are deferred and amortized as a yield adjustment to interest income over the lives of the related loans using the interest method.

Amortization of net deferred loan fees is discontinued when a loan is placed on nonaccrual status.

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

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

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

For portfolio segments other than consumer loans, the Company s practice is to charge-off any loan or portion of a loan when the loan is determined by management to be uncollectible due to the borrower s failure to meet repayment terms, the borrower s deteriorating or deteriorated financial condition, the depreciation of the underlying collateral, the loan s classification as a loss by regulatory examiners, or for other reasons. A partial charge-off is recorded on a loan when the uncollectibility of a portion of the loan has been confirmed, such as when a loan is discharged in bankruptcy, the collateral is liquidated, a loan is restructured at a reduced principal balance, or other identifiable events that lead management to determine the full principal balance of the loan will not be repaid. A specific reserve is recognized as a component of the allowance for estimated losses on loans individually evaluated for impairment. Partial charge-offs on nonperforming and impaired loans are included in the Company s historical loss experience used to estimate the general component of the allowance for loan losses as discussed below. Specific reserves are not considered charge-offs in management s analysis of the allowance for loan losses because they are estimates and the outcome of the loan relationship is undetermined. At September 30, 2013, the Company had eleven loans on which partial charge-offs of $497,000 had been recorded.

Consumer loans not secured by real estate are typically charged off at 90 days past due, or earlier if deemed uncollectible, unless the loans are in the process of collection. Overdrafts are charged off after 45 days past due. Charge-offs are typically recorded on loans secured by real estate when the property is foreclosed upon.

The allowance for loan losses reflects management s judgment of probable loan losses inherent in the loan portfolio at the balance sheet date. Additions to the allowance for loan losses are made by the provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

Table of Contents

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

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

The allowance consists of specific and general components. The specific component relates to loans that are individually evaluated for impairment or loans otherwise classified as doubtful, substandard, or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan.

The general component covers non-classified loans and classified loans that are found, upon individual evaluation, to not be impaired. Such loans are pooled by segment and losses are modeled using annualized historical loss experience adjusted for qualitative factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company over the most recent twelve calendar quarters unless the historical loss experience is not considered indicative of the level of risk in the remaining balance of a particular portfolio segment, in which case an adjustment is determined by management. The Company s historical loss experience is then adjusted by an overall loss factor weighting adjustment based on a qualitative analysis prepared by management and reviewed on a quarterly basis. The overall loss factor considers changes in underwriting standards, economic conditions, changes and trends in past due and classified loans and other internal and external factors.

Management also applies additional loss factor multiples to loans classified as watch, special mention and substandard that are not individually evaluated for impairment. The loss factor multiples for classified loans are based on management s assessment of historical trends regarding losses experienced on classified loans in prior periods. See below for additional discussion of the overall loss factor and loss factor multiples for classified loans as of September 30, 2013 and December 31, 2012, as well as a discussion of changes in management s allowance for loan losses methodology from 2012 to 2013.

Management exercises significant judgment in evaluating the relevant historical loss experience and the qualitative factors. Management also monitors the differences between estimated and actual incurred loan losses for loans considered impaired in order to evaluate the effectiveness of the estimation process and make any changes in the methodology as necessary.

Management utilizes the following portfolio segments in its analysis of the allowance for loan losses: residential real estate, land, construction, commercial real estate, commercial business, home equity and second mortgage, and other consumer loans. Additional discussion of the portfolio segments and the risks associated with each segment can be found in the Company s Annual Report on Form 10-K for the year ended December 31, 2012.

Table of Contents

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

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

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

Loans at September 30, 2013 and December 31, 2012 consisted of the following:

(In thousands)	**September 30, 2013**	**December 31, 2012**
Real estate mortgage loans:		
Residential	$ 108,317	$ 108,097
Land	10,090	9,607
Residential construction	15,089	12,753
Commercial real estate	77,820	68,731
Commercial real estate construction	978	3,299
Commercial business loans	20,049	18,612
Consumer loans:		
Home equity and second mortgage loans	34,614	36,962

Automobile loans		23,572		21,922
Loans secured by savings accounts		1,259		770
Unsecured loans		3,150		3,191
Other consumer loans		4,939		5,303
Gross loans		299,877		289,247
Deferred loan origination fees, net		297		202
Undisbursed portion of loans in process		(6,333)		(4,306)
Allowance for loan losses		(4,904)		(4,736)
Loans, net	$	288,937	$	280,407

Table of Contents

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

The following table provides the components of the Company s recorded investment in loans for each portfolio segment at September 30, 2013:

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity 2nd Mtg	& Other Consumer	Total
				(In thousands)				
Recorded Investment in Loans:								
Principal loan balance	$ 108,317	$ 10,090	$ 9,734	$ 77,820	$ 20,049	$ 34,614	$ 32,920	$ 293,544
Accrued interest receivable	423	49	18	179	42	124	155	990
Net deferred loan origination fees and costs	50	2	0	(34)	(9)	288	0	297
Recorded investment in loans	$ 108,790	$ 10,141	$ 9,752	$ 77,965	$ 20,082	$ 35,026	$ 33,075	$ 294,831
Recorded Investment in Loans as Evaluated for Impairment:								
Individually evaluated for impairment	$ 1,380	$ 123	$ 0	$ 1,102	$ 1,968	$ 106	$ 0	$ 4,679
Collectively evaluated for impairment	107,410	10,018	9,752	76,863	18,114	34,920	33,075	290,152
Acquired with deteriorated credit quality	0	0	0	0	0	0	0	0
Ending balance	$ 108,790	$ 10,141	$ 9,752	$ 77,965	$ 20,082	$ 35,026	$ 33,075	$ 294,831

Table of Contents

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

The following table provides the components of the Company s recorded investment in loans for each portfolio segment at December 31, 2012:

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity & 2nd Mtg	Other Consumer	Total
				(In thousands)				
Recorded Investment in Loans:								
Principal loan balance	$ 108,097	$ 9,607	$ 11,746	$ 68,731	$ 18,612	$ 36,962	$ 31,186	$ 284,941
Accrued interest receivable	444	48	29	188	53	147	184	1,093
Net deferred loan origination fees and costs	62	2	(12)	(17)	(10)	177	0	202
Recorded investment in loans	$ 108,603	$ 9,657	$ 11,763	$ 68,902	$ 18,655	$ 37,286	$ 31,370	$ 286,236
Recorded Investment in Loans as Evaluated for Impairment:								
Individually evaluated for impairment	$ 2,370	$ 125	$ 403	$ 2,836	$ 1,776	$ 73	$ 0	$ 7,583
Collectively evaluated for impairment	106,233	9,532	11,360	66,066	16,879	37,213	31,370	278,653
Acquired with deteriorated credit quality	0	0	0	0	0	0	0	0

Ending balance	$ 108,603	$ 9,657	$ 11,763	$ 68,902	$ 18,655	$ 37,286	$ 31,370	$ 286,236

Table of Contents

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

An analysis of the allowance for loan losses as of September 30, 2013 is as follows:

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity & 2nd Mtg	Other Consumer	Total
				(In thousands)				
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	$ 95	$ 0	$ 0	$ 144	$ 1,315	$ 8	$ 0	$ 1,562
Collectively evaluated for impairment	799	70	50	1,097	159	857	310	3,342
Acquired with deteriorated credit quality	0	0	0	0	0	0	0	0
Ending balance	$ 894	$ 70	$ 50	$ 1,241	$ 1,474	$ 865	$ 310	$ 4,904

An analysis of the allowance for loan losses as of December 31, 2012 is as follows:

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity & 2nd Mtg	Other Consumer	Total
				(In thousands)				
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	$ 213	$ 0	$ 0	$ 275	$ 1,098	$ 66	$ 0	$ 1,652
Collectively evaluated for impairment	709	71	0	1,035	125	853	291	3,084
Acquired with deteriorated credit quality	0	0	0	0	0	0	0	0
Ending balance	$ 922	$ 71	$ 0	$ 1,310	$ 1,223	$ 919	$ 291	$ 4,736

-17-

Table of Contents

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

An analysis of the changes in the allowance for loan losses for the three months and nine months ended September 30, 2013 is as follows:

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity & 2nd Mtg	Other Consumer	Total
				(In thousands)				
Allowance for loan losses:								
Changes in Allowance for Loan Losses for the three-months ended September 30, 2013								
Beginning balance	$ 905	$ 73	$ 60	$ 1,291	$ 1,260	$ 894	$ 352	$ 4,835
Provisions for loan losses	(26)	(3)	(10)	(52)	210	(13)	(6)	100
Charge-offs	0	0	0	(1)	0	(24)	(89)	(114)
Recoveries	15	0	0	3	4	8	53	83
Ending balance	$ 894	$ 70	$ 50	$ 1,241	$ 1,474	$ 865	$ 310	$ 4,904
Changes in Allowance for Loan Losses for the nine-months ended September 30, 2013								
Beginning balance	$ 922	$ 71	$ 0	$ 1,310	$ 1,223	$ 919	$ 291	$ 4,736
Provisions for loan losses	211	1	50	3	196	(37)	151	575
Charge-offs	(298)	(2)	0	(89)	0	(59)	(260)	(708)
Recoveries	59	0	0	17	55	42	128	301
Ending balance	$ 894	$ 70	$ 50	$ 1,241	$ 1,474	$ 865	$ 310	$ 4,904

-18-

Table of Contents

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

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

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

-19-

Table of Contents

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

During the nine months ended September 30, 2013, management increased the overall qualitative factor for each portfolio segment from 1.15 times the Company s historical loss factors to 1.18 times the Company s historical loss factors. The increase in the overall qualitative factor was based on management s analysis of changes and trends in the following qualitative factors:

Underwriting Standards Management reviews the findings of periodic internal audit loan reviews, independent outsourced loan reviews and loan reviews performed by the banking regulators to evaluate the risk associated with changes in underwriting standards. At September 30, 2013 and December 31, 2012, management assessed the risk associated with this component as neutral, requiring no adjustment to the historical loss factors.

Economic Conditions Management analyzes trends in housing and unemployment data in the Harrison, Floyd, Washington and Clark counties of Indiana, the Company s primary market area, to evaluate the risk associated with economic conditions. Due to a decrease in new home construction and an increase in unemployment in the Company s primary market area, management assigned a risk factor of 1.20 for this component at September 30, 2013 and December 31, 2012.

Past Due Loans Management analyzes trends in past due loans for the Company to evaluate the risk associated with delinquent loans. In general, past due loan ratios have remained at elevated levels compared to historical amounts since 2007, and management assigned a risk factor of 1.20 for this component at September 30, 2013 and December 31, 2012.

Other Internal and External Factors This component includes management s consideration of other qualitative factors such as loan portfolio composition. The Company has focused on the origination of commercial business and real estate loans in an effort to convert the Company s balance sheet from that of a traditional thrift institution to a commercial bank. In addition, the Company has increased its investment in mortgage loans in which it does not hold a first lien position. Commercial loans and second mortgage loans generally entail greater credit risk than residential mortgage loans secured by a first lien. As a result of changes in the loan portfolio composition and other factors, management increased its risk factor from 1.20 at December 31, 2012 to 1.30 at September 30, 2013.

Each of the four factors above was assigned an equal weight to arrive at an average for the overall qualitative factor of 1.18 and 1.15 at September 30, 2013 and December 31, 2012, respectively. The effect of the overall qualitative factor was to increase the estimated allowance for loan losses by $345,000 and $419,000 at September 30, 2013 and December 31, 2012, respectively. The effect of the increase in the overall qualitative factor from 1.15 at December 31, 2012 to 1.18 at September 30, 2013 was to increase the estimated allowance for loan losses by approximately $62,000.

Management also adjusts the historical loss factors for loans classified as watch, special mention and substandard that are not individually evaluated for impairment. The adjustments consider the increased likelihood of loss on classified loans based on the Company s separate historical experience for classified loans. The effect of the adjustments for classified loans was to increase the estimated allowance for loan losses by $400,000 and $664,000 at September 30, 2013 and December 31, 2012, respectively.

Table of Contents

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

The following table summarizes the Company s impaired loans as of September 30, 2013 and for the three months and nine months ended September 30, 2013:

	At September 30, 2013			Three Months Ended September 30, 2013			Nine Months Ended September 30, 2013		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Interest Recognized - Cash Method	Average Recorded Investment	Interest Income Recognized	Interest Recognized - Cash Method
	(In thousands)								
Loans with no related allowance recorded:									
Residential	$ 901	$ 1,160	$ 0	$ 1,041	$ 4	$ 2	$ 1,219	$ 8	$ 3
Land	123	132	0	125	0	0	125	0	0
Construction	0	0	0	102	0	0	217	0	0
Commercial real estate	136	140	0	138	0	0	471	0	0
Commercial business	0	0	0	0	0	0	0	0	0
Home Equity/2nd mortgage	62	65	0	161	2	2	141	3	3
Other consumer	0	0	0	0	0	0	0	0	0
	1,222	1,497	0	1,567	6	4	2,173	11	6
Loans with an allowance recorded:									
Residential	479	589	95	560	0	0	668	1	0
Land	0	0	0	0	0	0	2	0	0
Construction	0	0	0	0	0	0	0	0	0
Commercial real estate	966	1,055	144	977	0	0	1,147	0	0
Commercial business	1,968	2,136	1,315	1,872	0	0	1,824	4	3
Home Equity/2nd mortgage	44	52	8	55	0	0	54	1	0
Other consumer	0	0	0	0	0	0	0	0	0

	3,457	3,832	1,562	3,464	0	0	3,695	6	3
Total:									
Residential	1,380	1,749	95	1,601	4	2	1,887	9	3
Land	123	132	0	125	0	0	127	0	0
Construction	0	0	0	102	0	0	217	0	0
Commercial real estate	1,102	1,195	144	1,115	0	0	1,618	0	0
Commercial business	1,968	2,136	1,315	1,872	0	0	1,824	4	3
Home Equity/2nd mortgage	106	117	8	216	2	2	195	4	3
Other consumer	0	0	0	0	0	0	0	0	0
	$ 4,679	$ 5,329	$ 1,562	$ 5,031	$ 6	$ 4	$ 5,868	$ 17	$ 9

Table of Contents

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

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

	Three Months Ended September 30, 2012			Nine Months Ended September 30, 2012		
	Average Recorded Investment	Interest Income Recognized	Interest Recognized - Cash Method	Average Recorded Investment	Interest Income Recognized	Interest Recognized - Cash Method
Loans with no related allowance recorded:						
Residential	$ 1,152	$ 1	$ 1	$ 1,203	$ 2	$ 2
Land	23	0	0	23	0	1
Construction	330	0	0	293	0	0
Commercial real estate	1,229	0	0	1,231	0	0
Commercial business	0	0	0	0	0	0
Home Equity/2nd mortgage	43	0	0	64	2	1
Other consumer	0	1	0	0	1	0
	2,777	2	1	2,814	5	4
Loans with an allowance recorded:						
Residential	1,382	0	1	1,151	0	1
Land	0	0	0	0	0	0
Construction	0	0	0	0	0	0
Commercial real estate	1,630	0	0	1,602	0	0
Commercial business	1,826	0	0	1,877	0	0
Home Equity/2nd mortgage	128	0	0	111	0	0
Other consumer	0	0	0	0	0	0
	4,966	0	1	4,741	0	1
Total:						
Residential	2,534	1	2	2,354	2	3
Land	23	0	0	23	0	1
Construction	330	0	0	293	0	0
Commercial real estate	2,859	0	0	2,833	0	0

Commercial business	1,826	0	0	1,877	0	0
Home Equity/2nd mortgage	171	0	0	175	2	1
Other consumer	0	1	0	0	1	0
	$ 7,743	$ 2	$ 2	$ 7,555	$ 5	$ 5

Table of Contents

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

The following table summarizes the Company s impaired loans as of December 31, 2012:

	Recorded Investment	Unpaid Principal Balance	Related Allowance
		(In thousands)	
Loans with no related allowance recorded:			
Residential	$ 1,427	$ 1,760	$ 0
Land	125	126	0
Construction	403	413	0
Commercial real estate	1,535	1,944	0
Commercial business	0	0	0
HE/2nd mortgage	0	0	0
Other consumer	0	0	0
	3,490	4,243	0
Loans with an allowance recorded:			
Residential	943	1,020	213
Land	0	0	0
Construction	0	0	0
Commercial real estate	1,301	1,394	275
Commercial business	1,776	1,909	1,098
HE/2nd mortgage	73	73	66
Other consumer	0	0	0
	4,093	4,396	1,652
Total:			
Residential	2,370	2,780	213
Land	125	126	0
Construction	403	413	0
Commercial real estate	2,836	3,338	275
Commercial business	1,776	1,909	1,098

Home Equity/2nd mortgage		73		73		66
Other consumer		0		0		0
	$	7,583	$	8,639	$	1,652

Table of Contents

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

Nonperforming loans consists of nonaccrual loans and loans over 90 days past due and still accruing interest. The following table presents the recorded investment in nonperforming loans at September 30, 2013 and December 31, 2012:

	September 30, 2013			December 31, 2012		
	Nonaccrual Loans	Loans 90+ Days Past Due Still Accruing	Total Nonperforming Loans	Nonaccrual Loans	Loans 90+ Days Past Due Still Accruing	Total Nonperforming Loans
			(In thousands)			
Residential	$ 1,380	$ 334	$ 1,714	$ 2,370	$ 215	$ 2,585
Land	123	0	123	125	0	125
Construction	0	0	0	403	0	403
Commercial real estate	1,102	0	1,102	2,836	0	2,836
Commercial business	1,968	0	1,968	1,776	0	1,776
Home Equity/2nd mortgage	106	149	255	73	56	129
Other consumer	0	0	0	0	18	18
Total	$ 4,679	$ 483	$ 5,162	$ 7,583	$ 289	$ 7,872

The following table presents the aging of the recorded investment loans at September 30, 2013:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans
			(In thousands)			
Residential	$ 3,392	$ 669	$ 1,195	$ 5,256	$ 103,534	$ 108,790
Land	257	0	123	380	9,761	10,141
Construction	0	0	0	0	9,752	9,752
Commercial real estate	0	0	119	119	77,846	77,965
Commercial business	0	0	226	226	19,856	20,082
Home Equity/2nd mortgage	208	198	220	626	34,400	35,026
Other consumer	189	20	0	209	32,866	33,075

Total	$ 4,046	$ 887	$ 1,883	$ 6,816	$ 288,015	$ 294,831

-24-

Table of Contents

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

The following table presents the aging of the recorded investment in loans at December 31, 2012:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans
			(In thousands)			
Residential	$ 4,085	$ 871	$ 1,644	$ 6,600	$ 102,003	$ 108,603
Land	343	0	119	462	9,195	9,657
Construction	171	0	113	284	11,479	11,763
Commercial real estate	360	0	335	695	68,207	68,902
Commercial business	36	0	0	36	18,619	18,655
Home Equity/2nd mortgage	1,206	102	97	1,405	35,881	37,286
Other consumer	510	30	18	558	30,812	31,370
Total	$ 6,711	$ 1,003	$ 2,326	$ 10,040	$ 276,196	$ 286,236

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, public information, historical payment experience, credit documentation, and current economic trends, among other factors. The Company classifies loans based on credit risk at least quarterly. The Company uses the following regulatory definitions for risk ratings:

Special Mention: Loans classified as special mention have a potential weakness that deserves management s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution s credit position at some future date.

Substandard: Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful: Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loss: Loans classified as loss are considered uncollectible and of such little value that their continuance on the institution s books as an asset is not warranted.

Loans not meeting the criteria above that are analyzed individually as part of the described process are considered to be pass rated loans.

Table of Contents

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

The following table presents the recorded investment in loans by risk category as of the date indicated:

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity & 2nd Mtg	Other Consumer	Total
				(In thousands)				
September 30, 2013								
Pass	$ 104,583	$ 6,746	$ 9,752	$ 75,586	$ 17,356	$ 34,376	$ 33,047	$ 281,446
Special Mention	870	0	0	540	436	286	28	2,160
Substandard	1,957	3,272	0	737	322	258	0	6,546
Doubtful	1,380	123	0	1,102	1,968	106	0	4,679
Loss	0	0	0	0	0	0	0	0
Ending balance	$ 108,790	$ 10,141	$ 9,752	$ 77,965	$ 20,082	$ 35,026	$ 33,075	$ 294,831
December 31, 2012								
Pass	$ 102,618	$ 7,220	$ 11,244	$ 63,095	$ 15,026	$ 36,035	$ 31,302	$ 266,540
Special Mention	958	17	116	1,018	1,354	553	25	4,041
Substandard	2,657	2,295	0	1,953	499	625	43	8,072
Doubtful	2,370	125	403	2,836	1,776	73	0	7,583
Loss								