

First Internet Bancorp

Accountants' Report and Consolidated Financial Statements

December 31, 2008 and 2007

First Internet Bancorp
December 31, 2008 and 2007

Contents

Independent Accountants' Report..... 1

Consolidated Financial Statements

Balance Sheets..... 2
Statements of Income 3
Statements of Shareholders' Equity 4
Statements of Cash Flows 5
Notes to Financial Statements 6

Independent Accountants' Report

Board of Directors
First Internet Bancorp
Indianapolis, Indiana

We have audited the accompanying consolidated balance sheets of First Internet Bancorp as of December 31, 2008 and 2007, and the related consolidated statements of income, shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of First Internet Bancorp as of December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 14, the Company changed its method of accounting for fair value measurements in accordance with Statement of Financial Accounting Standards No. 157 in 2008.

BKD, LLP

Indianapolis, Indiana
February 26, 2009

First Internet Bancorp
Consolidated Balance Sheets
December 31, 2008 and 2007

Assets

	<u>2008</u>	<u>2007</u>
Cash and due from banks	\$ 1,707,844	\$ 3,111,486
Interest-bearing demand deposits	23,972,652	9,453,959
Federal funds sold	<u>99,341</u>	<u>52,608,153</u>
Total cash and cash equivalents	25,779,837	65,173,598
Securities available for sale – at fair value (amortized cost of \$172,756,373 in 2008 and \$118,703,612 in 2007)	168,806,509	118,524,630
Loans held for sale	4,203,190	3,060,300
Loans receivable – net of allowance for loan losses of \$4,616,006 and \$3,563,817 at December 31, 2008 and 2007	320,167,266	349,406,709
Accrued interest receivable	2,774,248	2,779,906
Federal Home Loan Bank of Indianapolis stock	3,637,600	3,637,600
Bank owned life insurance – at cash surrender value	7,267,261	6,968,068
Goodwill	4,687,349	4,687,349
Prepaid expenses and other assets	<u>5,720,467</u>	<u>3,662,914</u>
 Total	 <u>\$ 543,043,727</u>	 <u>\$ 557,901,074</u>

Liabilities and Shareholders' Equity

Liabilities

Deposits	\$ 439,241,806	\$ 461,562,873
Advances from Federal Home Loan Bank	57,000,000	48,700,000
Accrued payroll and related expenses	554,536	741,743
Accrued interest payable	156,029	138,266
Accrued expenses and other liabilities	<u>680,029</u>	<u>671,038</u>
Total liabilities	<u>497,632,400</u>	<u>511,813,920</u>

Shareholders' Equity

Preferred stock, no par value; 4,913,779 shares authorized; issued and outstanding – none		
Voting common stock, no par value; 45,000,000 shares authorized; 1,863,590 and 1,850,584 voting shares issued and outstanding	41,068,447	40,902,949
Non-voting common stock, no par value; 86,221 shares authorized; issued and outstanding	—	—
Retained earnings	6,874,753	5,298,708
Accumulated other comprehensive loss (net of income taxes of \$1,417,991 in 2008 and \$64,479 in 2007)	<u>(2,531,873)</u>	<u>(114,503)</u>
Total shareholders' equity	<u>45,411,327</u>	<u>46,087,154</u>
 Total liabilities and shareholders' equity	 <u>\$ 543,043,727</u>	 <u>\$ 557,901,074</u>

First Internet Bancorp
Consolidated Statements of Income
Years Ended December 31, 2008 and 2007

	2008	2007
Interest Income		
Securities	\$ 8,294,630	\$ 6,075,500
Loans	22,419,261	23,946,389
Federal funds sold and other short-term investments	<u>441,214</u>	<u>1,777,225</u>
Total interest income	<u>31,155,105</u>	<u>31,799,114</u>
Interest Expense		
Deposits	16,698,486	17,943,442
Other borrowed funds	<u>2,174,398</u>	<u>2,217,023</u>
Total interest expense	<u>18,872,884</u>	<u>20,160,465</u>
Net Interest Income	12,282,221	11,638,649
Provision for Loan Losses	<u>4,818,969</u>	<u>1,801,899</u>
Net Interest Income After Provision for Loan Losses	<u>7,463,252</u>	<u>9,836,750</u>
Noninterest Income		
Service charges and fees	1,322,511	1,141,601
Gain on loans sold	1,002,011	895,636
Other	<u>260,552</u>	<u>261,163</u>
Total noninterest income	<u>2,585,074</u>	<u>2,298,400</u>
Noninterest Expense		
Salaries and employee benefits	4,018,145	4,082,119
Marketing, advertising and promotion	41,381	40,045
Consulting and professional fees	557,292	497,352
Data processing	936,978	1,248,349
Premises and equipment	1,605,638	1,163,160
Deposit insurance premium	342,076	220,776
Other	<u>979,867</u>	<u>1,107,515</u>
Total noninterest expense	<u>8,481,377</u>	<u>8,359,316</u>
Income Before Income Taxes	1,566,949	3,775,834
Income Tax Provision	<u>(9,096)</u>	<u>947,992</u>
Net Income	<u>\$ 1,576,045</u>	<u>\$ 2,827,842</u>
Income Per Share of Common Stock		
Basic	\$ 0.84	\$ 1.51
Diluted	0.84	1.50
Weighted-Average Number of Common Shares Outstanding		
Basic	1,878,466	1,866,793
Diluted	1,886,466	1,879,550

First Internet Bancorp
Consolidated Statements of Shareholders' Equity
Years Ended December 31, 2008 and 2007

	Voting and Non-Voting Common Stock	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Shareholders' Equity
Balance, January 1, 2007	\$ 40,682,856	\$ (485,705)	\$ 2,470,866	\$ 42,668,017
Issuance of common stock for officer compensation	172,093			172,093
Comprehensive income				
Net income			2,827,842	2,827,842
Unrealized gain on securities available for sale - net of income tax		371,202		<u>371,202</u>
Total comprehensive income				3,199,044
Issuance of directors deferred stock rights	<u>48,000</u>			<u>48,000</u>
Balance, December 31, 2007	40,902,949	(114,503)	5,298,708	46,087,154
Issuance of common stock for officer compensation	114,248			114,248
Comprehensive loss				
Net income			1,576,045	1,576,045
Unrealized loss on securities available for sale - net of income tax		(2,417,370)		<u>(2,417,370)</u>
Total comprehensive loss				(841,325)
Issuance of directors deferred stock rights	<u>51,250</u>			<u>51,250</u>
Balance, December 31, 2008	<u>\$ 41,068,447</u>	<u>\$ (2,531,873)</u>	<u>\$ 6,874,753</u>	<u>\$ 45,411,327</u>

First Internet Bancorp
Consolidated Statements of Cash Flows
Years Ended December 31, 2008 and 2007

	2008	2007
Operating Activities		
Net income	\$ 1,576,045	\$ 2,827,842
Adjustments to reconcile net income to net cash from operating activities		
Depreciation	674,598	397,483
Amortization and accretion on securities	37,288	(201,930)
Loss from disposal of fixed assets	3,179	3,440
Increase in cash surrender value of Bank-owned life insurance	(299,193)	(279,503)
Provision for loan and lease losses	4,818,969	1,801,899
Deferred income taxes	931,013	(116,353)
Director fees and officer compensation	165,498	220,093
Gain from sale of available-for-sale securities	(154,601)	—
Changes in assets and liabilities		
Accrued interest receivable	5,658	(89,286)
Loans held for sale	(1,142,890)	(3,060,300)
Prepaid expenses and other assets	(1,832,850)	4,114,616
Accrued expenses and other liabilities	(160,453)	(1,022,417)
Net cash provided by operating activities	4,622,261	4,595,584
Investing Activities		
Net decrease in loans	24,420,474	15,841,688
Loans purchased	—	(13,553,490)
Maturities of securities available for sale	29,049,562	44,061,464
Proceeds from sale of securities available for sale	21,419,473	—
Purchase of securities available for sale	(104,404,483)	(43,984,776)
Cash received in acquisition of Landmark Financial Corporation, net of cash paid for stock	—	13,569,611
Proceeds from disposal of fixed assets	750	50
Capital expenditures	(480,731)	(1,182,575)
Net cash provided by (used in) investing activities	(29,994,955)	14,751,972
Financing Activities		
Net increase (decrease) in deposits	(22,321,067)	15,427,953
Maturities of FHLB advances	(11,700,000)	(7,000,000)
Proceeds from FHLB advances	20,000,000	—
Net cash provided by (used in) financing activities	(14,021,067)	8,427,953
Net Increase (Decrease) in Cash and Cash Equivalents	(39,393,761)	27,775,509
Cash and Cash Equivalents, Beginning of Year	65,173,598	37,398,089
Cash and Cash Equivalents, End of Year	\$ 25,779,837	\$ 65,173,598
Supplemental Disclosures of Cash Flow Information		
Cash paid during the year for interest	\$ 18,855,000	\$ 20,695,000
Cash paid during the year for taxes	505,000	859,000

First Internet Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

Note 1: Summary of Significant Accounting Policies

The accounting policies of First Internet Bancorp (Company) conform to accounting principles generally accepted in the United States of America. A summary of the Company's significant accounting policies follows:

Description of Business

The Company was incorporated on September 15, 2005, and was approved to consummate a plan of exchange on March 21, 2006, whereas the Company became a single-bank holding company with 100% ownership in First Internet Bank of Indiana (Bank) and Landmark Mortgage Company (LMC).

The Bank was incorporated on October 28, 1998, and was approved to accept FDIC insured deposits on December 28, 1998. The Bank commenced operations to the public in February 1999. The Bank provides commercial and retail banking, with operations conducted on the World Wide Web (Internet) at www.firstib.com and through its corporate office located in Indianapolis, Indiana. The majority of the Bank's income is derived from retail lending activities and investments in securities. The Bank is subject to competition from other financial institutions and is regulated by certain state and federal agencies and undergoes periodic examinations by those regulatory authorities. LMC is engaged in brokering mortgage loans between borrowers and lending institutions for a fee.

Principles of Consolidation

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

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Estimates most susceptible to change in the near term include the allowance for loan losses and the fair value of securities available for sale.

First Internet Bancorp

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

Securities

The Company classifies its securities in one of three categories and accounts for the investments as follows:

- Securities that the Company has the positive intent and ability to hold to maturity are classified as “securities held to maturity” and reported at amortized cost.
- Securities that are acquired and held principally for the purpose of selling them in the near term with the objective of generating economic profits on short-term differences in market characteristics are classified as “securities held for trading” and reported at fair value, with unrealized gains and losses included in earnings.
- Securities not classified as either held to maturity or trading securities are classified as “securities available for sale” and reported at fair value, with unrealized gains and losses, after applicable taxes, excluded from earnings and reported in a separate component of stockholders’ equity. Declines in the value of debt securities and marketable equity securities that are considered to be other than temporary are recorded as an other than temporary impairment of securities available for sale with the unrealized losses recorded in the statements of operations.

Interest and dividend income, adjusted by amortization of premium or discount, is included in earnings using the effective interest rate method. Purchases and sales of securities are recorded in the balance sheet on the trade date. Gains and losses from security sales or disposals are recognized as of the trade date in the statements of income for the period in which securities are sold or otherwise disposed of. Gains and losses on sales of securities are determined on the specific-identification method.

Revenue Recognition

Interest income on loans is based on the principal balance outstanding and is recognized as earned on the interest method, except for interest on loans on nonaccrual status, which is recorded as a reduction of loan principal when received.

Premiums and discounts are amortized using the effective interest rate method.

Loan fees, net of certain direct origination costs, primarily salaries and wages, are deferred and amortized to interest income as a yield adjustment over the life of the loan.

Loans are placed on nonaccrual status when management believes that the borrower’s financial condition, after giving consideration to economic and business conditions and collection efforts, is such that collection of interest is doubtful. Loans are charged against the allowance for loan losses when management believes that the collectibility of principal is unlikely.

First Internet Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

Provision for Loan Losses

A provision for estimated losses on loans is charged to operations based upon management's evaluation of the potential losses. Such an evaluation, which includes a review of all loans for which full collectibility may not be reasonably assured considers, among other matters, the estimated net realizable value of the underlying collateral, as applicable, economic conditions, industry loan and lease loss experience and other factors that are particularly susceptible to changes that could result in a material adjustment in the near term. While management endeavors to use the best information available in making its evaluations, future allowance adjustments may be necessary if economic conditions change substantially from the assumptions used in making the evaluations.

Statement of Financial Accounting Standards (SFAS) No. 114, *Accounting by Creditors for Impairment of a Loan*, as amended by SFAS No. 118, *Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures*, requires that impaired loans be measured based on the present value of expected future cash flows discounted at the loans effective interest rates or the fair value of the underlying collateral and allows existing methods for recognizing interest income.

FHLB Stock

Federal law requires a member institution of the Federal Home Loan Bank (FHLB) system to hold common stock of its district FHLB according to a predetermined formula. This investment is stated at cost, which represents redemption value, and may be pledged as collateral for FHLB advances.

Real Estate Owned

Real estate owned represents real estate acquired through foreclosure or deed in lieu of foreclosure and is recorded at its fair value less estimated costs to sell. When property is acquired, it is recorded at its fair value at the date of acquisition, with any resulting write-down charged against the allowance for loan and lease losses. Any subsequent deterioration of the property is charged directly to operating expense. Costs relating to the development and improvement of real estate owned are capitalized, whereas costs relating to holding and maintaining the property are charged to expense as incurred. The Company has \$398,000 and \$211,000 of real estate owned as of December 31, 2008 and 2007, respectively.

Equipment

Equipment is stated at cost, less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives, which range from three to five years.

First Internet Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

Income Taxes

Deferred income tax assets and liabilities reflect the impact of temporary differences between amounts of assets and liabilities for financial reporting purposes and the basis of such assets and liabilities as measured by tax laws and regulations. Deferred income tax expense or benefit is based upon the change in deferred tax assets and liabilities from period to period, subject to an ongoing assessment of realization of deferred tax assets.

The Company files income tax returns in the U.S. federal and Indiana jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local examinations by tax authorities for years before 2004.

The Company adopted the provisions of the Financial Accounting Standards Board (FASB) Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*, on January 1, 2007. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. As a result of the implementation of FIN 48, the Company did not identify any uncertain tax positions that it believes should be recognized in the financial statements.

Earnings Per Share

Earnings per share of common stock are based on the weighted-average number of basic shares and dilutive shares outstanding during the year.

The following is a reconciliation of the weighted-average common shares for the basic and diluted earnings per share computations for the years ended December 31, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Basic earnings per share		
Weighted-average common shares	<u>1,878,466</u>	<u>1,866,793</u>
Diluted earnings per share		
Weighted-average common shares	1,878,466	1,866,793
Dilutive effect of stock compensation	8,000	8,451
Dilutive effect of stock options	<u>—</u>	<u>4,306</u>
Weighted-average common and incremental shares	<u>1,886,466</u>	<u>1,879,550</u>
Number of stock options excluded from the calculation of earnings per share as the options' exercise prices were greater than the average market price of the Company's common stock	<u>225,700</u>	<u>205,500</u>

First Internet Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

Dividend Restrictions

Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to the Company or by the Company to shareholders.

Stock Compensation

At December 31, 2008, the Company has a stock-based employee compensation plan using the fair value recognition provisions of SFAS No. 123R, *Share-Based Payment*. The plan is described more fully in Note 9.

Comprehensive Income (Loss)

Comprehensive income (loss) includes net income and other comprehensive income (loss), which consists of net unrealized gains or losses on securities available for sale - net of income taxes.

Reclassification adjustments have been determined for all components of other comprehensive income or loss reported in the consolidated statements of changes in shareholders' equity. Amounts presented within those statements for the years ended December 31, 2008 and 2007, are as follows:

	<u>2008</u>	<u>2007</u>
Other comprehensive income		
Net unrealized holding gains (losses)	\$ (3,616,281)	\$ 573,824
Gains realized	<u>(154,601)</u>	<u>—</u>
Other comprehensive income (loss) before tax	(3,770,882)	573,824
Income tax provision (benefit)	<u>(1,353,512)</u>	<u>202,622</u>
Other comprehensive income (loss) - net of tax	<u>\$ (2,417,370)</u>	<u>\$ 371,202</u>

Statements of Cash Flows

Cash and cash equivalents are defined to include cash on-hand, non-interest bearing amounts due from other banks and Federal Funds Sold. Generally, Federal Funds are sold for one-day periods. The Company reports net cash flows for customer loan transactions and deposit transactions.

Bank-Owned Life Insurance

Bank-owned life insurance policies are carried at their cash surrender value. The Company recognizes tax-free income from the periodic increases in the cash surrender value of these policies and from death benefits.

First Internet Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

Goodwill

Goodwill is tested annually for impairment. If the implied fair value of goodwill is lower than its carrying amount, a goodwill impairment is indicated and goodwill is written down to its implied fair value. Subsequent increases in goodwill value are not recognized in the consolidated financial statements.

Current Economic Conditions

The current economic environment presents financial institutions with unprecedented circumstances and challenges which in some cases have resulted in large declines in the fair values of investments and other assets, constraints on liquidity and significant credit quality problems, including severe volatility in the valuation of real estate and other collateral supporting loans. The financial statements have been prepared using values and information currently available to the Company.

Given the volatility of current economic conditions, the values of assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments in asset values, the allowance for loan losses and capital that could negatively impact the Company's ability to meet regulatory capital requirements and maintain sufficient liquidity.

Reclassifications

Certain reclassifications have been made to the 2007 financial statements to conform to the 2008 financial statement presentation. These reclassifications had no effect on net income.

Note 2: Restriction on Cash and Due From Banks

The Company is required to maintain reserve funds in cash and/or on deposit with the Federal Reserve Bank. The reserve required at December 31, 2008 was \$263,000.

First Internet Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

Note 3: Securities

Securities at December 31, 2008 and 2007 are as follows:

	Amortized Cost	2008 Gross Unrealized		Fair Value
		Gains	Losses	
Securities available for sale				
U.S. government agencies	\$ 17,061,135	\$ 140	\$ (214,280)	\$ 16,846,995
Municipals	45,154,757	254,738	(1,560,944)	43,848,551
Mortgage-backed and asset-backed securities	105,422,386	1,476,552	(3,675,414)	103,223,524
Corporate bonds	<u>5,118,095</u>	<u>1,468</u>	<u>(232,124)</u>	<u>4,887,439</u>
Total available for sale	<u>\$ 172,756,373</u>	<u>\$ 1,732,898</u>	<u>\$ (5,682,762)</u>	<u>\$ 168,806,509</u>

	Amortized Cost	2007 Gross Unrealized		Fair Value
		Gains	Losses	
Securities available for sale				
U.S. government agencies	\$ 24,265,561	\$ 56,605	\$ (106,850)	\$ 24,215,316
Municipals	29,733,400	150,970	(312,719)	29,571,651
Mortgage-backed and asset-backed securities	62,704,874	492,307	(453,158)	62,744,023
Corporate bonds	<u>1,999,777</u>	<u>—</u>	<u>(6,137)</u>	<u>1,993,640</u>
Total available for sale	<u>\$ 118,703,612</u>	<u>\$ 699,882</u>	<u>\$ (878,864)</u>	<u>\$ 118,524,630</u>

The carrying value of mortgage-backed securities, corporate bonds, state and municipal obligations and U.S. treasury and agencies at December 31, 2008 are shown below by their contractual maturity date. Actual maturities will differ because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available for Sale	
	Amortized Cost	Fair Value
Within one year	\$ 1,998,572	\$ 1,993,449
One to five years	5,669,754	5,475,249
Five to ten years	11,802,954	11,795,607
After ten years	<u>47,862,707</u>	<u>46,318,680</u>
Mortgage-backed and asset-backed securities	67,333,987	65,582,985
	<u>105,422,386</u>	<u>103,223,524</u>
Totals	<u>\$ 172,756,373</u>	<u>\$ 168,806,509</u>

Gross gains of \$156,000 and \$0, and gross losses of \$1,000 and \$0 resulting from sales of available-for-sale securities were realized for 2008 and 2007, respectively.

First Internet Bancorp

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

Certain investments in debt securities are reported in the consolidated financial statements at an amount less than their historical cost. Total fair value of these investments at December 31, 2008 and 2007 was \$82,843,000 and \$57,195,000, which is approximately 49% and 48%, respectively, of the Company's available-for-sale investment portfolio. These declines primarily resulted from fluctuations in market interest rates after purchase.

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

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

The following table shows the Company's investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2008 and 2007:

	2008					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available for sale:						
U.S. government agencies	\$ 8,430,078	\$ (116,271)	\$ 4,416,777	\$ (98,009)	\$ 12,846,855	\$ (214,280)
Municipals	24,712,931	(1,364,404)	2,701,238	(196,540)	27,414,169	(1,560,944)
Mortgage-backed and asset-backed securities	27,353,327	(1,768,658)	11,340,893	(1,906,756)	38,694,220	(3,675,414)
Corporate bonds	<u>3,887,399</u>	<u>(232,124)</u>	<u>—</u>	<u>—</u>	<u>3,887,399</u>	<u>(232,124)</u>
	<u>\$ 64,383,735</u>	<u>\$(3,481,457)</u>	<u>\$ 18,458,908</u>	<u>\$(2,201,305)</u>	<u>\$ 82,842,643</u>	<u>\$(5,682,762)</u>

	2007					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available for sale:						
U.S. government agencies	\$ 8,461,189	\$ (93,926)	\$ 3,016,132	\$ (12,924)	\$ 11,477,321	\$ (106,850)
Municipals	12,524,625	(191,788)	4,700,030	(120,931)	17,224,655	(312,719)
Mortgage-backed and asset-backed securities	7,185,533	(63,307)	19,313,710	(389,851)	26,499,243	(453,158)
Corporate bonds	<u>—</u>	<u>—</u>	<u>1,993,640</u>	<u>(6,137)</u>	<u>1,993,640</u>	<u>(6,137)</u>
	<u>\$ 28,171,347</u>	<u>\$(349,021)</u>	<u>\$ 29,023,512</u>	<u>\$(529,843)</u>	<u>\$ 57,194,859</u>	<u>\$(878,864)</u>

First Internet Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

Note 4: Loans Receivable

Loans receivable at December 31, 2008 and 2007, are as follows:

	<u>2008</u>	<u>2007</u>
Real estate mortgage loans		
One-to-four family	\$ 57,269,195	\$ 56,042,165
Residential construction	9,338,676	28,291,635
Commercial	15,855,927	9,106,048
Other	671,228	1,084,662
Home equity loans	1,129,128	2,031,888
Consumer loans	231,731,551	249,124,218
Commercial loans	<u>2,443,075</u>	<u>252,079</u>
	318,438,780	345,932,695
Deferred loan origination costs and premiums and discounts on purchased loans	6,344,492	7,037,831
Allowance for loan and lease losses	<u>(4,616,006)</u>	<u>(3,563,817)</u>
	<u>\$ 320,167,266</u>	<u>\$ 349,406,709</u>

Activity in the allowance for loan losses for the years ended December 31, 2008 and 2007 is as follows:

	<u>2008</u>	<u>2007</u>
Beginning balance	\$ 3,563,817	\$ 3,376,257
Landmark Financial Corporation acquisition	—	855,000
Provision for loan losses	4,818,969	1,801,899
Charge-offs	(4,473,580)	(3,459,277)
Recoveries	<u>706,800</u>	<u>989,938</u>
Ending balance	<u>\$ 4,616,006</u>	<u>\$ 3,563,817</u>

Impaired loans totaled \$3,950,000 and \$975,000 at December 31, 2008 and 2007, respectively. An allowance for loan losses of \$862,000 and \$439,000 related to impaired loans at December 31, 2008 and 2007, respectively.

At December 31, 2008 and 2007, accruing loans past due 90 days or more totaled \$67,000 and \$198,000, respectively. Non-accruing loans, which include all impaired loans, at December 31, 2008 and 2007 were \$4,508,000 and \$1,285,000, respectively.

First Internet Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

Note 5: Equipment

Equipment included in other assets at December 31, 2008 and 2007 consists of the following:

	<u>2008</u>	<u>2007</u>
Furniture and equipment	\$ 2,954,289	\$ 2,972,677
Less accumulated depreciation	<u>(1,929,842)</u>	<u>(1,750,434)</u>
	<u>\$ 1,024,447</u>	<u>\$ 1,222,243</u>

Note 6: Goodwill

The change in the carrying amount of goodwill for the two years ended December 31, 2008 was:

Balance as of January 1, 2007	\$ —
Goodwill acquired during the year	<u>4,687,349</u>
Balance as of December 31, 2007	4,687,349
Changes in goodwill during the year	<u>—</u>
Balance as of December 31, 2008	<u>\$ 4,687,349</u>

Note 7: Deposits

Deposits at December 31, 2008 and 2007 are as follows:

	<u>2008</u>	<u>2007</u>
Regular savings accounts	\$ 4,853,358	\$ 4,062,621
Non-interest bearing demand deposit accounts	9,004,988	8,120,652
Interest bearing demand deposit accounts	48,811,828	49,449,468
Money market accounts	<u>76,984,369</u>	<u>76,907,565</u>
Total transaction accounts	139,654,543	138,540,306
Certificates of deposits	251,833,974	284,077,679
Brokered deposits	47,891,108	39,095,033
Premiums on brokered deposits	<u>(137,819)</u>	<u>(150,145)</u>
Total deposits	<u>\$ 439,241,806</u>	<u>\$ 461,562,873</u>

Certificates of deposit in the amount of \$100,000 or more totaled approximately \$109,907,000 and \$110,647,000 at December 31, 2008 and 2007, respectively.

First Internet Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

A summary of certificate accounts by scheduled maturities at December 31, 2008 is as follows:

2009	\$ 181,507,962
2010	44,013,511
2011	53,569,512
2012	12,999,048
2013	4,362,049
Thereafter	<u>3,273,000</u>
	<u>\$ 299,725,082</u>

Note 8: FHLB Advances

The Company has outstanding FHLB advances of \$57,000,000 and \$48,700,000 as of December 31, 2008 and 2007, respectively. Advances, at interest rates from 3.04 to 4.67 percent, are subject to restrictions or penalties in the event of prepayment. The advances are collateralized by mortgage loans pledged and held by the Company and investment securities pledged by the Company and held in safekeeping with the FHLB. Mortgage loans pledged, were approximately \$20,283,000 and \$25,092,000 as of December 31, 2008 and 2007, respectively, and the fair value of investment securities pledged was approximately \$53,873,000 and \$38,609,000 as of December 31, 2008 and 2007, respectively. The FHLB advances are scheduled to mature according to the following schedule:

	<u>Amount</u>
2009	\$ 15,000,000
2010	16,000,000
2011	7,000,000
2012	5,000,000
2013	9,000,000
Thereafter	<u>5,000,000</u>
	<u>\$ 57,000,000</u>

Amounts advanced totaling \$10,000,000 are subject to an option for the FHLB to convert the entire advance to a periodic adjustable rate one year after the date of the advance. If the FHLB exercises its option to convert the advance to an adjustable rate, the advance will be pre-payable at the Company's option, at par without a penalty fee.

First Internet Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

Note 9: Benefit Plans

401(k) Plan

The Company has a 401(k) plan established for substantially all full-time employees, as defined. Employee contributions are limited to the maximum established by the Internal Revenue Service on an annual basis. Effective January 1, 2008, the Company has elected to match contributions equal to 100% of the first 1% of employee deferrals and then 50% on deferrals over 1% up to a maximum of 6% of an individual's total eligible salary, as defined by the plan. Employer-matching contributions begin vesting after one year at a rate of 50% per year of employment and are fully vested after the completion of two years of service. Contributions each year during the years ended December 31, 2008 and 2007, totaled approximately \$82,000 and \$67,000, respectively.

Employment Agreements

The Company has entered into employment agreements with certain officers that provide for the continuation of salary and certain benefits for a specified period of time under certain conditions. Under the terms of the agreements, these payments could occur in the event of a change in control of the Company, as defined, along with other specific conditions.

Stock Options

The Company has a qualified stock option plan for Directors and key employees of the Company (Stock Option Plan) and has reserved 400,000 shares of common stock that may be issued pursuant to the Stock Option Plan. The option exercise price per share is the fair value of a share on the date of grant, and the stock options become exercisable in a series of three equal and successive annual installments, with the first one-third vesting at the end of one year measured from the grant date of the option. Each option grant expires within ten years of the grant date. The options are nontransferable and are forfeited upon termination of employment.

The following is an analysis of activity in the Stock Option Plan for the period ended December 31, 2008 and the stock options outstanding at the end of the year:

		2008	
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Life (In Years)
Outstanding, beginning of year	229,500	\$ 20.72	
Forfeited	<u>(3,800)</u>	21.10	
Outstanding, end of year	<u>225,700</u>	20.71	<u>2.5</u>
Exercisable, end of year	<u>225,700</u>	20.71	<u>2.5</u>

First Internet Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

Directors Deferred Stock Plan

The Company has adopted a stock compensation plan for members of the Board of Directors (Directors Deferred Stock Plan). The Company has reserved 60,000 shares of common stock that may be issued pursuant to the Directors Deferred Stock Plan. The plan provides directors the option to elect to receive up to 100% of their annual retainer in either common stock or deferred stock rights. Monthly meeting fees are paid in cash. The deferred stock right is payable to the director on the basis of one common share for each deferred stock right. Director compensation totaled \$286,000 and \$266,000 in 2008 and 2007, respectively, of which \$51,000 and \$48,000 in 2008 and 2007, respectively, were paid in either common stock or deferred stock rights. The common stock and deferred stock rights are granted on January 1 at fair value and vest from January 1st until December 31st. The Company recognizes compensation expense ratably over the vesting period based upon the fair value of the stock on the grant date.

The following is an analysis of deferred stock rights and common stock related to the Directors Deferred Stock Plan for the year ended December 31, 2008:

	<u>Deferred Rights</u>	<u>Common Shares</u>
Outstanding, beginning of year	18,546	
Granted	3,769	
Exercised	<u>(4,113)</u>	4,113
Outstanding, end of year	<u><u>18,202</u></u>	

Note 10: Income Taxes

The provision for income taxes consists of the following:

	<u>2008</u>	<u>2007</u>
Current	\$ (940,109)	\$ 1,064,345
Deferred	<u>931,013</u>	<u>(116,353)</u>
Total	\$ <u><u>(9,096)</u></u>	\$ <u><u>947,992</u></u>

First Internet Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

Income tax expense (benefit) is reconciled to the 34% statutory rate applied to pre-tax income as follows:

	2008	2007
Statutory rate times pre-tax income	\$ 532,763	\$ 1,283,784
Add (subtract) the tax effect of:		
Income from tax-exempt securities	(452,825)	(275,788)
State income tax, net of federal tax effect	16,597	47,830
Bank owned life insurance	(101,726)	(95,031)
Other differences	(3,905)	(12,803)
Total income taxes	\$ (9,096)	\$ 947,992

The net deferred tax asset at December 31 consists of the following:

	2008	2007
Deferred tax assets (liabilities)		
Allowance for loan losses	\$ 1,643,800	\$ 1,262,257
Depreciation	(108,804)	(64,782)
Deferred compensation	243,161	216,564
Deferred loan origination fees	(79,766)	(83,278)
Other	(15,165)	(70,259)
Total deferred tax assets, net	\$ 1,683,226	\$ 1,260,502

Note 11: Related Party Transactions

At December 31, 2008 and 2007, certain directors, executive officers and/or companies in which these individuals had a 10% or more beneficial ownership were indebted to the Company in the aggregate amount of approximately \$316,000 and \$504,000, respectively.

In management's opinion, such loans and other extensions of credit and deposits were made in the ordinary course of business and were made on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons. Further, in management's opinion, these loans did not involve more than normal risk of collectibility or present other unfavorable features.

Deposits from related parties held by the Company at December 31, 2008 and 2007 totaled \$3,968,000 and \$4,632,000, respectively.

The Company's card processing services are provided by OneBridge, which is controlled by a shareholder of the Company. Total expenses incurred related to card processing provided by OneBridge during the years ended December 31, 2008 and 2007, were approximately \$149,000 and \$118,000, respectively.

First Internet Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

Note 12: Regulatory Capital Requirements

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

Quantitative measures that have been established by regulation to ensure capital adequacy, require the Company to maintain minimum capital amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). As of December 31, 2008, management believes that the Company meets all capital adequacy requirements to which it is subject.

To be categorized as well capitalized, the Company must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. As of December 31, 2008, the most recent notification from the FDIC categorized the Company as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Company's categories.

	Actual Amount	Ratio	Minimum Capital Requirement Amount	Ratio	Minimum to be Well Capitalized Under Prompt Corrective Actions Amount	Ratio
As of December 31, 2008:						
Total capital (to risk weighted assets)	\$ 46,043,000	12.8%	\$ 28,804,000	8.0%	\$ 36,006,000	10.0%
Tier 1 capital (to risk weighted assets)	41,541,000	11.5	14,402,000	4.0	21,603,000	6.0
Tier 1 capital (to average assets)	41,541,000	7.9	21,152,000	4.0	26,441,000	5.0
As of December 31, 2007:						
Total capital (to risk weighted assets)	\$ 44,052,000	11.6%	\$ 30,356,000	8.0%	\$ 37,945,000	10.0%
Tier 1 capital (to risk weighted assets)	40,492,000	10.7	15,178,000	4.0	22,767,000	6.0
Tier 1 capital (to average assets)	40,492,000	7.5	21,746,000	4.0	27,182,000	5.0

Note 13: Commitments and Credit Risk

In the normal course of business, the Company makes various commitments to extend credit which are not reflected in the accompanying consolidated financial statements. At December 31, 2008 and 2007, the Company had outstanding loan commitments totaling approximately \$16,087,000 and \$23,687,000, respectively.

First Internet Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

The Company leases its office facilities under operating leases expiring between March 31, 2009 and November 18, 2014. The leases are subject to additional rentals based on building operating costs and property taxes in excess of specified amounts. Future minimum lease payments are as follows:

	Amount
2009	\$ 262,492
2010	249,351
2011	81,641
2012	81,641
2013	81,641
Thereafter	74,838
	\$ 831,604

Federal funds sold, totaling approximately \$99,000 and \$52,608,000 at December 31, 2008 and 2007, have been sold to JP Morgan Chase.

Note 14: Fair Value of Financial Instruments

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards No. 157 (FAS 157), *Fair Value Measurements*. FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FAS 157 has been applied prospectively as of the beginning of the year.

FAS 157 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. FAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes 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

First Internet Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

Following is a description of the valuation methodologies used for assets and liabilities measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy.

Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include U.S. Government agency securities, obligations of municipals and highly liquid mutual funds. 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. Government agency securities, mortgage backed securities and obligations of state, municipals and certain corporate, and other securities. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy and include other asset-backed securities.

The following table presents the fair value measurements of securities available for sale recognized in the accompanying balance sheet measured at fair value on a recurring basis and the level within the FAS 157 fair value hierarchy in which the fair value measurements fall at December 31, 2008:

	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Securities available for sale	\$ 168,806,509	\$ 5,928,902	\$ 160,241,207	\$ 2,636,400

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

	<u>Securities Available for Sale</u>
Balance, January 1, 2008	\$ —
Total realized and unrealized gains and losses	
Included in net income	—
Included in other comprehensive income	—
Purchases, issuances and settlements	—
Transfers in and/or out of Level 3	<u>2,636,400</u>
Balance, December 31, 2008	<u>\$ 2,636,400</u>

First Internet Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

Impaired Loans

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 in accordance with the provisions of Financial Accounting Standard No. 114 (FAS 114), *Accounting by Creditors for Impairment of a Loan*. Allowable methods for estimating fair value include using the fair value of the collateral for collateral dependent loans or, where a loan is determined not to be collateral dependent, using the discounted cash flow method.

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.

If the impaired loan is determined not to be collateral dependent, then the discounted cash flow method is used. This method requires the impaired loan to be recorded at the present value of expected future cash flows discounted at the loan's effective interest rate. The effective interest rate of a loan is the contractual interest rate adjusted for any net deferred loan fees or costs, premiums or discount existing at origination or acquisition of the loan.

Impaired loans are classified within Level 3 of the fair value hierarchy.

The following table presents the fair value measurements of impaired loans recognized in the accompanying balance sheet measured at fair value on a recurring basis and the level within the FAS 157 fair value hierarchy in which the fair value measurements fall at December 31, 2008:

	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	\$ 3,382,299	\$ —	\$ —	\$ 3,382,299

The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying balance sheet at amounts other than fair value.

Cash and Cash Equivalents

For these instruments, the carrying amount is a reasonable estimate of fair value.

Loans Held For Sale

The fair value of these financial instruments approximates carrying value.

First Internet Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

Loans Receivable

The fair value of loans receivable is estimated by discounting future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings and remaining maturities.

Accrued Interest Receivable

The fair value of these financial instruments approximates carrying value.

Federal Home Loan Bank Stock

The carrying amount approximates fair value.

Deposits

The fair value of non-interest bearing demand deposits and savings and NOW accounts is the amount payable as of the reporting date. The fair value of fixed maturity certificates of deposit is estimated using rates currently offered for deposits of similar remaining maturities.

FHLB Advances

The fair value of fixed rate advances is estimated using rates currently offered for similar remaining maturities.

Accrued Interest Payable

The fair value of these financial instruments approximates carrying value.

Commitments

The fair value of commitments to extend credit are based on fees currently charged to enter into similar agreements with similar maturities and interest rates. The Company determined that the fair value of commitments was zero based on the contractual value of outstanding commitments at December 31, 2008 and 2007.

First Internet Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

The following schedule includes the carrying value and estimated fair value of all financial assets and liabilities at December 31, 2008 and 2007:

	2008		2007	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	\$ 25,779,837	\$ 25,779,837	\$ 65,173,598	\$ 65,173,598
Securities available for sale	168,806,509	168,806,509	118,524,630	118,524,630
Loans held for sale	4,203,190	4,203,190	3,060,300	3,060,300
Loans receivable - net	320,167,266	308,818,590	349,406,709	344,473,769
Accrued interest receivable	2,774,248	2,774,248	2,779,906	2,779,906
FHLB stock	3,637,600	3,637,600	3,637,600	3,637,600
Deposits	439,241,806	445,433,632	461,562,873	463,541,120
FHLB advances	57,000,000	59,114,244	48,700,000	48,651,470
Accrued interest payable	156,029	156,029	138,266	138,266

Note 15: Acquisition

On January 1, 2007, the Company acquired 100% of the outstanding common stock of Landmark Financial Corporation (Landmark). The results of Landmark's operations have been included in the consolidated financial statements since that date. Landmark is a single-bank holding company located in Indianapolis, Indiana. As a result of the acquisition, the Company will have an opportunity to increase its deposit base and increase its mortgage lending capability. The aggregate purchase price was \$12,118,235.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition.

Cash and cash equivalents	\$ 25,687,846
Securities	132,662
Loans	43,717,822
Premises and equipment	32,671
Goodwill	4,687,349
Other assets	<u>1,401,868</u>
Total assets acquired	<u>75,660,218</u>
Deposits	62,645,642
Other liabilities	<u>896,341</u>
Total liabilities assumed	<u>63,541,983</u>
Net assets acquired	<u>\$ 12,118,235</u>

The \$4,687,349 of goodwill was assigned entirely to the banking segment of the business. Of that total amount, \$0 is expected to be deductible for tax purposes.