First Internet Bancorp

Accountants' Report and Consolidated Financial Statements

December 31, 2009 and 2008

First Internet Bancorp
December 31, 2009 and 2008

Contents

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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, 2009 and 2008, and the related consolidated statements of operations, 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, 2009 and 2008, 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.

BKD, LLP

Indianapolis, Indiana
February 18, 2010

First Internet Bancorp

Consolidated Balance Sheets
December 31, 2009 and 2008

Assets

	2009	2008
Cash and due from banks	$ 1,047,797	$ 1,707,844
Interest-bearing demand deposits	28,968,247	23,972,652
Federal funds sold	—	99,341
Total cash and cash equivalents	30,016,044	25,779,837
Securities available for sale - at fair value (amortized cost of $135,408,555 in 2009 and $172,756,373 in 2008)	133,583,840	168,806,509
Loans held for sale	7,168,658	4,203,190
Loans receivable - net of allowance for loan losses of $10,096,813 and $4,616,006 at December 31, 2009 and 2008	305,439,038	320,167,266
Accrued interest receivable	2,256,728	2,774,248
Federal Home Loan Bank of Indianapolis stock	3,637,600	3,637,600
Bank-owned life insurance - at cash surrender value	7,574,415	7,267,261
Goodwill	4,687,349	4,687,349
Prepaid expenses and other assets	10,251,650	5,720,467
Total assets	$ 504,615,322	$ 543,043,727

Liabilities and Shareholders' Equity

	2009	2008
Liabilities		
Deposits	$ 411,627,338	$ 439,241,806
Advances from Federal Home Loan Bank	47,000,000	57,000,000
Accrued payroll and related expenses	454,340	554,536
Accrued interest payable	133,722	156,029
Accrued expenses and other liabilities	636,074	680,029
Total liabilities	459,851,474	497,632,400
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; 1,871,590 and 1,863,590 voting shares issued and outstanding	41,186,247	41,068,447
Non-voting common stock, no par value; 86,221 shares authorized; issued and outstanding	—	—
Retained earnings	4,756,725	6,874,753
Accumulated other comprehensive loss (net of income taxes of $645,592 in 2009 and $1,417,991 in 2008)	(1,179,124)	(2,531,873)
Total shareholders' equity	44,763,848	45,411,327
Total liabilities and shareholders' equity	$ 504,615,322	$ 543,043,727

First Internet Bancorp

Consolidated Statements of Operations
Years Ended December 31, 2009 and 2008

	2009	2008
Interest Income		
Securities	$ 7,113,782	$ 8,294,630
Loans	21,433,143	22,419,261
Federal funds sold and other short-term investments	60,491	441,214
Total interest income	28,607,416	31,155,105
Interest Expense		
Deposits	12,776,116	16,698,486
Other borrowed funds	2,083,241	2,174,398
Total interest expense	14,859,357	18,872,884
Net Interest Income	13,748,059	12,282,221
Provision for Loan Losses	11,563,786	4,818,969
Net Interest Income After Provision for Loan Losses	2,184,273	7,463,252
Noninterest Income		
Service charges and fees	1,395,464	1,322,511
Gain on loans sold	1,826,637	1,002,011
Other than temporary impairment		
Total loss related to other than temporarily impaired securities	(1,648,440)	—
Portion of loss recognized in other comprehensive loss	1,348,440	—
Other than temporary impairment loss recognized in net loss	(300,000)	—
Loss on asset disposals	(336,754)	(53,721)
Other	317,984	314,273
Total noninterest income	2,903,331	2,585,074
Noninterest Expense		
Salaries and employee benefits	3,814,910	4,018,145
Marketing, advertising and promotion	278,117	41,381
Consulting and professional fees	620,346	557,292
Data processing	968,722	936,978
Premises and equipment	1,399,651	1,605,638
Deposit insurance premium	1,065,715	342,076
Other	1,193,882	979,867
Total noninterest expense	9,341,343	8,481,377
Income (Loss) Before Income Taxes	(4,253,739)	1,566,949
Income Tax Benefit	(2,135,711)	(9,096)
Net Income (Loss)	$ (2,118,028)	$ 1,576,045
Income (Loss) Per Share of Common Stock		
Basic	$ (1.12)	$ 0.84
Diluted	(1.12)	0.84
Weighted-Average Number of Common Shares Outstanding		
Basic	1,892,082	1,878,466
Diluted	1,892,082	1,886,466

First Internet Bancorp

Consolidated Statements of Shareholders' Equity
Years Ended December 31, 2009 and 2008

	Voting and Non-Voting Common Stock	Accumulated Other Comprehensive Loss	Retained Earnings	Total Shareholders' Equity
Balance, January 1, 2008	$ 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)		(2,417,370)
Total comprehensive loss				(841,325)
Issuance of directors deferred stock rights	51,250			51,250
Balance, December 31, 2008	41,068,447	(2,531,873)	6,874,753	45,411,327
Issuance of common stock for officer compensation	72,800			72,800
Comprehensive loss				
Net loss			(2,118,028)	(2,118,028)
Unrealized loss on securities available for sale for which an other than temporary impairment has been recognized in income (loss) - net of income tax		(871,357)		(871,357)
Unrealized gain on securities available for sale - net of income tax		2,224,106		2,224,106
Total comprehensive loss				(765,279)
Issuance of directors deferred stock rights	45,000			45,000
Balance, December 31, 2009	$ 41,186,247	$ (1,179,124)	$ 4,756,725	$ 44,763,848

See Notes to Consolidated Financial Statements

First Internet Bancorp

Consolidated Statements of Cash Flows
Years Ended December 31, 2009 and 2008

	2009	2008
Operating Activities		
Net income (loss)	$ (2,118,028)	$ 1,576,045
Adjustments to reconcile net income to net cash from operating activities		
Depreciation	605,657	674,598
Amortization and accretion on securities	230,144	37,288
Loss from disposal of fixed assets	19,113	3,179
Increase in cash surrender value of bank-owned life insurance	(307,154)	(299,193)
Provision for loan and lease losses	11,563,786	4,818,969
Deferred income taxes	(2,990,890)	931,013
Director fees and officer compensation	117,800	165,498
Loss on other than temporary impairment of security	300,000	—
Gain from sale of available for sale securities	(54,324)	(154,601)
Changes in assets and liabilities		
Accrued interest receivable	517,520	5,658
Loans held for sale	(2,965,468)	(1,142,890)
Prepaid expenses and other assets	(2,865,289)	(1,832,850)
Accrued expenses and other liabilities	(166,458)	(160,453)
Net cash provided by operating activities	1,886,409	4,622,261
Investing Activities		
Net decrease in loans	28,549,093	24,420,474
Loans purchased	(25,384,651)	—
Maturities of securities available for sale	50,489,795	29,049,562
Proceeds from sale of securities available for sale	4,537,750	21,419,473
Purchase of securities available for sale	(18,155,548)	(104,404,483)
Proceeds from disposal of fixed assets	—	750
Capital expenditures	(72,173)	(480,731)
Net cash provided by (used in) investing activities	39,964,266	(29,994,955)
Financing Activities		
Net decrease in deposits	(27,614,468)	(22,321,067)
Maturities of FHLB advances	(17,700,000)	(11,700,000)
Proceeds from FHLB advances	7,700,000	20,000,000
Net cash used in financing activities	(37,614,468)	(14,021,067)
Net Increase (Decrease) in Cash and Cash Equivalents	4,236,207	(39,393,761)
Cash and Cash Equivalents, Beginning of Year	25,779,837	65,173,598
Cash and Cash Equivalents, End of Year	$ 30,016,044	$ 25,779,837
Supplemental Disclosures of Cash Flow Information		
Cash paid during the year for interest	$ 14,882,000	$ 18,855,000
Cash paid during the year for taxes	1,654,000	505,000

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 on February 22, 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 was engaged in brokering mortgage loans between borrowers and lending institutions for a fee. LMC was merged out of existence effective May 31, 2009 when it was absorbed into the Company.

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.

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 consolidated balance sheet on the trade date. Gains and losses from security sales or disposals are recognized as of the trade date in the consolidated 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.

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, 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.

ASC Topic 310 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.

Federal Home Loan Bank (FHLB) Stock

Federal law requires a member institution of the 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 $126,000 and $398,000 of real estate owned as of December 31, 2009 and 2008, 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.

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 2005.

ASC Topic 740-10 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. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company did not identify any uncertain tax positions that it believes should be recognized in the consolidated financial statements.

Earnings (Loss) Per Share

Earnings (loss) 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, 2009 and 2008:

	2009	2008
Basic earnings per share		
Weighted-average common shares	1,892,082	1,878,466
Diluted earnings per share		
Weighted-average common shares	1,892,082	1,878,466
Dilutive effect of stock compensation	—	8,000
Dilutive effect of stock options	—	—
Weighted-average common and incremental shares	1,892,082	1,886,466
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	202,500	225,700

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, 2009, the Company has a stock-based employee compensation plan using the fair value recognition provisions of ASC Topic 718. The plan is described more fully in Note 9.

Comprehensive Income (Loss)

Comprehensive income (loss) consists of net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale which are also recognized as separate components of equity. Accumulated other comprehensive income (loss) at December 31, 2009 and 2008 is solely related to unrealized gains and losses on investment securities.

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, 2009 and 2008, are as follows:

	2009	2008
Other comprehensive income (loss)		
Net unrealized holding gains (losses)	$ 3,527,912	$ (3,616,281)
Unrealized loss on securities available for sale for which an other than temporary impairment has been recognized in income	(1,348,440)	—
Gains realized	(54,324)	(154,601)
Other comprehensive income (loss) before tax	2,125,148	(3,770,882)
Income tax provision (benefit)	772,399	(1,353,512)
Other comprehensive income (loss) - net of tax	$ 1,352,749	$ (2,417,370)

Statements of Cash Flows

Cash and cash equivalents are defined to include cash on-hand, noninterest and 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.

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. Due to national, state and local economic conditions, values for commercial and development real estate have declined significantly, and the market for these properties is depressed. The accompanying consolidated 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 consolidated 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 2008 financial statements to conform to the 2009 financial statement presentation. These reclassifications had no effect on net income.

Note 2: Cash and Cash Equivalents

Effective October 3, 2008, the FDIC's insurance limits increased to $250,000. The increase in federally insured limits is currently set to expire December 31, 2013. At December 31, 2009, the Company's interest-bearing cash accounts do not exceed federally insured limits. Additionally, approximately $6,285,000 and $22,684,000 of cash is held by the FHLB of Indianapolis and Federal Reserve Bank of Chicago, which is not federally insured.

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, 2009 was $219,000.

Note 3: Securities

Securities at December 31, 2009 and 2008 are as follows:

	2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available for sale				
U.S. government agencies	$ 14,599,505	$ 39,166	$ (89,439)	$ 14,549,232
Municipals	42,960,805	511,425	(679,496)	42,792,734
Mortgage-backed and asset-backed securities	70,077,957	2,302,027	(1,671,224)	70,708,760
Corporate bonds and other securities	7,770,288	1,883	(2,239,057)	5,533,114
Total available for sale	$ 135,408,555	$ 2,854,501	$ (4,679,216)	$ 133,583,840

	2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
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	101,422,386	1,476,552	(2,311,814)	100,587,124
Corporate bonds and other securities	9,118,095	1,468	(1,595,724)	7,523,839
Total available for sale	$ 172,756,373	$ 1,732,898	$ (5,682,762)	$ 168,806,509

The carrying value of securities at December 31, 2009 is 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	$ 1,002,869	$ 1,004,733
One to five years	4,922,917	4,819,265
Five to ten years	14,737,827	14,652,014
After ten years	44,666,985	42,399,068
	65,330,598	62,875,080
Mortgage-backed and asset-backed securities	70,077,957	70,708,760
Totals	$ 135,408,555	$ 133,583,840

Gross gains of $54,000 and $156,000, and gross losses of $0 and $1,000 resulting from sales of available for sale securities were realized for 2009 and 2008, respectively.

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, 2009 and 2008 was $40,759,000 and $82,843,000, which is approximately 31% and 49%, respectively, of the Company's available for sale investment portfolio. These declines primarily resulted from fluctuations in market interest rates after purchase.

Except as discussed below, 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 tables show 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, 2009 and 2008:

	2009					
	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	$ 1,980,100	$ (19,900)	$ 6,112,403	$ (69,539)	$ 8,092,503	$ (89,439)
Municipals	13,622,531	(263,244)	5,291,850	(416,252)	18,914,381	(679,496)
Mortgage-backed and asset-backed securities	764,792	(10,959)	8,456,079	(1,660,265)	9,220,871	(1,671,224)
Corporate bonds and other securities	—	—	4,531,230	(2,239,057)	4,531,230	(2,239,057)
	$ 16,367,423	$ (294,103)	$ 24,391,562	$ (4,385,113)	$ 40,758,985	$ (4,679,216)

	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)	8,704,493	(543,156)	36,057,820	(2,311,814)
Corporate bonds and other securities	3,887,399	(232,124)	2,636,400	(1,363,600)	6,523,799	(1,595,724)
	$ 64,383,735	$ (3,481,457)	$ 18,458,908	$ (2,201,305)	$ 82,842,643	$ (5,682,762)

U.S. Government Agencies

The unrealized losses on the Company's investments in direct obligations of U.S. government agencies were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Company does not intend to sell the investments and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other than temporarily impaired at December 31, 2009.

Municipals

The unrealized losses on the Company's investments in municipal securities were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Company does not intend to sell the investments and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other than temporarily impaired at December 31, 2009.

Mortgage-Backed and Asset-Backed Securities

The unrealized losses on the Company's investment in mortgage-backed and asset-backed securities were caused by interest rate increases. The Company expects to recover the amortized cost basis over the term of the securities. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other than temporarily impaired at December 31, 2009.

Corporate Bonds and Other Securities

The Company's unrealized loss on investments in corporate bonds and other securities is primarily made up of two investments. The first investment is a $2,000,000 par investment in I-PreTSL I B-2 pooled trust security. The unrealized loss was primarily caused by a recent sector downgrade by several industry analysts. The Company currently expects to recover the entire amortized cost basis of the investment. The determination of no credit loss was calculated by comparing expected discounted cash flows based on performance indicators of the underlying assets in the security to the carrying value of the investment. Because the Company does not intend to sell the investment and it is not more likely than not the Company will be required to sell the investment before recovery of its amortized cost basis, which may be maturity, it does not consider the remainder of the investment to be other than temporarily impaired at December 31, 2009.

The second investment is a $2,000,000 par investment in ALESCO IV Series B2 pooled trust security. The unrealized loss was primarily caused by (a) a recent decrease in performance and (b) a sector downgrade by several industry analysts. The Company currently expects ALESCO IV to settle the security at a price less than the amortized cost basis of the investment (that is, the Company expects to recover less than the entire amortized cost basis of the security). The Company has recognized a loss equal to the credit loss, establishing a new, lower amortized cost basis. The credit loss was calculated by comparing expected discounted cash flows based on performance indicators of the underlying assets in the security to the carrying value of the investment. Because the Company does not intend to sell the investment and it is not more likely than not the Company will be required to sell the investment before recovery of its new, lower amortized cost basis, which may be maturity, it does not consider the remainder of the investment in ALESCO IV to be other than temporarily impaired at December 31, 2009.

Credit Losses Recognized on Investments

Certain debt securities have experienced fair value deterioration due to credit losses, as well as due to other market factors, but are not otherwise other than temporarily impaired.

The following table provides information about debt securities for which only a credit loss was recognized in income and other losses are recorded in other comprehensive loss.

	2009 Accumulated Credit Losses
Credit losses on debt securities held	
Beginning of year	$ —
Additions related to other than temporary losses not previously recognized	300,000
End of year	$ 300,000

Note 4: Loans Receivable

Loans receivable at December 31, 2009 and 2008, are as follows:

	2009	2008
Real estate mortgage loans		
One-to-four family	$ 70,079,734	$ 57,269,195
Residential construction	8,114,361	9,338,676
Commercial	20,212,004	15,855,927
Other	58,018	671,228
Home equity loans	2,528,359	1,129,128
Consumer loans	205,702,195	231,731,551
Commercial loans	3,779,068	2,443,075
	310,473,739	318,438,780
Deferred loan origination costs and premiums and discounts on purchased loans	5,062,112	6,344,492
Allowance for loan and lease losses	(10,096,813)	(4,616,006)
	$ 305,439,038	$ 320,167,266

Activity in the allowance for loan losses for the years ended December 31, 2009 and 2008 is as follows:

	2009	2008
Beginning balance	$ 4,616,006	$ 3,563,817
Provision for loan losses	11,563,786	4,818,969
Charge-offs	(7,003,139)	(4,473,580)
Recoveries	920,160	706,800
Ending balance	$ 10,096,813	$ 4,616,006

Impaired loans totaled $4,839,000 and $3,950,000 at December 31, 2009 and 2008, respectively. An allowance for loan losses of $3,676,000 and $862,000 related to impaired loans at December 31, 2009 and 2008, respectively.

At December 31, 2009 and 2008, accruing loans past due 90 days or more totaled $119,000 and $67,000, respectively. Non-accruing loans, which include all impaired loans, at December 31, 2009 and 2008 were $10,300,000 and $4,508,000, respectively.

Note 5: Equipment

Equipment included in other assets at December 31, 2009 and 2008 consists of the following:

	2009	2008
Furniture and equipment	$ 2,874,277	$ 2,954,289
Less accumulated depreciation	(2,402,427)	(1,929,842)
	$ 471,850	$ 1,024,447

Note 6: Goodwill

The change in the carrying amount of goodwill for the two years ended December 31, 2009 was:

Balance as of January 1, 2008	$ 4,687,349
Changes in goodwill during the year	—
Balance as of December 31, 2008	4,687,349
Changes in goodwill during the year	—
Balance as of December 31, 2009	$ 4,687,349

Note 7: Deposits

Deposits at December 31, 2009 and 2008 are as follows:

	2009	2008
Regular savings accounts	$ 6,074,613	$ 4,853,358
Noninterest-bearing demand deposit accounts	7,675,998	9,004,988
Interest-bearing demand deposit accounts	53,108,261	48,811,828
Money market accounts	114,873,684	76,984,369
Total transaction accounts	181,732,556	139,654,543
Certificates of deposits	199,247,992	251,833,974
Brokered deposits	30,843,620	47,891,108
Premiums on brokered deposits	(196,830)	(137,819)
Total deposits	$ 411,627,338	$ 439,241,806

Certificates of deposit in the amount of $100,000 or more totaled approximately $88,305,000 and $109,907,000 at December 31, 2009 and 2008, respectively.

A summary of certificate accounts by scheduled maturities at December 31, 2009 is as follows:

2010	$ 105,749,815
2011	67,303,013
2012	24,261,428
2013	5,121,480
2014	19,031,153
Thereafter	8,624,723
	$ 230,091,612

Note 8: FHLB Advances

The Company has outstanding FHLB advances of $47,000,000 and $57,000,000 as of December 31, 2009 and 2008, respectively. Advances, at interest rates from 2.96 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 $12,059,000 and $20,283,000 as of December 31, 2009 and 2008, respectively, and the fair value of investment securities pledged was approximately $50,209,000 and $53,873,000 as of December 31, 2009 and 2008, respectively. The FHLB advances are scheduled to mature according to the following schedule:

	Amount
2010	$ 16,000,000
2011	7,000,000
2012	5,000,000
2013	9,000,000
2014	5,000,000
Thereafter	5,000,000
	$ 47,000,000

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.

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, 2009 and 2008, totaled approximately $98,000 and $82,000, 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, 2009 and the stock options outstanding at the end of the year:

	2009		
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Life (In Years)
Outstanding, beginning of year	225,700	$ 20.71	
Expired	(23,200)	11.16	
Outstanding, end of year	202,500	21.81	1.7
Exercisable, end of year	202,500	21.81	1.7

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 $276,000 and $286,000 in 2009 and 2008, respectively, of which $45,000 and $51,000 in 2009 and 2008, 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, 2009:

	Deferred Rights	Common Shares
Outstanding, beginning of year	18,202	
Granted	4,947	
Exercised	—	
Outstanding, end of year	23,149	

Note 10: Income Taxes

The benefit for income taxes consists of the following:

	2009	2008
Current	$ 855,179	$ (940,109)
Deferred	(2,990,890)	931,013
Total	$ (2,135,711)	$ (9,096)

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

	2009	2008
Statutory rate times pre-tax income (loss)	$ (1,446,271)	$ 532,763
Add (subtract) the tax effect of:		
Income from tax-exempt securities	(539,319)	(452,825)
State income tax, net of federal tax effect	(32,205)	16,597
Bank-owned life insurance	(104,432)	(101,726)
Other differences	(13,484)	(3,905)
Total income taxes	$ (2,135,711)	$ (9,096)

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

	2009	2008
Deferred tax assets (liabilities)		
Allowance for loan losses	$ 3,557,612	$ 1,643,800
Depreciation	(21,867)	(108,804)
Deferred compensation	290,486	243,161
Deferred loan origination fees	(62,293)	(79,766)
AMT credit carry forward	220,482	—
Prepaid assets	(106,096)	(79,856)
Other	23,475	64,691
Total deferred tax assets, net	$ 3,901,799	$ 1,683,226

Note 11: Related Party Transactions

At December 31, 2009 and 2008, 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 $291,000 and $316,000, 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, 2009 and 2008 totaled $10,836,000 and $3,968,000, 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, 2009 and 2008, were approximately $148,000 and $149,000, respectively.

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). However, the Bank has an agreement with the FDIC as of December 31, 2009 to maintain a minimum Tier I capital to average assets ratio of 8% and a minimum total capital to risk weighted assets ratio of 11%.

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, 2009, 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		Minimum Capital Requirement		Minimum to be Well Capitalized Under Prompt Corrective Actions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2009:						
Total capital (to risk weighted assets)	$ 41,968,000	10.6%	$ 31,612,000	8.0%	$ 39,515,000	10.0%
Tier 1 capital (to risk weighted assets)	36,964,000	9.4	15,806,000	4.0	23,709,000	6.0
Tier 1 capital (to average assets)	36,964,000	7.4	20,017,000	4.0	25,022,000	5.0
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

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, 2009 and 2008, the Company had outstanding loan commitments totaling approximately $14,391,000 and $16,087,000, respectively.

The Company leases its office facilities under operating leases expiring between December 31, 2010 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
2010	$ 247,074
2011	81,641
2012	81,641
2013	81,641
2014	74,838
Thereafter	—
	$ 566,835

Federal funds sold, totaling approximately $0 and $99,000 at December 31, 2009 and 2008, have been sold to JP Morgan Chase.

Note 14: Fair Value of Financial Instruments

ASC Topic 820, *Fair Value Measurements*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Topic 820 also specifies 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

Following is a description of the inputs and valuation methodologies used for assets and liabilities measured at fair value on a recurring basis and recognized in the accompanying consolidated 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 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 and asset-backed securities and obligations of state, municipals and certain corporate securities. Matrix pricing is a mathematical technique widely used in the banking industry to value investment securities without relying exclusively on quoted prices for specific investment securities but rather relying on the investment securities' relationship to other benchmark quoted investment 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 certain other securities. Fair values are calculated using discounted cash flows. Discounted cash flows are calculated based off of the anticipated future cash flows updated to incorporate loss severities and volatility. Rating agency and industry research reports as well as default and deferral activity are reviewed and incorporated into the calculation.

The following tables present the fair value measurements of securities available for sale recognized in the accompanying consolidated balance sheet measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2009 and 2008:

		2009 Fair Value Measurements Using		
	Fair Value	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
U.S. government agencies	$ 14,549,232	$ —	$ 14,549,232	$ —
Municipals	42,792,734	—	42,792,734	—
Mortgage-backed and asset-backed securities	70,708,760	—	70,708,760	—
Corporate bonds and other securities	5,533,114	1,001,883	2,922,070	1,609,161
	$ 133,583,840	$ 1,001,883	$ 130,972,796	$ 1,609,161

		2008 Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. government agencies	$ 16,846,995	$ 2,000,000	$ 14,846,995	$ —
Municipals	43,848,551	2,935,493	40,913,058	—
Mortgage-backed and asset-backed securities	100,587,124	—	100,587,124	—
Corporate bonds and other securities	7,523,839	993,409	3,894,030	2,636,400
	$ 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 consolidated balance sheet using significant unobservable (Level 3) inputs:

	Securities Available for Sale
Balance, January 1, 2008	$ —
Transfers in and/or out of Level 3	2,636,400
Balance, December 31, 2008	2,636,400
Total realized and unrealized gains and losses	
Included in net loss	(300,000)
Included in other comprehensive loss	(727,239)
Purchases, issuances and settlements	—
Transfers in and/or out of Level 3	—
Balance, December 31, 2009	$ 1,609,161

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. Allowable methods for determining the amount of impairment include estimating fair value using the fair value of the collateral for collateral dependent loans.

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

Impaired loans that are collateral dependent are classified within Level 3 of the fair value hierarchy when impairment is determined using the fair value method.

The following tables present the fair value measurements of impaired loans recognized in the accompanying consolidated balance sheets measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2009 and 2008:

		2009 Fair Value Measurements Using		
	Fair Value	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Impaired loans	$ 3,246,224	$ —	$ —	$ 3,246,224

		2008 Fair Value Measurements Using		
	Fair Value	**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 consolidated balance sheets 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.

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 noninterest-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, 2009 and 2008.

The following schedule includes the carrying value and estimated fair value of all financial assets and liabilities at December 31, 2009 and 2008:

	2009		2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	$ 30,016,044	$ 30,016,044	$ 25,779,837	$ 25,779,837
Loans held for sale	7,168,658	7,168,658	4,203,190	4,203,190
Loans receivable - net	305,439,038	295,985,606	320,167,266	308,818,590
Accrued interest receivable	2,256,728	2,256,728	2,774,248	2,774,248
FHLB stock	3,637,600	3,637,600	3,637,600	3,637,600
Deposits	411,627,338	418,084,256	439,241,806	445,433,632
FHLB advances	47,000,000	48,509,617	57,000,000	59,114,244
Accrued interest payable	133,722	133,722	156,029	156,029

Note 15: Subsequent Events

Subsequent events have been evaluated through February 18, 2010, which is the date the consolidated financial statements were available to be issued.