

FIRST CAPITAL INC
Form 10-Q
August 13, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2012

OR

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

For the transition period from _____ to _____

Commission File No. 0-25023

First Capital, Inc.

(Exact name of registrant as specified in its charter)

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Indiana
(State or other jurisdiction of
incorporation or organization)

35-2056949
(I.R.S. Employer
Identification Number)

220 Federal Drive NW, Corydon, Indiana
(Address of principal executive offices)

47112
(Zip Code)

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

Not applicable

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

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

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

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

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer (Check one):

Smaller Reporting Company

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

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

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PART I FINANCIAL INFORMATION
FIRST CAPITAL, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

(Unaudited)

	June 30, 2012	December 31, 2011
	<i>(In thousands)</i>	
ASSETS		
Cash and due from banks	\$ 7,746	\$ 10,794
Interest bearing deposits with banks	1,449	525
Federal funds sold	14,475	7,604
Total cash and cash equivalents	23,670	18,923
Securities available for sale, at fair value	125,029	111,440
Securities-held to maturity	14	16
Loans, net	274,324	276,047
Loans held for sale	1,861	2,909
Federal Home Loan Bank stock, at cost	2,820	2,820
Foreclosed real estate	588	661
Premises and equipment	10,609	10,721
Accrued interest receivable	1,694	1,801
Cash value of life insurance	6,086	5,991
Goodwill	5,386	5,386
Core deposit intangibles	2	32
Other assets	1,703	2,139
Total Assets	\$ 453,786	\$ 438,886
LIABILITIES		
Deposits:		
Noninterest-bearing	\$ 52,997	\$ 47,313
Interest-bearing	327,071	317,061
Total deposits	380,068	364,374
Retail repurchase agreements	9,268	9,125
Advances from Federal Home Loan Bank	10,650	12,350
Accrued interest payable	346	413
Accrued expenses and other liabilities	1,479	1,571
Total liabilities	401,811	387,833
EQUITY		
First Capital, Inc. stockholders' equity:		
Preferred stock of \$.01 par value per share Authorized 1,000,000 shares; none issued	0	0
Common stock of \$.01 par value per share Authorized 5,000,000 shares; issued 3,164,420 shares	32	32
Additional paid-in capital	24,313	24,313
Retained earnings-substantially restricted	33,192	32,297
Accumulated other comprehensive income	1,659	1,612

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Less treasury stock, at cost 379,419 shares (378,727 shares in 2011)	(7,326)	(7,312)
Total First Capital, Inc. stockholders equity	51,870	50,942
Noncontrolling interest in subsidiary	105	111
Total equity	51,975	51,053
Total Liabilities and Equity	\$ 453,786	\$ 438,886

See accompanying notes to consolidated financial statements.

Table of Contents**PART I FINANCIAL INFORMATION****FIRST CAPITAL, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF INCOME***(Unaudited)*

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	<i>(In thousands, except per share data)</i>			
INTEREST INCOME				
Loans, including fees	\$ 3,985	\$ 4,351	\$ 8,008	\$ 8,690
Securities:				
Taxable	421	498	855	951
Tax-exempt	230	271	463	542
Federal Home Loan Bank dividends	22	19	45	46
Federal funds sold and interest bearing deposits with banks	18	11	26	20
Total interest income	4,676	5,150	9,397	10,249
INTEREST EXPENSE				
Deposits	539	830	1,125	1,708
Retail repurchase agreements	9	18	21	34
Advances from Federal Home Loan Bank	102	158	207	316
Total interest expense	650	1,006	1,353	2,058
Net interest income	4,026	4,144	8,044	8,191
Provision for loan losses	300	425	775	925
Net interest income after provision for loan losses	3,726	3,719	7,269	7,266
NON INTEREST INCOME				
Service charges on deposit accounts	744	733	1,431	1,407
Commission income	36	52	80	82
Loss on sale of securities	0	(19)	0	(19)
Gain on sale of mortgage loans	247	100	505	225
Mortgage brokerage fees	6	16	19	30
Increase in cash surrender value of life insurance	47	51	95	104
Other income	20	22	45	49
Total non interest income	1,100	955	2,175	1,878
NON INTEREST EXPENSE				
Compensation and benefits	1,814	1,881	3,700	3,711
Occupancy and equipment	305	311	611	640
Data processing	333	291	657	581
Professional fees	159	164	312	313
Advertising	65	83	112	113
Other operating expenses	684	641	1,301	1,265
Total non interest expense	3,360	3,371	6,693	6,623
Income before income taxes	1,466	1,303	2,751	2,521
Income tax expense	427	358	790	677

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Net Income	\$ 1,039	\$ 945	\$ 1,961	\$ 1,844
Less: net income attributable to noncontrolling interest in subsidiary	4	4	7	7
Net Income Attributable to First Capital, Inc.	\$ 1,035	\$ 941	\$ 1,954	\$ 1,837
Earnings per common share attributable to First Capital, Inc.				
Basic	\$ 0.37	\$ 0.34	\$ 0.70	\$ 0.66
Diluted	\$ 0.37	\$ 0.34	\$ 0.70	\$ 0.66
Dividends per share	\$ 0.19	\$ 0.19	\$ 0.38	\$ 0.38

See accompanying notes to consolidated financial statements.

Table of Contents**PART I FINANCIAL INFORMATION****FIRST CAPITAL, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME***(Unaudited)*

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	<i>(In thousands)</i>			
Net Income	\$ 1,039	\$ 945	\$ 1,961	\$ 1,844
OTHER COMPREHENSIVE INCOME				
Unrealized gains on securities available for sale:				
Unrealized holding gains arising during the period	642	1,471	78	1,437
Income tax expense	(254)	(583)	(31)	(570)
Net of tax amount	388	888	47	867
Less: reclassification adjustment for realized losses included in net income	0	19	0	19
Income tax benefit	0	(7)	0	(7)
Net of tax amount	0	12	0	12
Other Comprehensive Income, net of tax	388	900	47	879
Comprehensive Income	\$ 1,427	\$ 1,845	\$ 2,008	\$ 2,723

Table of Contents**PART I FINANCIAL INFORMATION****FIRST CAPITAL, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY***(Unaudited)*

	Additional		Accumulated				Total
	Common	Paid-in	Retained	Other	Treasury	Noncontrolling	
<i>(In thousands, except share data)</i>	Stock	Capital	Earnings	Income	Stock	Interest	
Balances at January 1, 2011	\$ 32	\$ 24,313	\$ 30,442	\$ 391	\$ (7,285)	\$ 111	\$ 48,004
Net income	0	0	1,837	0	0	7	1,844
Change in unrealized gain on securities available for sale, net of reclassification adjustments and tax effect	0	0	0	879	0	0	879
Cash dividends	0	0	(1,059)	0	0	(13)	(1,072)
Purchase of 1,608 treasury shares	0	0	0	0	(27)	0	(27)
Balances at June 30, 2011	\$ 32	\$ 24,313	\$ 31,220	\$ 1,270	\$ (7,312)	\$ 105	\$ 49,628
Balances at January 1, 2012	\$ 32	\$ 24,313	\$ 32,297	\$ 1,612	\$ (7,312)	\$ 111	\$ 51,053
Net income	0	0	1,954	0	0	7	1,961
Change in unrealized gain on securities available for sale, net of reclassification adjustments and tax effect	0	0	0	47	0	0	47
Cash dividends	0	0	(1,059)	0	0	(13)	(1,072)
Purchase of 692 treasury shares	0	0	0	0	(14)	0	(14)
Balances at June 30, 2012	\$ 32	\$ 24,313	\$ 33,192	\$ 1,659	\$ (7,326)	\$ 105	\$ 51,975

See accompanying notes to consolidated financial statements.

Table of Contents**PART I FINANCIAL INFORMATION****FIRST CAPITAL, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF CASH FLOWS***(Unaudited)*

	Six Months Ended June 30,	
	2012	2011
	<i>(In thousands)</i>	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 1,961	\$ 1,844
Adjustments to reconcile net income to net cash and cash equivalents provided by operating activities:		
Amortization of premiums and accretion of discounts on securities, net	484	471
Depreciation and amortization expense	401	410
Deferred income taxes	(153)	22
Increase in cash value of life insurance	(95)	(104)
Provision for loan losses	775	925
Proceeds from sales of loans	19,935	12,324
Loans originated for sale	(18,382)	(8,008)
Gain on sale of loans	(505)	(225)
Decrease in accrued interest receivable	107	73
Decrease in accrued interest payable	(67)	(143)
Net change in other assets/liabilities	469	(231)
Net Cash Provided By Operating Activities	4,930	7,358
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of securities available for sale	(44,978)	(21,595)
Proceeds from maturities of securities available for sale	22,280	6,265
Proceeds from maturities of securities held to maturity	0	14
Proceeds from sales of securities available for sale	1,004	647
Principal collected on mortgage-backed obligations	7,697	5,223
Net decrease in loans receivable	412	3,866
Proceeds from sale of foreclosed real estate	609	357
Proceeds from redemption of Federal Home Loan Bank stock	0	374
Purchase of premises and equipment	(258)	(183)
Net Cash Used In Investing Activities	(13,234)	(5,032)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in deposits	15,694	(8,834)
Net decrease in advances from Federal Home Loan Bank	(1,700)	(450)
Net increase in retail repurchase agreements	143	607
Purchase of treasury stock	(14)	(27)
Dividends paid	(1,072)	(1,072)
Net Cash Provided By (Used In) Financing Activities	13,051	(9,776)
Net Increase (Decrease) in Cash and Cash Equivalents	4,747	(7,450)
Cash and cash equivalents at beginning of period	18,923	21,575

Cash and Cash Equivalents at End of Period

\$ 23,670 \$ 14,125

See accompanying notes to consolidated financial statements.

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Presentation of Interim Information

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

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

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

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

Table of Contents**FIRST CAPITAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Unaudited)***2. Investment Securities**

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

<i>(In thousands)</i>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2012				
Securities available for sale:				
Agency mortgage-backed securities	\$ 18,784	\$ 496	\$ 17	\$ 19,263
Agency CMO	26,500	208	47	26,661
Privately-issued CMO	720	13	49	684
Other debt securities:				
Agency notes and bonds	43,768	376	7	44,137
Municipal obligations	26,164	1,607	11	27,760
Subtotal debt securities	115,936	2,700	131	118,505
Mutual funds	6,501	47	24	6,524
Total securities available for sale	\$ 122,437	\$ 2,747	\$ 155	\$ 125,029
Securities held to maturity:				
Agency mortgage-backed securities	\$ 14	\$ 0	\$ 0	\$ 14
Total securities held to maturity	\$ 14	\$ 0	\$ 0	\$ 14
December 31, 2011				
Securities available for sale:				
Agency mortgage-backed securities	\$ 11,689	\$ 542	\$ 11	\$ 12,220
Agency CMO	23,196	152	60	23,288
Privately-issued CMO	896	16	32	880
Other debt securities:				
Agency notes and bonds	41,971	395	3	42,363
Municipal obligations	25,800	1,501	0	27,301
Subtotal debt securities	103,552	2,606	106	106,052
Mutual funds	5,369	52	33	5,388
Total securities available for sale	\$ 108,921	\$ 2,658	\$ 139	\$ 111,440
Securities held to maturity:				
Agency mortgage-backed securities	\$ 16	\$ 0	\$ 0	\$ 16

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Total securities held to maturity	\$	16	\$	0	\$	0	\$	16
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(2 continued)

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

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

	Securities Available for Sale		Securities Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
<i>(In thousands)</i>				
Due in one year or less	\$ 1,028	\$ 1,032	\$ 0	\$ 0
Due after one year through five years	7,490	7,644	0	0
Due after five years through ten years	17,022	17,455		
Due after ten years	44,392	45,766	0	0
	69,932	71,897	0	0
Mortgage-backed securities and CMO	46,004	46,608	14	14
	\$ 115,936	\$ 118,505	\$ 14	\$ 14

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

	Number of Investment Positions	Fair Value	Gross Unrealized Losses
<i>(Dollars in thousands)</i>			
Continuous loss position less than twelve months:			
Agency notes and bonds	5	\$ 4,747	\$ 6
Agency CMO	10	7,952	47
Agency mortgage-backed securities	3	3,099	17
Municipal obligations	2	413	11
Total less than twelve months	20	16,211	81

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Continuous loss position more than twelve months:			
Privately-issued CMO	1	194	49
Agency notes and bonds	1	1,043	1
Mutual fund	1	363	24
Total more than twelve months	3	1,600	74
 Total securities available for sale	 23	 \$ 17,811	 \$ 155

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(2 continued)

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

At June 30, 2012, the 21 U.S. government agency debt securities, including agency notes and bonds, mortgage-backed securities and CMO, and municipal obligations in a loss position had depreciated approximately 0.5% from the amortized cost basis. All of the U.S. government agency securities and municipal obligations are issued by U.S. government agencies, government-sponsored enterprises and municipal governments, or are secured by first mortgage loans and municipal project revenues. These unrealized losses related principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government, its agencies or other governments, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. As the Company has the ability to hold the debt securities until maturity, or the foreseeable future if classified as available for sale, no declines are deemed to be other-than-temporary.

At June 30, 2012, the privately-issued CMO in a loss position had depreciated approximately 20.1% from the amortized cost basis. The Company evaluates the existence of a potential credit loss component related to the decline in fair values of the privately-issued CMO portfolio each quarter using an independent third party analysis. At June 30, 2012, the privately-issued CMO in a loss position had an amortized cost of \$243,000 and a fair value of \$194,000, and had been downgraded to a substandard regulatory classification in 2009 due to a downgrade of the security's credit quality by various rating agencies. Based on the independent third party analysis performed in June 2012, the Company did not recognize an other-than-temporary impairment loss during the quarter ended June 30, 2012. While management did not anticipate a credit-related impairment loss at June 30, 2012, any future deterioration in market and economic conditions may have an adverse impact on the credit quality in future periods.

3. Loans and Allowance for Loan Losses

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

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

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

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

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

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

The Company's practice is to charge-off any loan or portion of a loan when the loan is determined by management to be uncollectible due to the borrower's failure to meet repayment terms, the borrower's deteriorating or deteriorated financial condition, the depreciation of the underlying collateral, the loan's classification as a loss by regulatory examiners, or for other reasons. A partial charge-off is recorded on a loan when the uncollectibility of a portion of the loan has been confirmed, such as when a loan is discharged in bankruptcy, the collateral is liquidated, a loan is restructured at a reduced principal balance, or other identifiable events that lead management to determine the full principal balance of the loan will not be repaid. A specific reserve is recognized as a component of the allowance for estimated losses on loans individually evaluated for impairment. Partial charge-offs on nonperforming and impaired loans are included in the Company's historical loss experience used to estimate the general component of the allowance for loan losses as discussed below. Specific reserves are not considered charge-offs in management's analysis of the allowance for loan losses because they are estimates and the outcome of the loan relationship is undetermined. At June 30, 2012, the Company had seven loans on which partial charge-offs of \$377,000 had been recorded.

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

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

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

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

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

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

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

Table of Contents**FIRST CAPITAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Unaudited)*

(3 continued)

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

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity & 2nd Mtg	Other Consumer	Total
<i>(In thousands)</i>								
Recorded Investment in Loans:								
Principal loan balance	\$ 111,743	\$ 9,779	\$ 7,967	\$ 60,054	\$ 19,981	\$ 38,097	\$ 30,990	\$ 278,611
Accrued interest receivable	423	45	13	155	59	142	157	994
Net deferred loan origination fees and costs	69	2	(13)	(8)	(10)	105	0	145
Recorded investment in loans	\$ 112,235	\$ 9,826	\$ 7,967	\$ 60,201	\$ 20,030	\$ 38,344	\$ 31,147	\$ 279,750
Recorded Investment in Loans as Evaluated for Impairment:								
Individually evaluated for impairment	\$ 2,370	\$ 41	\$ 265	\$ 2,730	\$ 1,843	\$ 239	\$ 0	\$ 7,488
Collectively evaluated for impairment	109,865	9,785	7,702	57,471	18,187	38,105	31,147	272,262
Acquired with deteriorated credit quality	0	0	0	0	0	0	0	0
Ending balance	\$ 112,235	\$ 9,826	\$ 7,967	\$ 60,201	\$ 20,030	\$ 38,344	\$ 31,147	\$ 279,750

Table of Contents**FIRST CAPITAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Unaudited)*

(3 continued)

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

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

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(3 continued)

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

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity & 2nd Mtg	Other Consumer	Total
	<i>(In thousands)</i>							
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	\$ 231	\$ 0	\$ 0	\$ 348	\$ 914	\$ 129	\$ 0	\$ 1,622
Collectively evaluated for impairment	942	102	40	478	240	711	297	2,810
Acquired with deteriorated credit quality	0	0	0	0	0	0	0	0
Ending balance	\$ 1,173	\$ 102	\$ 40	\$ 826	\$ 1,154	\$ 840	\$ 297	\$ 4,432

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

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

Table of Contents**FIRST CAPITAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Unaudited)*

(3 continued)

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

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity & 2nd Mtg	Other Consumer	Total
<i>(In thousands)</i>								
Allowance for loan losses:								
Changes in Allowance for Loan Losses for the three-months ended June 30, 2012								
Beginning balance	\$ 1,060	\$ 99	\$ 35	\$ 924	\$ 1,175	\$ 651	\$ 284	\$ 4,228
Provisions for loan losses	147	3	5	(98)	(22)	246	19	300
Charge-offs	(35)	0	0	0	0	(62)	(55)	(152)
Recoveries	1	0	0	0	1	5	49	56
Ending balance	\$ 1,173	\$ 102	\$ 40	\$ 826	\$ 1,154	\$ 840	\$ 297	\$ 4,432
Changes in Allowance for Loan Losses for the six-months ended June 30, 2012								
Beginning balance	\$ 828	\$ 93	\$ 33	\$ 1,269	\$ 1,160	\$ 400	\$ 399	\$ 4,182
Provisions for loan losses	646	12	7	(443)	(10)	607	(44)	775
Charge-offs	(312)	(4)	0	0	0	(176)	(146)	(638)
Recoveries	11	1	0	0	4	9	88	113
Ending balance	\$ 1,173	\$ 102	\$ 40	\$ 826	\$ 1,154	\$ 840	\$ 297	\$ 4,432

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(3 continued)

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

	Residential		Commercial	Commercial	Home Equity &	Other		
	Real Estate	Land	Construction	Real Estate	Business	2nd Mtg	Consumer	Total
	<i>(In thousands)</i>							
Allowance for loan losses:								
Changes in Allowance for Loan Losses for the three-months ended June 30, 2011								
Beginning balance	\$ 992	\$ 79	\$ 39	\$ 1,248	\$ 1,211	\$ 562	\$ 446	\$ 4,577
Provisions for loan losses	223	(20)	(13)	91	112	46	(14)	425
Charge-offs	(1)	0	0	(68)	(305)	(51)	(73)	(498)
Recoveries	3	0	0	0	2	5	47	57
Ending balance	\$ 1,217	\$ 59	\$ 26	\$ 1,271	\$ 1,020	\$ 562	\$ 406	\$ 4,561
Changes in Allowance for Loan Losses for the six-months ended June 30, 2011								
Beginning balance	\$ 1,024	\$ 55	\$ 21	\$ 1,051	\$ 1,251	\$ 606	\$ 465	\$ 4,473
Provisions for loan losses	454	4	5	288	70	133	(29)	925
Charge-offs	(265)	0	0	(68)	(305)	(208)	(138)	(984)
Recoveries	4	0	0	0	4	31	108	147
Ending balance	\$ 1,217	\$ 59	\$ 26	\$ 1,271	\$ 1,020	\$ 562	\$ 406	\$ 4,561

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

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

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

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

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

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

Each of the four factors above was assigned an equal weight to arrive at an average for the overall qualitative factor of 1.15 at June 30, 2012 and December 31, 2011. The effect of the overall qualitative factor was to increase the estimated allowance for loan losses by \$305,000 and \$317,000 at June 30, 2012 and December 31, 2011, respectively.

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(3 continued)

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

	At June 30, 2012			Three Months Ended June 30, 2012			Six Months Ended June 30, 2012		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Interest Recognized - Cash Method	Average Recorded Investment	Interest Income Recognized	Interest Recognized - Cash Method
Loans with no related allowance recorded:									
Residential	\$ 1,045	\$ 1,314	\$ 0	\$ 1,202	\$ 0	\$ 1	\$ 1,184	\$ 1	\$ 1
Land	41	42	0	41	0	0	29	0	0
Construction	265	270	0	266	0	0	259	0	0
Commercial real estate	1,237	1,530	0	1,244	0	0	1,234	0	0
Commercial business	0	0	0	0	0	0	0	0	0
Home Equity/2nd mortgage	85	92	0	85	1	0	86	2	1
Other consumer	0	0	0	0	0	0	0	0	0
	2,673	3,248	0	2,838	1	1	2,792	3	2
Loans with an allowance recorded:									
Residential	1,325	1,410	231	1,017	0	0	1,055	0	0
Land	0	0	0	0	0	0	0	0	0
Construction	0	0	0	0	0	0	0	0	0
Commercial real estate	1,493	1,593	348	1,502	0	0	1,547	0	0
Commercial business	1,843	1,909	914	1,885	0	0	1,899	0	0
Home Equity/2nd mortgage	154	156	129	171	0	1	114	0	1
Other consumer	0	0	0	0	0	0	0	0	0
	4,815	5,068	1,622	4,575	0	1	4,615	0	1
Total:									
Residential	2,370	2,724	231	2,219	0	1	2,239	1	1
Land	41								