

# Heartland BancCorp

Parent Company of Heartland Bank

FINANCIAL STATEMENT

**2015**



# **Heartland BancCorp**

Independent Auditor's Report and Consolidated Financial Statements

December 31, 2015 and 2014



**Heartland BancCorp**  
**December 31, 2015 and 2014**

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## Independent Auditor's Report

Board of Directors  
Heartland BancCorp  
Gahanna, Ohio

We have audited the accompanying consolidated financial statements of Heartland BancCorp, which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Heartland BancCorp as of December 31, 2015 and 2014, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*BKD, LLP*

Cincinnati, Ohio  
March 11, 2016

**Heartland BancCorp**  
**Consolidated Balance Sheets**  
**December 31, 2015 and 2014**

<b>Assets</b>	<b>2015</b>	<b>2014</b>
Cash and cash equivalents	\$ 36,994,171	\$ 22,561,068
Available-for-sale securities	114,492,664	101,479,692
Held-to-maturity securities, fair value of \$6,407,215 and \$6,914,217 at December 31, 2015 and 2014, respectively	6,044,094	6,454,963
Loans, net of allowance for loan losses of \$5,715,827 and \$5,350,637 at December 31, 2015 and 2014, respectively	540,958,372	498,585,125
Premises and equipment	13,506,350	12,653,144
Nonmarketable equity securities	2,658,239	2,655,439
Foreclosed assets held for sale	-	108,082
Interest receivable	1,958,082	1,803,108
Goodwill	417,353	417,353
Deferred income taxes	1,722,934	1,574,075
Life insurance assets	9,327,518	1,215,898
Other	1,416,804	174,341
	<hr/>	<hr/>
Total assets	<u>\$ 729,496,581</u>	<u>\$ 649,682,288</u>
 <b>Liabilities and Shareholders' Equity</b>		
<b>Liabilities</b>		
Deposits		
Demand	\$ 139,226,242	\$ 108,394,566
Savings, NOW and money market	219,076,813	203,367,315
Time	264,651,203	244,394,645
	<hr/>	<hr/>
Total deposits	622,954,258	556,156,526
	<hr/>	<hr/>
Short-term borrowings	29,150,118	28,395,316
Long-term debt	5,460,000	-
Interest payable and other liabilities	5,270,849	4,421,322
	<hr/>	<hr/>
Total liabilities	662,835,225	588,973,164
	<hr/>	<hr/>
<b>Shareholders' Equity</b>		
Common stock, without par value; authorized 5,000,000 shares; issued 2015 - 1,564,581 shares, 2014 - 1,554,457 shares	23,872,599	23,558,806
Retained earnings	41,991,488	36,160,565
Accumulated other comprehensive income (loss)	797,269	989,753
	<hr/>	<hr/>
Total shareholders' equity	66,661,356	60,709,124
	<hr/>	<hr/>
Total liabilities and shareholders' equity	<u>\$ 729,496,581</u>	<u>\$ 649,682,288</u>

**Heartland BancCorp**  
**Consolidated Statements of Income**  
**Years Ended December 31, 2015 and 2014**

	<b>2015</b>	<b>2014</b>
<b>Interest Income</b>		
Loans	\$ 25,775,945	\$ 22,767,132
Securities		
Taxable	1,376,312	1,256,494
Tax-exempt	1,551,627	1,626,882
Other	50,925	47,837
Total interest income	<u>28,754,809</u>	<u>25,698,345</u>
<b>Interest Expense</b>		
Deposits	3,256,624	2,834,757
Borrowings	49,252	16,601
Total interest expense	<u>3,305,876</u>	<u>2,851,358</u>
<b>Net Interest Income</b>	25,448,933	22,846,987
<b>Provision for Loan Losses</b>	760,000	1,255,000
<b>Net Interest Income After Provision for Loan Losses</b>	<u>24,688,933</u>	<u>21,591,987</u>
<b>Noninterest Income</b>		
Service charges	1,925,467	1,980,529
Net gains and commissions on loan sales	241,742	121,695
Net realized gain on sales of available-for-sale securities	18,291	136,701
Net realized gain on sales of foreclosed assets	5,308	209,901
Benefit in excess of life insurance cash value	879,488	-
Other	879,945	657,126
Total noninterest income	<u>3,950,240</u>	<u>3,105,952</u>
<b>Noninterest Expense</b>		
Salaries and employee benefits	10,331,707	9,294,269
Net occupancy and equipment expense	1,842,702	1,706,778
Data processing fees	1,082,143	1,018,464
Professional fees	498,406	772,812
Marketing expense	545,990	598,036
Printing and office supplies	158,877	165,248
State financial institution tax	423,926	373,224
FDIC Insurance premiums	411,000	342,089
Other	2,261,155	2,060,441
Total noninterest expense	<u>17,555,906</u>	<u>16,331,361</u>
<b>Income Before Income Tax</b>	11,083,267	8,366,578
<b>Provision for Income Taxes</b>	2,955,567	2,285,364
<b>Net Income</b>	<u>\$ 8,127,700</u>	<u>\$ 6,081,214</u>
<b>Basic Earnings Per Share</b>	<u>\$ 5.21</u>	<u>\$ 3.92</u>
<b>Diluted Earnings Per Share</b>	<u>\$ 5.13</u>	<u>\$ 3.87</u>

**Heartland BancCorp**  
**Consolidated Statements of Comprehensive Income**  
**Years Ended December 31, 2015 and 2014**

	<b>2015</b>	<b>2014</b>
<b>Net Income</b>	\$ 8,127,700	\$ 6,081,214
<b>Other Comprehensive Income (Loss):</b>		
Unrealized gain (loss) on available-for-sale securities, net of taxes of (\$92,940) and \$1,275,914, for 2015 and 2014, respectively	(180,412)	2,476,774
Reclassification adjustment for realized gains included in net income, net of taxes of \$6,219 and \$46,478, for 2015 and 2014, respectively	(12,072)	(90,223)
Other comprehensive income (loss)	(192,484)	2,386,551
<b>Comprehensive Income</b>	<b>\$ 7,935,216</b>	<b>\$ 8,467,765</b>

**Heartland BancCorp**  
**Consolidated Statements of Shareholders' Equity**  
**Years Ended December 31, 2015 and 2014**

	Common Stock		Retained	Accumulated Other Comprehensive	Total
	Shares	Amount	Earnings	Income (Loss)	
<b>Balance, January 1, 2014</b>	1,549,922	23,355,806	32,287,838	(1,396,798)	54,246,846
Net income			6,081,214		6,081,214
Other comprehensive income				2,386,551	2,386,551
Dividends on common stock, \$1.40 per share			(2,201,939)		(2,201,939)
Stock option expense		92,628			92,628
Stock options exercised	6,200	170,123	(6,548)		163,575
Tax benefit related to stock options exercised		3,519			3,519
Purchase of common stock	(1,665)	(63,270)			(63,270)
<b>Balance, December 31, 2014</b>	1,554,457	23,558,806	36,160,565	989,753	60,709,124
Net income			8,127,700		8,127,700
Other comprehensive loss				(192,484)	(192,484)
Dividends on common stock, \$1.47 per share			(2,296,777)		(2,296,777)
Stock option expense		114,393			114,393
Stock options exercised	14,660	394,996			394,996
Tax benefit related to stock options exercised		5,378			5,378
Purchase of common stock	(4,536)	(200,974)			(200,974)
<b>Balance, December 31, 2015</b>	1,564,581	\$ 23,872,599	\$ 41,991,488	\$ 797,269	\$ 66,661,356



**Heartland BancCorp**  
**Consolidated Statements of Cash Flows**  
**Years Ended December 31, 2015 and 2014**

	<b>2015</b>	<b>2014</b>
<b>Operating Activities</b>		
Net income	\$ 8,127,700	\$ 6,081,214
Items not requiring (providing) cash		
Depreciation and amortization	622,928	562,148
Provision for loan losses	760,000	1,255,000
Amortization of premiums and discounts on securities	613,525	730,737
Amortization of loan fees, net	(37,440)	20,497
Deferred income taxes	(100,312)	(202,690)
Net realized gains on sale of available-for-sale securities	(18,291)	(136,701)
Net gains on sales of foreclosed assets	(5,308)	(209,901)
Benefits in excess of life insurance cash value	(879,488)	-
Stock option expense	114,393	92,628
Tax benefit related to stock options exercised	5,378	3,519
Gain on sale of loans	(162,959)	(80,204)
Changes in		
Life insurance assets	(111,620)	-
Interest receivable	(154,974)	4,524
Other assets	(312,363)	707,704
Interest payable and other liabilities	818,242	241,460
	<b>9,279,411</b>	<b>9,069,935</b>
<b>Investing Activities</b>		
Purchase of available-for-sale securities	(67,695,130)	(29,398,932)
Purchase of held-to-maturity securities	(85,000)	(64,000)
Proceeds from maturities of available-for-sale securities	50,342,634	33,586,555
Proceeds from sales of available-for-sale securities	3,458,451	9,782,593
Proceeds from maturities of held-to-maturity securities	490,065	229,580
Purchase of nonmarketable equity securities	(2,800)	(765,489)
Net change in loans	(42,932,848)	(76,581,856)
Purchase of premises and equipment	(1,502,355)	(1,509,203)
Proceeds from sale of premises and equipment	26,221	263,508
Purchase of foreclosed assets	(19,375)	(183,548)
Proceeds from sale of foreclosed assets	132,765	1,670,322
Purchase of life insurance	(8,000,000)	-
	<b>(65,787,372)</b>	<b>(62,970,470)</b>

**Heartland BancCorp**  
**Consolidated Statements of Cash Flows (Continued)**  
**Years Ended December 31, 2015 and 2014**

	<b>2015</b>	<b>2014</b>
<b>Financing Activities</b>		
Net increase in demand deposits, money market, NOW and savings accounts	\$ 46,541,174	\$ 40,860,226
Net increase in certificates of deposit	20,256,558	24,472,847
Net increase (decrease) in short-term borrowings	754,802	(2,740,904)
Proceeds from issuance of subordinated notes	5,460,000	-
Proceeds from stock options exercised	394,996	163,575
Purchase of common stock	(200,974)	(63,270)
Dividends paid	(2,265,492)	(2,174,137)
	<u>70,941,064</u>	<u>60,518,337</u>
<b>Net cash provided by financing activities</b>	<u>70,941,064</u>	<u>60,518,337</u>
<b>Increase in Cash and Cash Equivalents</b>	14,433,103	6,617,802
<b>Cash and Cash Equivalents, Beginning of Year</b>	<u>22,561,068</u>	<u>15,943,266</u>
<b>Cash and Cash Equivalents, End of Year</b>	<u>\$ 36,994,171</u>	<u>\$ 22,561,068</u>
<b>Supplemental Cash Flows Information</b>		
Interest paid	\$ 3,300,243	\$ 2,838,939
Income taxes paid (net of refunds)	\$ 3,032,000	\$ 1,990,000
<b>Supplemental disclosure of noncash investing and financing activities</b>		
Transfers from loans to foreclosed assets held for sale	\$ -	\$ 527,746
Loans to facilitate the sale of foreclosed assets	\$ -	\$ 804,085

**Heartland BancCorp**  
**Notes to Consolidated Financial Statements**  
**December 31, 2015 and 2014**

**Note 1: Nature of Operations and Summary of Significant Accounting Policies**

***Nature of Operations***

Heartland BancCorp (“Company”) is a bank holding company whose principal activity is the ownership and management of its wholly-owned subsidiary, Heartland Bank (the “Bank”) and the Bank’s wholly-owned subsidiaries, Heartland Mortgage Corporation (inactive), Heartland Investments, Inc. (inactive) and Heartland Financial, LLC. The Bank is primarily engaged in providing a full range of banking and financial services to individual and corporate customers in Franklin and Licking counties of central Ohio. The Bank is subject to competition from other financial institutions. The Bank is subject to the regulation of certain federal and state agencies and undergoes annual examinations by those regulatory authorities.

***Principles of Consolidation***

The consolidated financial statements include the accounts of the Company, the Bank and Heartland Insurance Services, LLC. 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 reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change include the determination of the allowance for loan losses, valuation of real estate acquired in connection with foreclosures or in satisfaction of loans, valuation of deferred tax assets, and other-than-temporary impairments (OTTI) and fair values of financial instruments.

***Cash Equivalents***

The Company considers all liquid investments with original maturities of three months or less to be cash equivalents.

Frequently, the Company’s cash and cash equivalents accounts may exceed the FDIC’s insured limit of \$250,000. The Company believes the risk of loss to be very low.

**Heartland BancCorp**  
**Notes to Consolidated Financial Statements**  
**December 31, 2015 and 2014**

**Securities**

Available-for-sale securities, which include any security for which the Company has no immediate plan to sell but which may be sold in the future, are carried at fair value. Unrealized gains and losses are recorded, net of related income tax effects, in other comprehensive income.

Held-to-maturity securities, which include any security for which the Company has the positive intent and ability to hold until maturity, are carried at historical cost adjusted for amortization of premiums and accretion of discounts.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Realized gains and losses are recorded as net security gains (losses). Gains and losses on sales of securities are determined on the specific-identification method.

For debt securities with fair value below carrying value when the Company does not intend to sell a debt security, and it is more likely than not the Company will not have to sell the security before recovery of its cost basis, it recognizes the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income. For held-to-maturity debt securities, the amount of an other-than-temporary impairment recorded in other comprehensive income for the noncredit portion of a previous other-than-temporary impairment is amortized prospectively over the remaining life of the security on the basis of the timing of future estimated cash flows of the security.

For available-for-sale and held-to-maturity debt securities that management has no intent to sell and believes that it more likely than not will not be required to sell prior to recovery, only the credit loss component of the impairment is recognized in earnings, while the noncredit loss is recognized in accumulated other comprehensive income. The credit loss component recognized in earnings is identified as the amount of principal cash flows not expected to be received over the remaining term of the security as projected based on cash flow projections. The Company recognized no other-than temporary impairment in 2015 and 2014.

**Loans**

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoffs are reported at their outstanding principal balances adjusted for any charge-offs, the allowance for loan losses, any deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans.

For loans amortized at cost, interest income is accrued based on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, as well as premiums and discounts, are deferred and amortized as a level yield adjustment over the respective term of the loan.

# **Heartland BancCorp**

## **Notes to Consolidated Financial Statements**

### **December 31, 2015 and 2014**

For all loan classes, the accrual of interest is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. For all loan classes, past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

For all loan classes, all interest accrued but not collected for loans that are placed on nonaccrual or charged off are reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Nonaccrual loans are returned to accrual status when, in the opinion of management, the financial position of the borrower indicates there is no longer any reasonable doubt as to the timely collection of interest or principal. The Company requires a period of satisfactory performance of not less than six months before returning a nonaccrual loan to accrual status.

Discounts and premiums on purchased commercial real estate loans are amortized to income using the interest method over the remaining period to contractual maturity, adjusted for anticipated prepayments.

#### ***Allowance for Loan Losses***

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to income. Loan losses are charged against the allowance when management believes the un-collectability 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 collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired. For those loans that are classified as impaired, an allowance is established if the discounted cash flows, underlying 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 charge-off experience. Other adjustments may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss or risk rating data.

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

# **Heartland BancCorp**

## **Notes to Consolidated Financial Statements**

### **December 31, 2015 and 2014**

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 for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. Interest income on impaired loans is recognized on a cash basis after all past due and current principal payments have been made.

Groups of loans with similar risk characteristics are collectively evaluated for impairment based on the group's historical loss experience adjusted for changes in trends, conditions and other relevant factors that affect repayment of the loans. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment measurements, unless such loans are the subject of a restructuring agreement due to financial difficulties of the borrower.

In the course of working with borrowers, the Company may choose to restructure the contractual terms of certain loans. In this scenario, the Company attempts to work-out an alternative payment schedule with the borrower in order to optimize collectability of the loan. Any loans that are modified are reviewed by the Company to identify if a troubled debt restructuring ("TDR") has occurred, which is when, for economic or legal reasons related to a borrower's financial difficulties, the Company grants a concession to the borrower that it would not otherwise consider. Terms may be modified to fit the borrower's ability to repay in line with the borrower's current financial status, and the restructuring of the loan may include a transfer of assets from the borrower to satisfy the debt, a modification of loan terms or a combination of the two. If such efforts by the Company do not result in a satisfactory arrangement, the loan is referred to legal counsel, at which time foreclosure proceedings are initiated. At any time prior to a sale of the property at foreclosure, the Company may terminate foreclosure proceedings if the borrower is able to work-out a satisfactory payment plan.

It is the Company's policy that any restructured loans on nonaccrual status prior to being restructured remain on nonaccrual status until six months of satisfactory borrower performance, at which time management would consider its return to accrual status. If a loan is accruing at the time of restructuring, the Company reviews the loan to determine if it is appropriate to continue the accrual of interest on the restructured loan.

With regard to determination of the amount of the allowance for credit losses, troubled debt restructured loans are considered to be impaired. As a result, the method for determining the amount of impaired loans for each portfolio segment of troubled debt restructurings is the same as detailed previously.

#### ***Premises and Equipment***

Depreciable assets are stated at cost less accumulated depreciation. Depreciation is charged to expense using the straight-line method over the estimated useful lives of the assets.

**Heartland BancCorp**  
**Notes to Consolidated Financial Statements**  
**December 31, 2015 and 2014**

***Nonmarketable Equity Securities***

Nonmarketable equity securities consist of common stock in the Federal Reserve Bank (FRB) and Federal Home Loan Bank (FHLB) and Farmer Mac. The FRB and FHLB stocks are required investments for institutions that are members of the FRB and FHLB systems. The required investment in the common stock is based on a predetermined formula, carried at cost and evaluated for impairment. The common stock in Farmer Mac was purchased to participate in correspondent services offered by Farmer Mac to its shareholders.

***Foreclosed Assets Held for Sale***

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net income or expense from foreclosed assets. At December 31, 2015 the recorded investment of consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceeds are in process is \$995,000.

***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 financial statements. There were no changes in the carrying amount of goodwill.

***Company-owned Life Insurance***

The Company has purchased life insurance policies on certain key executives. Company-owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

***Stock Options***

At December 31, 2015, the Company has a share-based employee compensation plan, which is described more fully in Note 13.

***Transfers of Financial Assets***

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have

# Heartland BancCorp

## Notes to Consolidated Financial Statements

### December 31, 2015 and 2014

been isolated from the Company—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

#### ***Income Taxes***

The Company accounts for income taxes in accordance with income tax accounting guidance (ASC 740, *Income Taxes*). The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Tax positions are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances and information available at the reporting date and is subject to management's judgment.

If necessary, the Company recognizes interest and penalties on income taxes as a component of income tax expense.

The Company files consolidated income tax returns with its subsidiaries in the U.S. federal jurisdiction. With a few exceptions, the Company is no longer subject to tax authorities for years before 2012. As of December 31, 2015, the Company had no uncertain income tax positions.

#### ***Earnings Per Share***

Basic earnings per share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during each period. Diluted earnings per share reflects additional potential common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result



**Heartland BancCorp**  
**Notes to Consolidated Financial Statements**  
**December 31, 2015 and 2014**

from the assumed issuance. Potential common shares that may be issued by the Company relate solely to outstanding stock options and are determined using the treasury stock method.

***Comprehensive Income***

Comprehensive income consists of net income and other comprehensive income, net of applicable income taxes. Other comprehensive income includes unrealized gain (loss) on available-for-sale securities.

***Accumulated Other Comprehensive Income (Loss)***

Accumulated other comprehensive income (loss) consists of unrealized gain (loss) on available-for-sale securities, net of applicable income taxes.

***Marketing Costs***

Marketing costs are expensed as incurred.

***Reclassifications***

Certain reclassifications have been made to the 2014 financial statements to conform to the 2015 financial statement presentation. These reclassifications had no effect on net income.

**Note 2: Restriction on Cash and Due From Banks**

The Bank is required to maintain reserve funds in cash and/or on deposit with the Federal Reserve Bank. The reserve required at December 31, 2015 was \$9,562,000.

**Heartland BancCorp**  
**Notes to Consolidated Financial Statements**  
**December 31, 2015 and 2014**  
(Table Dollar Amounts in Thousands)

**Note 3: Securities**

The amortized cost and approximate fair values, together with gross unrealized gains and losses, of securities are as follows:

	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Approximate Fair Value</b>
<b>Available-for-sale Securities:</b>				
December 31, 2015:				
U.S. government agencies	\$ 36,082	\$ 7	\$ (237)	\$ 35,852
Mortgage-backed securities of U.S. Government sponsored enterprises	27,412	338	(274)	27,476
State and political subdivisions	49,791	1,500	(126)	51,165
Totals	<u>\$ 113,285</u>	<u>\$ 1,845</u>	<u>\$ (637)</u>	<u>\$ 114,493</u>
December 31, 2014:				
U.S. government agencies	\$ 23,838	\$ 28	\$ (164)	\$ 23,702
Mortgage-backed securities of U.S. Government sponsored enterprises	30,468	641	(268)	30,841
State and political subdivisions	44,674	1,515	(266)	45,923
Corporate bonds	1,000	14	-	1,014
Totals	<u>\$ 99,980</u>	<u>\$ 2,198</u>	<u>\$ (698)</u>	<u>\$ 101,480</u>
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Approximate Fair Value</b>
<b>Held-to-maturity Securities:</b>				
December 31, 2015:				
State and political subdivisions	<u>\$ 6,044</u>	<u>\$ 363</u>	<u>\$ -</u>	<u>\$ 6,407</u>
December 31, 2014:				
State and political subdivisions	<u>\$ 6,455</u>	<u>\$ 459</u>	<u>\$ -</u>	<u>\$ 6,914</u>

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The amortized cost and fair value of available-for-sale securities and held-to-maturity securities at December 31, 2015, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-sale		Held-to-maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within one year	\$ 901	\$ 916	\$ 37	\$ 37
One to five years	8,803	8,974	2,915	3,059
Five to ten years	41,464	41,827	2,753	2,950
After ten years	34,705	35,300	339	361
	85,873	87,017	6,044	6,407
Mortgage-backed securities of U.S. Government sponsored entities	27,412	27,476	-	-
Totals	<u>\$ 113,285</u>	<u>\$ 114,493</u>	<u>\$ 6,044</u>	<u>\$ 6,407</u>

The carrying value, which equals fair value, of securities pledged as collateral, to secure public deposits and for other purposes, was \$76,697,000 at December 31, 2015 and \$70,392,000 at December 31, 2014.

Gross gains of \$48,000 and \$367,000 resulting from sales of available-for-sale securities were realized for 2015 and 2014, respectively. There were losses resulting from the sale of available-for-sale securities of \$30,000 in 2015 and \$230,000 in 2014. The \$18,000 and \$137,000 net gains from the sales of available-for-sale securities were a reclassification from accumulated other comprehensive income (loss) and are included in the net gains on available-for-sale securities in the income statement for 2015 and 2014, respectively. The related tax expense of \$6,000 and \$46,000 were a reclassification from accumulated other comprehensive income (loss) and included in the provision for income tax in the income statement for 2015 and 2014, respectively.

Certain investments in debt securities are reported in the financial statements at an amount less than their historical cost. Total fair value of these investments at December 31, 2015 and 2014 was \$61,525,000 and \$38,198,000, which is approximately 51% and 35%, respectively, of the Company's available-for-sale and held-to-maturity investment portfolio. These declines resulted from changes in market interest rates.

Management believes the declines in fair value for these securities are temporary.

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The following tables show the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2015 and 2014:

Description of Securities	December 31, 2015					
	Less than 12 Months Unrealized		12 Months or More Unrealized		Total Unrealized	
	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
U.S. Government agencies	\$ 34,196	\$ (220)	\$ 982	\$ (17)	\$ 35,178	\$ (237)
Mortgage-backed securities of U.S. Government sponsored enterprises	4,712	(83)	7,337	(191)	12,049	(274)
State and political subdivisions	7,075	(25)	7,223	(101)	14,298	(126)
Total temporarily impaired securities	<u>\$ 45,983</u>	<u>\$ (328)</u>	<u>\$ 15,542</u>	<u>\$ (309)</u>	<u>\$ 61,525</u>	<u>\$ (637)</u>

Description of Securities	December 31, 2014					
	Less than 12 Months Unrealized		12 Months or More Unrealized		Total Unrealized	
	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
U.S. Government agencies	\$ 5,934	\$ (27)	\$ 8,737	\$ (137)	\$ 14,671	\$ (164)
Mortgage-backed securities of U.S. Government sponsored enterprises	609	(15)	10,819	(253)	11,428	(268)
State and political subdivisions	2,184	(14)	9,915	(252)	12,099	(266)
Total temporarily impaired securities	<u>\$ 8,727</u>	<u>\$ (56)</u>	<u>\$ 29,471</u>	<u>\$ (642)</u>	<u>\$ 38,198</u>	<u>\$ (698)</u>

The unrealized losses on the Company's investments in U.S. Government agencies, Mortgage-backed securities of U.S. Government sponsored enterprises and securities of state and political subdivisions were caused by changes in interest rates. 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, 2015.

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**Note 4: Loans and Allowance for Loan Losses**

Classes of loans at December 31, include:

	<u>2015</u>	<u>2014</u>
Commercial	\$ 68,439	\$ 52,238
Commercial Real Estate:		
Owner occupied	159,117	140,415
NonOwner occupied	171,496	168,854
Residential Real Estate:		
1-4 Family	116,856	112,400
Home Equity	22,251	21,505
Consumer	8,539	8,538
Total loans	<u>546,698</u>	<u>503,950</u>
Less		
Net deferred loan fees, premiums and discounts	(24)	(14)
Allowance for loan losses	<u>(5,716)</u>	<u>(5,351)</u>
Net loans	<u>\$ 540,958</u>	<u>\$ 498,585</u>

The risk characteristics of each loan portfolio segment are as follows:

***Commercial (Non-Real Estate)***

Commercial loans are based on the identified cash flows of the borrower and on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

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***Commercial Real Estate***

These loans are viewed as cash flow loans with a significant emphasis on the value of real estate securing the loan. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company's commercial real estate portfolio are diverse in terms of type within the Company's market area. Management monitors and evaluates commercial real estate loans based on collateral, market area, risk grade criteria, and concentrations. As a general rule, the Company avoids financing single purpose projects unless other underwriting factors are present to help mitigate risk. In addition, management tracks the level of owner-occupied commercial real estate loans versus higher risk non-owner occupied loans.

***Residential Real Estate and Consumer***

With respect to residential loans that are secured by one- to four-family residences and are generally owner occupied, the Company generally establishes a maximum loan-to-value ratio of 80% and requires private mortgage insurance of 35% coverage if that ratio is exceeded. Home equity loans are typically secured by a subordinate interest in one- to four-family residences, and other consumer loans are secured by consumer assets such as automobiles or recreational vehicles. Some consumer loans are unsecured such as small installment loans and certain lines of credit. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. The security value can also be impacted by changes in property values on residential properties. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

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The following tables present the balance in the allowance for loan losses and the recorded investment in loans based on portfolio segment and impairment method as of December 31, 2015 and 2014.

	2015						
	Commercial	Commercial Real Estate		Residential Real Estate			Total
		Occupied	Owner Occupied	NonOwner Occupied	1-4 family	Home Equity	
<b>December 31, 2015:</b>							
Allowance for loan losses:							
Balance, beginning of year	\$ 1,089	\$ 1,189	\$ 1,758	\$ 930	\$ 256	\$ 129	\$ 5,351
Provision charged to expense	99	348	96	(52)	145	124	760
Losses charged off	(460)	(32)	-	(45)	(9)	(153)	(699)
Recoveries	140	100	-	16	15	33	304
Balance, end of year	<u>\$ 868</u>	<u>\$ 1,605</u>	<u>\$ 1,854</u>	<u>\$ 849</u>	<u>\$ 407</u>	<u>\$ 133</u>	<u>\$ 5,716</u>
Ending balance: individually evaluated for impairment	<u>\$ 131</u>	<u>\$ 260</u>	<u>\$ 378</u>	<u>\$ 127</u>	<u>\$ 238</u>	<u>\$ -</u>	<u>\$ 1,134</u>
Ending balance: collectively evaluated for impairment	<u>\$ 737</u>	<u>\$ 1,345</u>	<u>\$ 1,476</u>	<u>\$ 722</u>	<u>\$ 169</u>	<u>\$ 133</u>	<u>\$ 4,582</u>
Loans:							
Ending balance	<u>\$ 68,439</u>	<u>\$ 159,117</u>	<u>\$ 171,496</u>	<u>\$ 116,856</u>	<u>\$ 22,251</u>	<u>\$ 8,539</u>	<u>\$ 546,698</u>
Ending balance: individually evaluated for impairment	<u>\$ 1,041</u>	<u>\$ 8,418</u>	<u>\$ 2,280</u>	<u>\$ 1,519</u>	<u>\$ 786</u>	<u>\$ 7</u>	<u>\$ 14,051</u>
Ending balance: collectively evaluated for impairment	<u>\$ 67,398</u>	<u>\$ 150,699</u>	<u>\$ 169,216</u>	<u>\$ 115,337</u>	<u>\$ 21,465</u>	<u>\$ 8,532</u>	<u>\$ 532,647</u>
<b>December 31, 2014:</b>							
Allowance for loan losses:							
Balance, beginning of year	\$ 555	\$ 1,726	\$ 1,135	\$ 876	\$ 211	\$ 173	\$ 4,676
Provision charged to expense	618	(398)	632	253	92	58	1,255
Losses charged off	(153)	(258)	(9)	(202)	(68)	(135)	(825)
Recoveries	69	119	-	3	21	33	245
Balance, end of year	<u>\$ 1,089</u>	<u>\$ 1,189</u>	<u>\$ 1,758</u>	<u>\$ 930</u>	<u>\$ 256</u>	<u>\$ 129</u>	<u>\$ 5,351</u>
Ending balance: individually evaluated for impairment	<u>\$ 544</u>	<u>\$ 229</u>	<u>\$ 496</u>	<u>\$ 418</u>	<u>\$ 113</u>	<u>\$ -</u>	<u>\$ 1,800</u>
Ending balance: collectively evaluated for impairment	<u>\$ 545</u>	<u>\$ 960</u>	<u>\$ 1,262</u>	<u>\$ 512</u>	<u>\$ 143</u>	<u>\$ 129</u>	<u>\$ 3,551</u>
Loans:							
Ending balance	<u>\$ 52,238</u>	<u>\$ 140,415</u>	<u>\$ 168,854</u>	<u>\$ 112,400</u>	<u>\$ 21,505</u>	<u>\$ 8,538</u>	<u>\$ 503,950</u>
Ending balance: individually evaluated for impairment	<u>\$ 1,329</u>	<u>\$ 8,178</u>	<u>\$ 2,202</u>	<u>\$ 1,907</u>	<u>\$ 434</u>	<u>\$ 34</u>	<u>\$ 14,084</u>
Ending balance: collectively evaluated for impairment	<u>\$ 50,909</u>	<u>\$ 132,237</u>	<u>\$ 166,652</u>	<u>\$ 110,493</u>	<u>\$ 21,071</u>	<u>\$ 8,504</u>	<u>\$ 489,866</u>

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***Internal Risk Categories***

Loan grades are numbered 1 through 8. Grades 1 through 4 are considered satisfactory grades. The grade of 5, or Special Mention, represents loans of lower quality and signs of potential weakness. The grades of 6, or Substandard, and 7, or Doubtful, refer to assets that are classified. The use and application of these grades by the Company will be uniform and shall conform to the Company's policy.

**Excellent (1)** loans are of superior quality with excellent credit strength and repayment ability proving a nominal credit risk.

**Good (2)** loans are of above average credit strength and repayment ability proving only a minimal credit risk.

**Satisfactory (3)** loans are of reasonable credit strength and repayment ability proving an average credit risk due to one or more underlying weaknesses.

**Watch (4)** borrowers in this grade are still considered acceptable from quality standpoint but have risk factors more substantial than for the typical satisfactory graded loan. Although identified weaknesses are present, performance on loans is acceptable with only moderate delinquency.

**Special Mention (5)** assets have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. Ordinarily, special mention credits have characteristics which corrective management action would remedy.

**Substandard (6)** loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

**Doubtful (7)** loans classified as doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of current known facts, conditions and values, highly questionable and improbable.

**Loss (8)** loans classified as loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value but rather it is not practical or desirable to defer writing off even though partial recovery may be affected in the future.



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The following tables present the credit risk profile of the Company's loan portfolio based on the Company's internal rating categories as of December 31, 2015 and 2014:

	2015						
	Commercial	Commercial Real Estate		Residential Real Estate		Consumer	Total
		Owner Occupied	NonOwner Occupied	1-4 Family	Home Equity		
Pass	\$ 60,871	\$ 139,952	\$ 159,596	\$ 113,090	\$ 20,570	\$ 8,451	\$ 502,530
Special mention	6,206	4,714	1,178	1,170	162	-	13,430
Substandard	1,362	14,451	10,722	2,596	1,519	88	30,738
Doubtful	-	-	-	-	-	-	-
Loss	-	-	-	-	-	-	-
<b>Total</b>	<b>\$ 68,439</b>	<b>\$ 159,117</b>	<b>\$ 171,496</b>	<b>\$ 116,856</b>	<b>\$ 22,251</b>	<b>\$ 8,539</b>	<b>\$ 546,698</b>

  

	2014						
	Commercial	Commercial Real Estate		Residential Real Estate		Consumer	Total
		Owner Occupied	NonOwner Occupied	1-4 Family	Home Equity		
Pass	\$ 48,860	\$ 124,054	\$ 162,731	\$ 108,889	\$ 20,719	\$ 8,439	\$ 473,692
Special mention	535	7,231	4,002	1,355	361	-	13,484
Substandard	2,843	9,130	2,121	2,156	425	95	16,770
Doubtful	-	-	-	-	-	4	4
Loss	-	-	-	-	-	-	-
<b>Total</b>	<b>\$ 52,238</b>	<b>\$ 140,415</b>	<b>\$ 168,854</b>	<b>\$ 112,400</b>	<b>\$ 21,505</b>	<b>\$ 8,538</b>	<b>\$ 503,950</b>

The Company evaluates the loan risk grading system definitions and allowance for loan loss methodology on an ongoing basis. No significant changes were made to either during the past year.

The following tables present the Company's loan portfolio aging analysis of the recorded investment in loans as of December 31, 2015 and 2014:

	2015						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Total Loans > 90 Days & Accruing
Commercial	\$ 209	\$ 5	\$ 855	\$ 1,069	\$ 67,370	\$ 68,439	\$ 107
Commercial Real Estate:							
Owner occupied	1,228	152	1,993	3,373	155,744	159,117	1,326
NonOwner occupied	-	-	1,147	1,147	170,349	171,496	437
Residential Real Estate:							
1-4 family	807	32	587	1,426	115,430	116,856	49
Home equity	37	1	321	359	21,892	22,251	-
Consumer	-	2	7	9	8,530	8,539	-
<b>Total</b>	<b>\$ 2,281</b>	<b>\$ 192</b>	<b>\$ 4,910</b>	<b>\$ 7,383</b>	<b>\$ 539,315</b>	<b>\$ 546,698</b>	<b>\$ 1,919</b>

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	2014						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Total Loans > 90 Days & Accruing
Commercial	\$ 299	\$ 236	\$ 148	\$ 683	\$ 51,555	\$ 52,238	\$ 44
Commercial Real Estate:							
Owner occupied	648	2,220	3,272	6,140	134,275	140,415	440
NonOwner occupied	-	990	247	1,237	167,617	168,854	-
Residential Real Estate:							
1-4 family	231	36	543	810	111,590	112,400	235
Home equity	55	181	52	288	21,217	21,505	5
Consumer	24	24	28	76	8,462	8,538	1
<b>Total</b>	<u>\$ 1,257</u>	<u>\$ 3,687</u>	<u>\$ 4,290</u>	<u>\$ 9,234</u>	<u>\$ 494,716</u>	<u>\$ 503,950</u>	<u>\$ 725</u>

A loan is considered impaired, in accordance with the impairment accounting guidance (ASC 310-10-35-16), when based on current information and events, it is probable the Company will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Impaired loans include nonperforming commercial loans but also include loans modified in troubled debt restructurings.

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The following tables present impaired loans for the years ended December 31, 2015 and 2014:

	2015				
	Recorded Balance	Unpaid Principal Balance	Specific Allowance	Average Balance of Impaired Loans	Interest Income Recognized
<b>Loans without a specific valuation allowance:</b>					
Commercial	\$ 719	\$ 440	\$ -	\$ 430	\$ 7
Commercial real estate:					
Owner occupied	7,914	7,914	-	8,091	425
NonOwner occupied	834	834	-	850	35
Residential real estate:					
1-4 family	1,303	1,303	-	1,415	63
Home equity	249	250	-	255	11
Consumer	7	7	-	7	-
<b>Loans with a specific valuation allowance:</b>					
Commercial	322	322	131	324	15
Commercial real estate:					
Owner occupied	504	526	260	537	-
NonOwner occupied	1,446	1,446	378	1,495	45
Residential real estate:					
1-4 family	216	216	127	218	10
Home equity	537	536	238	550	12
Consumer	-	-	-	-	-
<b>Total:</b>					
Commercial	1,041	762	131	754	22
Commercial real estate:					
Owner occupied	8,418	8,440	260	8,628	425
NonOwner occupied	2,280	2,280	378	2,345	80
Residential real estate:					
1-4 family	1,519	1,519	127	1,633	73
Home equity	786	786	238	805	23
Consumer	7	7	-	7	-
Totals	<u>\$ 14,051</u>	<u>\$ 13,794</u>	<u>\$ 1,134</u>	<u>\$ 14,172</u>	<u>\$ 623</u>

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	2014				
	Recorded Balance	Unpaid Principal Balance	Specific Allowance	Average Balance of Impaired Loans	Interest Income Recognized
<b>Loans without a specific valuation allowance:</b>					
Commercial	\$ 657	\$ 760	\$ -	\$ 775	\$ 38
Commercial real estate:					
Owner occupied	7,524	7,987	-	8,247	315
NonOwner occupied	246	254	-	261	14
Residential real estate:					
1-4 family	834	849	-	860	44
Home equity	113	123	-	140	2
Consumer	34	34	-	34	-
<b>Loans with a specific valuation allowance:</b>					
Commercial	672	672	544	705	29
Commercial real estate:					
Owner occupied	654	1,102	229	1,252	21
NonOwner occupied	1,956	1,956	496	1,976	108
Residential real estate:					
1-4 family	1,073	1,143	418	1,205	83
Home equity	321	321	113	327	14
Consumer	-	-	-	-	-
<b>Total:</b>					
Commercial	1,329	1,432	544	1,480	67
Commercial real estate:					
Owner occupied	8,178	9,089	229	9,499	336
NonOwner occupied	2,202	2,210	496	2,237	122
Residential real estate:					
1-4 family	1,907	1,992	418	2,065	127
Home equity	434	444	113	467	16
Consumer	34	34	-	34	-
Totals	<u>\$ 14,084</u>	<u>\$ 15,201</u>	<u>\$ 1,800</u>	<u>\$ 15,782</u>	<u>\$ 668</u>

Interest income recognized is not materially different than interest income that would have been recognized on a cash basis.

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The following table presents the Company's nonaccrual loans at December 31, 2015 and 2014. This table excludes performing troubled debt restructurings.

	<u>2015</u>	<u>2014</u>
Commercial	\$ 953	\$ 804
Commercial Real Estate:		
Owner occupied	667	2,906
NonOwner occupied	710	247
Residential Real Estate:		
1-4 family	571	344
Home equity	367	108
Consumer	<u>53</u>	<u>55</u>
	<u>\$ 3,321</u>	<u>\$ 4,464</u>
Total nonaccrual		

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The following table presents information regarding troubled debt restructurings by class for the year ended December 31, 2015 and 2014:

Newly classified troubled debt restructurings:

<b>2015</b>			
	<b>Number of Loans</b>	<b>Pre-Modification Recorded Balance</b>	<b>Post-Modification Recorded Balance</b>
Commercial	-	\$ -	\$ -
Commercial Real Estate:			
Owner occupied	5	3,246	3,213
NonOwner occupied	1	125	125
Residential Real Estate:			
1-4 family	1	75	75
Home equity	-	-	-
Consumer	-	-	-
Total	7	\$ 3,446	\$ 3,413

<b>2014</b>			
	<b>Number of Loans</b>	<b>Pre-Modification Recorded Balance</b>	<b>Post-Modification Recorded Balance</b>
Commercial	1	\$ 86	\$ 86
Commercial Real Estate:			
Owner occupied	2	609	469
NonOwner occupied	2	526	526
Residential Real Estate:			
1-4 family	3	185	185
Home equity	-	-	-
Consumer	-	-	-
Total	8	\$ 1,406	\$ 1,266

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The troubled debt restructurings described above did not increase the allowance for loan losses and did not result in charge offs during the years ended December 31, 2015 and 2014.

Newly restructured loans by type of modification:

**2015**

	<b>Interest Only Terms</b>	<b>Extension of Maturity</b>	<b>Combination</b>	<b>Advance Funds</b>	<b>Total Modification</b>
Commercial	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial Real Estate:					
Owner occupied	250	-	2,963	-	3,213
NonOwner occupied	-	-	125	-	125
Residential Real Estate:					
1-4 family	75	-	-	-	75
Home equity	-	-	-	-	-
Consumer	-	-	-	-	-
<b>Total</b>	<b>\$ 325</b>	<b>\$ -</b>	<b>\$ 3,088</b>	<b>\$ -</b>	<b>\$ 3,413</b>

**2014**

	<b>Interest Only Terms</b>	<b>Extension of Maturity</b>	<b>Combination</b>	<b>Advance Funds</b>	<b>Total Modification</b>
Commercial	\$ 86		\$ -		\$ 86
Commercial Real Estate:					
Owner occupied	351		118		469
NonOwner occupied	326	200			526
Residential Real Estate:					
1-4 family			185		185
Home equity			-		-
Consumer			-		-
<b>Total</b>	<b>\$ 763</b>	<b>\$ 200</b>	<b>\$ 303</b>	<b>\$ -</b>	<b>\$ 1,266</b>

There were no troubled debt restructurings modified in 2015 or 2014 that subsequently defaulted

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**Note 5: Premises and Equipment**

Major classifications of premises and equipment, stated at cost, are as follows:

	<u>2015</u>	<u>2014</u>
Land and improvements	\$ 3,836	\$ 3,760
Building and improvements	11,768	11,155
Equipment	<u>8,093</u>	<u>7,367</u>
Total	23,697	22,282
Less accumulated depreciation	<u>(10,191)</u>	<u>(9,629)</u>
Net premises and equipment	<u>\$ 13,506</u>	<u>\$ 12,653</u>

**Note 6: Interest-bearing Time Deposits**

Interest-bearing time deposits in denominations of \$250,000 or more were \$47,460,000 on December 31, 2015 and \$40,198,000 on December 31, 2014.

At December 31, 2015, the scheduled maturities of time deposits are as follows:

2016	\$ 144,383
2017	90,635
2018	5,178
2019	7,334
2020 and thereafter	<u>17,122</u>
Total time deposits	<u>\$ 264,651</u>

**Note 7: Short-term Borrowings**

Short-term borrowings consisted of the following at December 31:

	<u>2015</u>	<u>2014</u>
Securities sold under repurchase agreements	\$ 29,150	\$ 20,689
Federal Home Loan Bank overnight borrowings - fixed at 0.24% and mature daily	<u>-</u>	<u>7,706</u>
Total	<u>\$ 29,150</u>	<u>\$ 28,395</u>



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Securities sold under agreements to repurchase consist of obligations of the Bank to other parties. The obligations are secured by U. S. Government Agency, FHLB, FHLMC, FNMA and municipal securities and such collateral is held in safekeeping with a third party. The maximum amount of outstanding agreements at any month end during 2015 and 2014 totaled \$29,150,000 and \$29,976,000, respectively, and the daily average of such agreements totaled \$23,939,000 and \$25,138,000 for 2015 and 2014, respectively. These agreements mature daily. The following table represents the remaining contractual maturity of repurchase agreements disaggregated by the class of securities pledged as of December 31.

	<b>2015 Overnight &amp; Continuous</b>
December 31, 2015:	
U.S. government agencies	\$ 6,521
Mortgage-backed securities of U.S. Government sponsored enterprises	\$ 22,629
Totals	\$ 29,150

The Company has a Federal Funds Borrowing Line Agreement with US Bank and PNC Bank that allows the Company to borrow up to \$10,000,000 and \$5,000,000 in Federal Funds, respectively.

The Company has a Loan Agreement for a line of credit with United Bankers Bank of Minnesota that allows the Company to borrow up to \$4,000,000. This line of credit is collateralized by 46,659 shares of the Bank, which are wholly owned by the Company. At December 31, 2015, the Company has \$4,000,000 available on its line of credit with United Bankers Bank. This 1-year agreement expires on June 2, 2016. Variable interest rates are set daily based upon prime rate as published in the Wall Street Journal. Advances are prepayable with no fee.

The Company has a cash management advance (CMA) line of credit with the Federal Home Loan Bank (FHLB) of Cincinnati. FHLB borrowings are collateralized by all shares of FHLB stock owned by the Bank and by the Bank's residential mortgage loans.

At December 31, 2015 and 2014, the Company has \$84,533,000 and \$72,294,000, respectively, available on its CMA line of credit. The CMA application expires on September 23, 2016. The Company has the option of selecting a variable interest rate set daily for 90 days or a fixed interest rate for a maximum of thirty days. Variable interest rates are set daily based upon the FHLB's published interest rates. Variable interest rate advances are prepayable with no fee. The fixed rate is not prepayable prior to maturity.

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**Note 8: Long-term Debt**

On November 12, 2015, the Company completed a private issuance and sale, of subordinated notes, to 14 accredited investors for an aggregate of \$5,460,000, comprised of: \$3,000,000 at 5.50 percent fixed, \$750,000 at 5.00 percent fixed, \$1,410,000 at 4.50 percent fixed, and \$300,000 at a floating rate equal to the 1-Year Treasury Rate plus 1.63%, reset quarterly. Interest is payable in January, April, July, and October of each year. The interest rate at December 31, 2015 was 4.99 percent. The subordinated notes will mature on November 12, 2025, and the Company cannot redeem the notes prior to November 12, 2020, subject to approval of the Board of Governors of the Federal Reserve System, as required by law or regulation.

**Note 9: Income Taxes**

The provision for income taxes includes these components:

	<b>2015</b>	<b>2014</b>
Taxes currently payable	\$ 3,056	\$ 2,488
Deferred income taxes	(100)	(203)
Income tax expense	\$ 2,956	\$ 2,285

A reconciliation of income tax expense at the statutory rate to the Company's actual income tax expense is shown below:

	<b>2015</b>	<b>2014</b>
Computed at the statutory rate (34%)	\$ 3,768	\$ 2,844
Increase (decrease) resulting from		
Tax exempt interest	(562)	(585)
Cash surrender value, net of premiums	(347)	4
Other	97	22
Actual tax expense	\$ 2,956	\$ 2,285

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The tax effects of temporary differences related to deferred taxes shown on the balance sheets were:

	<b>2015</b>	<b>2014</b>
Deferred tax assets		
Allowance for loan losses	\$ 1,943	\$ 1,819
Deferred compensation	786	732
Stock option expense	54	22
Other	7	-
	<hr/>	<hr/>
Total Deferred Tax Assets	2,790	2,573
Deferred tax liabilities		
Depreciation	(394)	(248)
Purchase accounting adjustments	(20)	(26)
FHLB stock dividends	(152)	(152)
Prepaid expenses	(41)	(60)
Unrealized gains on available-for-sale securities	(460)	(509)
Other	-	(4)
	<hr/>	<hr/>
Total Deferred Tax Liabilities	(1,067)	(999)
Net deferred tax asset	<hr/> <hr/>	<hr/> <hr/>
	\$ 1,723	\$ 1,574

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**Note 10: Regulatory Matters**

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking 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 financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting guidelines. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Furthermore, the Company's regulators could require adjustments to regulatory capital not reflected in these financial statements.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined) to risk-weighted assets (as defined), common equity Tier 1 capital (as defined) to total risk-weighted assets (as defined) and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2015, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

As of December 31, 2015, the most recent notification from the Federal Reserve categorized the Company and Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, the Company and Bank must maintain capital ratios as set forth in the table that follows. There are no conditions or events since that notification that management believes have changed the Company or Bank's category.

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The Company's and Bank's actual capital amounts and ratios are presented in the following table.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of December 31, 2015</b>						
Total Capital (to Risk-Weighted Assets)						
Consolidated	\$ 71,163	13.0%	\$ 43,827	8.0%	N/A	N/A
Bank	75,579	13.8%	43,817	8.0%	\$ 54,771	10.0%
Tier I Capital (to Risk-Weighted Assets)						
Consolidated	65,447	12.0%	32,870	6.0%	N/A	N/A
Bank	69,863	12.8%	32,863	6.0%	43,817	8.0%
Common Equity Tier I Capital (to Risk-Weighted Assets)						
Consolidated	65,447	12.0%	24,653	4.5%	N/A	N/A
Bank	69,863	12.8%	24,647	4.5%	35,601	6.5%
Tier I Capital (to Average Assets)						
Consolidated	65,447	9.2%	28,443	4.0%	N/A	N/A
Bank	69,863	9.8%	28,415	4.0%	35,519	5.0%
<b>As of December 31, 2014</b>						
Total Capital (to Risk-Weighted Assets)						
Consolidated	\$ 64,649	13.9%	\$ 37,317	8.0%	\$ 46,646	10.0%
Bank	63,758	13.7%	37,307	8.0%	46,634	10.0%
Tier I Capital (to Risk-Weighted Assets)						
Consolidated	59,298	12.7%	18,658	4.0%	27,988	6.0%
Bank	58,407	12.5%	18,654	4.0%	27,980	6.0%
Common Equity Tier I Capital (to Risk-Weighted Assets)						
Consolidated	N/A	N/A	N/A	N/A	N/A	N/A
Bank	N/A	N/A	N/A	N/A	N/A	N/A
Tier I Capital (to Average Assets)						
Consolidated	59,298	9.1%	26,049	4.0%	32,561	5.0%
Bank	58,407	9.0%	26,038	4.0%	32,547	5.0%

The Bank is subject to certain restrictions on the amount of dividends that it may declare without prior regulatory approval. Generally, the Bank's payment of dividends is limited to net income for the current year plus the two preceding calendar years, less capital distributions paid over the comparable time period.

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***Basel III Capital Rules***

In July 2013, the three federal bank regulatory agencies jointly published final rules (the Basel III Capital Rules) establishing a new comprehensive capital framework for U.S. banking organizations. The rules implement the Basel Committee's December 2010 framework known as "Basel III" for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act. These rules substantially revise the risk-based capital requirements applicable to bank holding companies and depository institutions, compared to the current U.S. risk-based capital rules. The Basel III Capital Rules define the components of capital and address other issues affecting the numerator in banking institutions' regulatory capital ratios. These rules also address risk weights and other issues affecting the denominator in banking institutions' regulatory capital ratios and replace the existing risk-weighting approach with a more risk-sensitive approach. The Basel III Capital Rules were effective for the Company on January 1, 2015 (subject to a four-year phase-in period).

The Basel III Capital Rules, among other things, (i) introduce a new capital measure called "Common Equity Tier 1" (CET1), (ii) specify that Tier 1 capital consist of CET1 and "Additional Tier 1 Capital" instruments meeting specified requirements, (iii) define CET1 narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iv) expand the scope of the deductions/adjustments as compared to existing regulations.

Under the Basel III Capital Rules, the initial minimum capital ratios as of January 1, 2015, are as follows:

- 4.5% CET1 to risk-weighted assets
- 6.0% Tier 1 capital to risk-weighted assets
- 8.0% Total capital to risk-weighted assets
- 4.0% Minimum leverage ratio

Implementation of the deductions and other adjustments to CET1 began on January 1, 2015, and will phase in over a four-year period (beginning at 40% on January 1, 2015, and an additional 20% per year thereafter). Under the new rule, in order to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers, a banking organization must hold a capital conservation buffer composed of CET1 capital above its minimum risk-based capital requirements. The implementation of the capital conservation buffer begins on January 1, 2016, at the 0.625% level and will phase in over a four-year period (increasing by that amount on each subsequent January 1 until it reaches 2.5% on January 1, 2019).

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**Note 11: Related Party Transactions**

At December 31, 2015 and 2014, the Bank had loans outstanding and lines of credit available to executive officers, directors, significant shareholders and their affiliates (related parties), in the amount of \$26,776,000 and \$26,470,000, 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 collectability or present other unfavorable features.

Deposits from related parties held by the Bank at December 31, 2015 and 2014, totaled \$9,519,000 and \$11,220,000, respectively.

**Note 12: Employee Benefits**

The Company has a retirement savings 401(k) plan covering substantially all employees. Employees may contribute up to the maximum amount allowable by the Internal Revenue Service with the Company matching 50% of the employee's contribution not to exceed 3% of the employee's compensation. In addition, the Company may make additional discretionary contributions allocated to all eligible participants based on compensation. Employee contributions are always 100% vested. Employer contributions vest 20% annually until the employee becomes fully vested after five years of participation in the plan. Employer contributions charged to expense for 2015 and 2014, were \$168,000 and \$144,000, respectively.

The Company has supplemental retirement plans for certain former and current Senior Officers. Officers in the plans, upon retirement, will receive annually for ten or fifteen years a percentage of their final annual payroll amount exclusive of incentive and bonus amounts and may be partially offset by 401(k) or 401(k) and social security retirement benefits. The plans are uniquely designed for each participant. The charge to expense for 2015 and 2014 were \$335,000 and \$253,000, respectively. Such charges reflect the straight-line accrual over the period until full eligibility of the present value of benefits due each participant on the full eligibility date. For plans executed before 2015, a 6% discount factor is used. For plans executed after January 1, 2015, the accumulation period crediting rate is 50% of the prior year Return on Equity of The Company; and the distribution period crediting rate is equal to the 10-Year U.S. Treasury note on the first day of each year plus 1%. The resulting liability at December 31, 2015 and 2014 was \$2,312,000 and \$2,152,000, respectively. The Company purchased life insurance on the participants.

The Bank has employment agreements with certain officers of the Bank. Under these agreements, the officers are employed for rolling two or three-year periods. Unless the Bank serves a termination notice to the officers before December 31 of each year, the agreements are automatically extended for one additional year. The Bank's Board of Directors approve the officers' base salaries annually. The agreements prohibit the officers from soliciting banking

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business from customers of the Bank for a period of two years following the termination of the employment agreements.

**Note 13: Stock Option Plan**

The Company has a fixed option plan under which the Company may grant options to selected directors, Advisory Board Members and employees for up to 249,738 shares of common stock that vest over two years or immediately if the recipient is 65 years old or older. The Company believes that such awards better align the interests of its employees with those of its shareholders. The exercise price of each option is intended to equal the fair value of the Company's stock on the date of grant. An option's maximum term is ten years. The compensation cost for the stock option expense recognized in 2015 totaled \$114,000 with a related tax benefit in 2015 of \$38,000. The compensation cost for the stock option expense recognized in 2014 totaled \$93,000 with a related tax benefit in 2014 of \$32,000. As of December 31, 2015, there was \$259,000 of total unrecognized compensation cost related to non-vested share based compensation arrangements granted under the Plan.

A summary of the status of the plan at December 31, 2015 and changes during the year then ended is presented below:

	<b>Shares</b>	<b>Weighted-Average Exercise Price</b>	<b>2015 Weighted-Average Remaining Contractual Term (Years)</b>	<b>Aggregate Intrinsic Value</b>
Outstanding, beginning of year	118,600	\$ 31.40		
Granted	67,900	45.01		
Exercised	(13,960)	26.65		
Forfeited or expired	(12,850)	35.78		
Outstanding, end of year	<u>159,690</u>	\$ 37.26	<u>7.05</u>	<u>\$ 1,237,000</u>
Exercisable, end of year	<u>91,990</u>	\$ 31.55	<u>5.21</u>	<u>\$ 1,237,000</u>

The weighted-average grant-date fair value of options granted during 2015 was \$4.82. There were no stock options granted in 2014. The total intrinsic value of options exercised during the year ended December 31, 2015 and 2014 was \$256,000 and \$84,000, respectively.



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The fair value of each option award granted is estimated on the date of the grant using a Black-Scholes valuation model that uses the assumptions noted in the following table. Expected volatility is based on historical volatility of the Company's stock and other factors. The Company uses the simplified method to estimate option exercise and employee termination within the valuation model due to lack of historical data. The expected term of options granted represents the period of time that options are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

	<b>2015</b>
Dividend yields	3.36%
Volatility factors of expected market price of common stock	15.14%
Risk-free interest rate	2.35%
Expected life of options	10.00
Weighted-average fair value of options granted during the year	\$4.82

**Note 14: Earnings Per Share**

Earnings per share (EPS) were computed as follows:

	<b>Year Ended December 31, 2015</b>		
	<b>Income</b>	<b>Weighted-Average Shares</b>	<b>Per Share Amount</b>
Basic earnings per share			
Income available to common stockholders	\$ 8,128	1,558,843	\$ 5.21
Effect of dilutive securities			
Stock options		27,036	
Diluted earnings per share			
assumed conversions			
stockholders and assumed conversions	\$ 8,128	1,585,879	\$ 5.13

Options to purchase 67,700 shares of common stock at a weighted-average exercise price of \$45.01 per share were outstanding at December 31, 2015, but were not included in the computation of diluted EPS because the options' exercise price was greater than the average market price of the common shares.

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	Year Ended December 31, 2014		
	Income	Weighted-Average Shares	Per Share Amount
Basic earnings per share			
Income available to common stockholders	\$ 6,081	1,552,172	<u>\$ 3.92</u>
Effect of dilutive securities			
Stock options		<u>19,912</u>	
Diluted earnings per share			
assumed conversions			
stockholders and assumed conversions	<u>\$ 6,081</u>	<u>1,572,084</u>	<u>\$ 3.87</u>

As of December 31, 2014, all options to purchase shares of common stock were included in the computation of diluted EPS because the options' exercise price was not greater than the average market price of the common shares.

**Note 15: Disclosures about Fair Value of Assets and Liabilities**

Fair value is 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. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

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**Recurring Measurements**

The following tables present the fair value measurements of assets recognized in the accompanying balance sheets 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, 2015 and 2014:

	<b>Fair Value Measurements Using</b>			
	<b>Fair Value</b>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>
December 31, 2015:				
U.S. government agencies	\$ 35,852	\$ -	\$ 35,852	\$ -
Mortgage-backed securities of U.S. government sponsored enterprises	27,475	-	27,475	-
State and political subdivisions	51,165	-	51,165	-
December 31, 2014:				
U.S. government agencies	\$ 23,702	\$ -	\$ 23,702	\$ -
Mortgage-backed securities of U.S. government sponsored enterprises	30,841	-	30,841	-
State and political subdivisions	45,923	-	45,923	-
Corporate Bonds	1,014	-	1,014	-

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a recurring basis and recognized in the accompanying balance sheets. There have been no significant changes in the valuation techniques during the year-ended December 31, 2015.

**Available-for-Sale Securities**

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. Level 2 securities include U.S. government agencies, Mortgage-backed securities of U.S. government sponsored enterprises, State and political subdivisions and corporate bonds. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

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***Nonrecurring Measurements***

The following tables present the fair value measurement of assets 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, 2015 and 2014:

	<b>Fair Value Measurements Using</b>			
	<b>Fair Value</b>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>
December 31, 2015:				
Collateral-dependent impaired loans	\$ 1,891	\$ -	\$ -	\$ 1,891
December 31, 2014:				
Collateral-dependent impaired loans	\$ 2,876	\$ -	\$ -	\$ 2,876

Following is a description of the valuation methodologies used for assets measured at fair value on a nonrecurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy. For assets classified within Level 3 of the fair value hierarchy, the process used to develop the reported fair value is described below.

***Collateral-dependent Impaired Loans, Net of ALLL***

The estimated fair value of collateral-dependent impaired loans is based on the appraised fair value of the collateral, less estimated cost to sell. Collateral-dependent impaired loans are classified within Level 3 of the fair value hierarchy.

The Company considers the appraisal or evaluation as the starting point for determining fair value and then considers other factors and events in the environment that may affect the fair value. Appraisals of the collateral underlying collateral-dependent loans are obtained when the loan is determined to be collateral-dependent and subsequently as deemed necessary by management. Appraisals are reviewed for accuracy and consistency. Appraisers are selected from the list of approved appraisers maintained by management. The appraised values are reduced by discounts to consider lack of marketability and estimated cost to sell if repayment or satisfaction of the loan is dependent on the sale of the collateral. These discounts and estimates are developed by comparison to historical results.

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***Unobservable (Level 3) Inputs***

The following table presents quantitative information about unobservable inputs used in nonrecurring Level 3 fair value measurements at December 31, 2015 and 2014.

	<b>Fair Value at 12/31/2015</b>	<b>Valuation Technique</b>	<b>Unobservable Inputs</b>	<b>Weighted Average</b>
Collateral-dependent impaired loans	\$ 1,891	Market comparable properties	Marketability discounts	10%
	<b>Fair Value at 12/31/2014</b>	<b>Valuation Technique</b>	<b>Unobservable Inputs</b>	<b>Weighted Average</b>
Collateral-dependent impaired loans	\$ 2,876	Market comparable properties	Marketability discounts	10%

***Sensitivity of Significant Unobservable Inputs***

The following is a discussion of the sensitivity of significant unobservable inputs, the interrelationships between those inputs and other unobservable inputs used in recurring fair value measurement and of how those inputs might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement.

***Collateral-dependent impaired loans***

The significant unobservable input used in the fair value measurement of the Company's collateral-dependent impaired loans is the marketability discount. Significant increases in this input in isolation would result in a significantly lower fair value measurement.

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***Fair Value of Financial Instruments***

The following table presents estimated fair values of the Company's financial instruments and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2015 and 2014.

	Carrying Amount	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)
December 31, 2015				
Financial assets				
Cash and cash equivalents	\$ 36,994	\$ 36,994	\$ -	\$ -
Held-to-maturity securities	6,044	-	6,407	-
Loans, net of allowance for loan losses	540,958	-	-	550,843
Nonmarketable equity securities	2,658	-	2,658	-
Interest receivable	1,958	1,958	-	-
Financial liabilities				
Deposits	622,954	-	620,352	-
Short-term borrowings	29,150	-	29,148	-
Long-term borrowings	5,460	-	5,429	-
Interest payable	109	109	-	-
December 31, 2014				
Financial assets				
Cash and cash equivalents	\$ 22,561	\$ 22,561	\$ -	\$ -
Held-to-maturity securities	6,455	-	6,914	-
Loans, net of allowance for loan losses	498,585	-	-	508,661
Nonmarketable equity securities	2,655	-	2,655	-
Interest receivable	1,803	1,803	-	-
Financial liabilities				
Deposits	556,157	-	555,567	-
Short-term borrowings	28,395	-	28,395	-
Interest payable	103	103	-	-

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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 and Nonmarketable Equity Securities and Interest Receivable***

The carrying amount approximates fair value.

***Held-to-maturity Securities***

Fair value is based on quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

***Loans***

Fair value is estimated by discounting the future cash flows using the market rates at which similar notes would be made to borrowers with similar credit ratings and for the same remaining maturities. The market rates used are based on current rates the Bank would impose for similar loans and reflect a market participant assumption about risks associated with nonperformance, illiquidity, and the structure and term of the loans along with local economic and market conditions.

***Deposits***

Fair value of term deposits is estimated by discounting the future cash flows using rates of similar deposits with similar maturities. The market rates used were obtained from a knowledgeable independent third party and reviewed by the Company. The rates were the average of current rates offered by local competitors of the bank.

The estimated fair value of demand, NOW, savings and money market deposits is the book value since rates are regularly adjusted to market rates and amounts are payable on demand at the reporting date.

***Short-term Borrowings and Interest Payable***

The carrying amount approximates fair value.

***Subordinated Debentures***

Fair value of the subordinated debt is estimated by discounting the estimated future cash flows using current estimated market rates. The market rates used were based on the 10-Year treasury constant maturity as of December 31, 2015 adjusted for spreads over the 10-Year treasury at the issuance date of the subordinated notes.

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***Commitments to Originate Loans, Forward Sale Commitments, Letters of Credit and Lines of Credit***

The fair value of commitments to originate loans is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates.

The fair value of forward sale commitments is estimated based on current market prices for loans of similar terms and credit quality. The fair values of letters of credit and lines of credit are based on fees currently charged for similar agreements or on the estimated cost to terminate or otherwise settle the obligations with the counterparties at the reporting date. The fair values of commitments were not material at December 31, 2015 and 2014.

**Note 16: Commitments and Credit Risk**

As of December 31, 2015, the Bank had \$55,834,000 in outstanding loan balances to churches within the Bank's lending area with an additional \$1,694,000 available to be drawn.

***Letters of Credit***

Letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing and similar transactions.

The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

The Bank had total outstanding letters of credit amounting to \$519,000 and \$482,000 at December 31, 2015 and 2014, respectively, with maturities within the next 12 months.

***Lines of Credit***

Lines of credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Lines of credit generally have fixed expiration dates. Since a portion of the line may expire without being drawn upon, the total unused lines do not necessarily represent future cash requirements. Each customer's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if deemed necessary, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, commercial real estate and residential real estate. Management uses the same credit policies in granting lines of credit as it does for on-balance-sheet instruments.

At December 31, 2015, the Bank had granted unused lines of credit to borrowers aggregating approximately \$27,255,000 and \$31,588,000 for commercial lines and open-end consumer lines, respectively. At December 31, 2014, the Bank had granted unused lines of credit to borrowers



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aggregating approximately \$30,281,000 and \$29,304,000 for commercial lines and open-end consumer lines, respectively.

***Commitments to Originate Loans***

Commitments to originate loans are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since a portion of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Each customer's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if deemed necessary, is based on management's credit evaluation of the counterparty. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, commercial real estate and residential real estate.

At December 31, 2015, and 2014, the Bank had outstanding commitments to originate variable rate loans aggregating approximately \$24,037,000 and \$9,361,000, respectively. The commitments extended over varying periods of time with the majority being disbursed within a one-year period

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**Note 17: Condensed Financial Information (Parent Company Only)**

Presented below is condensed financial information as to the financial position, results of operations and cash flows of the Company:

**Condensed Balance Sheets**

	<b>December 31,</b>	
	<b>2015</b>	<b>2014</b>
<b>Assets</b>		
Cash and cash equivalents	\$ 1,451	\$ 1,390
Investment in common stock of the Bank	70,756	59,399
Other assets	521	493
	<u>72,728</u>	<u>61,282</u>
Total assets	<u>\$ 72,728</u>	<u>\$ 61,282</u>
<b>Liabilities</b>		
Long Term Debt	5,460	-
Other liabilities	607	573
	<u>6,067</u>	<u>573</u>
Total liabilities	<u>6,067</u>	<u>573</u>
<b>Shareholders' Equity</b>	<u>66,661</u>	<u>60,709</u>
Total liabilities and shareholders' equity	<u>\$ 72,728</u>	<u>\$ 61,282</u>

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**Condensed Statements of Income and Comprehensive Income**

	<b>Year Ending December 31,</b>	
	<b>2015</b>	<b>2014</b>
<b>Income</b>		
Dividends from the Bank	\$ 2,333	\$ 2,202
Total income	2,333	2,202
<b>Expenses</b>		
Interest expense	36	-
Other expenses	238	168
Total expenses	274	168
<b>Income Before Income Tax and Equity in Undistributed Income of the Bank</b>	2,059	2,034
<b>Income Tax Benefit</b>	(93)	(57)
<b>Income Before Equity in Undistributed Income of the Bank</b>	2,152	2,091
<b>Equity in Undistributed Income of the Bank</b>	5,976	3,990
<b>Net Income</b>	\$ 8,128	\$ 6,081
<b>Comprehensive Income</b>	\$ 7,935	\$ 8,468

**Heartland BancCorp**  
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**Condensed Statements of Cash Flows**

	<b>Year Ending December 31,</b>	
	<b>2015</b>	<b>2014</b>
<b>Operating Activities</b>		
Net income	\$ 8,128	\$ 6,081
Stock option expense	114	93
Tax benefit related to stock options exercised	5	4
Items not providing cash	(6,115)	(4,235)
Net cash provided by operating activities	2,132	1,943
<b>Investing Activities</b>		
Investment in Common Stock of Bank	(5,460)	-
<b>Financing Activities</b>		
Proceeds from long-term debt	5,460	-
Cash dividends paid	(2,265)	(2,174)
Proceeds from stock options exercised	395	164
Purchase of common stock	(201)	(63)
Net cash used in financing activities	(3,389)	(2,073)
<b>Net Change in Cash and Cash Equivalents</b>	61	(130)
<b>Cash and Cash Equivalents at Beginning of Year</b>	1,390	1,520
<b>Cash and Cash Equivalents at End of Year</b>	\$ 1,451	\$ 1,390

**Note 18: Subsequent Events**

Subsequent events have been evaluated through the date of the Independent Auditor's Report, which is the date the financial statements were available to be issued.

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