FIRST CAPITAL INC
Form 10-Q
August 11, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2011

OR

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

For the transition period from to

Commission File No. 0-25023

First Capital, Inc.

(Exact name of registrant as specified in its charter)

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

220 Federal Drive NW, Corydon, Indiana 47112

(Address of principal executive offices) (Zip Code)

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

Not applicable

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

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

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

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

(Check one):

Large Accelerated Filer	¨	Accelerated Filer	¨
Non-accelerated Filer	¨	Smaller Reporting Company	x

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 2,785,693 shares of common stock were outstanding as of July 29, 2011.

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PART I - FINANCIAL INFORMATION

FIRST CAPITAL, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

(Unaudited)

	June 30, 2011	December 31, 2010
	(In thousands)	
ASSETS		
Cash and due from banks	$ 12,902	$ 10,463
Interest bearing deposits with banks	1,105	2,496
Federal funds sold	118	8,616
Total cash and cash equivalents	14,125	21,575
Securities available for sale, at fair value	111,227	100,851
Securities-held to maturity	17	32
Loans, net	289,437	294,550
Loans held for sale	284	4,375
Federal Home Loan Bank stock, at cost	2,820	3,194
Foreclosed real estate	556	591
Premises and equipment	10,800	10,992
Accrued interest receivable	1,821	1,894
Cash value of life insurance	5,892	5,789
Goodwill	5,386	5,386
Core deposit intangibles	63	98
Other assets	2,551	3,051
Total Assets	$ 444,979	$ 452,378
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 46,208	$ 40,774
Interest-bearing	322,961	337,229
Total deposits	369,169	378,003
Retail repurchase agreements	9,276	8,669
Advances from Federal Home Loan Bank	15,279	15,729
Accrued interest payable	506	649
Accrued expenses and other liabilities	1,121	1,324
Total liabilities	395,351	404,374
EQUITY		
First Capital, Inc. stockholders equity:		
Preferred stock of $.01 par value per share		
Authorized 1,000,000 shares; none issued	0	0
Common stock of $.01 par value per share		
Authorized 5,000,000 shares; issued 3,164,420 shares	32	32
Additional paid-in capital	24,313	24,313

Retained earnings-substantially restricted	31,220	30,442
Accumulated other comprehensive income	1,270	391
Less treasury stock, at cost - 378,727 shares (377,119 shares in 2010)	(7,312)	(7,285)
Total First Capital, Inc. stockholders equity	49,523	47,893
Noncontrolling interest in subsidiary	105	111
Total equity	49,628	48,004
Total Liabilities and Equity	$ 444,979	$ 452,378

See accompanying notes to consolidated financial statements.

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PART I - FINANCIAL INFORMATION

FIRST CAPITAL, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
	(In thousands, except per share data)			
INTEREST INCOME				
Loans, including fees	$ 4,351	$ 4,726	$ 8,690	$ 9,372
Securities:				
Taxable	498	569	951	1,120
Tax-exempt	271	263	542	523
Federal Home Loan Bank dividends	19	17	46	35
Fed funds sold and interest bearing deposits with banks	11	8	20	12
Total interest income	5,150	5,583	10,249	11,062
INTEREST EXPENSE				
Deposits	830	1,155	1,708	2,386
Retail repurchase agreements	18	17	34	34
Advances from Federal Home Loan Bank	158	261	316	522
Total interest expense	1,006	1,433	2,058	2,942
Net interest income	4,144	4,150	8,191	8,120
Provision for loan losses	425	420	925	880
Net interest income after provision for loan losses	3,719	3,730	7,266	7,240
NON-INTEREST INCOME				
Service charges on deposit accounts	733	726	1,407	1,314
Commission income	52	38	82	76
Loss on sale of securities	(19)	0	(19)	0
Gain on sale of mortgage loans	100	162	225	279
Mortgage brokerage fees	16	0	30	0
Increase in cash surrender value of life insurance	51	54	104	110
Other income	22	23	49	47
Total non-interest income	955	1,003	1,878	1,826
NON-INTEREST EXPENSE				
Compensation and benefits	1,881	1,744	3,711	3,510
Occupancy and equipment	311	347	640	685
Data processing	291	278	581	244
Professional fees	164	184	313	390
Advertising	83	52	113	91
Other operating expenses	641	790	1,265	1,365
Total non-interest expense	3,371	3,395	6,623	6,285
Income before income taxes	1,303	1,338	2,521	2,781
Income tax expense	358	346	677	785

Net Income	$ 945	$ 992	$ 1,844	$ 1,996
Less: net income attributable to noncontrolling interest in subsidiary	4	4	7	7
Net Income Attributable to First Capital, Inc.	$ 941	$ 988	$ 1,837	$ 1,989
Other comprehensive income, net of tax				
Unrealized gain on securities available for sale:				
Unrealized holding gains arising during the period	888	309	867	589
Less: reclassification adjustment	12	0	12	0
Other comprehensive income	900	309	879	589
Comprehensive Income	$ 1,841	$ 1,297	$ 2,716	$ 2,578
Earnings per common share attributable to First Capital, Inc.				
Basic	$ 0.34	$ 0.35	$ 0.66	$ 0.71
Diluted	$ 0.34	$ 0.35	$ 0.66	$ 0.71
Dividends per share	$ 0.19	$ 0.18	$ 0.38	$ 0.36

See accompanying notes to consolidated financial statements.

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PART I - FINANCIAL INFORMATION

FIRST CAPITAL, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended June 30, 2011	2010
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 1,844	$ 1,996
Adjustments to reconcile net income to net cash and cash equivalents provided by operating activities:		
Amortization of premiums and accretion of discounts on securities, net	471	432
Depreciation and amortization expense	410	465
Deferred income taxes	22	185
Increase in cash value of life insurance	(104)	(110)
Provision for loan losses	925	880
Proceeds from sales of mortgage loans	12,324	16,562
Mortgage loans originated for sale	(8,008)	(17,296)
Net gain on sale of mortgage loans	(225)	(279)
Decrease in accrued interest receivable	73	27
Decrease in accrued interest payable	(143)	(269)
Net change in other assets/liabilities	(231)	5
Net Cash Provided By Operating Activities	7,358	2,598
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of securities available for sale	(21,595)	(35,011)
Proceeds from maturities of securities available for sale	6,265	18,396
Proceeds from maturities of securities held to maturity	14	10
Proceeds from sales of securities available for sale	647	0
Principal collected on mortgage-backed obligations	5,223	6,754
Net decrease in loans receivable	3,866	3,332
Proceeds from sale of foreclosed real estate	357	750
Proceeds from redemption of Federal Home Loan Bank stock	374	0
Purchase of premises and equipment	(183)	(56)
Net Cash Used In Investing Activities	(5,032)	(5,825)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net decrease in deposits	(8,834)	(3,693)
Net increase (decrease) in advances from Federal Home Loan Bank	(450)	4,225
Net increase in retail repurchase agreements	607	454
Exercise of stock options	0	282
Purchase of treasury stock	(27)	(35)
Dividends paid	(1,072)	(1,016)
Net Cash Provided By (Used In) Financing Activities	(9,776)	217

Net Decrease in Cash and Cash Equivalents	(7,450)	(3,010)
Cash and cash equivalents at beginning of period	21,575	15,857
Cash and Cash Equivalents at End of Period	$ 14,125	$ 12,847

See accompanying notes to consolidated financial statements.

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Presentation of Interim Information

First Capital, Inc. (Company) is the thrift holding company for First Harrison Bank (Bank). The information presented in this report relates primarily to the Bank s operations. First Harrison Investments, Inc. and First Harrison Holdings, Inc. are wholly-owned Nevada corporate subsidiaries of the Bank that jointly own First Harrison, LLC, a Nevada limited liability corporation that holds and manages an investment portfolio. First Harrison REIT, Inc. (REIT) was incorporated as a wholly-owned subsidiary of First Harrison Holdings, Inc. to hold a portion of the Bank s real estate mortgage loan portfolio. On January 21, 2009, the REIT issued 105 shares of 12.5% redeemable cumulative preferred stock with an aggregate liquidation value of $105,000 in a private placement offering in order to satisfy certain ownership requirements to qualify as a real estate investment trust. At June 30, 2011, this noncontrolling interest represented 0.2% ownership of the REIT.

In the opinion of management, the unaudited consolidated financial statements include all normal adjustments considered necessary to present fairly the financial position as of June 30, 2011, and the results of operations for the three and six months ended June 30, 2011 and 2010 and the cash flows for the six months ended June 30, 2011 and 2010. All of these adjustments are of a normal, recurring nature. Such adjustments are the only adjustments included in the unaudited consolidated financial statements. Interim results are not necessarily indicative of results for a full year.

The accompanying unaudited consolidated financial statements and notes have been prepared in accordance with generally accepted accounting principles (GAAP) for interim financial statements and are presented as permitted by the instructions to Form 10-Q. Accordingly, they do not contain certain information included in the Company s annual audited consolidated financial statements and related footnotes for the year ended December 31, 2010 included in the Form 10-K.

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

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

2. Comprehensive Income

Comprehensive income is defined as the change in equity (net assets) of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. Comprehensive income for the Company includes net income attributable to the Company and other comprehensive income representing the net unrealized gains and losses on securities available for sale. The following table sets forth the components of other comprehensive income and the allocated tax amounts for the three and six months ended June 30, 2011 and 2010:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	**2010**	**2011**	**2010**
	(In thousands)		(In thousands)	
Unrealized gains on securities:				
Unrealized holding gains arising during the period	$ 1,471	$ 511	$ 1,436	$ 975
Income tax expense	(583)	(202)	(569)	(386)
Net of tax amount	888	309	867	589
Less: reclassification adjustment for losses included in net income	19	0	19	0
Income tax benefit	(7)	0	(7)	0
Net of tax amount	12	0	12	0
Other comprehensive income	$ 900	$ 309	$ 879	$ 589

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. Investment Securities

Debt and equity securities have been classified in the consolidated balance sheets according to management s intent. Investment securities at June 30, 2011 and December 31, 2010 are summarized as follows:

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2011				
Securities available for sale:				
Agency mortgage-backed securities	$ 11,720	$ 618	$ 0	$ 12,338
Agency CMO	19,063	192	10	19,245
Privately-issued CMO	1,166	21	29	1,158
Other debt securities:				
Agency notes and bonds	46,008	403	7	46,404
Municipal obligations	28,608	820	40	29,388
Subtotal - debt securities	106,565	2,054	86	108,533
Mutual funds	2,673	43	22	2,694
Total Securities available for sale	$ 109,238	$ 2,097	$ 108	$ 111,227
Securities held to maturity:				
Agency mortgage-backed securities	$ 17	$ 0	$ 0	$ 17
Total securities held to maturity	$ 17	$ 0	$ 0	$ 17
December 31, 2010				
Securities available for sale:				
Agency mortgage-backed securities	$ 12,101	$ 580	$ 0	$ 12,681
Agency CMO	11,987	46	65	11,968
Privately-issued CMO	1,688	10	46	1,652
Other debt securities:				
Agency notes and bonds	42,400	297	317	42,380
Municipal obligations	29,366	371	281	29,456
Subtotal - debt securities	97,542	1,304	709	98,137
Mutual funds	2,705	36	27	2,714

Total Securities available for sale	$ 100,247	$ 1,340	$ 736	$ 100,851
Securities held to maturity:				
Agency mortgage-backed securities	$ 18	$ 0	$ 0	$ 18
Municipal obligations	14	0	0	14
Total securities held to maturity	$ 32	$ 0	$ 0	$ 32

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

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

The amortized cost and fair value of debt securities as of June 30, 2011, by contractual maturity, are shown below. Expected maturities of mortgage-backed securities may differ from contractual maturities because the mortgages underlying the obligations may be prepaid without penalty.

	Securities Available for Sale		Securities Held to Maturity	
(In thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 3,102	$ 3,134	$ 0	$ 0
Due after one year through five years	13,222	13,398	0	0
Due after five years through ten years	14,391	14,681		
Due after ten years	43,901	44,579	0	0
	74,616	75,792	0	0
Mortgage-backed securities and CMO	31,949	32,741	17	17
	$ 106,565	$ 108,533	$ 17	$ 17

Information pertaining to investment securities available for sale with gross unrealized losses at June 30, 2011, aggregated by investment category and the length of time that individual investment securities have been in a continuous position, follows:

(Dollars in thousands)	Number of Investment Positions	Fair Value	Gross Unrealized Losses
Continuous loss position less than twelve months:			
Agency CMO	5	$ 4,511	$ 10
Agency notes and bonds	4	4,733	7
Municipal obligations	4	1,377	15

Total less than twelve months	13	10,621	32
Continuous loss position more than twelve months:			
Privately-issued CMO	1	369	29
Municipal obligations	2	905	25
Mutual fund	1	349	22
Total more than twelve months	4	1,623	76
Total securities available for sale	17	$ 12,244	$ 108

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(3 continued)

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

At June 30, 2011, the 15 U.S. government agency debt securities, including agency notes and bonds, mortgage-backed securities and CMO, and municipal obligations in a loss position had depreciated approximately 0.5% from the amortized cost basis. All of the U.S. government agency securities and municipal obligations are issued by U.S. government agencies, government-sponsored enterprises and municipal governments, or are secured by first mortgage loans and municipal project revenues. These unrealized losses related principally to current interest rates for similar types of securities. In analyzing an issuer s financial condition, management considers whether the securities are issued by the federal government, its agencies or other governments, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer s financial condition. As the Company has the ability to hold the debt securities until maturity, or the foreseeable future if classified as available for sale, no declines are deemed to be other-than-temporary.

At June 30, 2011, the privately-issued CMO in a loss position had depreciated approximately 7.3% from the amortized cost basis. The Company evaluates the existence of a potential credit loss component related to the decline in fair values of the privately-issued CMO portfolio each quarter using an independent third party analysis. At June 30, 2011, the Company holds one privately-issued CMO with an amortized cost of $398,000 and a fair value of $369,000 that was downgraded to a substandard regulatory classification in 2009 due to a downgrade of the security s credit quality by various rating agencies. Based on the independent third party analysis performed in June 2011, the Company expects to collect the contractual principal and interest cash flows for this security, and, as a result, no other-than-temporary impairment has been recognized. While the Company did not recognize a credit-related impairment loss at June 30, 2011, additional deterioration in market and economic conditions may have an adverse impact on the credit quality in the future.

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. Loans and Allowance for Loan Losses

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

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

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

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

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

The Company s practice is to charge-off any loan or portion of a loan when the loan is determined by management to be uncollectible due to the borrower s failure to meet repayment terms, the borrower s deteriorating or deteriorated financial condition, the depreciation of the underlying collateral, the loan s classification as a loss by regulatory examiners, or for other reasons. A partial charge-off is recorded on a loan when the uncollectibility of a portion of the loan has been confirmed, such as when a loan is discharged in bankruptcy, the collateral is liquidated, a loan is restructured at a reduced principal balance, or other identifiable events that lead management to determine the full principal balance of the loan will not be repaid. A specific reserve is recognized as a component of the allowance for estimated losses on loans individually evaluated for impairment. Partial charge-offs on nonperforming and impaired loans are included in the Company s historical loss experience used to estimate the general component of the allowance for loan losses as discussed below. Specific reserves are not considered charge-offs in management s analysis of the allowance for loan losses because they are estimates and the outcome of the loan relationship is undetermined. At June 30, 2011 and December 31, 2010, the Company had no loans outstanding on which a partial charge-off had been recorded.

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

FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(4 continued)

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

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

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

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

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

Loans modified in a troubled debt restructuring are placed on nonaccrual status until the Company determines the future collection of principal and interest is reasonably assured, which generally requires that the borrower demonstrate a period of performance according to the restructured terms of at least six consecutive months. At June 30, 2011, troubled debt restructurings totaled $3.7 million and the related allowance for loan losses on troubled debt restructurings was $1.4 million. At December 31, 2010, troubled debt restructurings totaled $3.9 million and the related allowance for loan losses on troubled debt restructurings was $1.5 million. All troubled debt restructurings were on nonaccrual status at June 30, 2011 and December 31, 2010.

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(4 continued)

The following table provides the components of the Company s recorded investment in loans for each portfolio segment at June 30, 2011 and December 31, 2010:

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity & 2nd Mtg	Other Consumer	Total
				(In thousands)				
June 30, 2011								
Principal loan balance	$ 123,361	$ 9,110	$ 6,029	$ 58,143	$ 26,734	$ 40,849	$ 29,587	$ 293,813
Accrued interest receivable	467	34	14	149	78	154	164	1,060
Net deferred loan origination fees	79	1	0	3	1	101	0	185
Recorded investment in loans	$ 123,907	$ 9,145	$ 6,043	$ 58,295	$ 26,813	$ 41,104	$ 29,751	$ 295,058
December 31, 2010								
Principal loan balance	$ 130,143	$ 9,534	$ 5,032	$ 59,901	$ 21,911	$ 43,046	$ 29,234	$ 298,801
Accrued interest receivable	480	54	16	174	68	171	199	1,162
Net deferred loan origination fees	91	1	0	10	0	120	0	222
Recorded investment in loans	$ 130,714	$ 9,589	$ 5,048	$ 60,085	$ 21,979	$ 43,337	$ 29,433	$ 300,185

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(4 continued)

An analysis of the allowance for loan losses and recorded investment in loans as of June 30, 2011, and for the three- and six-month periods then ended is as follows:

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity & 2nd Mtg	Other Consumer	Total
				(In thousands)				
Allowance for loan losses:								
Changes in Allowance for Loan Losses for the three-months ended June 30, 2011:								
Beginning balance	$ 992	$ 79	$ 39	$ 1,248	$ 1,211	$ 562	$ 446	$ 4,577
Provisions for loan losses	223	(20)	(13)	91	112	46	(14)	425
Charge-offs	(1)	0	0	(68)	(305)	(51)	(73)	(498)
Recoveries	3	0	0	0	2	5	47	57
Ending balance	$ 1,217	$ 59	$ 26	$ 1,271	$ 1,020	$ 562	$ 406	$ 4,561
Changes in Allowance for Loan Losses for the six-months ended June 30, 2011:								
Beginning balance	$ 1,024	$ 55	$ 21	$ 1,051	$ 1,251	$ 606	$ 465	$ 4,473
Provisions for loan losses	454	4	5	288	70	133	(29)	925
Charge-offs	(265)	0	0	(68)	(305)	(208)	(138)	(984)
Recoveries	4	0	0	0	4	31	108	147
Ending balance	$ 1,217	$ 59	$ 26	$ 1,271	$ 1,020	$ 562	$ 406	$ 4,561
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	$ 534	$ 0	$ 0	$ 598	$ 940	$ 253	$ 0	$ 2,325
Collectively evaluated for impairment	683	59	26	673	80	309	406	2,236
Acquired with deteriorated credit quality	0	0	0	0	0	0	0	0
Ending balance	$ 1,217	$ 59	$ 26	$ 1,271	$ 1,020	$ 562	$ 406	$ 4,561
Recorded investment in loans:								
Individually evaluated for impairment	$ 3,309	$ 6	$ 485	$ 1,408	$ 1,999	$ 480	$ 0	$ 7,687
Collectively evaluated for impairment	120,598	9,139	5,558	56,887	24,814	40,624	29,751	287,371
Acquired with deteriorated credit quality	0	0	0	0	0	0	0	0

Ending balance	$ 123,907	$ 9,145	$ 6,043	$ 58,295	$ 26,813	$ 41,104	$ 29,751	$ 295,058

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(4 continued)

An analysis of the Company s allowance for loan losses and recorded investment in loans as of December 31, 2010 is as follows:

	Residential Real Estate	Land	Construction	Commercial Real Estate	Commercial Business	Home Equity & 2nd Mtg	Other Consumer	Total
				(In thousands)				
Allowance for loan losses:								
Individually evaluated for impairment	$ 458	$ 0	$ 0	$ 607	$ 1,089	$ 338	$ 0	$ 2,492
Collectively evaluated for impairment	566	55	21	444	162	268	465	1,981
Acquired with deteriorated credit quality	0	0	0	0	0	0	0	0
Ending balance	$ 1,024	$ 55	$ 21	$ 1,051	$ 1,251	$ 606	$ 465	$ 4,473
Recorded investment in loans:								
Individually evaluated for impairment	$ 3,285	$ 0	$ 279	$ 1,780	$ 2,168	$ 398	$ 17	$ 7,927
Collectively evaluated for impairment	127,429	9,589	4,769	58,305	19,811	42,939	29,416	292,258
Acquired with deteriorated credit quality	0	0	0	0	0	0	0	0
Ending balance	$ 130,714	$ 9,589	$ 5,048	$ 60,085	$ 21,979	$ 43,337	$ 29,433	$ 300,185

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(4 continued)

At June 30, 2011 and December 31, 2010, for each loan portfolio segment management applied an overall qualitative factor of 1.15 to the Company s historical loss factors based on the most recent calendar quarters. The overall qualitative factor is derived from management s analysis of changes and trends in the following qualitative factors:

Underwriting Standards Management reviews the findings of periodic internal audit loan reviews, independent outsourced loan reviews and loan reviews performed by the banking regulators to evaluate the risk associated with changes in underwriting standards. At June 30, 2011 and December 31, 2010, management assessed the risk associated with this component as neutral, requiring no adjustment to the historical loss factors.

Economic Conditions Management analyzes trends in housing and unemployment data in the Harrison, Floyd and Clark counties of Indiana, the Company s primary market area, to evaluate the risk associated with economic conditions. Due to a decrease in new home construction and an increase in unemployment in the Company s primary market area, management assigned a risk factor of 1.20 for the component at June 30, 2011 and December 31, 2010.

Past Due Loans Management analyzes trends in past due loans for the Company to evaluate the risk associated with delinquent loans. In general, past due loan ratios have remained at elevated levels compared to historical amounts since 2007, and management assigned a risk factor of 1.20 for the component at June 30, 2011 and December 31, 2010.

Other Internal and External Factors This component includes management s consideration of other qualitative factors such as loan portfolio composition. The Company has focused on origination of commercial business and real estate loans in an effort to convert the Company s balance sheet from that of a traditional thrift institution to a commercial bank. In addition, the Company has increased its investment in mortgage loans in which it does not hold a first lien position. Commercial loans and second mortgage loans generally entail greater risk than residential mortgage loans secured by a first lien. As a result of changes in the loan portfolio composition, management assigned a risk factor of 1.20 for this component at June 30, 2011 and December 31, 2010.

Each of the four factors above was assigned an equal weight to arrive at an average for the overall qualitative factor of 1.15 at June 30, 2011 and December 31, 2010. The effect of the overall qualitative factor was to increase the estimated allowance for loan losses by $297,000 and $258,000 at June 30, 2011 and December 31, 2010, respectively.

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(4 continued)

The Company s impaired loans by class of loans as of June 30, 2011 and for the three- and six-month periods then ended is as follows:

	At June 30, 2011			Three Months Ended June 30, 2011			Six Months Ended June 30, 2011		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Interest Recognized - Cash Method	Average Recorded Investment	Interest Income Recognized	Interest Recognized - Cash Method
					(In thousands)				
Loans with no related allowance recorded:									
Residential	$ 828	$ 827	$ 0	$ 947	$ 6	$ 2	$ 977	$ 10	$ 4
Land	6	6	0	6	0	0	4	0	0
Construction	485	485	0	441	0	0	294	0	0
Commercial real estate	401	401	0	438	0	0	424	0	0
Commercial business	0	0	0	0	0	0	7	0	0
HE/2nd mortgage	17	17	0	17	2	0	19	2	0
Other consumer	0	0	0	0	1	1	6	1	1
	1,737	1,736	0	1,849	9	3	1,731	13	5
Loans with an allowance recorded:									
Residential	2,481	2,479	534	2,156	0	34	2,187	0	34
Land	0	0	0	0	0	0	0	0	0
Construction	0	0	0	0	0	0	93	0	0
Commercial real estate	1,007	1,006	598	1,011	0	0	1,134	0	0
Commercial business	1,999	1,999	940	2,071	0	0	2,097	0	0
HE/2nd mortgage	463	463	253	484	0	0	447	0	0
Other consumer	0	0	0	12	0	0	8	0	0
	5,950	5,947	2,325	5,734	0	34	5,966	0	34
Total:									
Residential	3,309	3,306	534	3,103	6	36	3,164	10	38
Land	6	6	0	6	0	0	4	0	0
Construction	485	485	0	441	0	0	387	0	0
Commercial real estate	1,408	1,407	598	1,449	0	0	1,558	0	0
Commercial business	1,999	1,999	940	2,071	0	0	2,104	0	0
HE/2nd mortgage	480	480	253	501	2	0	466	2	0
Other consumer	0	0	0	12	1	1	14	1	1

	$ 7,687	$ 7,683	$ 2,325	$ 7,583	$ 9	$ 37	$ 7,697	$ 13	$ 39

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FIRST CAPITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(4 continued)

The following table summarizes the Company s impaired loans by class of loans as of December 31, 2010:

	Recorded Investment	Unpaid Principal Balance *(In thousands)*	Related Allowance
Loans with no related allowance recorded:			
Residential	$ 1,037	$ 1,026	$ 0
Land	0	0	0
Construction	0	0	0
Commercial real estate	398	398	0
Commercial business	20	20	0
HE/2nd mortgage	25	25	0
Other consumer	17	17	0
	1,497	1,486	0
Loans with an allowance recorded:			
Residential	2,248	2,244	458
Land	0	0	0
Construction	279	279	0
Commercial real estate	1,382	1,382	607
Commercial business	2,148	2,148	1,089
HE/2nd mortgage	373	373	338
Other consumer	0	0	0
	6,430	6,426	2,492
Total:			
Residential	3,285	3,270	458
Land	0	0	0
Construction	279	279	0
Commercial real estate	1,780	1,780	607
Commercial business	2,168	2,168	1,089
HE/2nd mortgage	398	398	338
Other consumer	17	17	0
	$ 7,927	$ 7,912	$ 2,492

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FIRST CAPITAL, INC.

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(4 continued)

Nonperforming loans consists of nonaccrual loans and loans over 90 days past due and still accruing interest. The following table presents the recorded investment in nonperforming loans by class of loans at June 30, 2011 and December 31, 2010:

	June 30, 2011			December 31, 2010		
	Nonaccrual Loans	Loans 90+ Days Past Due Still Accruing	Total Nonperforming Loans	Nonaccrual Loans	Loans 90+ Days Past Due Still Accruing	Total Nonperforming Loans
			(In thousands)			
Residential	$ 3,309	$ 380	$ 3,689	$ 2,951	$ 334	$ 3,285
Land	6	0	6	0	0	0
Construction	485	0	485	279	0	279
Commercial real estate	1,408	0	1,408	1,780	0	1,780
Commercial business	1,999	0	1,999	2,148	20	2,168
HE/2nd mortgage	480	131	611	390	8	398
Other consumer	0	34	34	0	17	17
Total	$					