

# **Home Financial Bancorp**

Accountants' Report and Consolidated Financial Statements

June 30, 2009 and 2008

# Home Financial Bancorp

June 30, 2009 and 2008

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## Independent Accountants' Report

Audit Committee, Board of Directors and Stockholders  
Home Financial Bancorp  
Spencer, Indiana

We have audited the accompanying consolidated balance sheets of Home Financial Bancorp as of June 30, 2009 and 2008, and the related consolidated statements of income, stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Home Financial Bancorp as of June 30, 2009 and 2008, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 19, the Company changed its method of accounting for fair value measurements in accordance with Statement of Financial Accounting Standards No. 157 in 2009.

*BKD, LLP*

Indianapolis, Indiana  
September 14, 2009

**Home Financial Bancorp**  
**Consolidated Balance Sheets**  
**June 30, 2009 and 2008**

**Assets**

	<u>2009</u>	<u>2008</u>
Cash	\$ 754,304	\$ 533,961
Short-term interest-bearing deposits	<u>4,515,541</u>	<u>4,263,261</u>
Total cash and cash equivalents	5,269,845	4,797,222
Interest-bearing deposits	1,000,000	400,000
Investment securities - available for sale	1,391,394	1,016,643
Loans, net of allowance for loan losses of \$612,506 and \$591,831	56,816,797	59,636,795
Real estate acquired for development	307,863	377,188
Premises and equipment	1,957,013	2,013,264
Federal Home Loan Bank of Indianapolis stock	1,187,700	1,187,700
Interest receivable	370,097	392,466
Other assets	<u>1,550,395</u>	<u>1,331,127</u>
Total assets	<u>\$ 69,851,104</u>	<u>\$ 71,152,405</u>

**Liabilities**

Deposits		
Noninterest-bearing deposits	\$ 3,913,255	\$ 3,849,086
Interest-bearing deposits	<u>39,352,402</u>	<u>38,314,440</u>
Total deposits	43,265,657	42,163,526
Borrowings	18,500,000	21,000,000
Other liabilities	<u>390,611</u>	<u>307,012</u>
Total liabilities	<u>62,156,268</u>	<u>63,470,538</u>

**Commitments and Contingencies**

**Stockholders' Equity**

Preferred stock, without par value		
Authorized and unissued - 2,000,000 shares	—	—
Common stock, without par value		
Authorized - 5,000,000 shares		
Issued and outstanding - 2009 - 1,352,926 shares and 2008 - 1,356,726 shares	3,070,676	3,080,176
Additional paid-in capital	108,442	85,219
Retained earnings	4,498,593	4,516,135
Accumulated other comprehensive income	<u>17,125</u>	<u>337</u>
Total stockholders' equity	<u>7,694,836</u>	<u>7,681,867</u>
Total liabilities and stockholders' equity	<u>\$ 69,851,104</u>	<u>\$ 71,152,405</u>

# Home Financial Bancorp

## Consolidated Statements of Income

### Years Ended June 30, 2009 and 2008

	2009	2008
<b>Interest Income</b>		
Loans	\$ 4,422,163	\$ 4,819,489
Deposits with financial institutions	79,484	121,643
Investment securities	58,032	109,264
Federal Home Loan Bank stock	<u>39,312</u>	<u>58,698</u>
Total interest and dividend income	<u>4,598,991</u>	<u>5,109,094</u>
<b>Interest Expense</b>		
Deposits	1,051,259	1,467,206
Federal Home Loan Bank advances	<u>865,371</u>	<u>933,494</u>
Total interest expense	<u>1,916,630</u>	<u>2,400,700</u>
<b>Net Interest Income</b>	2,682,361	2,708,394
Provision for loan losses	<u>375,000</u>	<u>240,000</u>
<b>Net Interest Income After Provision for Loan Losses</b>	<u>2,307,361</u>	<u>2,468,394</u>
<b>Other Income</b>		
Service charges on deposit accounts	498,861	559,465
Gain on sale of real estate acquired for development	36,894	—
Net gain on sale of available-for-sale securities	—	39,495
Other income	<u>233,459</u>	<u>248,734</u>
Total other income	<u>769,214</u>	<u>847,694</u>
<b>Other Expenses</b>		
Salaries and employee benefits	1,146,332	1,194,207
Net occupancy expenses	128,518	129,230
Equipment expenses	36,629	24,941
Computer processing fees	420,765	388,991
ATM transaction fees	130,174	107,164
Printing and office supplies	48,223	47,246
Legal and professional fees	122,905	137,299
Director and committee fees	74,150	75,600
Advertising expense	86,131	80,199
Reposessed property expense	330,320	259,523
Loss on sale of real estate acquired for development	—	21,946
Equity in losses of partnership	82,707	52,500
Other expenses	<u>400,487</u>	<u>387,517</u>
Total other expenses	<u>3,007,341</u>	<u>2,906,363</u>
<b>Income Before Income Tax</b>	69,234	409,725
Income tax expense (benefit)	<u>(80,130)</u>	<u>54,125</u>
<b>Net Income</b>	<u>\$ 149,364</u>	<u>\$ 355,600</u>
<b>Net Income Per Share</b>		
Basic	\$ .11	\$ .27
Diluted	.11	.27

**Home Financial Bancorp**  
**Consolidated Statements of Stockholders' Equity**  
**Years Ended June 30, 2009 and 2008**

	Common Shares	Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
<b>Balances, July 1, 2007</b>	1,360,769	\$ 3,090,415	\$ 68,719	\$ 4,339,394	\$ (18,768)	\$ 7,479,760
Comprehensive income						
Net income				355,600		355,600
Other comprehensive income, net of tax						
Unrealized gains on securities, net of reclassification adjustment					19,105	<u>19,105</u>
Comprehensive income						<u>374,705</u>
Cash dividends (\$.12 per share)				(163,459)		(163,459)
Recognition Retention Plan and Trust (RRP) shares earned			16,500			16,500
Issuance of stock	5,957	14,761				14,761
Purchase of stock	<u>(10,000)</u>	<u>(25,000)</u>		<u>(15,400)</u>		<u>(40,400)</u>
<b>Balances, June 30, 2008</b>	1,356,726	3,080,176	85,219	4,516,135	337	7,681,867
Comprehensive income						
Net income				149,364		149,364
Other comprehensive income, net of tax						
Unrealized gains on securities, net of reclassification adjustment					16,788	<u>16,788</u>
Comprehensive income						<u>166,152</u>
Cash dividends (\$.12 per share)				(162,617)		(162,617)
Recognition Retention Plan and Trust (RRP) shares earned			23,223			23,223
Purchase of stock	<u>(3,800)</u>	<u>(9,500)</u>		<u>(4,289)</u>		<u>(13,789)</u>
<b>Balances, June 30, 2009</b>	<u>1,352,926</u>	<u>\$ 3,070,676</u>	<u>\$ 108,442</u>	<u>\$ 4,498,593</u>	<u>\$ 17,125</u>	<u>\$ 7,694,836</u>

# Home Financial Bancorp

## Consolidated Statements of Cash Flows

### Years Ended June 30, 2009 and 2008

	2009	2008
<b>Operating Activities</b>		
Net income	\$ 149,364	\$ 355,600
Items not requiring (providing) cash		
Provision for loan losses	375,000	240,000
Investment securities amortization, net	2,690	2,903
RRP shares earned	23,223	16,500
Depreciation	85,577	81,639
Deferred income taxes	(32,931)	(96,004)
(Gain) loss on sale of real estate acquired for development	(36,894)	21,946
Foreclosed asset losses	124,011	157,439
Investment securities gains	—	(39,495)
Losses from partnership	82,707	52,500
Net change in interest receivable	22,369	24,345
Other adjustments	<u>(126,265)</u>	<u>331,603</u>
Net cash provided by operating activities	<u>668,851</u>	<u>1,148,976</u>
<b>Investing Activities</b>		
Net change in interest-bearing deposits	(600,000)	900,599
Purchase of securities available for sale	(496,575)	—
Proceeds from sales of securities available for sale	—	804,634
Proceeds from maturities and paydowns of securities available for sale	146,929	133,678
Net changes in loans	1,844,509	574,373
Proceeds from sale of foreclosed assets	510,242	382,740
Purchase of premises and equipment	(29,326)	(38,104)
Purchase of real estate acquired for development and development cost	(11,334)	(19,357)
Proceeds from sale of real estate acquired for development	<u>13,600</u>	<u>52,000</u>
Net cash provided by investing activities	<u>1,378,045</u>	<u>2,790,563</u>
<b>Financing Activities</b>		
Net change in		
Noninterest-bearing deposits	64,171	345,670
Interest-bearing deposits	1,037,961	(3,700,292)
Proceeds from other borrowings	3,000,000	7,000,000
Repayment of other borrowings	(5,500,000)	(7,500,000)
Issuance of stock	—	14,761
Purchase of stock	(13,789)	(40,400)
Dividends paid	<u>(162,616)</u>	<u>(163,151)</u>
Net cash used in financing activities	<u>(1,574,273)</u>	<u>(4,043,412)</u>
<b>Net Change in Cash and Cash Equivalents</b>	472,623	(103,873)
<b>Cash and Cash Equivalents, Beginning of Year</b>	<u>4,797,222</u>	<u>4,901,095</u>
<b>Cash and Cash Equivalents, End of Year</b>	<u>\$ 5,269,845</u>	<u>\$ 4,797,222</u>
<b>Additional Cash Flows and Supplementary Information</b>		
Interest paid	\$ 1,930,375	\$ 2,405,725
Income tax paid (refunded)	41,221	(7,730)
Transfers from loans to foreclosed assets	722,889	618,089

**Home Financial Bancorp**  
**Notes to Consolidated Financial Statements**  
**June 30, 2009 and 2008**  
(Table Dollar Amounts in Thousands, Except Share Data)

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

The accounting and reporting policies of Home Financial Bancorp (Company) and its wholly owned subsidiary, Owen Community Bank, s.b. (Bank) and the Bank's wholly owned subsidiaries, BSF, Inc. (BSF) and OCB Insurance Agency, Inc., conform to accounting principles generally accepted in the United States of America and reporting practices followed by the thrift industry. The more significant of the policies are described below.

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.

The Company is a savings and loan holding company whose principal activity is the ownership and management of the Bank. The Bank operates under a federal thrift charter, known as a federal stock savings bank, and provides full banking services. As a federally chartered thrift, the Bank is subject to regulation by the Office of Thrift Supervision and the Federal Deposit Insurance Corporation.

The Bank generates mortgage and consumer loans and receives deposits from customers located primarily in Owen, Putnam and surrounding counties. The Bank's loans are generally secured by specific items of collateral including real property and consumer assets.

BSF engages in purchasing and developing large tracts of real estate. After land is purchased, BSF subdivides the real estate into lots, makes improvements such as streets, and sells individual lots, usually on contract for deed.

**Consolidation** - The consolidated financial statements include the accounts of the Company, Bank and BSF after elimination of all material intercompany transactions.

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

**Investment Securities** - Debt securities are classified as held to maturity when the Company has the positive intent and ability to hold the securities to maturity. Securities held to maturity are carried at amortized cost. Debt securities not classified as held to maturity are classified as available for sale. Securities available for sale are carried at fair value with unrealized gains and losses reported separately in accumulated other comprehensive income, net of tax.

Amortization of premiums and accretion of discounts are recorded using the interest method as interest income from 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.

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**Loans** are carried at the principal amount outstanding. A loan is impaired when, based on current information or events, it is probable that the Company will be unable to collect all amounts due (principal and interest) according to the contractual terms of the loan agreement. Loans whose payments have insignificant delays not exceeding 90 days outstanding are not considered impaired. The Company considers its investment in one-to-four family residential loans and consumer loans to be homogeneous and therefore excluded from separate identification for evaluation of impairment. Interest income is accrued on the principal balances of loans. The accrual of interest on impaired and nonaccrual loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed when considered uncollectible. Interest income is subsequently recognized only to the extent cash payments are received. Certain loan fees and direct costs are being deferred and amortized as an adjustment of yield on the loans over the contractual lives of the loans. When a loan is paid off or sold, any unamortized loan origination fee balance is credited to income.

**Allowance for loan losses** is maintained to absorb loan losses based on management's continuing review and evaluation of the loan portfolio and its judgment as to the impact of economic conditions on the portfolio. The evaluation by management includes consideration of past loss experience, changes in the composition of the portfolio, the current condition and amount of loans outstanding, and the probability of collecting all amounts due. Impaired loans are measured by the present value of expected future cash flows, or the fair value of the collateral of the loan, if collateral dependent. 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 determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. Management believes that as of June 30, 2009, the allowance for loan losses is adequate based on information currently available. A worsening or protracted economic decline in the area within which the Company operates would increase the likelihood of additional losses due to credit and market risks and could create the need for additional loss reserves.

**Real estate acquired for development** is carried at the lower of cost or fair value. Costs relating to development and improvements of property are allocated to individual lots and capitalized, whereas costs relating to holding the property are expensed. Gains and losses on sales of lots are determined on the specific-identification method.

**Home Financial Bancorp**  
**Notes to Consolidated Financial Statements**  
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**Premises and equipment** are carried at cost net of accumulated depreciation. Depreciation is computed using the accelerated and straight-line methods based principally on the estimated useful lives of the assets. Maintenance and repairs are expensed as incurred while major additions and improvements are capitalized. Gains and losses on dispositions are included in current operations.

**Federal Home Loan Bank (FHLB) stock** is a required investment for institutions that are members of the FHLB system. The required investment in the common stock is based on a predetermined formula.

**Pension plan costs** are based on actuarial computations and charged to current operations. The funding policy is to pay at least the minimum amounts required by ERISA.

**Stock options** - At June 30, 2009, the Company has a stock-based employee compensation plan, which is described more fully in Note 16. No options were granted during the two years in the period ended June 30, 2009 and all previously granted shares were fully vested prior to July 1, 2007.

**Income tax** in the consolidated statements of income includes deferred income tax provisions or benefits for all significant temporary differences in recognizing income and expenses for financial reporting and income tax purposes. The Company and Bank file consolidated tax returns.

**Uncertain Tax Positions** - In accordance with Financial Accounting Standards Board (FASB) Staff Position No. FIN 48-3, the Company has elected to defer the effective date of FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, until its fiscal year ended June 30, 2010. The Company has continued to account for any uncertain tax positions in accordance with literature that was authoritative immediately prior to the effective date of FIN 48, such as FASB Statement No. 109, *Accounting for Income Taxes*, and FASB Statement No. 5, *Accounting for Contingencies*.

**Earnings per share** have been computed based upon the weighted-average common shares and potential common shares outstanding during the period. RRP shares have been excluded from the computation of average common shares and potential common shares outstanding.

**Subsequent events** have been evaluated through September 14, 2009, which is the date the financial statements were available to be issued.

**Reclassifications** - Certain reclassifications have been made to the 2008 financial statements to conform to the 2009 financial statement presentation. These reclassifications had no effect on net income.

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

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

**Note 2: Investment Securities**

	2009			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Available for sale				
Federal agencies	\$ 506	\$ 5	\$ —	\$ 511
Mortgage-backed securities	359	21	—	380
Corporate bonds	497	2	—	499
Marketable equity securities	<u>1</u>	<u>—</u>	<u>—</u>	<u>1</u>
Total investment securities	<u>\$ 1,363</u>	<u>\$ 28</u>	<u>\$ —</u>	<u>\$ 1,391</u>

	2008			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Available for sale				
Federal agencies	\$ 507	\$ —	\$ (8)	\$ 499
Mortgage-backed securities	419	9	(1)	427
Municipal bonds	89	—	—	89
Marketable equity securities	<u>1</u>	<u>1</u>	<u>—</u>	<u>2</u>
Total investment securities	<u>\$ 1,016</u>	<u>\$ 10</u>	<u>\$ (9)</u>	<u>\$ 1,017</u>

**Home Financial Bancorp**  
**Notes to Consolidated Financial Statements**  
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Maturities of available-for-sale investments at June 30, 2009:

	<b>Amortized Cost</b>	<b>Approximate Fair Value</b>
One to five years	\$ 1,003	\$ 1,010
Mortgage-backed and marketable equity securities not due on a single maturity date	360	381
	\$ 1,363	\$ 1,391

Securities with a carrying value of \$380,000 and \$926,000 were pledged at June 30, 2009 and 2008 to secure FHLB advances.

Proceeds from sales of securities available for sale during 2009 and 2008 were \$0 and \$805,000, respectively. Gains realized from sales of securities during 2009 and 2008 totaled \$0 and \$39,000, respectively. There were no losses from sales of securities realized during 2009 and 2008. Net gains on security transactions for 2009 and 2008 resulted in a tax expense of \$0 and \$15,000.

At June 30, 2009, no investments were in a loss position. At June 30, 2008, certain investments in debt and marketable equity securities are reported in the 2008 financial statements at an amount less than their historical cost. Total fair value of these investments at June 30, 2008 was \$668,000, which is approximately 65.7 percent of the Company's investment portfolio. These declines primarily resulted from changes in market interest rates.

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

The following tables show our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2008.

<b>Description of Securities</b>	<b>2008</b>				<b>Total</b>	
	<b>Less Than 12 Months Fair Value</b>	<b>Unrealized Losses</b>	<b>12 Months or More Fair Value</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>
Federal agencies	\$ 499	\$ (8)	\$ —	\$ —	\$ 499	\$ (8)
Mortgage-backed securities	169	(1)	—	—	169	(1)
Total temporarily impaired securities	\$ 668	\$ (9)	\$ —	\$ —	\$ 668	\$ (9)

**Home Financial Bancorp**  
**Notes to Consolidated Financial Statements**  
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**Note 3: Loans and Allowance**

	<b>2009</b>	<b>2008</b>
Real estate mortgage loans		
Residential	\$ 41,027	\$ 41,857
Mobile home and land	6,258	7,547
Nonresidential	6,354	6,534
Mobile home loans	3,236	3,797
Commercial and industrial	201	203
Consumer loans	<u>396</u>	<u>611</u>
	<u>57,472</u>	<u>60,549</u>
Undisbursed portion of loans	—	(275)
Deferred loan fees	(42)	(45)
Allowance for loan losses	<u>(613)</u>	<u>(592)</u>
	<u>(655)</u>	<u>(912)</u>
Total loans	<u>\$ 56,817</u>	<u>\$ 59,637</u>

	<b>2009</b>	<b>2008</b>
Allowance for loan losses		
Balances, July 1	\$ 592	\$ 565
Provision for loan losses	375	240
Recoveries	6	7
Loans charged off	<u>(360)</u>	<u>(220)</u>
Balances, June 30	<u>\$ 613</u>	<u>\$ 592</u>

Information on impaired loans is summarized below:

	<b>2009</b>	<b>2008</b>
Impaired loans with an allowance	\$ 1,047	\$ —
Impaired loans for which the discounted cash flows or collateral value exceeds the carrying value of the loan	<u>—</u>	<u>—</u>
Total impaired loans	<u>\$ 1,047</u>	<u>\$ —</u>

**Home Financial Bancorp**  
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	<u>2009</u>	<u>2008</u>
Average balance of impaired loans	\$ 974	\$ —
Interest income recognized on impaired loans	37	—
Cash-basis interest included above	37	—
Allowance for impaired loans (included in the Company's allowance for loan losses)	\$ 157	\$ —

At June 30, 2009 and 2008, accruing loans delinquent 90 days or more totaled \$0 and \$665,000, respectively. Non-accruing loans at June 30, 2009 and 2008 were \$2,635,000 and \$1,365,000, respectively.

**Note 4: Premises and Equipment**

	<u>2009</u>	<u>2008</u>
Land	\$ 348	\$ 348
Buildings	2,629	2,634
Equipment	<u>1,106</u>	<u>1,071</u>
Total cost	4,083	4,053
Accumulated depreciation	<u>(2,126)</u>	<u>(2,040)</u>
Net	\$ <u>1,957</u>	\$ <u>2,013</u>

**Home Financial Bancorp**  
**Notes to Consolidated Financial Statements**  
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**Note 5: Investment in Limited Partnership**

An investment in a limited partnership of \$245,000 and \$327,000 at June 30, 2009 and 2008 included in other assets represents a 99 percent equity in Cunot Apartments (Cunot), a limited partnership organized to build, own and operate a 24-unit apartment complex for senior living. In addition to recording its equity in the losses of Cunot, the Company has recorded the benefit of low income housing tax credits of \$107,000 for each of the years ended June 30, 2009 and 2008. Condensed unaudited financial statements for Cunot at June 30, 2009 and 2008 and for the two years then ended are as follows:

	<b>2009</b>	<b>2008</b>
Condensed balance sheets		
Assets		
Cash	\$ 99	\$ 134
Land and property	1,117	1,141
Other assets	3	3
Total assets	\$ 1,219	\$ 1,278
Liabilities		
Notes payable	\$ 610	\$ 610
Other liabilities	361	342
Total liabilities	971	952
Partners' equity	248	326
Total liabilities and partners' equity	\$ 1,219	\$ 1,278
	<b>2009</b>	<b>2008</b>
Condensed statements of operations		
Total revenue	\$ 73	\$ 73
Total expenses	(165)	(132)
Net loss	\$ (92)	\$ (59)

**Home Financial Bancorp**  
**Notes to Consolidated Financial Statements**  
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**Note 6: Deposits**

	<b>2009</b>	<b>2008</b>
Noninterest-bearing demand	\$ 3,913	\$ 3,849
Interest-bearing demand	2,413	2,448
Money market deposits	3,629	2,823
Savings	8,553	7,792
Certificates of \$100,000 or more	9,585	7,843
Other certificates	15,173	17,409
Total deposits	\$ 43,266	\$ 42,164

Certificates maturing in years ending June 30:

2010	\$ 17,054
2011	4,158
2012	1,769
2013	1,203
2014	574
	\$ 24,758

Brokered deposits totaled approximately \$1.1 million at June 30, 2009 and 2008.

**Note 7: Borrowings**

The Federal Home Loan Bank (FHLB) advances totaled \$18,500,000 and \$21,000,000 at June 30, 2009 and 2008, respectively.

At June 30, 2009, the FHLB advances are secured by mortgage loans and investment securities totaling \$38,548,000. Advances, at interest rates from 0.51 to 5.56 percent, are subject to restrictions or penalties in the event of prepayment. Advances totaling \$2,000,000 may, at certain dates, be converted to adjustable rate advances by the FHLB. If converted, the advances may be prepaid without penalty.

FHLB advance maturities in years ending June 30:

2010	\$ 5,500
2011	4,500
2012	3,500
2013	1,000
2014	1,500
Thereafter	2,500
	\$ 18,500

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**Note 8: Income Tax**

	<b>2009</b>	<b>2008</b>
Income tax expense (benefit)		
Currently payable		
Federal	\$ (62)	\$ 113
State	15	37
Deferred		
Federal	(25)	(94)
State	<u>(8)</u>	<u>(2)</u>
Total income tax expense (benefit)	<u>\$ (80)</u>	<u>\$ 54</u>
	<b>2009</b>	<b>2008</b>
Reconciliation of federal statutory to actual tax expense (benefit)		
Federal statutory income tax at 34%	\$ 24	\$ 139
Effect of state income taxes	4	23
Business tax credits	(107)	(107)
Tax-exempt interest	<u>(1)</u>	<u>(1)</u>
Actual tax expense (benefit)	<u>\$ (80)</u>	<u>\$ 54</u>
Effective tax rate	<u>(66.3)%</u>	<u>13.2%</u>

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A cumulative net deferred tax asset is included in other assets. The components of the asset are as follows:

	<b>2009</b>	<b>2008</b>
<b>Assets</b>		
Allowance for loan losses	\$ 297	\$ 251
Pension and employee benefit	11	10
Loan fees	18	19
Other real estate owned	21	—
Low income housing credit carry over	199	210
Unrealized capital loss carryforward	50	58
Total assets	596	548
<b>Liabilities</b>		
Depreciation	(92)	(90)
State income tax	(11)	(9)
FHLB stock	(50)	(49)
Prepaid expenses	(39)	(30)
Other	(54)	(41)
Total liabilities	(246)	(219)
<b>Valuation Allowance</b>		
Beginning balance	(50)	(30)
Increase during the period	—	(20)
Ending balance	(50)	(50)
Net deferred tax asset	\$ 300	\$ 279

Management believes the low income housing credits will be utilized during the carry forward limitation period.

Retained earnings at June 30, 2009, include approximately \$700,000 for which no deferred federal income tax liability has been recognized. This amount represents an allocation of income to bad debt deductions as of June 30, 1988 for tax purposes only. Reduction of amounts so allocated for purposes other than tax bad debt losses including redemption of bank stock or excess dividends, or loss of “bank status” would create income for tax purposes only, which income would be subject to the then-current corporate income tax rate. The unrecorded deferred federal income tax liability on the above amount was approximately \$240,000 at June 30, 2009.

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**Note 9: Other Comprehensive Income**

	<b>Before-Tax Amount</b>	<b>2009 Tax Expense</b>	<b>Net-of-Tax Amount</b>
Unrealized gains on securities			
Unrealized holding gains arising during the year	\$ 28	\$ (11)	\$ 17
Less: reclassification adjustment for gains realized in net income	—	—	—
Other comprehensive income	\$ 28	\$ (11)	\$ 17
	<b>Before-Tax Amount</b>	<b>2008 Tax Expense</b>	<b>Net-of-Tax Amount</b>
Unrealized gains on securities			
Unrealized holding gains arising during the year	\$ 71	\$ (28)	\$ 43
Less: reclassification adjustment for gains realized in net income	39	(15)	24
Other comprehensive income	\$ 32	\$ (13)	\$ 19

**Note 10: Commitments and Contingent Liabilities**

In the normal course of business, there are outstanding commitments and contingent liabilities, such as commitments to extend credit, which are not included in the accompanying consolidated financial statements. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit is represented by the contractual or notional amount of those instruments. The Company uses the same credit policies in making such commitments as it does for instruments that are included in the consolidated balance sheets.

Financial instruments whose contract amount represents credit risk as of June 30 were as follows:

	<b>2009</b>	<b>2008</b>
Commitments to extend credit	\$ 1,799	\$ 1,346
Unused lines of credit	219	251

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Commitments to extend credit 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 many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation. Collateral held varies, but may include residential real estate or other assets of the borrower.

The Company has entered into agreements with two officers, which provide for salary continuation for a three-year period under certain circumstances, primarily related to change of control of the Company or Bank, as defined. Under the terms of the agreements, these payments could occur if, following a change of control, such officers are terminated other than for cause or unreasonable changes are made in their employment relationships. These agreements extend automatically for one year on each anniversary date unless certain conditions are met.

The Company and Bank are also subject to claims and lawsuits, which arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate determination of such possible claims or lawsuits will not have a material adverse effect on the consolidated financial position of the Company or Bank.

**Note 11: Stockholders' Equity**

The Company's Board of Directors has approved the repurchase of up to 15 percent of the Company's outstanding shares of common stock. Such purchases will be made subject to market conditions in open market or block transactions.

**Note 12: Dividends and Capital Restrictions**

Without prior approval, current regulations allow the Bank to pay dividends to the Company not exceeding retained net profits for the current calendar year to date plus those for the previous two calendar years. At June 30, 2009, total stockholder's equity of the Bank was \$7,333,000 of which \$7,129,000 was restricted from dividend distribution to the Company. Although well capitalized, under current regulations in effect, the Bank is required to apply to the Office of Thrift Supervision to pay dividends to the Company.

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**Note 13: Regulatory Capital**

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies and is assigned to a capital category. The assigned capital category is largely determined by three ratios that are calculated according to the regulations: total risk adjusted capital, Tier 1 capital, and Tier 1 leverage ratios. The ratios are intended to measure capital relative to assets and credit risk associated with those assets and off-balance sheet exposures of the entity. The capital category assigned to an entity can also be affected by qualitative judgments made by regulatory agencies about the risk inherent in the entity's activities that are not part of the calculated ratios.

There are five capital categories defined in the regulations, ranging from well capitalized to critically undercapitalized. Classification of a bank in any of the undercapitalized categories can result in actions by regulators that could have a material effect on a bank's operations. At June 30, 2009 and 2008, the Bank was categorized as well capitalized and met all subject capital adequacy requirements. There are no conditions or events since June 30, 2009 that management believes has changed the Bank's classification.

The Bank's actual and required capital amounts and ratios are as follows:

	Actual		2009 Required for Adequate Capital		Required To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total risk-based capital (to risk-weighted assets)	\$ 7,223	17.6%	\$ 3,275	8.0%	\$ 4,093	10.0%
Tier I capital (to risk-weighted assets)	6,711	16.4%	1,637	4.0%	2,456	6.0%
Core capital (to adjusted total assets)	6,711	9.7%	2,767	4.0%	3,459	5.0%
Core capital (to adjusted tangible assets)	6,711	9.7%	1,384	2.0%	—	—
Tangible capital (to adjusted total assets)	6,711	9.7%	1,038	1.5%	—	—

	Actual		2008 Required for Adequate Capital		Required To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total risk-based capital (to risk-weighted assets)	\$ 7,272	17.0%	\$ 3,426	8.0%	\$ 4,283	10.0%
Tier I capital (to risk-weighted assets)	6,737	15.7%	1,713	4.0%	2,570	6.0%
Core capital (to adjusted total assets)	6,737	9.6%	2,818	4.0%	3,522	5.0%
Core capital (to adjusted tangible assets)	6,737	9.6%	1,409	2.0%	—	—
Tangible capital (to adjusted total assets)	6,737	9.6%	1,057	1.5%	—	—

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**Note 14: Employee Benefit Plans**

The Bank is a participant in a pension fund known as the Pentegra Group. This plan is a multi-employer plan; separate actuarial valuations are not made with respect to each participating employer. On July 1, 2006, the Company elected to freeze the defined-benefit plan to stop accruing benefits to plan participants beyond what was already earned to that date and to prevent new participants from entering the plan. The plan required contributions in the amount of \$19,000 and \$11,000 for the years ended June 30, 2009 and 2008. The plan provides pension benefits for substantially all of the Bank's employees.

The Company has a Retirement Savings Section 401(k) plan in which substantially all employees may participate. The Company matches participant contributions at the rate of 50 percent of the first 6 percent of base salary contributed by participants. The Company contributes an additional 2 percent of participant base salary regardless of participant contributions. The Company's expense for the plan was \$35,000 and \$38,000 for the years ended June 30, 2009 and 2008.

The Company has an ESOP covering substantially all employees of the Bank. The ESOP acquired 161,896 shares of the Company's common stock at \$2.50 per share with funds provided by a loan from the Company. Compensation expense is recorded equal to the fair market value of the stock when contributions, which are determined annually by the Board of Directors of the Bank, are made to the ESOP. The expense under the ESOP was \$14,000 for each of the years ended June 30, 2009 and 2008. At June 30, 2009, all 161,896 ESOP shares have been allocated. As of June 30, 2009, no unearned shares remained. The Company is obligated at the option of each beneficiary to repurchase shares of the ESOP upon the beneficiary's termination or after retirement.

The Company has a Recognition and Retention Plan and Trust (RRP). The RRP may acquire up to 130,948 shares of the Company's common stock for awards to management. Shares awarded to management under the RRP vest at a rate of 20 percent at the end of each full 12 months of service with the Bank after the date of grant. As of June 30, 2009, 100,948 shares of common stock have been awarded to management. Expense under the RRP was \$23,000 and \$17,000 for the years ended June 30, 2009 and 2008.

The Company has entered into employee agreements with certain officers that provide for the continuation of salary and certain benefits for a specified period of time.

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**Note 15: Related Party Transactions**

The Bank has entered into transactions with certain directors and officers. Such transactions were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other customers, and did not, in the opinion of management, involve more than normal credit risk or present other unfavorable features. The aggregate amount of loans, as defined, to such related parties were as follows:

Balances, July 1, 2008	\$	370
New loans, including renewals		81
Payments, etc. including renewals		<u>(57)</u>
Balances, June 30, 2009	\$	<u>394</u>

Deposits from related parties held by the Bank at June 30, 2009 and 2008 totaled \$1,219,000 and \$1,281,000.

**Note 16: Stock Option Plan**

The Company has reserved 202,370 shares of Company stock for the granting of options to certain directors, officers and other key employees of the Company and the Bank.

Non-qualified stock options for 3,000 shares had been granted with ten year terms that expired August 25, 2008.

A summary of option activity under the Plan as of June 30, 2009, and changes during the year then ended, is presented below:

	Shares	2009 Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term
Outstanding, beginning of year	3,000	\$ 4.13	
Exercised	—	—	
Expired	<u>(3,000)</u>	4.13	
Outstanding, end of year	<u>—</u>	\$ —	<u>—</u>
Exercisable, end of year	<u>—</u>	\$ —	<u>—</u>

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**Note 17: Earnings Per Share**

Earnings per share were computed as follows:

	<b>Net Income</b>	<b>2009 Weighted- Average Shares</b>	<b>Per- Share Amount</b>
<b>Basic Earnings Per Share</b>			
Income available to common stockholders	\$ 149	1,311,314	\$ .11
<b>Effect of Dilutive Stock Options</b>	—	756	
<b>Diluted Earnings Per Share</b>			
Income available to common stockholders and assumed conversions	\$ 149	1,312,070	\$ .11
	<b>Net Income</b>	<b>2008 Weighted- Average Shares</b>	<b>Per- Share Amount</b>
<b>Basic Earnings Per Share</b>			
Income available to common stockholders	\$ 356	1,313,016	\$ .27
<b>Effect of Dilutive Stock Options</b>	—	3,580	
<b>Diluted Earnings Per Share</b>			
Income available to common stockholders and assumed conversions	\$ 356	1,316,596	\$ .27

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**Note 18: Condensed Financial Information (Parent Company Only)**

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

**Condensed Balance Sheets**

	<b>2009</b>	<b>2008</b>
<b>Assets</b>		
Cash and cash equivalents	\$ 220	\$ 172
Securities available for sale	1	2
Premises and equipment	454	471
Investment in subsidiaries	7,318	7,318
Other assets	186	223
Total assets	\$ 8,179	\$ 8,186
<b>Liabilities</b>		
	\$ 484	\$ 504
<b>Stockholders' Equity</b>		
	7,695	7,682
Total liabilities and stockholders' equity	\$ 8,179	\$ 8,186

**Condensed Statements of Income**

	<b>2009</b>	<b>2008</b>
<b>Income</b>		
Dividends from Bank	\$ 256	\$ 223
Net gains on available-for-sale securities	—	7
Interest and other income	52	56
Total income	308	286
<b>Expenses</b>		
Salaries and employee benefits	20	21
Legal and professional fees	49	40
Other expenses	93	94
Total expenses	162	155
<b>Income before income tax benefit and equity in undistributed income of Bank</b>	146	131
<b>Income tax expense</b>	(44)	(36)
<b>Income before equity in undistributed income of Bank</b>	190	167
<b>Equity in undistributed income (loss) of Bank</b>	(41)	189
<b>Net Income</b>	\$ 149	\$ 356

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**Condensed Statements of Cash Flows**

	<b>2009</b>	<b>2008</b>
<b>Operating Activities</b>		
Net income	\$ 149	\$ 356
Items not requiring (providing) cash	76	(177)
Net cash provided by operating activities	225	179
<b>Investing Activity</b> - proceeds from sales of securities available for sale		
	—	39
<b>Financing Activities</b>		
Dividends paid	(163)	(164)
Issuance of stock	—	15
Purchase of stock	(14)	(40)
Net cash used in financing activities	(177)	(189)
<b>Net Change in Cash and Cash Equivalents</b>	48	29
<b>Cash and Cash Equivalents at Beginning of Year</b>	172	143
<b>Cash and Cash Equivalents at End of Year</b>	\$ 220	\$ 172

**Note 19: Disclosures About Fair Value of Financial Instruments**

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

FAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. FAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

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

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

**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 pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 1 securities include stock of a public traded company. Level 2 securities include agency securities, mortgage-backed securities and corporate bonds. Third-party vendors compile prices from various sources and may apply such techniques as matrix pricing to determine the value of identical or similar investment securities (Level 2). Matrix pricing is a mathematical technique widely used in the banking industry to value investment securities without relying exclusively on quoted prices for specific investment securities but rather relying on the investment securities' relationship to other benchmark quoted investment securities. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

The following table presents the fair value measurements of assets and liabilities recognized in the accompanying consolidated balance sheet measured at fair value on a recurring basis and the level within the FAS 157 fair value hierarchy in which the fair value measurements fall at June 30, 2009:

	<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>
Available-for-sale securities	\$ 1,391	\$ 1	\$ 1,390	\$ —

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

**Impaired Loans**

Loan impairment is reported when scheduled payments under contractual terms are deemed uncollectible. A portion of the allowance for loan losses is allocated to impaired loans if the value of such loans is deemed to be less than the unpaid balance. If these allocations cause the allowance for loan losses to increase, such increase is reported as a component of the provision for loan losses. Loan losses are charged against the allowance when management believes the uncollectability of the loan is confirmed. During the twelve months of 2009, impaired loans were partially charged-off or re-evaluated. This valuation would be considered Level 3, consisting of appraisals of underlying collateral and discounted cash flow analysis.

The following table presents the fair value measurements of assets recognized in the accompanying consolidated balance sheet measured at fair value on a nonrecurring basis and the level within the FAS 157 fair value hierarchy in which the fair value measurements fall at June 30, 2009:

	Fair Value Measurements Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	\$ <u>890</u>	\$ <u>—</u>	\$ <u>—</u>	\$ <u>890</u>

**Note 20: Federal Deposit Insurance Corporation (FDIC) Special Assessment**

In February 2009, the Board of Directors of the Federal Deposit Insurance Corporation (FDIC) voted to amend the restoration plan for the Deposit Insurance Fund (DIF). The amended restoration plan extended the period of time to raise the DIF reserve ratio to 1.15 percent from five to seven years. The amended restoration plan also includes a final rule that sets assessment rates. Under this final rule, beginning on April 1, 2009, the Company expects the FDIC premium assessed to the Company to increase.

In May 2009, the Board of the FDIC finalized a rule imposing a special assessment on insured institutions as of June 30, 2009, which will be payable on September 30, 2009. The special assessment is 5 basis points of the Bank's total assets less Tier 1 capital. Accordingly, the Company has a liability recorded in the amount of \$43,000 at June 30, 2009.