

# **Home Financial Bancorp**

Accountants' Report and Consolidated Financial Statements

June 30, 2008 and 2007

# Home Financial Bancorp

June 30, 2008 and 2007

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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, 2008 and 2007, 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, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*BKD, LLP*

Indianapolis, Indiana  
September 16, 2008

**Home Financial Bancorp**  
**Consolidated Balance Sheets**  
**June 30, 2008 and 2007**

**Assets**

	<u>2008</u>	<u>2007</u>
Cash	\$ 533,961	\$ 534,225
Short-term interest-bearing deposits	<u>4,263,261</u>	<u>4,366,870</u>
Total cash and cash equivalents	4,797,222	4,901,095
Interest-bearing deposits	400,000	1,300,599
Investment securities - available for sale	1,016,643	1,886,730
Loans, net of allowance for loan losses of \$591,831 and \$564,793	59,636,795	61,036,866
Real estate acquired for development	377,188	431,778
Premises and equipment	2,013,264	2,056,799
Federal Home Loan Bank of Indianapolis stock	1,187,700	1,187,700
Interest receivable	392,466	416,811
Other assets	<u>1,331,127</u>	<u>1,681,808</u>
Total assets	<u>\$ 71,152,405</u>	<u>\$ 74,900,186</u>

**Liabilities**

Deposits		
Noninterest-bearing deposits	\$ 3,849,086	\$ 3,503,416
Interest-bearing deposits	<u>38,314,440</u>	<u>42,014,732</u>
Total deposits	42,163,526	45,518,148
Borrowings	21,000,000	21,500,000
Other liabilities	<u>307,012</u>	<u>402,278</u>
Total liabilities	<u>63,470,538</u>	<u>67,420,426</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 - 2008 - 1,356,726 shares and 2007 - 1,360,769 shares	3,080,176	3,090,415
Additional paid-in capital	85,219	68,719
Retained earnings	4,516,135	4,339,394
Accumulated other comprehensive income (loss)	<u>337</u>	<u>(18,768)</u>
Total stockholders' equity	<u>7,681,867</u>	<u>7,479,760</u>
Total liabilities and stockholders' equity	<u>\$ 71,152,405</u>	<u>\$ 74,900,186</u>

# Home Financial Bancorp

## Consolidated Statements of Income

### Years Ended June 30, 2008 and 2007

	2008	2007
<b>Interest Income</b>		
Loans	\$ 4,819,489	\$ 4,873,815
Deposits with financial institutions	121,643	177,675
Investment securities	109,264	171,820
Federal Home Loan Bank stock	<u>58,698</u>	<u>56,476</u>
Total interest and dividend income	<u>5,109,094</u>	<u>5,279,786</u>
<b>Interest Expense</b>		
Deposits	1,467,206	1,637,020
Federal Home Loan Bank advances	<u>933,494</u>	<u>910,879</u>
Total interest expense	<u>2,400,700</u>	<u>2,547,899</u>
<b>Net Interest Income</b>	2,708,394	2,731,887
Provision for loan losses	<u>240,000</u>	<u>260,000</u>
<b>Net Interest Income After Provision for Loan Losses</b>	<u>2,468,394</u>	<u>2,471,887</u>
<b>Other Income</b>		
Service charges on deposit accounts	559,465	392,902
Net gain on sale of available-for-sale securities	39,495	42,939
Other income	<u>248,734</u>	<u>181,483</u>
Total other income	<u>847,694</u>	<u>617,324</u>
<b>Other Expenses</b>		
Salaries and employee benefits	1,194,207	1,284,996
Net occupancy expenses	129,230	130,587
Equipment expenses	24,941	64,022
Computer processing fees	388,991	327,635
Printing and office supplies	47,246	54,468
Legal and professional fees	137,299	132,073
Director and committee fees	75,600	71,300
Advertising expense	80,199	74,305
Repossessed property expense	259,523	302,360
Loss on sale of real estate acquired for development	21,946	11,330
Equity in losses of partnership	52,500	25,900
Other expenses	<u>494,681</u>	<u>398,946</u>
Total other expenses	<u>2,906,363</u>	<u>2,877,922</u>
<b>Income Before Income Tax</b>	409,725	211,289
Income tax expense	<u>54,125</u>	<u>36,055</u>
<b>Net Income</b>	<u>\$ 355,600</u>	<u>\$ 175,234</u>
<b>Net Income Per Share</b>		
Basic	\$ .27	\$ .13
Diluted	.27	.13

**Home Financial Bancorp**  
**Consolidated Statements of Stockholders' Equity**  
**Years Ended June 30, 2008 and 2007**

	Common Shares	Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
<b>Balances, July 1, 2006</b>	1,354,450	\$ 3,056,034	\$ 54,079	\$ 4,337,781	\$ (19,325)	\$ 7,428,569
Comprehensive income						
Net income				175,234		175,234
Other comprehensive income, net of tax						
Unrealized gains on securities, net of reclassification adjustment					557	<u>557</u>
Comprehensive income						<u>175,791</u>
Cash dividends (\$.12 per share)				(162,366)		(162,366)
Recognition Retention Plan and Trust (RRP) shares earned			14,640			14,640
Issuance of stock	10,619	45,131				45,131
Purchase of stock	<u>(4,300)</u>	<u>(10,750)</u>		<u>(11,255)</u>		<u>(22,005)</u>
<b>Balances, June 30, 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>	<u>1,356,726</u>	<u>\$ 3,080,176</u>	<u>\$ 85,219</u>	<u>\$ 4,516,135</u>	<u>\$ 337</u>	<u>\$ 7,681,867</u>

# Home Financial Bancorp

## Consolidated Statements of Cash Flows

### Years Ended June 30, 2008 and 2007

	2008	2007
<b>Operating Activities</b>		
Net income	\$ 355,600	\$ 175,234
Items not requiring (providing) cash		
Provision for loan losses	240,000	260,000
Investment securities amortization, net	2,903	967
RRP shares earned	16,500	14,640
Depreciation	81,639	88,234
Deferred income taxes	(96,004)	(25,389)
Loss on sale of real estate acquired for development	21,946	11,330
Foreclosed asset losses	157,439	107,824
Investment securities gains	(39,495)	(42,939)
Losses from partnership	52,500	25,900
Net change in interest receivable	24,345	6,824
Other adjustments	<u>331,603</u>	<u>(207,700)</u>
Net cash provided by operating activities	<u>1,148,976</u>	<u>414,925</u>
<b>Investing Activities</b>		
Net change in interest-bearing deposits	900,599	199,401
Proceeds from sales of securities available for sale	804,634	98,534
Proceeds from maturities and paydowns of securities available for sale	133,678	107,140
Net changes in loans	574,373	527,994
Proceeds from sale of foreclosed assets	382,740	939,908
Purchase of premises and equipment	(38,104)	(67,689)
Purchase of real estate acquired for development and development cost	(19,357)	(69,134)
Proceeds from sale of real estate acquired for development	52,000	44,700
Proceeds from sale of FHLB of Indianapolis stock	<u>—</u>	<u>37,300</u>
Net cash provided by investing activities	<u>2,790,563</u>	<u>1,818,154</u>
<b>Financing Activities</b>		
Net change in		
Noninterest-bearing deposits	345,670	(83,597)
Interest-bearing deposits	(3,700,292)	1,058,811
Proceeds from other borrowings	7,000,000	7,500,000
Repayment of other borrowings	(7,500,000)	(10,000,000)
Issuance of stock	14,761	45,131
Purchase of stock	(40,400)	(22,005)
Dividends paid	<u>(163,151)</u>	<u>(162,366)</u>
Net cash used in financing activities	<u>(4,043,412)</u>	<u>(1,664,026)</u>
<b>Net Change in Cash and Cash Equivalents</b>	(103,873)	569,053
<b>Cash and Cash Equivalents, Beginning of Year</b>	<u>4,901,095</u>	<u>4,332,042</u>
<b>Cash and Cash Equivalents, End of Year</b>	<u>\$ 4,797,222</u>	<u>\$ 4,901,095</u>
<b>Additional Cash Flows and Supplementary Information</b>		
Interest paid	\$ 2,405,725	\$ 2,551,080
Income tax paid, net of refunds	(7,730)	46,783
Transfers from loans to foreclosed assets	618,089	900,562

**Home Financial Bancorp**  
**Notes to Consolidated Financial Statements**  
**June 30, 2008 and 2007**  
(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 subsidiary, BSF, Inc. (BSF), 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.

**Home Financial Bancorp**  
**Notes to Consolidated Financial Statements**  
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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, 2008, 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.

**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.

**Home Financial Bancorp**  
**Notes to Consolidated Financial Statements**  
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**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, 2008, 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, 2008 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.

**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.

**Note 2: Investment Securities**

		2008		
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
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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	Amortized Cost	2007		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
Available for sale				
U. S. Treasury securities	\$ 486	\$ —	\$ (17)	\$ 469
Federal agencies	755	—	(22)	733
Mortgage-backed securities	525	4	(5)	524
Municipal bonds	119	—	—	119
Marketable equity securities	<u>33</u>	<u>9</u>	<u>—</u>	<u>42</u>
Total investment securities	<u>\$ 1,918</u>	<u>\$ 13</u>	<u>\$ (44)</u>	<u>\$ 1,887</u>

Maturities of available-for-sale investments at June 30, 2008:

	Amortized Cost	Approximate Fair Value
One to five years	\$ 89	\$ 89
After five through ten years	507	499
Mortgage-backed and marketable equity securities not due on a single maturity date	<u>420</u>	<u>429</u>
	<u>\$ 1,016</u>	<u>\$ 1,017</u>

Securities with a carrying value of \$926,000 and \$1,725,000 were pledged at June 30, 2008 and 2007 to secure FHLB advances.

Proceeds from sales of securities available for sale during 2008 and 2007 were \$805,000 and \$99,000, respectively. Gains realized from sales of securities during 2008 and 2007 totaled \$39,000 and \$43,000, respectively. There were no losses from sales of securities realized during 2008 and 2007. Net gains on security transactions for 2008 and 2007 resulted in a tax expense of \$15,000 and \$17,000.

Certain investments in debt and marketable equity securities are reported in the 2007 financial statements at an amount less than their historical cost. Total fair value of these investments at June 30, 2008 and 2007 was \$668,000 and \$1,405,000, which is approximately 65.7 and 74.5 percent of the Company's investment portfolio. These declines primarily resulted from increases in market interest rates and failure of certain investments to maintain consistent credit quality ratings or meet projected earnings targets.

**Home Financial Bancorp**  
**Notes to Consolidated Financial Statements**  
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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 and 2007.

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

Description of Securities	2007				Total	
	Less than 12 Months Fair Value	12 Months Unrealized Losses	12 Months or More Fair Value	12 Months or More Unrealized Losses	Fair Value	Unrealized Losses
U. S. Treasury securities	\$ —	\$ —	\$ 468	\$ (17)	\$ 468	\$ (17)
Federal agencies	—	—	733	(22)	733	(22)
Mortgage-backed securities	<u>—</u>	<u>—</u>	<u>204</u>	<u>(5)</u>	<u>204</u>	<u>(5)</u>
Total temporarily impaired securities	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,405</u>	<u>\$ (44)</u>	<u>\$ 1,405</u>	<u>\$ (44)</u>

**Home Financial Bancorp**  
**Notes to Consolidated Financial Statements**  
**June 30, 2008 and 2007**  
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**Note 3: Loans and Allowance**

	<u>2008</u>	<u>2007</u>
Real estate mortgage loans		
Residential	\$ 41,857	\$ 40,625
Mobile home and land	7,547	9,707
Nonresidential	6,534	6,935
Mobile home loans	3,797	4,411
Commercial and industrial	203	220
Consumer loans	<u>611</u>	<u>606</u>
	<u>60,549</u>	<u>62,504</u>
Undisbursed portion of loans	(275)	(855)
Deferred loan fees	(45)	(47)
Allowance for loan losses	<u>(592)</u>	<u>(565)</u>
	<u>(912)</u>	<u>(1,467)</u>
 Total loans	 <u>\$ 59,637</u>	 <u>\$ 61,037</u>

	<u>2008</u>	<u>2007</u>
Allowance for loan losses		
Balances, July 1	\$ 565	\$ 500
Provision for loan losses	240	260
Recoveries	7	4
Loans charged off	<u>(220)</u>	<u>(199)</u>
 Balances, June 30	 <u>\$ 592</u>	 <u>\$ 565</u>

At June 30, 2008 and 2007, accruing loans delinquent 90 days or more totaled \$665,000 and \$0, respectively. Non-accruing loans at June 30, 2008 and 2007 were \$1,365,000 and \$1,009,000, respectively.

**Note 4: Premises and Equipment**

	<u>2008</u>	<u>2007</u>
Land	\$ 348	\$ 348
Buildings	2,634	2,621
Construction in progress	—	4
Equipment	<u>1,071</u>	<u>1,043</u>
Total cost	4,053	4,016
Accumulated depreciation	<u>(2,040)</u>	<u>(1,959)</u>
 Net	 <u>\$ 2,013</u>	 <u>\$ 2,057</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 \$327,000 and \$379,000 at June 30, 2008 and 2007 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 and \$107,000 for the years ended June 30, 2008 and 2007. Condensed unaudited financial statements for Cunot at June 30, 2008 and 2007 and for the two years then ended are as follows:

	<b>2008</b>	<b>2007</b>
Condensed balance sheets		
Assets		
Cash	\$ 134	\$ 116
Land and property	1,141	1,178
Other assets	3	3
Total assets	\$ 1,278	\$ 1,297
Liabilities		
Notes payable	\$ 610	\$ 610
Other liabilities	342	301
Total liabilities	952	911
Partners' equity	326	386
Total liabilities and partners' equity	\$ 1,278	\$ 1,297
	<b>2008</b>	<b>2007</b>
Condensed statements of operations		
Total revenue	\$ 73	\$ 75
Total expenses	(132)	(115)
Net loss	\$ (59)	\$ (40)

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

	<b>2008</b>	<b>2007</b>
Noninterest-bearing demand	\$ 3,849	\$ 3,440
Interest-bearing demand	2,448	2,422
Money market deposits	2,823	2,598
Savings	7,792	6,243
Certificates of \$100,000 or more	7,843	10,098
Other certificates	17,409	20,717
Total deposits	\$ 42,164	\$ 45,518

Certificates maturing in years ending June 30:

2009	\$ 15,055
2010	5,041
2011	2,390
2012	1,630
2013	1,136
	\$ 25,252

Brokered deposits totaled approximately \$1.1 million and \$3.5 million at June 30, 2008 and 2007.

**Note 7: Borrowings**

FHLB advance maturities in years ending June 30:

2009	\$ 4,000
2010	4,500
2011	4,500
2012	3,500
2013	1,000
Thereafter	3,500
	\$ 21,000

The Federal Home Loan Bank advances are secured by mortgage loans and investment securities totaling \$41,293,000. Advances, at interest rates from 2.80 to 5.56 percent, are subject to restrictions or penalties in the event of prepayment. Advances totaling \$3,000,000 may, at certain dates, be converted to adjustable rate advances by the FHLB. If converted, the advances may be prepaid without penalty.

**Home Financial Bancorp**  
**Notes to Consolidated Financial Statements**  
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**Note 8: Income Tax**

	<b>2008</b>	<b>2007</b>
Income tax expense		
Currently payable		
Federal	\$ 113	\$ 60
State	37	1
Deferred		
Federal	(94)	(50)
State	<u>(2)</u>	<u>25</u>
Total income tax expense	<u>\$ 54</u>	<u>\$ 36</u>
	<b>2008</b>	<b>2007</b>
Reconciliation of federal statutory to actual tax expense		
Federal statutory income tax at 34%	\$ 139	\$ 72
Effect of state income taxes	23	16
Business tax credits	(107)	(107)
Tax-exempt interest	(1)	(2)
Valuation allowance	—	30
Other	<u>—</u>	<u>27</u>
Actual tax expense	<u>\$ 54</u>	<u>\$ 36</u>
Effective tax rate	13.2%	17.1%

**Home Financial Bancorp**  
**Notes to Consolidated Financial Statements**  
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A cumulative net deferred tax asset is included in other assets. The components of the asset are as follows:

	<b>2008</b>	<b>2007</b>
<b>Assets</b>		
Allowance for loan losses	\$ 251	\$ 239
Pension and employee benefit	10	9
Securities available for sale	—	12
Loan fees	19	20
Partnership investment	210	97
Unrealized capital loss carryforward	58	46
Total assets	548	423
<b>Liabilities</b>		
Depreciation	(90)	(81)
State income tax	(9)	(8)
FHLB stock	(49)	(49)
Prepaid expenses	(30)	(30)
Other	(41)	(30)
Total liabilities	(219)	(198)
<b>Valuation Allowance</b>		
Beginning balance	(30)	—
Increase during the period	(20)	(30)
Ending balance	(50)	(30)
Net deferred tax asset	\$ 279	\$ 195

Retained earnings at June 30, 2008, 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, 2008.

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**Note 9: Other Comprehensive Income**

	<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	<u>39</u>	<u>(15)</u>	<u>24</u>
Other comprehensive income	<u>\$ 32</u>	<u>\$ (13)</u>	<u>\$ 19</u>
	<b>Before-Tax Amount</b>	<b>2007 Tax Expense</b>	<b>Net-of-Tax Amount</b>
Unrealized gains on securities			
Unrealized holding gains arising during the year	\$ 44	\$ (17)	\$ 27
Less: reclassification adjustment for gains realized in net income	<u>43</u>	<u>(17)</u>	<u>26</u>
Other comprehensive income	<u>\$ 1</u>	<u>\$ —</u>	<u>\$ 1</u>

**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 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>2008</b>	<b>2007</b>
Commitments to extend credit	\$ 1,346	\$ 2,771
Unused lines of credit	251	293

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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 credit worthiness 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**

The Company is not subject to any regulatory restriction on the payment of dividends to its stockholders.

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, 2008, total stockholder's equity of the Bank was \$7,308,000 of which \$6,886,000 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, 2008 and 2007, the Bank was categorized as well capitalized and met all subject capital adequacy requirements. There are no conditions or events since June 30, 2008 that management believes has changed the Bank's classification.

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

	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%	—	—

	Actual		2007 Required for Adequate Capital		Required To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total risk-based capital (to risk-weighted assets)	\$ 7,101	15.7%	\$ 3,610	8.0%	\$ 4,513	10.0%
Tier I capital (to risk-weighted assets)	6,536	14.5%	1,805	4.0%	2,708	6.0%
Core capital (to adjusted total assets)	6,536	8.8%	2,986	4.0%	3,733	5.0%
Core capital (to adjusted tangible assets)	6,536	8.8%	1,493	2.0%	—	—
Tangible capital (to adjusted total assets)	6,536	8.8%	1,120	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 \$11,000 and \$28,000 for the years ended June 30, 2008 and 2007. 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. In addition, beginning in 2007, the Company contributes an additional 2 percent of participant base salary regardless of participant contributions. The Company's expense for the plan was \$38,000 and \$40,000 for the years ended June 30, 2008 and 2007.

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 and \$14,000 for the years ended June 30, 2008 and 2007. At June 30, 2008, all 161,896 ESOP shares have been allocated. As of June 30, 2008, 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, 2008, 100,948 shares of common stock have been awarded to management. Expense under the RRP was \$17,000 and \$15,000 for the years ended June 30, 2008 and 2007.

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, 2007	\$	396
New loans, including renewals		43
Payments, etc. including renewals		<u>(69)</u>
 Balances, June 30, 2008	 \$	 <u>370</u>

Deposits from related parties held by the Bank at June 30, 2008 and 2007 totaled \$1,281,000 and \$1,353,000.

**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.

Incentive stock options for 41,681 shares of common stock have been granted with ten year terms that expired October 13, 2007 and non-qualified options for 24,000 and 3,000 shares have been granted with ten year terms that expire October 14, 2007 and August 25, 2008.

A summary of option activity under the Plan as of June 30, 2008, and changes during the year then ended, is presented below:

	Shares	2008 Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term
Outstanding, beginning of year	68,681	\$ 4.24	
Exercised	(21,268)	4.25	
Expired	<u>(44,413)</u>	4.25	
 Outstanding, end of year	 <u>3,000</u>	 \$ 4.13	 <u>0.17</u>
 Exercisable, end of year	 <u>3,000</u>	 \$ 4.13	 <u>0.17</u>

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**Note 17: Earnings Per Share**

Earnings per share were computed as follows:

	<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
	<b>Net Income</b>	<b>2007 Weighted- Average Shares</b>	<b>Per- Share Amount</b>
<b>Basic Earnings Per Share</b>			
Income available to common stockholders	\$ 175	1,299,108	\$ .13
<b>Effect of Dilutive Stock Options</b>	—	13,115	
<b>Diluted Earnings Per Share</b>			
Income available to common stockholders and assumed conversions	\$ 175	1,312,223	\$ .13

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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>2008</b>	<b>2007</b>
<b>Assets</b>		
Cash and cash equivalents	\$ 172	\$ 143
Securities available for sale	2	42
Premises and equipment	471	490
Investment in subsidiaries	7,318	7,089
Other assets	223	318
Total assets	\$ 8,186	\$ 8,082
<b>Liabilities</b>		
	\$ 504	\$ 602
<b>Stockholders' Equity</b>		
	7,682	7,480
Total liabilities and stockholders' equity	\$ 8,186	\$ 8,082

**Condensed Statements of Income**

	<b>2008</b>	<b>2007</b>
<b>Income</b>		
Dividends from Bank	\$ 223	\$ 131
Net gains on available-for-sale securities	7	43
Interest and other income	56	54
Total income	286	228
<b>Expenses</b>		
Salaries and employee benefits	21	20
Legal and professional fees	40	39
Other expenses	94	82
Total expenses	155	141
<b>Income (loss) before income tax benefit and equity in undistributed income of Bank</b>	131	87
<b>Income tax (expense) benefit</b>	36	(13)
<b>Income before equity in undistributed income of Bank</b>	167	74
<b>Equity in undistributed income of Bank</b>	189	101
<b>Net Income</b>	\$ 356	\$ 175

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**Condensed Statements of Cash Flows**

	<b>2008</b>	<b>2007</b>
<b>Operating Activities</b>		
Net income	\$ 356	\$ 175
Items not providing cash	<u>(177)</u>	<u>(98)</u>
Net cash provided by operating activities	<u>179</u>	<u>77</u>
<b>Investing Activity</b> - proceeds from sales of securities available for sale	<u>39</u>	<u>99</u>
<b>Financing Activities</b>		
Dividends paid	(164)	(162)
Issuance of stock	15	45
Purchase of stock	<u>(40)</u>	<u>(22)</u>
Net cash used in financing activities	<u>(189)</u>	<u>(139)</u>
<b>Net Change in Cash and Cash Equivalents</b>	29	37
<b>Cash and Cash Equivalents at Beginning of Year</b>	<u>143</u>	<u>106</u>
<b>Cash and Cash Equivalents at End of Year</b>	<u>\$ 172</u>	<u>\$ 143</u>