

Edgar Filing: First Internet Bancorp - Form 10-Q

First Internet Bancorp
Form 10-Q
August 02, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period ended June 30, 2016

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 Number 001-35750

First Internet Bancorp
(Exact Name of Registrant as Specified in Its Charter)

Indiana 20-3489991
(State or Other Jurisdiction of (I.R.S. Employer
Incorporation or Organization) Identification No.)

11201 USA Parkway 46037
Fishers, IN
(Address of Principal Executive Offices) (Zip Code)
(317) 532-7900
(Registrant's Telephone Number, Including Area Code)

(Former Name, Former Address and Former Fiscal Year,
if Changed Since Last Report)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).

Large Accelerated Filer Accelerated Filer

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Non-accelerated Filer (Do not check if a smaller reporting company) Smaller Reporting Company

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

As of July 29, 2016, the registrant had 5,533,050 shares of common stock issued and outstanding.

Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains “forward-looking statements” within the meaning of the federal securities laws. These statements are not historical facts, rather statements based on the current expectations of First Internet Bancorp and its consolidated subsidiaries (“we,” “our,” “us” or the “Company”) regarding its business strategies, intended results and future performance. Forward-looking statements are generally preceded by terms such as “expects,” “believes,” “anticipates,” “intends,” “plan,” and similar expressions. Such statements are subject to certain risks and uncertainties including: general economic conditions, whether national or regional, and conditions in the lending markets in which we participate that may have an adverse effect on the demand for our loans and other products; our credit quality and related levels of nonperforming assets and loan losses, and the value and salability of the real estate that we own or that is the collateral for our loans; failures of or interruptions in the communication and information systems on which we rely to conduct our business that could reduce our revenues, increase our costs or lead to disruptions in our business; our plans to grow our commercial real estate and commercial and industrial loan portfolios which may carry greater risks of non-payment or other unfavorable consequences; our dependence on capital distributions from First Internet Bank of Indiana (the “Bank”); results of examinations of us by our regulators, including the possibility that our regulators may, among other things, require us to increase our allowance for loan losses or to write-down assets; changing bank regulatory conditions, policies or programs, whether arising as new legislation or regulatory initiatives, that could lead to restrictions on activities of banks generally, or the Bank in particular; more restrictive regulatory capital requirements; increased costs, including deposit insurance premiums; regulation or prohibition of certain income producing activities or changes in the secondary market for loans and other products; changes in market rates and prices that may adversely impact the value of securities, loans, deposits and other financial instruments and the interest rate sensitivity of our balance sheet; our liquidity requirements being adversely affected by changes in our assets and liabilities; the effect of legislative or regulatory developments, including changes in laws concerning taxes, banking, securities, insurance and other aspects of the financial services industry; competitive factors among financial services organizations, including product and pricing pressures and our ability to attract, develop and retain qualified banking professionals; the growth and profitability of noninterest or fee income being less than expected; the loss of any key members of senior management; the effect of changes in accounting policies and practices, as may be adopted by the Financial Accounting Standards Board, the Securities and Exchange Commission (the “SEC”), the Public Company Accounting Oversight Board and other regulatory agencies; and the effect of fiscal and governmental policies of the United States federal government. Additional factors that may affect our results include those discussed in our most recent Annual Report on Form 10-K under the heading “Risk Factors” and in other reports filed with the SEC. We caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. The factors listed above could affect our financial performance and could cause our actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements.

Except as required by law, we do not undertake, and specifically disclaim any obligation, to publicly release the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

(i)

PART I

ITEM 1. FINANCIAL STATEMENTS

First Internet Bancorp

Condensed Consolidated Balance Sheets

(Amounts in thousands except share data)

	June 30, 2016 (Unaudited)	December 31, 2015
Assets		
Cash and due from banks	\$ 1,868	\$ 1,063
Interest-bearing demand deposits	68,140	24,089
Total cash and cash equivalents	70,008	25,152
Interest-bearing time deposits	250	1,000
Securities available-for-sale, at fair value (amortized cost of \$430,070 and \$215,576 in 2016 and 2015, respectively)	433,806	213,698
Loans held-for-sale (includes \$38,128 and \$24,065 at fair value in 2016 and 2015, respectively)	44,503	36,518
Loans	1,111,622	953,859
Allowance for loan losses	(10,016)	(8,351)
Net loans	1,101,606	945,508
Accrued interest receivable	5,508	4,105
Federal Home Loan Bank of Indianapolis stock	8,595	8,595
Cash surrender value of bank-owned life insurance	12,932	12,727
Premises and equipment, net	9,267	8,521
Goodwill	4,687	4,687
Other real estate owned	4,488	4,488
Accrued income and other assets	6,818	4,871
Total assets	\$ 1,702,468	\$ 1,269,870
Liabilities and Shareholders' Equity		
Liabilities		
Noninterest-bearing deposits	\$ 28,066	\$ 23,700
Interest-bearing deposits	1,360,867	932,354
Total deposits	1,388,933	956,054
Advances from Federal Home Loan Bank	147,974	190,957
Subordinated debt, net of unamortized discounts and debt issuance costs of \$222 and \$276 in 2016 and 2015, respectively	12,778	12,724
Accrued interest payable	138	117
Accrued expenses and other liabilities	16,966	5,688
Total liabilities	1,566,789	1,165,540
Commitments and Contingencies		
Shareholders' Equity		
Preferred stock, no par value; 4,913,779 shares authorized; issued and outstanding - none	—	—
Voting common stock, no par value; 45,000,000 shares authorized; 5,533,050 and 4,481,347 shares issued and outstanding in 2016 and 2015, respectively	95,642	72,559
Nonvoting common stock, no par value; 86,221 shares authorized; issued and outstanding - none	—	—
Retained earnings	37,630	32,980

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Accumulated other comprehensive income (loss)	2,407	(1,209)
Total shareholders' equity	135,679	104,330
Total liabilities and shareholders' equity	\$1,702,468	\$ 1,269,870

See Notes to Condensed Consolidated Financial Statements

1

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First Internet Bancorp
 Condensed Consolidated Statements of Income – Unaudited
 (Amounts in thousands except share and per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Interest Income				
Loans	\$11,661	\$9,043	\$22,850	\$17,433
Securities – taxable	1,747	945	2,916	1,667
Securities – non-taxable	368	59	533	59
Other earning assets	195	83	365	158
Total interest income	13,971	10,130	26,664	19,317
Interest Expense				
Deposits	3,930	2,137	6,818	4,090
Other borrowed funds	735	421	1,399	881
Total interest expense	4,665	2,558	8,217	4,971
Net Interest Income	9,306	7,572	18,447	14,346
Provision for Loan Losses	924	304	1,870	746
Net Interest Income After Provision for Loan Losses	8,382	7,268	16,577	13,600
Noninterest Income				
Service charges and fees	215	193	415	369
Mortgage banking activities	3,295	2,214	5,549	5,100
Gain on sale of securities	177	—	177	—
Loss on asset disposals	(48)	(33)	(64)	(47)
Other	109	102	211	202
Total noninterest income	3,748	2,476	6,288	5,624
Noninterest Expense				
Salaries and employee benefits	4,329	3,787	8,227	7,365
Marketing, advertising, and promotion	434	334	898	786
Consulting and professional services	895	564	1,533	1,156
Data processing	275	233	549	481
Loan expenses	200	181	384	362
Premises and equipment	963	691	1,761	1,333
Deposit insurance premium	215	160	395	310
Other	564	377	1,133	791
Total noninterest expense	7,875	6,327	14,880	12,584
Income Before Income Taxes	4,255	3,417	7,985	6,640
Income Tax Provision	1,421	1,152	2,719	2,312
Net Income	\$2,834	\$2,265	\$5,266	\$4,328
Income Per Share of Common Stock				
Basic	\$0.57	\$0.50	\$1.11	\$0.96
Diluted	\$0.57	\$0.50	\$1.10	\$0.95
Weighted-Average Number of Common Shares Outstanding				
Basic	4,972,759	4,529,823	4,757,243	4,523,336
Diluted	4,992,025	4,550,034	4,782,700	4,536,736
Dividends Declared Per Share	\$0.06	\$0.06	\$0.12	\$0.12

See Notes to Condensed Consolidated Financial Statements

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First Internet Bancorp
 Condensed Consolidated Statements of Comprehensive Income – Unaudited
 (Amounts in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net income	\$2,834	\$2,265	\$5,266	\$4,328
Other comprehensive income (loss)				
Net unrealized holding gains (losses) on securities available-for-sale recorded within other comprehensive income before income tax	3,917	(2,539)	5,791	(1,721)
Reclassification adjustment for gains realized	(177)	—	(177)	—
Other comprehensive income (loss) before income tax	3,740	(2,539)	5,614	(1,721)
Income tax provision (benefit)	1,331	(909)	1,998	(618)
Other comprehensive income (loss)	2,409	(1,630)	3,616	(1,103)
Comprehensive income	\$5,243	\$635	\$8,882	\$3,225

See Notes to Condensed Consolidated Financial Statements

First Internet Bancorp

Condensed Consolidated Statement of Shareholders' Equity - Unaudited

Six Months Ended June 30, 2016

(Amounts in thousands except per share data)

	Voting and Nonvoting Common Stock	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Shareholders' Equity
Balance, January 1, 2016	\$ 72,559	\$ (1,209)	\$ 32,980	\$ 104,330
Net income	—	—	5,266	5,266
Other comprehensive income	—	3,616	—	3,616
Dividends declared (\$0.12 per share)	—	—	(616)	(616)
Net cash proceeds from common stock issuance	22,754	—	—	22,754
Recognition of the fair value of share-based compensation	358	—	—	358
Deferred stock rights and restricted stock units issued in lieu of cash dividends payable on outstanding deferred stock rights and restricted stock units	14	—	—	14
Excess tax benefit on share-based compensation	48	—	—	48
Common stock redeemed for the net settlement of share-based awards	(91)	—	—	(91)
Balance, June 30, 2016	\$ 95,642	\$ 2,407	\$ 37,630	\$ 135,679

See Notes to Condensed Consolidated Financial Statements

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First Internet Bancorp
Condensed Consolidated Statements of Cash Flows – Unaudited
(Amounts in thousands)

	Six Months Ended	
	June 30,	
	2016	2015
Operating Activities		
Net income	\$5,266	\$4,328
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	1,468	922
Increase in cash surrender value of bank-owned life insurance	(205)	(199)
Provision for loan losses	1,870	746
Share-based compensation expense	358	458
Gain from sale of available-for-sale securities	(177)	—
Loans originated for sale	(259,095)	(277,913)
Proceeds from sale of loans	256,592	287,065
Gain on loans sold	(4,496)	(4,845)
(Increase) decrease in fair value of loans held-for-sale	(986)	492
Gain on derivatives	(67)	(747)
Net change in accrued income and other assets	(3,942)	250
Net change in accrued expenses and other liabilities	1,485	(563)
Net cash (used in) provided by operating activities	(1,929)	9,994
Investing Activities		
Net loan activity, excluding purchases	(136,643)	(81,290)
Net change in interest-bearing time deposits	750	750
Maturities of securities available-for-sale	16,303	10,515
Proceeds from sale of securities available-for-sale	49,430	—
Purchase of securities available-for-sale	(272,129)	(65,821)
Purchase of Federal Home Loan Bank of Indianapolis stock	—	(1,596)
Purchase of premises and equipment	(1,653)	(1,586)
Loans purchased	(21,325)	—
Net cash used in investing activities	(365,267)	(139,028)
Financing Activities		
Net increase in deposits	432,879	97,905
Cash dividends paid	(538)	(534)
Proceeds from advances from Federal Home Loan Bank	40,000	180,000
Repayment of advances from Federal Home Loan Bank	(83,000)	(146,000)
Net proceeds from common stock issuance	22,754	—
Other, net	(43)	(24)
Net cash provided by financing activities	412,052	131,347
Net Increase in Cash and Cash Equivalents	44,856	2,313
Cash and Cash Equivalents, Beginning of Period	25,152	28,289
Cash and Cash Equivalents, End of Period	\$70,008	\$30,602
Supplemental Disclosures		
Cash paid during the period for interest	\$8,196	\$4,960
Cash paid during the period for taxes	2,911	1,070
Cash dividends declared, paid in subsequent period	331	267
Securities purchased during the period, settled in subsequent period	8,705	—
See Notes to Condensed Consolidated Financial Statements		

First Internet Bancorp

Notes to Condensed Consolidated Financial Statements – Unaudited

(Table amounts in thousands except share and per share data)

Note 1: Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and pursuant to the rules and regulations of the SEC. Accordingly, they do not include all of the information or footnotes necessary for a complete presentation of financial condition, results of operations, or cash flows in accordance with GAAP. In our opinion, all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation have been included. The results of operations for the three and six months ended June 30, 2016 are not necessarily indicative of the results expected for the year ending December 31, 2016 or any other period. The June 30, 2016 condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the First Internet Bancorp Annual Report on Form 10-K for the year ended December 31, 2015.

The preparation of the condensed consolidated financial statements in conformity with GAAP requires management to make estimates, judgments, or assumptions that could have a material effect on the carrying value of certain assets and liabilities. These estimates, judgments, and assumptions affect the amounts reported in the condensed consolidated financial statements and the disclosures provided. The determination of the allowance for loan losses, valuations and impairments of investment securities, and the accounting for income tax expense are highly dependent upon management’s estimates, judgments, and assumptions where changes in any of these could have a significant impact on the financial statements.

The condensed consolidated financial statements include the accounts of First Internet Bancorp (the “Company”), its wholly-owned subsidiary, First Internet Bank of Indiana (the “Bank”), and the Bank’s wholly-owned subsidiary, JKH Realty Services, LLC. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Company is subject to claims and lawsuits that arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the consolidated financial position, results of operations, and cash flows of the Company.

Certain reclassifications have been made to the 2015 financial statements to conform to the presentation of the 2016 financial statements. These reclassifications had no effect on net income.

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Note 2: Earnings Per Share

Earnings per share of common stock are based on the weighted-average number of basic shares and dilutive shares outstanding during the period.

The following is a reconciliation of the weighted-average common shares for the basic and diluted earnings per share computations for the three and six months ended June 30, 2016 and 2015.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Basic earnings per share				
Net income	\$2,834	\$ 2,265	\$5,266	\$ 4,328
Weighted-average common shares	4,972,759	5,529,823	4,757,248	5,523,336
Basic earnings per common share	\$0.57	\$ 0.50	\$ 1.11	\$ 0.96
Diluted earnings per share				
Net income	\$2,834	\$ 2,265	\$5,266	\$ 4,328
Weighted-average common shares	4,972,759	5,529,823	4,757,248	5,523,336
Dilutive effect of warrants	9,743	7,006	10,518	3,522
Dilutive effect of equity compensation	9,523	13,205	14,939	9,878
Weighted-average common and incremental shares	4,992,025	5,550,034	4,782,705	5,536,736
Diluted earnings per common share	\$0.57	\$ 0.50	\$ 1.10	\$ 0.95
Number of warrants excluded from the calculation of diluted earnings per share as the exercise prices were greater than the average market price of the Company's common stock during the period	—	—	—	—

Note 3: Securities

The following tables summarize securities available-for-sale as of June 30, 2016 and December 31, 2015.

	June 30, 2016			
	Amortized Cost	Gross Unrealized Gains	Losses	Fair Value
Securities available-for-sale				
U.S. Government-sponsored agencies	\$75,133	\$701	\$(156)	\$75,678
Municipal securities	78,594	2,227	(23)	80,798
Mortgage-backed securities	233,886	2,147	(122)	235,911
Asset-backed securities	19,457	—	(125)	19,332
Corporate securities	20,000	—	(926)	19,074
Other securities	3,000	13	—	3,013
Total available-for-sale	\$430,070	\$5,088	\$(1,352)	\$433,806

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Losses	Fair Value
Securities available-for-sale				
U.S. Government-sponsored agencies	\$38,093	\$139	\$(482)	\$37,750
Municipal securities	21,091	385	(7)	21,469
Mortgage-backed securities	113,948	110	(1,006)	113,052

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Asset-backed securities	19,444	—	(83)	19,361
Corporate securities	20,000	—	(913)	19,087
Other securities	3,000	—	(21)	2,979
Total available-for-sale	\$215,576	\$634	\$(2,512)		\$213,698

7

The carrying value of securities at June 30, 2016 is shown below by their contractual maturity date. Actual maturities will differ because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-Sale	
	Amortized Cost	Fair Value
Within one year	\$—	\$—
One to five years	400	362
Five to ten years	32,047	31,904
After ten years	141,280	143,284
	173,727	175,550
Mortgage-backed securities	233,886	235,911
Asset-backed securities	19,457	19,332
Other securities	3,000	3,013
Total	\$430,070	\$433,806

Gross gains of \$0.2 million and gross losses of \$0.0 million resulted from sales of available-for-sale securities during the three and six months ended June 30, 2016. There were no gross gains or losses recognized during the three and six months ended June 30, 2015.

Certain investments in debt securities are reported in the condensed consolidated financial statements at an amount less than their historical cost. The total fair value of these investments at June 30, 2016 and December 31, 2015 was \$103.1 million and \$166.1 million, which was approximately 24% and 78%, respectively, of the Company's available-for-sale securities portfolio. These declines resulted primarily from fluctuations in market interest rates after purchase.

U. S. Government-Sponsored Agencies, Municipal Securities and Corporate Securities

The unrealized losses on the Company's investments in securities issued by U.S. Government-sponsored agencies, municipal organizations and corporate entities were caused by interest rate changes. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Company does not intend to sell the investments and it is not likely that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at June 30, 2016.

Mortgage-Backed and Asset-Backed Securities

The unrealized losses on the Company's investments in mortgage-backed and asset-backed securities were caused by interest rate changes. The Company expects to recover the amortized cost bases over the term of the securities. Because the Company does not intend to sell the investments and it is not likely that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at June 30, 2016.

Should any future impairment of these securities become other-than-temporary, the cost basis of the security will be reduced, with the resulting loss recognized in net income in the period in which the other-than-temporary impairment ("OTTI") is identified.

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The following tables show the available-for-sale securities portfolio's 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, 2016 and December 31, 2015.

	June 30, 2016					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available-for-sale						
U.S. Government-sponsored agencies	\$19,171	\$ (116)	\$4,043	\$ (40)	\$23,214	\$ (156)
Municipal securities	2,241	(23)	—	—	2,241	(23)
Mortgage-backed securities	39,268	(122)	—	—	39,268	(122)
Asset-backed securities	9,806	(43)	9,526	(82)	19,332	(125)
Corporate securities	4,904	(95)	14,170	(831)	19,074	(926)
Total	\$75,390	\$ (399)	\$27,739	\$ (953)	\$103,129	\$ (1,352)

	December 31, 2015					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available-for-sale						
U.S. Government-sponsored agencies	\$18,289	\$ (237)	\$8,537	\$ (245)	\$26,826	\$ (482)
Municipal securities	1,026	(7)	—	—	1,026	(7)
Mortgage-backed securities	74,198	(562)	22,655	(444)	96,853	(1,006)
Asset-backed securities	19,361	(83)	—	—	19,361	(83)
Corporate securities	19,087	(913)	—	—	19,087	(913)
Other securities	2,979	(21)	—	—	2,979	(21)
Total	\$134,940	\$ (1,823)	\$31,192	\$ (689)	\$166,132	\$ (2,512)

There were no amounts reclassified from accumulated other comprehensive income (loss) during the three and six months ended June 30, 2015. Amounts reclassified from accumulated other comprehensive income (loss) and the affected line items in the consolidated statements of income during the three and six months ended June 30, 2016 were as follows:

Details About Accumulated Other Comprehensive Income Components	Amounts Reclassified from Accumulated Other Comprehensive Income for the		Affected Line Item in the Statements of Income
	Three Months Ended June 30, 2016	Six Months Ended June 30, 2016	
Unrealized gains and losses on securities available-for-sale			
Gain realized in earnings	\$ 177	\$ 177	Gain on sale of securities

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Total reclassified amount before tax	177	177	Income Before Income Taxes
Tax expense	60	60	Income Tax Provision
Total reclassifications out of accumulated other comprehensive income	\$ 117	\$ 117	Net Income

9

Note 4: Loans

Loans that management intends to hold until maturity are reported at their outstanding principal balance adjusted for unearned income, charge-offs, the allowance for loan losses, any unamortized deferred fees or costs on originated loans, and unamortized premiums or discounts on purchased loans.

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

Categories of loans include:

	June 30, 2016	December 31, 2015
Commercial loans		
Commercial and industrial	\$ 111,130	\$ 102,000
Owner-occupied commercial real estate	46,543	44,462
Investor commercial real estate	12,976	16,184
Construction	53,368	45,898
Single tenant lease financing	500,937	374,344
Total commercial loans	724,954	582,888
Consumer loans		
Residential mortgage	202,107	214,559
Home equity	38,981	43,279
Other consumer	141,756	108,312
Total consumer loans	382,844	366,150
Total commercial and consumer loans	1,107,798	949,038
Deferred loan origination costs and premiums and discounts on purchased loans	3,824	4,821
Total loans	1,111,622	953,859
Allowance for loan losses	(10,016)	(8,351)
Net loans	\$ 1,101,606	\$ 945,508

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

Commercial and Industrial: Commercial and industrial loans' sources of repayment are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected, and the collateral securing these loans may fluctuate in value. Loans are made for working capital, equipment purchases, or other purposes. Most commercial and industrial loans are secured by the assets being financed and may incorporate a personal guarantee.

Owner-Occupied Commercial Real Estate: The primary source of repayment is the cash flow from the ongoing operations and activities conducted by the borrower, or an affiliate of the borrower, who owns the property. This portfolio segment is generally concentrated in the Central Indiana and greater Phoenix, Arizona markets and its loans often times are secured by manufacturing and service facilities, as well as office buildings.

Investor Commercial Real Estate: These loans are underwritten primarily based on the cash flow expected to be generated from the property and are secondarily supported by the value of the real estate. These loans typically incorporate a personal guarantee. This portfolio segment typically involves higher loan principal amounts, and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Investor commercial real estate loans may be more adversely

affected by conditions in the real estate markets, changing industry dynamics, or the overall health of the general economy. The properties securing the Company's investor commercial real estate portfolio tend to be diverse in terms of property type and are typically located in the state of Indiana and markets adjacent to Indiana. Management monitors and evaluates commercial real estate loans based on property financial performance, collateral value, guarantor strength, and other risk grade criteria. As a general rule, the Company avoids financing special use projects or properties outside of its designated market areas unless other underwriting factors are present to help mitigate risk.

Construction: Construction loans are secured by real estate and improvements and are made to assist in the construction of new structures, which may include commercial (retail, industrial, office, multi-family) properties or single family residential properties offered for sale by the builder. These loans generally finance a variety of project costs, including land, site preparation, construction, closing and soft costs and interim financing needs. The cash flows of builders, while initially predictable, may fluctuate with market conditions, and the value of the collateral securing these loans may be subject to fluctuations based on general economic changes.

Single Tenant Lease Financing: These loans are made to property owners of real estate subject to long term lease arrangements with single tenant operators. The real estate is typically operated by regionally, nationally or globally branded businesses. The loans are underwritten based on the financial strength of the borrower, characteristics of the real estate, cash flows generated from the lease arrangements and the financial strength of the tenant. Similar to the other loan portfolio segments, management monitors and evaluates these loans based on borrower and tenant financial performance, collateral value, industry trends and other risk grade criteria.

Residential Mortgage: With respect to residential loans that are secured by 1-4 family residences and are generally owner occupied, the Company typically establishes a maximum loan-to-value ratio and requires private mortgage insurance if that ratio is exceeded. Repayment of these loans is primarily dependent on the financial circumstances of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Repayment can also be impacted by changes in residential property values. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers in geographically diverse locations throughout the country.

Home Equity: Home equity loans and lines of credit are typically secured by a subordinate interest in 1-4 family residences. The properties securing the Company's home equity portfolio segment are generally geographically diverse as the Company offers these products on a nationwide basis. Repayment of home equity loans and lines of credit may be impacted by changes in property values on residential properties and unemployment levels, among other economic conditions and financial circumstances in the market.

Other Consumer: These loans primarily consist of consumer loans and credit cards. Consumer loans may be secured by consumer assets such as horse trailers or recreational vehicles. Some consumer loans are unsecured, such as small installment loans, home improvement loans and certain lines of credit. Repayment of consumer loans is primarily dependent upon the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers in geographically diverse locations throughout the country.

Allowance for Loan Losses Methodology

Company policy is designed to maintain an adequate allowance for loan losses (“ALLL”). The portfolio is segmented by loan type, and the required ALLL for types of performing homogeneous loans which do not have a specific reserve is determined by applying a factor based on average historical losses, adjusted for current economic factors and portfolio trends. Management believes the historical loss experience methodology is appropriate in the current economic environment as it captures loss rates that are comparable to the current period being analyzed. Management adds qualitative factors for observable trends, changes in internal practices, changes in delinquencies and impairments, and external factors. Observable factors include changes in the composition and size of portfolios, as well as loan terms or concentration levels. The Company evaluates the impact of internal changes such as management and staff experience levels or modification to loan underwriting processes. Delinquency trends are scrutinized for both volume and severity of past due, nonaccrual, or classified loans as well as any changes in the value of underlying collateral. Finally, the Company considers the effect of other external factors such as national, regional, and local economic and business conditions, as well as competitive, legal, and regulatory requirements. Loans that are considered to be impaired are evaluated to determine the need for a specific allowance by applying at least one of three methodologies: present value of future cash flows; fair value of collateral less costs to sell; or the loan’s observable market price. All troubled debt restructurings (“TDR”) are considered impaired loans. Loans evaluated for impairment are removed from other pools to prevent double-counting. Accounting Standards Codification (“ASC”) Topic 310, Receivables, requires

that impaired loans be measured based on the present value of expected future cash flows discounted at the loans' effective interest rates or the fair value of the underlying collateral less costs to sell and allows existing methods for recognizing interest income.

Provision for Loan Losses

A provision for estimated losses on loans is charged to income based upon management's evaluation of the potential losses. Such an evaluation, which includes a review of all loans for which full repayment may not be reasonably assured, considers, among other matters, the estimated net realizable value of the underlying collateral, as applicable, economic conditions, loan loss experience, and other factors that are particularly susceptible to changes that could result in a material adjustment in the near term. While management attempts to use the best information available in making its evaluations, future allowance adjustments may be necessary if economic conditions change substantially from the assumptions used in making the evaluations.

Policy for Charging Off Loans

The Company's policy is to charge off a loan at any point in time when it no longer can be considered a bankable asset, meaning collectible within the parameters of policy. A secured loan is generally charged down to the estimated fair value of the collateral, less costs to sell, no later than when it is 120 days past due as to principal or interest. An unsecured loan generally is charged off no later than when it is 180 days past due as to principal or interest. A home improvement loan generally is charged off no later than when it is 90 days past due as to principal or interest.

The following tables present changes in the balance of the ALLL during the three and six month periods ended June 30, 2016 and 2015.

	Three Months Ended June 30, 2016								Total
	Commercial and industrial	Owner-occupied commercial real estate	Investor commercial real estate	Construction	Single tenant lease financing	Residential mortgage	Home equity	Other consumer	
Allowance for loan losses:									
Balance, beginning of period	\$ 1,383	\$ 475	\$ 197	\$ 563	\$ 4,678	\$ 871	\$ 120	\$ 933	\$ 9,220
Provision (credit) charged to expense	451	(14)	(26)	(8)	381	42	30	68	924
Losses charged off	—	—	—	—	—	(134)	(33)	(65)	(232)
Recoveries	—	—	—	—	—	2	4	98	104
Balance, end of period	\$ 1,834	\$ 461	\$ 171	\$ 555	\$ 5,059	\$ 781	\$ 121	\$ 1,034	\$ 10,016
	Six Months Ended June 30, 2016								Total
	Commercial and industrial	Owner-occupied commercial real estate	Investor commercial real estate	Construction	Single tenant lease financing	Residential mortgage	Home equity	Other consumer	
Allowance for loan losses:									
Balance, beginning of period	\$ 1,367	\$ 476	\$ 212	\$ 500	\$ 3,931	\$ 896	\$ 125	\$ 844	\$ 8,351
Provision (credit) charged to expense	467	(15)	(41)	55	1,128	(8)	23	261	1,870
Losses charged off	—	—	—	—	—	(134)	(33)	(214)	(381)
Recoveries	—	—	—	—	—	27	6	143	176
Balance, end of period	\$ 1,834	\$ 461	\$ 171	\$ 555	\$ 5,059	\$ 781	\$ 121	\$ 1,034	\$ 10,016

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Three Months Ended June 30, 2015

	Commercial and industrial	Owner-occupied real estate	Investor commercial real estate	Construction	Single tenant lease financing	Residential mortgage	Home equity	Other consumer	Total
Allowance for loan losses:									
Balance, beginning of period	\$ 1,010	\$ 391	\$ 218	\$ 359	\$ 2,452	\$ 988	\$ 203	\$ 757	\$ 6,378
Provision (credit) charged to expense	191	48	(457)	(132)	641	42	(46)	17	304
Losses charged off	—	—	—	—	—	(100)	—	(132)	(232)
Recoveries	—	—	500	—	—	3	—	120	623
Balance, end of period	\$ 1,201	\$ 439	\$ 261	\$ 227	\$ 3,093	\$ 933	\$ 157	\$ 762	\$ 7,073

Six Months Ended June 30, 2015

	Commercial and industrial	Owner-occupied real estate	Investor commercial real estate	Construction	Single tenant lease financing	Residential mortgage	Home equity	Other consumer	Total
Allowance for loan losses:									
Balance, beginning of period	\$ 920	\$ 345	\$ 261	\$ 330	\$ 2,061	\$ 985	\$ 207	\$ 691	\$ 5,800
Provision (credit) charged to expense	281	94	(500)	(103)	1,032	(152)	(50)	144	746
Losses charged off	—	—	—	—	—	(171)	—	(289)	(460)
Recoveries	—	—	500	—	—	271	—	216	987
Balance, end of period	\$ 1,201	\$ 439	\$ 261	\$ 227	\$ 3,093	\$ 933	\$ 157	\$ 762	\$ 7,073

The following tables present the recorded investment in loans based on portfolio segment and impairment method as of June 30, 2016, and December 31, 2015.

June 30, 2016

	Commercial and industrial	Owner-occupied real estate	Investor commercial real estate	Construction	Single tenant lease financing	Residential mortgage	Home equity	Other consumer	Total
Loans:									
Ending balance: collectively evaluated for impairment	\$ 106,414	\$ 46,543	\$ 12,976	\$ 53,368	\$ 500,937	\$ 200,260	\$ 38,981	\$ 141,603	\$ 1,101,082
Ending balance: individually evaluated for impairment	4,716	—	—	—	—	1,847	—	153	6,716
Ending balance	\$ 111,130	\$ 46,543	\$ 12,976	\$ 53,368	\$ 500,937	\$ 202,107	\$ 38,981	\$ 141,756	\$ 1,107,798
Allowance for loan losses:									
Ending balance: collectively evaluated for	\$ 1,362	\$ 461	\$ 171	\$ 555	\$ 5,059	\$ 781	\$ 121	\$ 1,034	\$ 9,544

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impairment									
Ending balance:									
individually	472	—	—	—	—	—	—	—	472
evaluated for									
impairment									
Ending balance	\$1,834	\$ 461	\$ 171	\$ 555	\$5,059	\$781	\$121	\$1,034	\$10,016

13

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	December 31, 2015								
	Commercial and industrial	Owner-occupied commercial real estate	Investor commercial real estate	Construction	Single tenant lease financing	Residential mortgage	Home equity	Other consumer	Total
Loans:									
Ending balance:									
collectively evaluated for impairment	\$ 102,000	\$ 44,462	\$ 16,184	\$ 45,898	\$ 374,344	\$ 213,426	\$ 43,279	\$ 108,163	\$ 947,756
Ending balance:									
individually evaluated for impairment	—	—	—	—	—	1,133	—	149	1,282
Ending balance	\$ 102,000	\$ 44,462	\$ 16,184	\$ 45,898	\$ 374,344	\$ 214,559	\$ 43,279	\$ 108,312	\$ 949,038
Allowance for loan losses:									
Ending balance:									
collectively evaluated for impairment	\$ 1,367	\$ 476	\$ 212	\$ 500	\$ 3,931	\$ 896	\$ 125	\$ 844	\$ 8,351
Ending balance:									
individually evaluated for impairment	—	—	—	—	—	—	—	—	—
Ending balance	\$ 1,367	\$ 476	\$ 212	\$ 500	\$ 3,931	\$ 896	\$ 125	\$ 844	\$ 8,351

The Company utilizes a risk grading matrix to assign a risk grade to each of its commercial loans. Loans are graded on a scale of 1 to 9. A description of the general characteristics of the nine risk grades is as follows:

•“Pass” (Grades 1-5) - Higher quality loans that do not fit any of the other categories described below.

•“Special Mention” (Grade 6) - Loans that possess some credit deficiency or potential weakness which deserve close attention.

•“Substandard” (Grade 7) - Loans that possess a defined weakness or weaknesses that jeopardize the liquidation of the debt. Loans characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected. Loans that are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any.

•“Doubtful” (Grade 8) - Such loans have been placed on nonaccrual status and may be heavily dependent upon collateral possessing a value that is difficult to determine or based upon some near-term event which lacks clear certainty. These loans have all of the weaknesses of those classified as Substandard; however, based on existing conditions, these weaknesses make full collection of the principal balance highly improbable.

•“Loss” (Grade 9) - Loans that are considered uncollectible and of such little value that continuing to carry them as assets is not warranted.

Nonaccrual Loans

Any loan which becomes 90 days delinquent or for which the full collection of principal and interest may be in doubt will be considered for nonaccrual status. At the time a loan is placed on nonaccrual status, all accrued but unpaid interest will be reversed from interest income. Placing the loan on nonaccrual status does not relieve the borrower of the obligation to repay interest. A loan placed on nonaccrual status may be restored to accrual status when all delinquent principal and interest has been brought current, and the Company expects full payment of the remaining contractual principal and interest.

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The following tables present the credit risk profile of the Company's commercial and consumer loan portfolios based on rating category and payment activity as of June 30, 2016 and December 31, 2015.

June 30, 2016

	Commercial and industrial	Owner-occupied commercial real estate	Investor commercial real estate	Construction	Single tenant lease financing	Total
Rating:						
1-5 Pass	\$104,842	\$ 46,531	\$ 12,976	\$ 53,074	\$500,937	\$718,360
6 Special Mention	1,001	—	—	294	—	1,295
7 Substandard	5,287	12	—	—	—	5,299
8 Doubtful	—	—	—	—	—	—
Total	\$111,130	\$ 46,543	\$ 12,976	\$ 53,368	\$500,937	\$724,954

June 30, 2016

	Residential mortgage	Home equity	Other consumer	Total
Performing	\$201,263	\$38,981	\$141,682	\$381,926
Nonaccrual	844	—	74	918
Total	\$202,107	\$38,981	\$141,756	\$382,844

December 31, 2015

	Commercial and industrial	Owner-occupied commercial real estate	Investor commercial real estate	Construction	Single tenant lease financing	Total
Rating:						
1-5 Pass	\$95,589	\$ 43,913	\$ 14,746	\$ 45,599	\$374,344	\$574,191
6 Special Mention	2,006	535	—	299	—	2,840
7 Substandard	4,405	14	1,438	—	—	5,857
8 Doubtful	—	—	—	—	—	—
Total	\$102,000	\$ 44,462	\$ 16,184	\$ 45,898	\$374,344	\$582,888

December 31, 2015

	Residential mortgage	Home equity	Other consumer	Total
Performing	\$214,456	\$43,279	\$108,248	\$365,983
Nonaccrual	103	—	64	167
Total	\$214,559	\$43,279	\$108,312	\$366,150

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The following tables present the Company's loan portfolio delinquency analysis as of June 30, 2016 and December 31, 2015.

	June 30, 2016					Total Commercial and Consumer Loans	Non- accrual Loans	Total Loans 90 Days or More Past Due and Accruing
	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current			
Commercial and industrial	\$ 17	\$ —	\$ —	\$ 17	\$ 111,113	\$ 111,130	\$ 4,716	\$ —
Owner-occupied commercial real estate	—	—	—	—	46,543	46,543	—	—
Investor commercial real estate	—	—	—	—	12,976	12,976	—	—
Construction	—	—	—	—	53,368	53,368	—	—
Single tenant lease financing	—	—	—	—	500,937	500,937	—	—
Residential mortgage	—	—	810	810	201,297	202,107	844	—
Home equity	—	—	—	—	38,981	38,981	—	—
Other consumer	127	42	5	174	141,582	141,756	74	5
Total	\$ 144	\$ 42	\$ 815	\$ 1,001	\$ 1,106,797	\$ 1,107,798	\$ 5,634	\$ 5

	December 31, 2015					Total Commercial and Consumer Loans	Non- accrual Loans	Total Loans 90 Days or More Past Due and Accruing
	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current			
Commercial and industrial	\$ 29	\$ —	\$ —	\$ 29	\$ 101,971	\$ 102,000	\$ —	\$ —
Owner-occupied commercial real estate	—	—	—	—	44,462	44,462	—	—
Investor commercial real estate	—	—	—	—	16,184	16,184	—	—
Construction	—	—	—	—	45,898	45,898	—	—
Single tenant lease financing	—	—	—	—	374,344	374,344	—	—
Residential mortgage	300	23	45	368	214,191	214,559	103	—
Home equity	20	—	—	20	43,259	43,279	—	—
Other consumer	116	12	—	128	108,184	108,312	64	—
Total	\$ 465	\$ 35	\$ 45	\$ 545	\$ 948,493	\$ 949,038	\$ 167	\$ —

Impaired Loans

A loan is designated as impaired, in accordance with the impairment accounting guidance 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. Payments with delays generally not exceeding 90 days outstanding are not considered impaired. Certain nonaccrual and substantially all delinquent loans more than 90 days past due may be considered to be impaired. Generally, loans are placed on nonaccrual status at 90 days past due and accrued interest is reversed against earnings, unless the loan is well-secured and in the process of collection. 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.

Impaired loans include nonperforming loans as well as loans modified in TDRs where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the

loan, payment extensions, forgiveness of principal, forbearance, or other actions intended to maximize collection.

ASC Topic 310, Receivables, requires that impaired loans be measured based on the present value of expected future cash flows discounted at the loans' effective interest rates or the fair value of the underlying collateral, less costs to sell, and allows existing methods for recognizing interest income.

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The following table presents the Company's impaired loans as of June 30, 2016 and December 31, 2015. The Company had no impaired loans with a specific valuation allowance as of December 31, 2015.

	June 30, 2016			December 31, 2015		
	Recorded Balance	Unpaid Principal Balance	Specific Allowance	Recorded Balance	Unpaid Principal Balance	Specific Allowance
Loans without a specific valuation allowance						
Residential mortgage	\$ 1,847	\$ 1,973	\$ —	\$ 1,133	\$ 1,154	\$ —
Other consumer	153	184	—	149	178	—
Total	2,000	2,157	—	1,282	1,332	—
Loans with a specific valuation allowance						
Commercial and industrial	\$ 4,716	\$ 4,716	\$ 472	\$ —	\$ —	\$ —
Total	4,716	4,716	472	—	—	—
Total impaired loans	\$ 6,716	\$ 6,873	\$ 472	\$ 1,282	\$ 1,332	\$ —

The table below presents average balances and interest income recognized for impaired loans during the three and six month periods ended June 30, 2016 and June 30, 2015.

	Three Months Ended June 30, 2016		Six Months Ended		Three Months Ended June 30, 2015		Six Months Ended	
	Average Balance	Interest Income	Average Balance	Interest Income	Average Balance	Interest Income	Average Balance	Interest Income
Loans without a specific valuation allowance								
Investor commercial real estate	\$—	\$ —	\$—	\$ —	\$—	\$ —	\$43	\$ 2
Residential mortgage	1,489	1	1,278	4	1,110	2	1,085	4
Other consumer	138	2	147	4	215	3	168	6
Total	1,627	3	1,425	8	1,325	5	1,296	12
Loans with a specific valuation allowance								
Commercial and industrial	\$ 1,179	\$ —	590	—	\$—	\$ —	—	—
Residential mortgage	—	—	—	—	60	—	30	—
Other consumer	—	—	—	—	—	—	27	1
Total	1,179	—	590	—	60	—	57	1
Total impaired loans	\$ 2,806	\$ 3	\$ 2,015	\$ 8	\$ 1,385	\$ 5	\$ 1,353	\$ 13

There were no residential mortgage loans in other real estate owned at June 30, 2016 or December 31, 2015 and there were less than \$0.1 million of loans at June 30, 2016 and December 31, 2015 in the process of foreclosure.

Note 5: Premises and Equipment

The following table summarizes premises and equipment at June 30, 2016 and December 31, 2015.

	June 30, December 31,	
	2016	2015
Land	\$ 2,500	\$ 2,500
Building and improvements	4,702	4,636
Furniture and equipment	6,298	6,164
Less: accumulated depreciation	(4,233)	(4,779)
	\$ 9,267	\$ 8,521

Note 6: Goodwill

The following table shows the changes in the carrying amount of goodwill for the periods ended June 30, 2016 and December 31, 2015.

Balance as of January 1, 2015	\$4,687
Changes in goodwill during the year	—
Balance as of December 31, 2015	4,687
Changes in goodwill during the period	—
Balance as of June 30, 2016	\$4,687

Goodwill is tested for impairment on an annual basis as of August 31, or whenever events or changes in circumstances indicate the carrying amount of goodwill exceeds its implied fair value. No events or changes in circumstances have occurred since the August 31, 2015 annual impairment test that would suggest it was more likely than not goodwill impairment existed.

Note 7: Subordinated Debt

In June 2013, the Company issued a subordinated debenture (the “Debenture”) in the principal amount of \$3.0 million. The Debenture bears a fixed interest rate of 8.00% per year, payable quarterly, and is scheduled to mature on June 28, 2021. The Debenture may be repaid, without penalty, at any time after June 28, 2016. The Debenture is intended to qualify as Tier 2 capital under regulatory guidelines.

In connection with the Debenture, the Company also issued a warrant to purchase up to 48,750 shares of common stock at an initial per share exercise price equal to \$19.33. The warrant became exercisable on June 28, 2014 and, unless previously exercised, will expire on June 28, 2021. The Company has the right to force an exercise of the warrant after the Debenture has been repaid in full if the 20-day volume-weighted average price of a share of its common stock exceeds \$30.00.

The Company used the Black-Scholes option pricing model to assign a fair value of \$0.3 million to the warrant as of June 28, 2013. The following assumptions were used to value the warrant: a risk-free interest rate of 0.66% per the U.S. Treasury yield curve in effect at the date of issuance, an expected dividend yield of 1.19% calculated using the dividend rate and stock price at the date of the issuance, and an expected volatility of 34% based on the estimated volatility of the Company’s stock over the expected term of the warrant, which is estimated to be three years.

In October 2015, the Company issued subordinated notes (the “Notes”) in the principal amount of \$10.0 million. The Notes bear a fixed interest rate of 6.4375% per year, payable quarterly, and are scheduled to mature on October 1, 2025. The Notes may be repaid, without penalty, on any interest payment date on or after October 15, 2020. The Notes are intended to qualify as Tier 2 capital under regulatory guidelines.

The following table presents the principal balance and unamortized discount and debt issuance costs for the Debenture and the Notes as of June 30, 2016 and December 31, 2015.

	June 30, 2016		December 31, 2015	
	Unamortized Discount		Unamortized Discount	
	Principal and Debt Issuance Costs		Principal and Debt Issuance Costs	
8.00% subordinated debenture, due 2021	\$3,000	\$ —	\$3,000	\$ (42)
6.4375% subordinated notes, due 2025	10,000	(222)	10,000	(234)

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Total \$13,000 \$ (222) \$13,000 \$ (276)

18

Note 8: Benefit Plans

Employment Agreement

The Company has entered into an employment agreement with its Chief Executive Officer that provides for the continuation of salary and certain benefits for a specified period of time under certain conditions. Under the terms of the agreement, these payments could occur in the event of a change in control of the Company, as defined in the agreement, along with other specific conditions.

2013 Equity Incentive Plan

The 2013 Equity Incentive Plan (the “2013 Plan”) authorizes the issuance of 750,000 shares of the Company’s common stock in the form of equity-based awards to employees, directors, and other eligible persons. Under the terms of the 2013 Plan, the pool of shares available for issuance may be used for available types of equity awards under the 2013 Plan, which includes stock options, stock appreciation rights, restricted stock awards, stock unit awards, and other share-based awards. All employees, consultants, and advisors of the Company or any subsidiary, as well as all non-employee directors of the Company, are eligible to receive awards under the 2013 Plan.

The Company recorded \$0.2 million and \$0.4 million of share-based compensation expense for the three and six month periods ended June 30, 2016, respectively, related to awards made under the 2013 Plan. The Company recorded \$0.2 million and \$0.5 million of share-based compensation expense for the three and six month periods ended June 30, 2015, respectively, related to awards made under the 2013 Plan.

The following table summarizes the status of the 2013 Plan awards as of June 30, 2016, and activity for the six months ended June 30, 2016.

	Restricted Stock Units	Weighted-Average Grant Date Fair Value Per Share	Restricted Stock Awards	Weighted-Average Grant Date Fair Value Per Share	Deferred Stock Units	Weighted-Average Grant Date Fair Value Per Share
Nonvested at December 31, 2015	28,302	\$ 18.90	27,529	\$ 18.17	—	\$ —
Granted	30,704	25.63	10,232	24.44	5	24.10
Vested	(9,470)	18.92	(18,815)	19.94	(5)	24.10
Nonvested at June 30, 2016	49,536	\$ 23.07	18,946	\$ 19.81	—	\$ —

At June 30, 2016, the total unrecognized compensation cost related to nonvested awards was \$1.1 million with a weighted-average expense recognition period of 2.1 years.

Directors Deferred Stock Plan

Until January 1, 2014, the Company had a stock compensation plan for members of the Board of Directors (“Directors Deferred Stock Plan”). The Company reserved 180,000 shares of common stock that could have been issued pursuant to the Directors Deferred Stock Plan. The plan provided directors the option to elect to receive up to 100% of their annual retainer in either common stock or deferred stock rights. Deferred stock rights were to be settled in common stock following the end of the deferral period payable on the basis of one share of common stock for each deferred stock right.

The following table summarizes the status of deferred stock rights related to the Directors Deferred Stock Plan for the six months ended June 30, 2016.

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	Deferred Stock Rights
Outstanding, beginning of period	81,693
Granted	341
Exercised	—
Outstanding, end of period	82,034

All deferred stock rights granted during the 2016 period were additional rights issued in lieu of cash dividends payable on outstanding deferred stock rights.

Note 9: Fair Value of Financial Instruments

ASC Topic 820, Fair Value Measurement, 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. ASC Topic 820 also specifies 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

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

Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid mutual funds. 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 2 securities include U.S. Government-sponsored agencies, municipal securities, mortgage and asset-backed securities and certain corporate securities. 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 also 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. Fair values are calculated using discounted cash flows. Discounted cash flows are calculated based off of the anticipated future cash flows updated to incorporate loss severities. Rating agency and industry research reports as well as default and deferral activity are reviewed and incorporated into the calculation. The Company did not own any securities classified within Level 3 of the hierarchy as of June 30, 2016 or December 31, 2015.

Loans Held-for-Sale (mandatory pricing agreements)

The fair value of loans held-for-sale is determined using quoted prices for similar assets, adjusted for specific attributes of that loan (Level 2).

Forward Contracts

The fair values of forward contracts on to-be-announced securities are determined using quoted prices in active markets, or benchmarked thereto (Level 1).

Interest Rate Lock Commitments

The fair values of interest rate lock commitments (“IRLCs”) are determined using the projected sale price of individual loans based on changes in market interest rates, projected pull-through rates (the probability that an IRLC will ultimately result in an originated loan), the reduction in the value of the applicant’s option due to the passage of time, and the remaining origination costs to be incurred based on management’s estimate of market costs (Level 3).

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The following tables present the fair value measurements of assets and liabilities recognized in the accompanying condensed consolidated balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2016 and December 31, 2015.

	June 30, 2016			
	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Government-sponsored agencies	\$75,678	\$ —	\$ 75,678	\$ —
Municipal securities	80,798	—	80,798	—
Mortgage-backed securities	235,911	—	235,911	—
Asset-backed securities	19,332	—	19,332	—
Corporate securities	19,074	—	19,074	—
Other securities	3,013	3,013	—	—
Total available-for-sale securities	433,806	3,013	430,793	—
Loans held-for-sale (mandatory pricing agreements)	38,128	—	38,128	—
Forward contracts	(1,045)	(1,045)	—	—
IRLCs	1,724	—	—	1,724

	December 31, 2015			
	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Government-sponsored agencies	\$37,750	\$ —	\$ 37,750	\$ —
Municipal securities	21,469	—	21,469	—
Mortgage-backed securities	113,052	—	113,052	—
Asset-backed securities	19,361	—	19,361	—
Corporate securities	19,087	—	19,087	—
Other securities	2,979	2,979	—	—
Total available-for-sale securities	213,698	2,979	210,719	—
Loans held-for-sale (mandatory pricing agreements)	24,065	—	24,065	—
Forward contracts	30	30	—	—
IRLCs	582	—	—	582

The following tables reconcile the beginning and ending balances of recurring fair value measurements recognized in the accompanying condensed consolidated balance sheets using significant unobservable (Level 3) inputs for the three and six month periods ended June 30, 2016 and June 30, 2015.

	Three Months Ended Interest Rate Lock Commitments
Balance, April 1, 2016	\$ 1,283
Total realized gains	
Included in net income	441
Balance, June 30, 2016	\$ 1,724

Balance, April 1, 2015	\$ 913
Total realized gains	
Included in net income	(290)
Balance, June 30, 2015	\$ 623

	Six Months Ended Interest Rate Lock Commitments
Balance, January 1, 2016	\$ 582
Total realized gains	
Included in net income	1,142
Balance, June 30, 2016	\$ 1,724

Balance, January 1, 2015	\$ 521
Total realized gains	
Included in net income	102
Balance, June 30, 2015	\$ 623

The following describes valuation methodologies and inputs used for assets measured at fair value on a nonrecurring basis, as well as the general classification of such assets pursuant to the valuation hierarchy.

Impaired Loans

Loans for which it is probable that the Company will not collect all principal and interest due according to contractual terms are measured for impairment. The amount of the impairment may be determined based on the fair value of the underlying collateral, less costs to sell, the estimated present value of future cash flows or the loan's observable market price.

If the impaired loan is identified as collateral dependent, the fair value of the underlying collateral, less costs to sell, is used to measure impairment. This method requires obtaining a current independent appraisal of the collateral and applying a discount factor to the value. If the impaired loan is not collateral dependent, the Company utilizes a discounted cash flow analysis to measure impairment.

Impaired loans with a specific valuation allowance based on the value of the underlying collateral or a discounted cash flow analysis are classified as Level 3 assets.

Significant Unobservable (Level 3) Inputs

The following tables present quantitative information about significant unobservable inputs used in recurring and nonrecurring Level 3 fair value measurements other than goodwill.

	Fair Value at June 30, 2016	Valuation Technique	Significant Unobservable Inputs	Range
IRLCs	1,724	Discounted cash flow	Loan closing rates	36% - 99%
	Fair Value at December 31, 2015	Valuation Technique	Significant Unobservable Inputs	Range
IRLCs	\$ 582	Discounted cash flow	Loan closing rates	43% - 100%

The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying condensed consolidated balance sheets at amounts other than fair value.

Cash and Cash Equivalents

For these instruments, the carrying amount is a reasonable estimate of fair value.

Interest-Bearing Time Deposits

The fair value of these financial instruments approximates carrying value.

Loans Held-for-Sale (best efforts pricing agreements)

The fair value of these loans approximates carrying value.

Loans

The fair value of loans is estimated by discounting future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings and remaining maturities.

Accrued Interest Receivable

The fair value of these financial instruments approximates carrying value.

Federal Home Loan Bank of Indianapolis Stock

The fair value approximates carrying value.

Deposits

The fair value of noninterest-bearing and interest-bearing demand deposits, savings and money market accounts approximates carrying value. The fair value of fixed maturity certificates of deposit and brokered deposits are estimated using rates currently offered for deposits of similar remaining maturities.

Advances from Federal Home Loan Bank

The fair value of fixed rate advances is estimated using rates currently available for advances with similar remaining maturities. The carrying value of variable rate advances approximates fair value.

Subordinated Debt

The fair value of the Company's subordinated debt is estimated using discounted cash flow analysis, based on current borrowing rates for similar types of debt instruments.

Accrued Interest Payable

The fair value of these financial instruments approximates carrying value.

Commitments

The fair value of commitments to extend credit are based on fees currently charged to enter into similar agreements with similar maturities and interest rates. The Company determined that the fair value of commitments was zero based on the contractual value of outstanding commitments at each of June 30, 2016 and December 31, 2015.

The following tables summarize the carrying value and estimated fair value of all financial assets and liabilities at June 30, 2016 and December 31, 2015.

	Carrying Amount	June 30, 2016 Fair Value Measurements Using		
		Quoted Prices In Active Market for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	\$ 70,008	\$ 70,008	\$ —	\$ —
Interest-bearing time deposits	250	250	—	—
Loans held-for-sale (best efforts pricing agreements)	6,375	—	6,375	—
Loans	1,111,622	—	—	1,138,152
Accrued interest receivable	5,508	5,508	—	—
Federal Home Loan Bank of Indianapolis stock	8,595	—	8,595	—
Deposits	1,388,933	513,929	—	867,231
Advances from Federal Home Loan Bank	147,974	—	146,276	—
Subordinated debt	12,778	—	13,023	—
Accrued interest payable	138	138	—	—
		December 31, 2015 Fair Value Measurements Using		
	Carrying Amount	Quoted Prices In Active Market for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	\$ 25,152	\$ 25,152	\$ —	\$ —
Interest-bearing time deposits	1,000	1,000	—	—
Loans held-for-sale (best efforts pricing agreements)	12,453	—	12,453	—
Loans	953,859	—	—	967,303
Accrued interest receivable	4,105	4,105	—	—
Federal Home Loan Bank of Indianapolis stock	8,595	—	8,595	—
Deposits	956,054	472,481	—	478,360
Advances from Federal Home Loan Bank	190,957	—	188,126	—
Subordinated debt	12,724	—	13,212	—

Accrued interest payable	117	117	—	—
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Note 10: Mortgage Banking Activities

The Company's residential real estate lending business originates mortgage loans for customers and sells a majority of the originated loans into the secondary market. The Company hedges its mortgage banking pipeline by entering into forward contracts for the future delivery of mortgage loans to third party investors and entering into interest rate lock commitments with potential borrowers to fund specific mortgage loans that will be sold into the secondary market. To facilitate the hedging of the loans, the Company has elected the fair value option for loans originated and intended for sale in the secondary market under mandatory pricing agreements. Changes in the fair value of loans held-for-sale, interest rate lock commitments and forward contracts are recorded in the mortgage banking activities line item within noninterest income. Refer to Note 11 for further information on derivative financial instruments.

During the three months ended June 30, 2016 and 2015, the Company originated mortgage loans held-for-sale of \$151.1 million and \$143.8 million, respectively, and sold \$139.6 million and \$143.3 million of mortgage loans, respectively, into the secondary market. During the six months ended June 30, 2016 and 2015, the Company originated mortgage loans held-for-sale of \$259.1 million and \$277.9 million, respectively, and sold \$256.6 million and \$287.1 million of mortgage loans, respectively, into the secondary market.

The following table provides the components of income from mortgage banking activities for the three and six months ended June 30, 2016 and 2015.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Gain on loans sold	\$2,896	\$2,531	\$4,496	\$4,845
Gain (loss) resulting from the change in fair value of loans held-for-sale	632	(669)	986	(492)
Gain (loss) resulting from the change in fair value of derivatives	(233)	352	67	747
Net revenue from mortgage banking activities	\$3,295	\$2,214	\$5,549	\$5,100

Note 11: Derivative Financial Instruments

The Company uses derivative financial instruments to help manage exposure to interest rate risk and the effects that changes in interest rates may have on net income and the fair value of assets and liabilities. The Company enters into forward contracts for the future delivery of mortgage loans to third party investors and enters into IRLCs with potential borrowers to fund specific mortgage loans that will be sold into the secondary market. The forward contracts are entered into in order to economically hedge the effect of changes in interest rates resulting from the Company's commitment to fund the loans.

Each of these items are considered derivatives, but are not designated as accounting hedges, and are recorded at fair value with changes in fair value reflected in noninterest income on the condensed consolidated statements of income. The fair value of derivative instruments with a positive fair value are reported in accrued income and other assets in the condensed consolidated balance sheets while derivative instruments with a negative fair value are reported in accrued expenses and other liabilities in the condensed consolidated balance sheets.

The following table presents the notional amount and fair value of IRLCs and forward contracts utilized by the Company at June 30, 2016 and December 31, 2015.

	June 30, 2016		December 31, 2015	
	Notional Fair Amount	Fair Value	Notional Fair Amount	Fair Value
Asset Derivatives				

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Derivatives not designated as hedging instruments

IRLCs	\$60,328	\$1,724	\$28,444	\$582
Forward contracts	—	—	42,743	30

Liability Derivatives

Derivatives not designated as hedging instruments

Forward contracts	98,252	(1,045)	—	—
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25

Fair values of derivative financial instruments were estimated using changes in mortgage interest rates from the date the Company entered into the IRLC and the balance sheet date. The following table summarizes the periodic changes in the fair value of the derivative financial instruments on the condensed consolidated statements of income for the three and six month periods ended June 30, 2016 and 2015.

	Amount of gain / (loss) recognized in the three months ended		Amount of gain / (loss) recognized in the six months ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Asset Derivatives				
Derivatives not designated as hedging instruments				
IRLCs	\$ 441	\$ (290)	\$ 1,142	\$ 102
Forward contracts	—	642	—	645
Liability Derivatives				
Derivatives not designated as hedging instruments				
Forward contracts	(674)	—	(1,075)	—

Note 12: Recent Accounting Pronouncements

Accounting Standards Update 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (June 2016)

The main objective of this Update is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in this Update replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates.

The amendments affect entities holding financial assets that are not accounted for at fair value through net income. The amendments affect loans, debt securities, off-balance-sheet credit exposures, and any other financial assets not excluded from the scope that have the contractual right to receive cash. The amendments in this Update affect an entity to varying degrees depending on the credit quality of the assets held by the entity, their duration, and how the entity applies current GAAP. There is diversity in practice in applying the incurred loss methodology, which means that before transition some entities may be more aligned, under current GAAP, than others to the new measure of expected credit losses. The following describes the main provisions of this Update.

- **Assets Measured at Amortized Cost:** The amendments in this Update require a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset(s) to present the net carrying value at the amount expected to be collected on the financial asset. The income statement reflects the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectibility of the reported amount. An entity must use judgment in determining

the relevant information and estimation methods that are appropriate in its circumstances.

- Available-for-Sale Debt Securities: Credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses. Available-for-sale accounting recognizes that value may be realized either through collection of contractual cash flows or through sale of the security. Therefore, the amendments limit the amount of the allowance for credit losses to the amount by which fair value is below amortized cost because the classification as available for sale is premised on an investment strategy that recognizes that the investment could be sold at fair value, if cash collection would result in the realization of an amount less than fair value.

For public business entities that are U.S. Securities and Exchange Commission filers, the amendments in this Update are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. All entities may adopt the amendments in this Update earlier as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. An entity will apply the amendments in this Update through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (that is, a modified-retrospective approach). A prospective transition approach is required for debt securities for which an other-than-temporary impairment had been recognized before the effective date. The effect of a prospective transition approach is to maintain the same amortized cost basis before and after the effective date of this Update.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this report. This discussion and analysis includes certain forward-looking statements that involve risks, uncertainties, and assumptions. You should review the "Risk Factors" section of our Annual Report on Form 10-K for the year ended December 31, 2015 for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by such forward-looking statements. See also "Cautionary Note Regarding Forward-Looking Statements" at the beginning of this report.

Overview

First Internet Bancorp ("we," "our," "us," or the "Company") is a bank holding company that conducts its business activities through its wholly-owned subsidiary, First Internet Bank of Indiana, an Indiana chartered bank (the "Bank"). The Bank was the first state-chartered, Federal Deposit Insurance Corporation ("FDIC") insured Internet bank and commenced banking operations in 1999. The Company was incorporated under the laws of the State of Indiana on September 15, 2005. On March 21, 2006, we consummated a plan of exchange by which we acquired all of the outstanding shares of the Bank.

We offer a full complement of products and services on a nationwide basis. We conduct our deposit operations primarily over the Internet and have no traditional branch offices. We have diversified our operations by adding commercial real estate ("CRE") lending, including nationwide single tenant lease financing, and commercial and industrial ("C&I") lending, including business banking/treasury management services to meet the needs of high-quality commercial borrowers and depositors.

Our business model differs from that of a typical community bank. We do not have a conventional brick and mortar branch system; but instead operate through our scalable Internet banking platform. The market area for our residential real estate lending, consumer lending, and deposit gathering activities is the entire United States. We also offer single tenant lease financing on a nationwide basis. Our other commercial banking activities, including CRE and C&I loans, corporate credit cards, and corporate treasury management services, are offered by our commercial banking team to businesses primarily within Central Indiana, Phoenix, Arizona, and adjacent markets. We have no significant customer concentrations within our loan portfolio.

Results of Operations

The following table provides a summary of the Company's financial performance for the five most recent quarters and six months ended June 30, 2016 and 2015.

(dollars in thousands except for share and per share data)	Three Months Ended					Six Months Ended		
	June 30, 2016	March 31, 2016	December 31, 2015	September 30, 2015	June 30, 2015	June 30, 2016	June 30, 2015	
Income Statement Summary:								
Net interest income	\$9,306	\$9,141	\$ 8,568	\$ 7,839	\$7,572	\$18,447	\$14,346	
Provision for loan losses	924	946	746	454	304	1,870	746	
Noninterest income	3,748	2,540	2,143	2,374	2,476	6,288	5,624	
Noninterest expense	7,875	7,005	6,492	6,207	6,327	14,880	12,584	
Income tax provision	1,421	1,298	1,195	1,229	1,152	2,719	2,312	
Net income	\$2,834	\$2,432	\$ 2,278	\$ 2,323	\$2,265	\$5,266	\$4,328	
Per Share Data:								
Earnings per share - basic	\$0.57	\$0.54	\$ 0.50	\$ 0.51	\$0.50	\$1.11	\$0.96	
Earnings per share - diluted	\$0.57	\$0.53	\$ 0.50	\$ 0.51	\$0.50	\$1.10	\$0.95	
Dividends declared per share	\$0.06	\$0.06	\$ 0.06	\$ 0.06	\$0.06	\$0.12	\$0.12	
Book value per common share	\$24.52	\$23.98	\$ 23.28	\$ 22.95	\$22.28	\$24.52	\$22.28	
Tangible book value per common share ¹	\$23.67	\$22.93	\$ 22.24	\$ 21.90	\$21.23	\$23.67	\$21.23	
Common shares outstanding	5,533,050	4,497,284	4,481,347	4,484,513	4,484,513	5,533,050	4,484,513	
Average common shares outstanding:								
Basic	4,972,759	4,541,728	4,534,910	4,532,360	4,529,823	4,757,243	4,523,336	
Diluted	4,992,025	4,575,555	4,580,353	4,574,455	4,550,034	4,782,700	4,536,736	
Performance Ratios:								
Return on average assets	0.71	% 0.72	% 0.74	% 0.82	% 0.84	% 0.72	% 0.84	%
Return on average shareholders' equity	9.67	% 9.20	% 8.73	% 9.14	% 9.15	% 9.45	% 8.85	%
Return on average tangible common equity ¹	10.07	% 9.63	% 9.14	% 9.58	% 9.60	% 9.86	% 9.29	%
Net interest margin	2.39	% 2.78	% 2.85	% 2.84	% 2.87	% 2.57	% 2.86	%
Capital Ratios:								
Tangible common equity to tangible assets ¹	7.72	% 6.77	% 7.88	% 8.46	% 8.66	% 7.72	% 8.66	%
Tier 1 leverage ratio	8.08	% 7.65	% 8.28	% 8.81	% 8.93	% 8.08	% 8.93	%
Common equity tier 1 capital ratio	10.66	% 9.38	% 10.11	% 10.74	% 11.12	% 10.66	% 11.12	%
Tier 1 capital ratio	10.66	% 9.38	% 10.11	% 10.74	% 11.12	% 10.66	% 11.12	%
Total risk-based capital ratio	12.54	% 11.38	% 12.25	% 11.90	% 12.28	% 12.54	% 12.28	%

¹ This information represents a non-GAAP financial measure. See the "Reconciliation of Non-GAAP Financial Measures" for a reconciliation of these measures to their most directly comparable GAAP measures.

During the second quarter 2016, net income was \$2.8 million, or \$0.57 per diluted share, compared to second quarter 2015 net income of \$2.3 million, or \$0.50 per diluted share, resulting in an increase in net income of \$0.6 million, or 25.1%. During the six months ended June 30, 2016, net income was \$5.3 million, or \$1.10 per diluted share, compared to the six months ended June 30, 2015 net income of \$4.3 million, or \$0.95 per diluted share, resulting in an increase in net income of \$0.9 million, or 21.7%.

The increase in net income in the second quarter 2016 compared to the second quarter 2015 was primarily due to a \$1.7 million, or 22.9%, increase in net interest income and a \$1.3 million, or 51.4%, increase in noninterest income, partially offset by a \$1.5 million, or 24.5%, increase in noninterest expense, a \$0.6 million, or 203.9%, increase in provision for loan losses and a \$0.3 million, or 23.4%, increase in income tax expense.

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The increase in net income in the six months ended June 30, 2016 compared to the six months ended June 30, 2015 was primarily due to a \$4.1 million, or 28.6%, increase in net interest income and a \$0.7 million, or 11.8%, increase in noninterest income, partially offset by a \$2.3 million, or 18.2%, increase in noninterest expense, a \$1.1 million, or 150.7%, increase in provision for loan losses and a \$0.4 million, or 17.6%, increase in income tax expense.

During the second quarter 2016, return on average assets and return on average shareholders' equity were 0.71% and 9.67%, respectively, compared to 0.84% and 9.15%, respectively, for the second quarter 2015. During the six months ended June 30, 2016, return on average assets and return on average shareholders' equity were 0.72% and 9.45%, respectively, compared to 0.84% and 8.85%, respectively, for the six months ended June 30, 2015.

Consolidated Average Balance Sheets and Net Interest Income Analyses

For the periods presented, the following tables provide the average balances of interest-earning assets and interest-bearing liabilities and the related yields and cost of funds. The tables do not reflect any effect of income taxes. Balances are based on the average of daily balances. Nonaccrual loans are included in average loan balances.

(dollars in thousands)

	Three Months Ended					
	June 30, 2016		March 31, 2016		June 30, 2015	
	Average Balance	Yield/Cost	Average Balance	Yield/Cost	Average Balance	Yield/Cost
Assets						
Interest-earning assets						
Loans, including loans held-for-sale	\$1,110,282	4.22 %	\$1,020,168	4.41 %	\$825,620	4.39 %
Securities - taxable	307,336	2.29 %	202,898	2.32 %	174,057	2.18 %
Securities - non-taxable	51,162	2.89 %	22,179	2.99 %	7,807	3.03 %
Other earning assets	97,774	0.80 %	78,291	0.87 %	49,001	0.68 %
Total interest-earning assets	1,566,554	3.59 %	1,323,536	3.86 %	1,056,485	3.85 %
Allowance for loan losses	(9,472)		(8,655)		(6,545)	
Noninterest-earning assets	39,422		37,951		35,178	
Total assets	\$1,596,504		\$1,352,832		\$1,085,118	
Liabilities						
Interest-bearing liabilities						
Interest-bearing demand deposits	\$83,712	0.55 %	\$81,338	0.55 %	\$76,095	0.55 %
Regular savings accounts	28,023	0.57 %	25,021	0.58 %	23,873	0.57 %
Money market accounts	363,767	0.71 %	350,809	0.71 %	282,015	0.72 %
Certificates and brokered deposits	809,450	1.56 %	575,976	1.48 %	440,752	1.36 %
Total interest-bearing deposits	1,284,952	1.23 %	1,033,144	1.12 %	822,735	1.04 %
Other borrowed funds	161,127	1.83 %	185,618	1.44 %	137,421	1.23 %
Total interest-bearing liabilities	1,446,079	1.30 %	1,218,762	1.17 %	960,156	1.07 %
Noninterest-bearing deposits	27,687		22,899		20,697	
Other noninterest-bearing liabilities	4,825		4,893		4,932	
Total liabilities	1,478,591		1,246,554		985,785	
Shareholders' equity	117,913		106,278		99,333	
Total liabilities and shareholders' equity	\$1,596,504		\$1,352,832		\$1,085,118	
Interest rate spread ¹		2.29 %		2.69 %		2.78 %
Net interest margin ²		2.39 %		2.78 %		2.87 %

¹ Yield on total interest-earning assets minus cost of total interest-bearing liabilities

² Net interest income divided by total interest-earning assets (annualized)

30

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(dollars in thousands)	Six Months Ended				
	June 30, 2016		June 30, 2015		
	Average Balance	Yield/Cost	Average Balance	Yield/Cost	
Assets					
Interest-earning assets					
Loans, including loans held-for-sale	\$1,065,225	4.31 %	\$803,086	4.38 %	
Securities - taxable	255,116	2.30 %	159,729	2.10 %	
Securities - non-taxable	36,671	2.92 %	3,925	3.03 %	
Other earning assets	88,033	0.83 %	45,342	0.70 %	
Total interest-earning assets	1,445,045	3.71 %	1,012,082	3.85 %	
Allowance for loan losses	(9,063)		(6,215)		
Noninterest-earning assets	38,686		34,864		
Total assets	\$1,474,668		\$1,040,731		
Liabilities					
Interest-bearing liabilities					
Interest-bearing demand deposits	\$82,525	0.55 %	\$75,752	0.55 %	
Regular savings accounts	26,522	0.58 %	22,991	0.58 %	
Money market accounts	357,288	0.71 %	278,185	0.72 %	
Certificates and brokered deposits	692,713	1.53 %	415,566	1.37 %	
Total interest-bearing deposits	1,159,048	1.18 %	792,494	1.04 %	
Other borrowed funds	173,372	1.62 %	123,680	1.44 %	
Total interest-bearing liabilities	1,332,420	1.24 %	916,174	1.09 %	
Noninterest-bearing deposits	25,293		21,477		
Other noninterest-bearing liabilities	4,859		4,488		
Total liabilities	1,362,572		942,139		
Shareholders' equity	112,096		98,592		
Total liabilities and shareholders' equity	\$1,474,668		\$1,040,731		
Interest rate spread ¹		2.47 %		2.76 %	
Net interest margin ²		2.57 %		2.86 %	

¹ Yield on total interest-earning assets minus cost of total interest-bearing liabilities

² Net interest income divided by total interest-earning assets (annualized)

Rate/Volume Analysis

The following table illustrates the impact of changes in the volume of interest-earning assets and interest-bearing liabilities and interest rates on net interest income for the periods indicated. The change in interest not due solely to volume or rate has been allocated in proportion to the absolute dollar amounts of the change in each.

(dollars in thousands)	Rate/Volume Analysis of Net Interest Income								
	Three Months Ended			Three Months Ended			Six Months Ended		
	June 30, 2016 vs.			June 30, 2016 vs. June			June 30, 2016 vs. June		
	March 31, 2016			30, 2015			30, 2015		
	Due to Changes in			Due to Changes in			Due to Changes in		
	Volume	Rate	Net	Volume	Rate	Net	Volume	Rate	Net
Interest income									
Loans, including loans held-for-sale	\$2,923	\$(2,451)	\$472	\$4,878	\$(2,260)	\$2,618	\$6,236	\$(819)	\$5,417
Securities – taxable	683	(105)	578	753	49	802	1,077	172	1,249
Securities – non-taxable	241	(38)	203	328	(19)	309	480	(6)	474
Other earning assets	102	(77)	25	95	17	112	173	34	207
Total	3,949	(2,671)	1,278	6,054	(2,213)	3,841	7,966	(619)	7,347