

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report Under Section 13 or 15(d)  
of the Securities Exchange Act of 1934

(Mark One)

[X] Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the quarterly period ended September 30, 2003, 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: 0-26128

NorthWest Indiana Bancorp

(Exact name of registrant as specified in its charter)

Indiana  
(State or other jurisdiction of incorporation  
or organization)

35-1927981  
(I.R.S. Employer  
Identification Number)

9204 Columbia Avenue  
Munster, Indiana  
(Address of principal executive office)

46321  
(ZIP code)

Registrant’s telephone number, including area code: (219) 836-4400

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act ). Yes [ ] No [X]

There were 2,751,235 shares of the registrant’s Common Stock, without par value, outstanding at September 30, 2003.

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## NorthWest Indiana Bancorp Consolidated Balance Sheets

| (Dollars in thousands)   | September 30,<br>2003<br>(unaudited) | December 31,<br>2002 |
|--|--------------------------------------|----------------------|
| <b>ASSETS</b>  |                                      |                      |
| Cash and non-interest bearing balances in financial institutions   | \$ 25,870                            | \$ 18,026            |
| Interest bearing balances in financial institutions  | 19,035                               | 15,625               |
| Federal funds sold   | 170                                  | 1,549                |
| Total cash and cash equivalents  | 45,075                               | 35,200               |
| Securities available-for-sale  | 56,052                               | 56,002               |
| Securities held-to-maturity; fair value: September 30, 2003 - \$1,542<br>December 31, 2002 - \$594   | 1,542                                | 569                  |
| Loans held for sale  | 1,944                                | 601                  |
| Loans receivable   | 405,428                              | 380,428              |
| Less: allowance for loan losses  | (3,869)                              | (3,635)              |
| Net loans receivable   | 401,559                              | 376,793              |
| Federal Home Loan Bank stock   | 2,741                                | 2,672                |
| Accrued interest receivable  | 2,247                                | 2,363                |
| Premises and equipment   | 13,144                               | 9,460                |
| Foreclosed real estate   | —                                    | 127                  |
| Other assets   | 3,178                                | 4,215                |
| Total assets   | \$527,482                            | \$488,002            |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                                      |                      |
| Deposits:  |                                      |                      |
| Non-interest bearing   | \$ 48,609                            | \$ 36,308            |
| Interest bearing   | 392,448                              | 370,365              |
| Total  | 441,057                              | 406,673              |
| Borrowed funds   | 41,293                               | 36,065               |
| Accrued expenses and other liabilities   | 4,205                                | 6,116                |
| Total liabilities  | 486,555                              | 448,854              |
| Commitments and contingencies  | —                                    | —                    |
| Stockholders' Equity:  |                                      |                      |
| Preferred stock, no par or stated value; 10,000,000 shares authorized, none outstanding  | —                                    | —                    |
| Common stock, no par or stated value; 10,000,000 shares authorized;<br>shares issued: September 30, 2003 - 2,819,399,<br>December 31, 2002 - 2,807,293<br>shares outstanding: September 30, 2003 - 2,751,235,<br>December 31, 2002 - 2,739,129 | 352                                  | 351                  |
| Additional paid in capital   | 3,522                                | 3,392                |
| Accumulated other comprehensive income   | 616                                  | 950                  |
| Retained earnings  | 37,877                               | 35,895               |
| Treasury stock, common shares at cost: September 30, 2003 - 68,164,<br>December 31, 2002 - 68,164  | (1,440)                              | (1,440)              |
| Total stockholders' equity   | 40,927                               | 39,148               |
| Total liabilities and stockholders' equity   | \$527,482                            | \$488,002            |

See accompanying notes to consolidated financial statements.

**NorthWest Indiana Bancorp**  
**Consolidated Statements of Income**  
**(unaudited)**

| (Dollars in thousands, except per share data)       | Three Months Ended<br>September 30,<br>2003 | Three Months Ended<br>September 30,<br>2002 | Nine Months Ended<br>September 30,<br>2003 | Nine Months Ended<br>September 30,<br>2002 |
|---|---|---|--|--|
| Interest income:                                    |   |   |  |  |
| Loans receivable                                    |   |   |  |  |
| Real estate loans                                   | \$5,463                                     | \$5,514                                     | \$16,299                                   | \$16,310                                   |
| Commercial loans                                    | 538   | 555   | 1,540                                      | 1,666                                      |
| Consumer loans                                      | 92  | 126   | 294  | 427  |
|   | <u>6,093</u>                                | <u>6,195</u>                                | <u>18,133</u>                              | <u>18,403</u>                              |
| Total loan interest                                 | 6,093                                       | 6,195                                       | 18,133                                     | 18,403                                     |
| Securities  | 453   | 735   | 1,553                                      | 2,303                                      |
| Other interest earning assets                       | 36  | 35  | 88   | 104  |
|   | <u>6,582</u>                                | <u>6,965</u>                                | <u>19,774</u>                              | <u>20,810</u>                              |
| Total interest income                               | 6,582                                       | 6,965                                       | 19,774                                     | 20,810                                     |
| Interest expense:                                   |   |   |  |  |
| Deposits  | 1,454                                       | 2,094                                       | 4,781                                      | 6,561                                      |
| Borrowed funds                                      | 328   | 390   | 971  | 1,154                                      |
|   | <u>1,782</u>                                | <u>2,484</u>                                | <u>5,752</u>                               | <u>7,715</u>                               |
| Total interest expense                              | 1,782                                       | 2,484                                       | 5,752                                      | 7,715                                      |
| Net interest income                                 | 4,800                                       | 4,481                                       | 14,022                                     | 13,095                                     |
| Provision for loan losses                           | 100   | 220   | 360  | 500  |
|   | <u>4,700</u>                                | <u>4,261</u>                                | <u>13,662</u>                              | <u>12,595</u>                              |
| Net interest income after provision for loan losses | 4,700                                       | 4,261                                       | 13,662                                     | 12,595                                     |
| Noninterest income:                                 |   |   |  |  |
| Fees and service charges                            | 477   | 479   | 1,377                                      | 1,316                                      |
| Gain on sale of loans, net                          | 67  | 68  | 383  | 121  |
| Trust operations                                    | 105   | 136   | 339  | 412  |
| Gain on sale of securities, net                     | 31  | 54  | 119  | 143  |
| Gain/(loss) on sale of foreclosed real estate       | —   | 16  | (4)  | 40   |
| Other   | 5   | 2   | 21   | 7  |
|   | <u>685</u>                                  | <u>755</u>                                  | <u>2,235</u>                               | <u>2,039</u>                               |
| Total noninterest income                            | 685   | 755   | 2,235                                      | 2,039                                      |
| Noninterest expense:                                |   |   |  |  |
| Compensation and benefits                           | 1,520                                       | 1,487                                       | 4,602                                      | 4,423                                      |
| Occupancy and equipment                             | 501   | 439   | 1,507                                      | 1,291                                      |
| Data processing                                     | 174   | 175   | 508  | 466  |
| Marketing   | 32  | 38  | 133  | 126  |
| Other   | 731   | 617   | 2,078                                      | 1,771                                      |
|   | <u>2,958</u>                                | <u>2,756</u>                                | <u>8,828</u>                               | <u>8,077</u>                               |
| Total noninterest expense                           | 2,958                                       | 2,756                                       | 8,828                                      | 8,077                                      |
| Income before income tax expenses                   | 2,427                                       | 2,260                                       | 7,069                                      | 6,557                                      |
| Income tax expenses                                 | 883   | 858   | 2,616                                      | 2,482                                      |
|   | <u>\$1,544</u>                              | <u>\$1,402</u>                              | <u>\$ 4,453</u>                            | <u>\$ 4,075</u>                            |
| Net income  | \$1,544                                     | \$1,402                                     | \$ 4,453                                   | \$ 4,075                                   |
| Earnings per common share:                          |   |   |  |  |
| Basic   | \$ 0.56                                     | \$ 0.51                                     | \$ 1.62                                    | \$ 1.49                                    |
| Diluted   | \$ 0.55                                     | \$ 0.51                                     | \$ 1.60                                    | \$ 1.48                                    |
| Dividends declared per common share                 | \$ 0.30                                     | \$ 0.28                                     | \$ 0.90                                    | \$ 0.84                                    |

See accompanying notes to consolidated financial statements.

**NorthWest Indiana Bancorp**  
**Consolidated Statements of Changes in Stockholders' Equity**  
**(unaudited)**

| (Dollars in thousands)  | Three Months Ended    |                       | Nine Months Ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 30,<br>2003 | September 30,<br>2002 | September 30,<br>2003 | September 30,<br>2002 |
| Balance at beginning of period  | \$40,392              | \$37,528              | \$39,148              | \$35,882              |
| Comprehensive income:   |                       |                       |                       |                       |
| Net income  | 1,544                 | 1,402                 | 4,453                 | 4,075                 |
| Net unrealized gain/(loss) on securities available-for-sale, net of reclassifications and tax effects | (263)                 | 325                   | (334)                 | 702                   |
| Comprehensive income  | 1,281                 | 1,727                 | 4,119                 | 4,777                 |
| Issuance of shares of common stock  | 79                    | 16                    | 131                   | 144                   |
| Cash dividends  | (825)                 | (767)                 | (2,471)               | (2,299)               |
| Balance at end of period  | \$40,927              | \$38,504              | \$40,927              | \$38,504              |

See accompanying notes to consolidated financial statements.

**NorthWest Indiana Bancorp**  
**Consolidated Statements of Cash Flows**  
**(unaudited)**

| (Dollars in thousands)   | Nine Months Ended<br>September 30, |           |
|--|------------------------------------|-----------|
|  | 2003                               | 2002      |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |                                    |           |
| Net income   | \$ 4,453                           | \$ 4,075  |
| Adjustments to reconcile net income to net cash provided by operating activities:    |                                    |           |
| Origination of loans for sale  | (16,150)                           | (4,487)   |
| Sale of loans originated for sale  | 15,025                             | 5,279     |
| Depreciation and amortization, net of accretion                                      | 1,307                              | 915       |
| Amortization of mortgage servicing rights  | 88                                 | 27        |
| Amortization of investment in real estate limited partnerships                       | 37                                 | 37        |
| Equity in (gain)/loss of investment in limited partnership, net of interest received | 11                                 | (7)       |
| Equity in gain of investment in limited liability corporation                        | (40)                               | —         |
| Net gains on sale of securities  | (119)                              | (143)     |
| Net gains on sale of loans   | (383)                              | (121)     |
| Net (gain)/loss on sale of foreclosed real estate                                    | 4                                  | (40)      |
| Provision for loan losses  | 360                                | 500       |
| Net change in:   |                                    |           |
| Interest receivable  | 116                                | 34        |
| Other assets   | 1,349                              | (791)     |
| Accrued expenses and other liabilities   | (1,072)                            | 809       |
| Total adjustments  | 533                                | 2,012     |
| Net cash from operating activities   | 4,986                              | 6,087     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |                                    |           |
| Proceeds from maturities and pay downs of securities available-for-sale              | 22,800                             | 6,260     |
| Proceeds from sales of securities available-for-sale                                 | 10,488                             | 8,886     |
| Purchase of securities available-for-sale  | (35,215)                           | (10,723)  |
| Proceeds from maturities and pay downs of securities held-to-maturity                | 382                                | 2,000     |
| Purchase of securities held-to-maturity  | (1,355)                            | —         |
| Purchase of Federal Home Loan Bank stock   | (69)                               | (448)     |
| Loan participations purchased  | (7,886)                            | (14,711)  |
| Net change in loans receivable   | (17,853)                           | (17,987)  |
| Purchase of premises and equipment, net  | (4,470)                            | (960)     |
| Proceeds from sale of foreclosed real estate   | 737                                | 104       |
| Net cash from investing activities   | (32,441)                           | (27,579)  |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |                                    |           |
| Change in deposits   | 34,384                             | 27,639    |
| Proceeds from FHLB advances  | 5,000                              | 9,000     |
| Change in other borrowed funds   | 228                                | (12,525)  |
| Proceeds from issuance of common stock   | 131                                | 144       |
| Dividends paid   | (2,413)                            | (2,241)   |
| Net cash from financing activities   | 37,330                             | 22,017    |
| Net change in cash and cash equivalents  | 9,875                              | 525       |
| Cash and cash equivalents at beginning of period                                     | 35,200                             | 16,936    |
| Cash and cash equivalents at end of period   | \$ 45,075                          | \$ 17,461 |
| <b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>   |                                    |           |
| Cash paid during the period for:   |                                    |           |
| Interest   | \$ 5,765                           | \$ 7,749  |
| Income taxes   | \$ 2,692                           | \$ 2,715  |
| <b>SUPPLEMENTAL NONCASH INFORMATION:</b>   |                                    |           |
| Transfers from loans to foreclosed real estate                                       | \$ 614                             | \$ 514    |

See accompanying notes to consolidated financial statements.

NorthWest Indiana Bancorp

Notes to Consolidated Financial Statements

Note 1 — Basis of Presentation

The consolidated financial statements include the accounts of NorthWest Indiana Bancorp (the Bancorp), its wholly-owned subsidiary, Peoples Bank SB (the Bank), and the Bank’s wholly-owned subsidiaries, Peoples Service Corporation and NWIN, LLC. NWIN, LLC began operations on July 25, 2003, as an investment subsidiary based in Las Vegas, Nevada. The Bancorp has no other business activity other than being a holding company for the Bank. The Bancorp’s earnings are dependent upon the earnings of the Bank. The accompanying unaudited consolidated financial statements were prepared in accordance with instructions for Form 10-Q and, therefore, do not include all disclosures required by accounting principles generally accepted in the United States of America for complete presentation of financial statements. In the opinion of management, the consolidated financial statements contain all adjustments (consisting only of normal recurring accruals) necessary to present fairly the consolidated balance sheets of the Bancorp as of September 30, 2003 and December 31, 2002, and the consolidated statements of income and changes in stockholders’ equity for the three and nine months ended September 30, 2003 and 2002, and cash flows for the nine months ended September 30, 2003 and 2002. The income reported for the nine month period ended September 30, 2003 is not necessarily indicative of the results to be expected for the full year.

Note 2 — Use of Estimates

Preparing 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, liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period, as well as the disclosures provided. Actual results could differ from those estimates. Estimates associated with the allowance for loan losses, fair values of financial instruments and status of contingencies are particularly susceptible to material change in the near term.

Note 3 — Concentrations of Credit Risk

The Bancorp grants residential, commercial real estate, commercial business and installment loans to customers in its primary market area of Lake County, in northwest Indiana. Substantially all loans are secured by specific items of collateral including residences, business assets and consumer assets.

Note 4 — Reclassifications

Certain amounts reported in the December 31, 2002 consolidated financial statements and the September 30, 2002 Form 10-Q have been reclassified to conform to the September 30, 2003 presentation.

Note 5 — Stock Compensation

The following proforma information presents net income and basic and diluted earnings per share had the fair value method been used to measure compensation for stock options granted. The exercise price of options granted is equivalent to the market price of the underlying stock at the grant date; therefore, no compensation expense has been recorded for stock options granted.

|                                    | Three Months Ended<br>September 30, |         | Nine Months Ended<br>September 30, |         |
|------------------------------------|-------------------------------------|---------|------------------------------------|---------|
|                                    | 2003                                | 2002    | 2003                               | 2002    |
| Net income as reported             | \$1,544                             | \$1,402 | \$4,453                            | \$4,075 |
| Proforma net income                | 1,533                               | 1,392   | 4,419                              | 4,046   |
| Reported earnings per common share |                                     |         |                                    |         |
| Basic                              | 0.56                                | 0.51    | 1.62                               | 1.49    |
| Diluted                            | 0.55                                | 0.51    | 1.60                               | 1.48    |
| Proforma earnings per common share |                                     |         |                                    |         |
| Basic                              | 0.56                                | 0.51    | 1.61                               | 1.48    |
| Diluted                            | 0.55                                | 0.50    | 1.59                               | 1.47    |

The weighted average fair value of stock options granted during the nine months ended September 30, 2003 and 2002 were \$1.42 and \$1.82. The fair value of options granted during the nine months ended September 30, 2003 and 2002 were estimated using an option pricing model with the following weighted average information as of the grant dates:

|                            | 2003      | 2002      |
|----------------------------|-----------|-----------|
| Risk free rate of interest | 3.46%     | 4.69%     |
| Expected option life       | 6-7 years | 6-7 years |
| Expected dividend yield    | 4.40%     | 4.70%     |
| Expected volatility        | 10.0%     | 10.9%     |

In future years, as additional options are granted, the proforma effect on net income and earnings per share may increase. Stock options are used to attract and retain the best available personnel, to provide additional incentives for employees and to encourage their continued employment by facilitating employees’ purchases of an equity interest in the Bancorp. Options are issued for ten-year periods and have varying vesting schedules. Information about options available for grant and options granted follows:

|                               | Available<br>For Grant | Options<br>Outstanding | Weighted-<br>Average<br>Exercise<br>Price |
|-------------------------------|------------------------|------------------------|---|
| Balance at December 31, 2002  | 70,217                 | 116,818                | \$19.71                                   |
| Options exercised             | —                      | (12,106)               | 16.23                                     |
| Options issued                | (23,025)               | 23,025                 | 25.25                                     |
| Options forfeited             | 3,000                  | (3,000)                | 21.36                                     |
| Balance at September 30, 2003 | 50,192                 | 124,737                | 21.03                                     |

At September 30, 2003, options outstanding had a weighted average remaining life of approximately 6 to 7 years. There were 34,555 options exercisable September 30, 2003 with a weighted-average exercise price of \$18.75.

During the current nine month period, pursuant to the Bancorp’s Stock Option and Incentive Plan the Options Committee granted the issuance of restricted stock to several employees. At September 30, 2003, 2,550 restricted shares were issued at a price of \$25.25 per share. Stock restrictions generally expire upon completion of five years of service after the date of grant.



**Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

**Summary**

NorthWest Indiana Bancorp (the Bancorp) is a bank holding company registered with the Board of Governors of the Federal Reserve System. Peoples Bank SB, an Indiana savings bank, is a wholly-owned subsidiary of the Bancorp. The Bancorp has no other business activity other than being the holding company for the Bank.

At September 30, 2003, the Bancorp had total assets of \$527.5 million and total deposits of \$441.1 million. Stockholders’ equity totaled \$40.9 million or 7.8% of total assets, with book value per share at \$14.88. Net income for the nine months ended September 30, 2003, was \$4.5 million, or \$1.62 earnings per common share for basic and \$1.60 for diluted calculations. The annualized return on average assets (ROA) was 1.22%, while the annualized return on average stockholders’ equity (ROE) was 14.77%, for the nine months ended September 30, 2003.

**Financial Condition**

During the nine months ended September 30, 2003, total assets increased by \$39.5 million (8.1%), with interest-earning assets increasing by \$29.5 million (6.4%). At September 30, 2003, interest-earning assets totaled \$486.9 million and represented 93.6% of total assets. During the nine months ended September 30, 2003, premises and equipment increased by \$3.7 million (38.9%), as a result of funding the construction of a new corporate center.

Loans receivable totaled \$405.4 million at September 30, 2003, compared to \$380.4 million at December 31, 2002. At September 30, 2003, loans receivable represented 83.7% of interest-earning assets, 76.9% of total assets and 91.9% of total deposits. The loan portfolio, which is the Bancorp’s largest asset, is a significant source of both interest and fee income. The Bancorp’s lending strategy stresses quality loan growth, product diversification, and competitive and profitable pricing. The loan portfolio includes \$18.3 million (4.5%) in construction and development loans, \$234.1 million (57.7%) in residential mortgage loans, \$10.6 million (2.6%) in multifamily loans, \$96.4 million (23.8%) in commercial real estate loans, \$5.1 million (1.3%) in consumer loans, and \$40.9 million (10.1%) in commercial business and other loans. Adjustable rate loans comprised 39.0% of total loans at September 30, 2003. During the nine months ended September 30, 2003, loans increased by \$25.0 million (6.6%), including \$11.9 million in residential mortgage loans, \$9.0 million in commercial real estate and \$4.9 million in construction and development loans. Management believes that, despite concerns about the pace of economic activity and uncertainty of world affairs, the positive trend in loan growth will continue during the remaining months of 2003 because of a low interest rate environment and an aggressive marketing and call program effort. Management expects to fund loan growth with retail funds.

The Bancorp is primarily a portfolio lender. Mortgage banking activities are generally limited to the sale of fixed rate mortgage loans with contractual maturities exceeding 15 years. These loans are identified as held for sale when originated and sold, on a case-by-case basis, in the secondary market as part of the Bancorp’s efforts to manage interest rate risk. The Bancorp retains the servicing on all loans sold in the secondary market. During the nine months ended September 30, 2003, the Bancorp sold \$15.0 million in fixed rate mortgages compared to \$5.3 million during the nine months ended September 30, 2002. Net gains realized from current year sales totaled \$383 thousand compared to \$121 thousand for the nine months ended September 30, 2002. The increase in gains is a result of the Bancorp’s loan pricing strategy and an increase in the origination of loans for sale. The recent increase in interest rates has resulted in a reduction of loans originated for sale, and may reflect lower gains in future periods. At September 30, 2003, the Bancorp had \$1.9 million classified as loans held for sale.

The primary objective of the Bancorp’s investment portfolio is to provide for the liquidity needs of the Bancorp and to contribute to profitability by providing a stable flow of dependable earnings. Funds are generally invested in federal funds, interest bearing balances in financial institutions, U.S. government securities and federal agency obligations. Investments are generally for terms ranging from one day to seven years. The investment portfolio totaled \$79.5 million at September 30, 2003, compared to \$76.4 million at December 31, 2002. At September 30, 2003, the investment portfolio represented 16.3% of interest-earning assets, 15.1% of total assets and was invested as follows: 74.9% in U.S. government agency debt securities, 21.9% in U.S. government agency mortgage-backed securities and collateralized mortgage obligations, and 3.2% in municipal securities. At September 30, 2003, securities available-for-sale (AFS) totaled \$57.0 million or 99.0% of total securities. AFS securities are those the Bancorp may decide to sell if needed for liquidity, asset-liability management or other reasons. In addition, at September 30, 2003, the Bancorp had \$19.0 million in interest bearing balances in financial institutions, \$170 thousand in federal funds sold, and \$2.7 million in Federal Home Loan Bank (FHLB) stock. During the nine months ended September 30, 2003, securities increased by \$3.1 million (4.1%), due to growth of retail funds.

The allowance for loan losses (ALL) is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses, and decreased by charge-offs less recoveries. A loan is charged-off against the allowance by management as a loss when deemed uncollectible, although collection efforts continue and future recoveries may occur.

The determination of the amounts of the ALL and provisions for loan losses is based on management's current judgments about the credit quality of the loan portfolio with consideration given to all known relevant internal and external factors that affect loan collectibility as of the reporting date. The appropriateness of the current year provision and the overall adequacy of the ALL are determined through a disciplined and consistently applied quarterly process that combines a review of the current position with a risk assessment worksheet.

The Risk Assessment Worksheet covers the residential, commercial real estate, commercial business, and consumer loan portfolios. Management uses a risk rating system to assist in determining the appropriate level for the ALL. Management assigns risk factors to non-performing loans; loans that management has internally classified as impaired; loans that management has internally classified as substandard, doubtful, loss, or watch; and, performing loans. Risk factors are based on an evaluation of the Bank's own historical information, industry trends, and subjective assessment and interpretation. While management evaluates the loan portfolio as a pool, judgment is applied to determine risk factors associated with impaired loans and large commercial loans.

At September 30, 2003, non-performing loans, which include those loans that are 90 days or more past due and those loans that have been placed on non-accrual status, totaled \$2.2 million, a decrease of \$171 thousand from the \$2.4 million reported at December 31, 2002. The ratio of non-performing loans to total loans was 0.55% at September 30, 2003, compared to 0.63% at December 31, 2002. The ratio of non-performing loans to total assets was 0.42% at September 30, 2003, compared to 0.49% at December 31, 2002. The September 30, 2003 balance includes \$1.7 million in loans accounted for on a non-accrual basis and \$560 thousand in accruing loans which were contractually past due 90 days or more. Loans, internally classified as substandard totaled \$2.8 million at September 30, 2003 and December 31, 2002. No loans were classified as doubtful or loss. Substandard loans include non-performing loans and potential problem loans, where information about possible credit issues or other conditions causes management to question the ability of such borrowers to comply with loan covenants or repayment terms.

The balance for non-performing and substandard loans includes three loans to three borrowers totaling \$619 thousand that have been classified as impaired. Impaired loans are loans where full payment under the loan terms is not expected. There were no other loans considered to be impaired loans as of, or for the nine months ended September 30, 2003.

At September 30, 2003, management is of the opinion that there are no loans, except those discussed above, where known information about possible credit problems of borrowers causes management to have serious doubts as to the ability of such borrowers to comply with the present loan repayment terms and which may result in disclosure of such loans as non-accrual, past due or restructured loans. Also, at September 30, 2003, there were no other interest bearing assets that would be required to be disclosed as non-accrual, past due, restructured or potential problems if such assets were loans. Management does not anticipate that any of the non-performing loans or classified loans would materially impact future operations, liquidity or capital resources.

During the nine months ended September 30, 2003, additions to the ALL account totaled \$360 thousand compared to \$500 thousand for the nine months ended September 30, 2002. The decrease during the current year was due to an improvement in non-performing loan ratios and a reduction in loan charge-offs. Charge-offs, net of recoveries, totaled \$126 thousand for the current period compared to \$236 thousand for the nine months ended September 30, 2002. Changes in the provision are directionally consistent with changes in observable data and take into consideration management's current judgments about the credit quality of the loan portfolio, loan portfolio growth, changes in the portfolio mix and local economic conditions. While the quality of the loan portfolio remains sound, provisions during the current period were warranted because of increased average daily loan balances and apparent weaknesses in the local economy.

The ALL to total loans was 0.95% at September 30, 2003, compared to .96% at December 31, 2002, while the ALL to nonperforming loans (coverage ratio) was 174.8% compared to 152.4% for the same periods. The September 30, 2003 balance in the ALL account of \$3.9 million is considered adequate by management after evaluation of the loan portfolio, past experience and current economic and market conditions. While management may periodically allocate portions of the allowance for specific problem loans, the whole allowance is available for any loan charge-offs that occur. The allocation of the ALL reflects performance and growth trends within the various loan categories, as well as, consideration of the facts and circumstances that affect the repayment of individual loans, and loans which have been pooled as of the evaluation date, with particular attention given to non-performing loans and loans which have been classified as substandard, doubtful or loss. Management has allocated general reserves to both performing and non-performing loans based on current information available.

At September 30, 2003, the Bancorp carried no foreclosed real estate, compared to \$127 thousand at December 31, 2002.

Deposits are a fundamental and cost-effective source of funds for lending and other investment purposes. The Bancorp offers a variety of products designed to attract and retain customers, with the primary focus on building and expanding relationships. At September 30, 2003, deposits totaled \$441.1 million. During the nine months ended September 30, 2003, deposits increased by \$34.4 million (8.5%). Checking accounts increased by \$15.3 million (17.7%), money market deposit accounts (MMDA's) increased \$13.0 million (19.9%) and savings accounts increased \$6.2 million (9.7%). During the period certificates of deposits decreased by \$194 thousand (0.1%). At September 30, 2003, the deposit base was comprised of 23.1% checking accounts, 17.8% MMDA's, 15.9% savings accounts and 43.2% certificates of deposit. The growth in deposits was a result of competitive product offerings, an aggressive marketing program, and volatility in the financial markets.

Borrowings are primarily used to fund asset growth not supported by deposit generation. At September 30, 2003, borrowed funds totaled \$41.3 million compared to \$36.1 million at December 31, 2002, an increase of \$5.2 million (14.5%). Retail repurchase agreements totaled \$11.0 million at September 30, 2003, compared to \$12.6 million at December 31, 2002, a decrease of \$1.6 million (12.7%). FHLB advances totaled \$26.5 million at September 30, 2003, compared to \$21.5 million at December 31, 2002, an increase of \$5.0 million, as the Bancorp extended the maturity structure of interest-bearing liabilities at cost effective interest rates. Other short-term borrowings totaled \$3.8 million at September 30, 2003, compared to \$1.9 million at December 31, 2002, an increase of \$1.8 million to meet short-term funding requirements.

**Liquidity and Capital Resources**

For the Bancorp, liquidity management refers to the ability to generate sufficient cash to fund current loan demand, meet deposit withdrawals, and pay dividends and operating expenses. Because the Bancorp is subject to legal reserve requirements under Federal Reserve Regulation D, liquidity is managed to ensure that the Bancorp maintains an adequate level of legal reserves. In addition, liquidity is managed to meet the cash demands of depositors and its loan customers. Because profitability and liquidity are often conflicting objectives, management attempts to maximize the Bancorp's net interest margin by making adequate, but not excessive, liquidity provisions.

Changes in the liquidity position result from operating, investing and financing activities. Cash flows from operating activities are generally the cash effects of transactions and other events that enter into the determination of net income. The primary investing activities include loan originations, loan repayments, investments in interest bearing balances in financial institutions, and the purchase, sale, and maturity of investment securities. Financing activities focus almost entirely on the generation of customer deposits. In addition, the Bancorp utilizes borrowings (i.e., retail repurchase agreements and advances from the FHLB) as a source of funds.

During the nine months ended September 30, 2003, cash and cash equivalents increased \$9.9 million compared to a \$525 thousand increase for the nine months ended September 30, 2002, principally due to deposit growth during 2003. The primary sources of cash were proceeds from maturities and sales of securities, loan sales, deposit growth, FHLB advances and cash provided by operating activities. The primary uses of cash were loan originations, purchase of securities, construction disbursements for the new corporate center and the payment of common stock dividends. During the current nine months cash provided by operating activities totaled \$5.0 million compared to \$6.1 million for the nine months ended September 30, 2002. Cash outflows from investing activities totaled \$32.4 million compared to \$27.6 million for the nine months ended September 30, 2002. The increase for the current period was due primarily to security purchases and construction disbursements for the new corporate center. Net cash inflows from financing activities totaled \$37.3 million during the current period compared to \$22.0 million for the nine months ended September 30, 2002. The increase in net cash inflows was primarily due to an increase in deposits, principally core deposit growth. The Bancorp paid dividends on common stock of \$2.4 million during the current nine months compared to \$2.2 million for the nine months ended September 30, 2002.

At September 30, 2003, outstanding commitments to fund loans totaled \$74.3 million. Approximately 85% of the commitments were at variable rates. Management believes that the Bancorp has sufficient cash flow and borrowing capacity to fund all outstanding commitments and to maintain proper levels of liquidity. The following table presents the Bancorp's consolidated long term, non-deposit related, contractual obligations as well as commitments to extend credit to our borrowers, in aggregate and by payment due dates at September 30, 2003. Dollar amounts are in thousands.

|  | Less Than<br>One Year | One Through<br>Three Years | Four Through<br>Five Years | After<br>Five Years | Total     |
|--|-----------------------|----------------------------|----------------------------|---------------------|-----------|
| Long-term contractual obligations:                                       |                       |                            |                            |                     |           |
| FHLB advances  | \$ 6,000              | \$15,500                   | \$5,000                    | \$ —                | \$ 26,500 |
| Limited partnership obligation   | 63                    | 127                        | 89                         | —                   | 279       |
|  |                       |                            |                            |                     |           |
| Total long-term contractual obligations                                  | 6,063                 | 15,627                     | 5,089                      | —                   | 26,779    |
| Commitments to extend credit:  |                       |                            |                            |                     |           |
| Commitments to make loans & unused approved lines of credit              | 27,213                | 47,123                     | —                          | —                   | 74,336    |
| Performance standby letters of credit                                    | 1,998                 | 521                        | —                          | —                   | 2,519     |
|  |                       |                            |                            |                     |           |
| Total commitments to extend credit                                       | 29,242                | 47,644                     | —                          | —                   | 76,855    |
|  |                       |                            |                            |                     |           |
| Total long-term contractual obligations and commitments to extend credit | \$35,274              | \$63,271                   | \$5,089                    | \$ —                | \$103,634 |
|  |                       |                            |                            |                     |           |

During October 2003, the Bancorp completed the construction of a \$6.1 million state-of-the-art corporate center in Munster, Indiana. The corporate center affords the Bancorp the opportunity to continue offering superior customer service, while providing for future growth and operating efficiencies. For the nine months ended September 30, 2003, capitalized interest totaled \$52 thousand. Management does not expect the facility to have a material impact on noninterest expense during future periods.

Management strongly believes that maintaining a high level of capital enhances safety and soundness. During the nine months ended September 30, 2003, stockholders’ equity increased by \$1.8 million (4.5%). The increase resulted primarily from earnings of \$4.5 million during the period. In addition, \$131 thousand represents proceeds from the exercise of 12,106 stock options. The Bancorp declared \$2.5 million in cash dividends for the nine month period ended September 30, 2003. The decrease in the unrealized gain on available-for-sale securities, net of tax was \$334 thousand for the current period.

The Bancorp is subject to risk-based capital guidelines adopted by the Board of Governors of the Federal Reserve System (the FRB), and the Bank is subject to risk-based capital guidelines adopted by the FDIC. As applied to the Bancorp and the Bank, the FRB and FDIC capital requirements are substantially identical. The Bancorp and the Bank are required to maintain a total risk-based capital ratio of 8%, of which 4% must be Tier 1 capital. In addition, the FRB and FDIC regulations provide for a minimum Tier 1 leverage ratio (Tier 1 capital to adjusted average assets) of 3% for financial institutions that meet certain specified criteria, including that they have the highest regulatory rating and are not experiencing or anticipating significant growth. All other financial institutions are required to maintain a Tier 1 leverage ratio of 3% plus an additional cushion of at least one to two percent.

The following table shows that, at September 30, 2003, and December 31, 2002, the Bancorp’s capital exceeded all regulatory capital requirements. The Bancorp’s and the Bank’s regulatory capital ratios were substantially the same at both dates. The dollar amounts are in millions.

|   | Actual |       | Required for<br>adequate capital |       | To be well<br>capitalized |       |
|---|--------|-------|----------------------------------|-------|---------------------------|-------|
|   | Amount | Ratio | Amount                           | Ratio | Amount                    | Ratio |
| At September 30, 2003                     |        |       |                                  |       |                           |       |
| Total capital to risk-weighted assets     | \$45.5 | 12.8% | \$28.0                           | 8.4%  | \$35.5                    | 10.0% |
| Tier 1 capital to risk-weighted assets    | \$41.6 | 11.7% | \$14.0                           | 4.2%  | \$21.3                    | 6.0%  |
| Tier 1 capital to adjusted average assets | \$41.6 | 8.3%  | \$15.1                           | 3.0%  | \$25.2                    | 5.0%  |
|   |        |       |                                  |       |                           |       |
|   | Actual |       | Required for<br>adequate capital |       | To be well<br>capitalized |       |
|   | Amount | Ratio | Amount                           | Ratio | Amount                    | Ratio |
| At December 31, 2002                      |        |       |                                  |       |                           |       |
| Total capital to risk-weighted assets     | \$41.8 | 13.1% | \$25.6                           | 8.0%  | \$32.0                    | 10.0% |
| Tier 1 capital to risk-weighted assets    | \$38.1 | 11.9% | \$12.8                           | 4.0%  | \$19.2                    | 6.0%  |
| Tier 1 capital to adjusted average assets | \$38.1 | 7.6%  | \$15.0                           | 3.0%  | \$25.0                    | 5.0%  |

The Bancorp’s ability to pay dividends to its shareholders is entirely dependent upon the Bank’s ability to pay dividends to the Bancorp. Under Indiana law, the Bank may pay dividends from its undivided profits

(generally, earnings less losses, bad debts, taxes and other operating expenses) as is considered expedient by the Bank’s Board of Directors. However, the Bank must obtain the approval of the Indiana Department of Financial Institutions for the payment of a dividend if the total of all dividends declared by the Bank during the current year, including the proposed dividend, would exceed the sum of retained net income for the year to date plus its retained net income for the previous two years. For this purpose, “retained net income” means net income as calculated for call report purposes, less all dividends declared for the applicable period. Moreover, the FDIC and the Federal Reserve Board may prohibit the payment of dividends if it determines that the payment of dividends would constitute an unsafe or unsound practice in the light of the financial condition of the Bank. The aggregate amount of dividends, which may be declared by the Bank in 2003, without prior regulatory approval, approximates \$4,953,000 plus current 2003 net profits.

**Results of Operations — Comparison of the Quarter Ended September 30, 2003 to the Quarter Ended September 30, 2002**

Net income for the three months ended September 30, 2003 was \$1.5 million compared to \$1.4 million for the quarter ended September 30, 2002, an increase of \$142 thousand (10.1%), principally due to a decrease in interest expense. The earnings represent a ROA of 1.23% for the quarter ended September 30, 2003 compared to 1.22% for the quarter ended September 30, 2002. The ROE was 15.18% for the current quarter compared to 14.67% for the quarter ended September 30, 2002.

Net interest income for the three months ended September 30, 2003 was \$4.8 million, up \$319 thousand (7.1%), compared to \$4.5 million for the quarter ended September 30, 2002. The increase in net interest income was due to a lower cost of funds. The weighted-average yield on interest-earning assets was 5.56% for the three months ended September 30, 2003 compared to 6.38% for the three months ended September 30, 2002. The weighted-average cost of funds for the quarter ended September 30, 2003, was 1.55% compared to 2.38% for the quarter ended September 30, 2002. The impact of the 5.56% return on interest-earning assets and the 1.55% cost of funds resulted in an interest rate spread of 4.01% for the current quarter compared to 4.00% for the quarter ended September 30, 2002. During the current quarter, total interest income decreased by \$383 thousand (5.5%) while total interest expense decreased by \$702 thousand (28.3%). The net interest margin was 4.06% for the three months ended September 30, 2003 compared to 4.10% for the quarter ended September 30, 2002.

During the three months ended September 30, 2003, interest income from loans decreased by \$102 thousand (1.6%) compared to the three months ended September 30, 2002. The decrease was due to lower yields on loans outstanding, as the current interest rate environment resulted in new originations at low rates, and continued increases in prepayment, modification and refinance activity. The weighted-average yield on loans outstanding was 6.05% for the current quarter compared to 6.78% for the three months ended September 30, 2002. Loan balances averaged \$402.9 million for the current quarter, up \$37.5 million (10.3%) from \$365.4 million for the three months ended September 30, 2002. During the three months ended September 30, 2003, interest income on investments and other deposits decreased by \$281 thousand (34.9%) compared to the quarter ended September 30, 2002. The decrease was due lower portfolio yields resulting from prepayments of mortgage related securities. The weighted-average yield on securities and other deposits was 2.78% for the current quarter compared to 4.31% for the three months ended September 30, 2002. Securities and other deposits averaged \$70.3 million for the current quarter, down \$1.1 million (1.5%) from \$71.4 million for the three months ended September 30, 2002.

Interest expense for deposits decreased by \$640 thousand (30.6%) during the current quarter compared to the three months ended September 30, 2002. The decrease was due to a reduction in the weighted-average rate paid on deposits. The weighted-average rate paid on deposits for the three months ended September 30, 2003 was 1.38% compared to 2.22% for the quarter ended September 30, 2002. Total deposit balances averaged \$422.0 million for the current quarter, up \$44.3 million (11.7%) from \$377.7 million for the quarter ended September 30, 2002. Interest expense on borrowed funds decreased by \$62 thousand (15.9%) during the current quarter due to a decrease in average daily balances and a lower cost of funds. The weighted-average cost of borrowed funds was 3.44% for the current quarter compared to 3.91% for the three months ended September 30, 2002. Borrowed funds averaged \$38.1 million during the quarter ended September 30, 2003, a decrease of \$1.8 million (4.5%) from \$39.9 million for the quarter ended September 30, 2002.

Noninterest income for the quarter ended September 30, 2003 was \$685 thousand, down \$70 thousand (9.3%) from \$755 thousand for the quarter ended September 30, 2002. During the current quarter fees and service charges totaled \$477 thousand, a decrease of \$2 thousand (0.4%) from \$479 thousand for the quarter ended September 30, 2002. The decrease was primarily due to the amortization of mortgage servicing rights. Gains on sales of loans totaled \$67 thousand for the three months ended September 30, 2003, compared to \$68 thousand during the three months ended September 30, 2002, a decrease of \$1 thousand (1.5%). Fees from Trust operations totaled \$105 thousand for the quarter ended September 30, 2003, a decrease of \$31 thousand (22.8%) from \$136 thousand for the quarter ended September 30, 2002. During the current quarter gains on the sale of

securities totaled \$31 thousand, a decrease of \$23 thousand (42.6%) from \$54 thousand for the quarter ended September 30, 2002. Securities sales for the three months ended September 30, 2003, totaled \$2.1 million compared to \$2.9 million for the nine months ended September 30, 2002, as securities with high prepayment speeds were sold and reinvested at higher yields. There were no gains or losses from the sale of foreclosed real estate during the current quarter. During the quarter ended September 20, 2002, gains from the sale of foreclosed real estate totaled \$16 thousand.

Noninterest expense for the quarter ended September 30, 2003 was \$3.0 million, up \$202 thousand (7.3%) from \$2.8 million for the three months ended September 30, 2002. Increases were due primarily to account growth, system usage and expansion of banking activities. The increase in compensation and benefits was due to additional staffing for current operations. The increase in occupancy expense was due to increased depreciation expense for planned capital expenditures. Other expense changes were due to standard increases in operations. The Bancorp's efficiency ratio was 53.9% for the quarter ended September 30, 2003 compared to 52.6% for the three months ended September 30, 2002. The ratio is determined by dividing total noninterest expense by the sum of net interest income and total noninterest income for the period.

Income tax expenses for the three months ended September 30, 2003 totaled \$883 thousand compared to \$858 thousand for the three months ended September 30, 2002, an increase of \$25 thousand (2.9%). The increase was due to an increase in pretax earnings during the current quarter. The combined effective federal and state tax rates for the Bancorp was 36.4% for the three months ended September 30, 2003 compared to 38.0% for the three months ended September 30, 2002.

**Results of Operations — Comparison of the Nine Months Ended September 30, 2003 to the Nine Months Ended September 30, 2002**

Net income for the nine months ended September 30, 2003 was \$4.5 million compared to \$4.1 million for the nine months ended September 30, 2002, an increase of \$378 thousand (9.3%), principally due to decreases in interest expense and increases in noninterest income. The earnings represent a ROA of 1.22% for the nine months ended September 30, 2003 compared to 1.19% for the nine months ended September 30, 2002. The ROE was 14.77% for the current nine months compared to 14.58% for the nine months ended September 30, 2002.

Net interest income for the nine months ended September 30, 2003 was \$14.0 million, up \$927 thousand (7.1%), compared to \$13.1 million for the nine months ended September 30, 2002. The increase was due to the cost of funds falling more rapidly than the yield on earning assets. The weighted-average yield on interest-earning assets was 5.72% for the nine months ended September 30, 2003 compared to 6.40% for the nine months ended September 30, 2002. The weighted-average cost of funds for the nine months ended September 30, 2003, was 1.73% compared to 2.48% for the nine months ended September 30, 2002. The impact of the 5.72% return on interest-earning assets and the 1.73% cost of funds resulted in an interest rate spread of 3.99% for the current nine months compared to 3.93% for the nine months ended September 30, 2002. During the current nine months, total interest income decreased by \$1.0 million (5.0%) while total interest expense decreased by \$2.0 million (25.4%). The net interest margin was 4.06% for the nine months ended September 30, 2003 compared to 4.03% for the nine months ended September 30, 2002.

During the nine months ended September 30, 2003, interest income from loans decreased by \$270 thousand (1.5%) compared to the nine months ended September 30, 2002. The decrease was due to lower yields on loans outstanding, as the current interest rate environment resulted in new originations at low rates, and continued increases in prepayment, modification and refinance activity. The weighted-average yield on loans outstanding was 6.19% for the current nine months compared to 6.79% for the nine months ended September 30, 2002. Loan balances averaged \$390.9 million for the current nine months, up \$29.8 million (8.3%) from \$361.1 million for the nine months ended September 30, 2002. During the nine months ended September 30, 2003, interest income on investments and other deposits decreased by \$766 thousand (31.8%) compared to the nine months ended September 30, 2002. The decrease was due to lower yields as funds from security maturities and calls were reinvested at lower rates. The weighted-average yield on securities and other deposits was 3.14% for the current period compared to 4.45% for the nine months ended September 30, 2002. Securities and other deposits averaged \$69.7 million for the current nine months, down \$2.5 million (3.5%) from \$72.2 million for the nine months ended September 30, 2002.

Interest expense for deposits decreased by \$1.8 million (27.1%) during the current nine months compared to the nine months ended September 30, 2002. The decrease was due to a reduction in the weighted-average rate paid on deposits. The weighted-average rate paid on deposits for the nine months ended September 30, 2003 was 1.57% compared to 2.35% for the nine months ended September 30, 2002. Total deposit balances averaged \$406.9 million for the current nine months, up \$33.9 million (9.1%) from \$373.0 million for the nine months ended September 30, 2002. Interest expense on borrowed funds decreased by \$183 thousand (15.9%) during the

current nine months due to a decrease in average daily balances and a lower cost of funds. The weighted-average cost of borrowed funds was 3.50% for the current quarter compared to 3.66% for the three months ended September 30, 2002. Borrowed funds averaged \$36.9 million during the nine months ended September 30, 2003, a decrease of \$5.2 million (12.4%) from \$42.1 million for the nine months ended September 30, 2002.

Noninterest income for the nine months ended September 30, 2003 was \$2.2 million, up \$196 thousand (9.6%) from \$2.0 million for the nine months ended September 30, 2002. During the current nine months fees and service charges totaled \$1.4 million, an increase of \$61 thousand (4.6%) from \$1.3 million for the nine months ended September 30, 2002. The increase was due to account growth and increased activity. Gains on sales of loans totaled \$383 thousand for the nine months ended September 30, 2003, compared to \$121 thousand during the nine months ended September 30, 2002, due to increased sales volume. Loan sales for the nine months ended September 30, 2003, totaled \$15.0 million compared to \$5.3 million for the nine months ended September 30, 2002. Fees from Trust operations totaled \$339 thousand for the nine months ended September 30, 2003, a decrease of \$73 thousand (17.7%) from \$412 thousand for the nine months ended September 30, 2002. During the nine months ended September 30, 2003, the Bancorp reported \$119 thousand in gains on the sale of securities compared to \$143 thousand for the nine months ended September 30, 2002, as securities with high prepayment speeds were sold and reinvested at higher yields. Securities sales for the nine months ended September 30, 2003, totaled \$10.5 million compared to \$8.9 million for the nine months ended September 30, 2002. During the current period losses from the sale of foreclosed real estate totaled \$4 thousand, while gains from the sale of foreclosed real estate totaled \$40 thousand for the nine months ended September 30, 2003.

Noninterest expense for the nine months ended September 30, 2003 was \$8.8 million, up \$751 thousand (9.3%) from \$8.1 million for the nine months ended September 30, 2002. Increases were due primarily to account growth, system usage and expansion of banking activities. The increase in compensation and benefits was due to additional staffing for current operations. The increase in occupancy expense was due to increased depreciation expense for planned capital expenditures. Other expense changes were due to standard increases in operations. The Bancorp’s efficiency ratio was 54.5% for the nine months ended September 30, 2003 compared to 53.8% for the nine months ended September 30, 2002.

Income tax expenses for the nine months ended September 30, 2003 totaled \$2.6 million compared to \$2.5 million for the nine months ended September 30, 2002, an increase of \$134 thousand (5.4%). The increase was due to an increase in pretax earnings during the current period. The combined effective federal and state tax rates for the Bancorp was 37.0% for the nine months ended September 30, 2003 compared to 37.9% for the nine months ended September 30, 2002.

**Critical Accounting Policies**

Critical accounting policies are those accounting policies that management believes are most important to the portrayal of the Bancorp’s financial condition and that require management’s most difficult, subjective or complex judgments. The Bancorp’s critical accounting policies are summarized below:

Allowance for Loan Losses — The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses, and decreased by charge-offs less recoveries. Estimating the risk of loss and the amount of loss on any loan is necessarily subjective. Accordingly, the allowance is maintained by management at a level considered adequate based on past loss experience, general economic conditions, information about specific borrower situations including their financial position and collateral values, and other factors and estimates which are subject to change over time. While management may periodically allocate portions of the allowance for specific problem loans, the whole allowance is available for any loan charge-offs that occur. Loan losses are charged against the allowance when management believes that uncollectibility of a loan a balance is confirmed.

Mortgage Servicing Rights — Mortgage servicing rights are recognized as assets for the allocated value of retained servicing rights on loans sold. Mortgage servicing rights are expensed in proportion to, and over the period of, estimated net servicing revenues. Impairment is evaluated based on the fair value of the rights, using groupings of the underlying loans as to interest rates and then, secondly as to prepayment characteristics. Any impairment of a grouping is reported as a valuation allowance.

**Forward-Looking Statements**

Statements contained in this report on Form 10-Q that are not historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The words or phrases “would be,” “will allow,” “intends to,” “will likely result,” “are expected to,” “will continue,” “is anticipated,” “estimate,” “project,” or similar expressions are also intended to identify “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act. The Bancorp cautions readers that forward-looking statements, including without limitation those relating to the Bancorp’s future business prospects, interest income and expense, net income, liquidity, and capital needs are subject to certain risks and uncertainties that could cause actual results to differ materially from those indicated in the forward-looking statements, due to, among other things, factors identified in this filing, including the following:

**Regulatory Risk.** The banking industry is heavily regulated. These regulations are intended to protect depositors, not shareholders. The Bank and Bancorp are subject to regulation and supervision by the Indiana Department of Financial Institutions, Federal Deposit Insurance Corporation, and the Board of Governors of the Federal Reserve System. The burden imposed by federal and state regulations puts banks at a competitive disadvantage compared to less regulated competitors such as finance companies, mortgage banking companies and leasing companies. The banking industry continues to lose market share to competitors.

**Legislation.** Because of concerns relating to the competitiveness and the safety and soundness of the industry, Congress continues to consider a number of wide-ranging proposals for altering the structure, regulation, and competitive relationships of the nation’s financial institutions. Management cannot predict whether or in what form any of these proposals will be adopted or the extent to which the business of the Bancorp or the Bank may be affected thereby.

**Credit Risk.** One of the greatest risks facing lenders is credit risk, that is, the risk of losing principal and interest due to a borrower’s failure to perform according to the terms of a loan agreement. While management attempts to provide an allowance for loan losses at a level adequate to cover probable incurred losses based on loan portfolio growth, past loss experience, general economic conditions, information about specific borrower situations, and other factors, future adjustments to reserves may become necessary, and net income could be significantly affected, if circumstances differ substantially from assumptions used with respect to such factors.

**Exposure to Local Economic Conditions.** The Bank’s primary market area for deposits and loans encompasses Lake County, in northwest Indiana, where all of its offices are located. Ninety-five percent of the Bank’s business activities are within this area. This concentration exposes the Bank to risks resulting from changes in the local economy. A dramatic drop in local real estate values would, for example, adversely affect the quality of the Bank’s loan portfolio.

**Interest Rate Risk.** The Bancorp’s earnings depend to a great extent upon the level of net interest income, which is the difference between interest income earned on loans and investments and the interest expense paid on deposits and other borrowings. Interest rate risk (IRR) is the risk that the earnings and capital will be adversely affected by changes in interest rates. Further discussion of interest rate risk can be found in this report under Item 3., “Quantitative and Qualitative Disclosures About Market Risk”.

**Competition.** The activities of the Bancorp and the Bank in the geographic market served involve competition with other banks as well as with other financial institutions and enterprises, many of which have substantially greater resources than those available to the Bancorp. In addition, non-bank competitors are generally not subject to the extensive regulation applicable to the Bancorp and the Bank.



**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

The Bancorp’s primary market risk exposure is interest rate risk. Interest rate risk is the risk that the Bancorp’s earnings and capital will be adversely affected by changes in interest rates. The primary approach to interest rate risk management is one that focuses on adjustments to the Bancorp’s asset/liability mix in order to limit the magnitude of interest rate risk. The Board of Directors has delegated the responsibility for measuring, monitoring and controlling interest rate risk to the Bancorp’s asset/liability management committee (ALCO). The ALCO is responsible for developing and implementing interest rate risk management strategies, establishing and maintaining a system of limits and controls, and establishing and utilizing an interest rate risk measurement system. The ALCO, which is made up of members of senior management, generally meets monthly with board presentations occurring quarterly.

Performance from an interest rate risk perspective can be measured in many ways. Methodologies used by the Bancorp focus on net interest income and the net economic value of equity. Net interest income is defined as interest income less interest expense. Variability in net interest income arises because its components — interest income and interest expense — do not change equally as rates vary. This mismatch occurs because individual assets and liabilities reprice differently as rates change. Factors which affect net interest income include changes in the level of interest rates, changes in the relationship between Bancorp yield rates and interest costs, changes in the volume of assets and liabilities outstanding, and changes in the composition or mix of assets and liabilities. Management uses rate shock (i.e., instantaneous and sustained parallel shifts in the yield curve in 1% increments up and down 2%) for stress testing the net interest income under several rate change levels. In order to simulate activity, maturing balances are replaced with new balances at the new rate level and repricing balances are adjusted to the new rate shock level. The results are compared to limits set by the Board of Directors and are monitored to identify unfavorable trends. Net economic value of equity is the net present value of the Bancorp’s portfolio of assets and liabilities. By marking-to-market the components of the balance sheet, management can compute the net economic value of equity. As rates change over time, the market values of Bancorp assets and liabilities will change, with longer-term products fluctuating more than short-term products. In most cases, rate-sensitive assets and liabilities will not have the same maturity characteristics. Therefore, as rates vary, the market value of the rate-sensitive assets will not change equally with the market value of rate-sensitive liabilities. This will cause the net economic value of equity to vary. The focus of the net economic value of equity is to determine the percentage decline in the net economic value of equity caused by a 2% increase or decrease in interest rates, whichever produces the larger decline. A large value indicates a large percentage decline in the net economic value of equity due to changes in interest rates and, thus, high interest rate sensitivity. A low value indicates a small percentage decline in the net economic value of equity due to changes in interest rates and, thus, low interest rate sensitivity. As with net interest income, the results are compared to limits set by the Board of Directors and are monitored to identify unfavorable trends.

Presented in the following tables is forward-looking information about the Bancorp’s sensitivity to changes in interest rates as of September 30, 2003 and December 31, 2002. The tables incorporate the Bancorp’s internal system generated data as related to the maturity and repayment/withdrawal of interest-earning assets and interest-bearing liabilities. Prepayment assumptions are based on published data. Present value calculations use current published market interest rates. For core deposits that have no contractual maturity, the table presents principal cash flows and, as applicable, related weighted-average interest rates based on the Bancorp’s historical experience, management’s judgment, and statistical analysis, as applicable, concerning their most likely withdrawal behaviors, but not as to when they could be repriced.

| <b>September 30, 2003</b> |               | <b>Net Interest Income</b> |                       | <b>Net Economic Value of Equity</b> |               |                       |
|---------------------------|---------------|----------------------------|-----------------------|-------------------------------------|---------------|-----------------------|
| <b>Change in rates</b>    | <b>Amount</b> | <b>% Chg.</b>              | <b>Policy Limit %</b> | <b>Amount</b>                       | <b>% Chg.</b> | <b>Policy Limit %</b> |
| 2%                        | \$19,616      | -3.0                       | - 20                  | \$52,353                            | -15.7         | - 30                  |
| 1%                        | \$20,025      | -1.0                       | - 10                  | \$58,231                            | - 6.2         | - 15                  |
| 0%                        | \$20,230      | 0.0                        |                       | \$62,081                            | 0.0           |                       |
| -1%                       | \$19,706      | -2.6                       | - 10                  | \$61,860                            | - 0.4         | - 15                  |
| -2%                       | \$18,680      | -7.7                       | - 20                  | \$62,349                            | - 0.4         | - 30                  |

| <b>December 31, 2003</b> |               | <b>Net Interest Income</b> |                       | <b>Net Economic Value of Equity</b> |               |                       |
|--------------------------|---------------|----------------------------|-----------------------|-------------------------------------|---------------|-----------------------|
| <b>Change in rates</b>   | <b>Amount</b> | <b>% Chg.</b>              | <b>Policy Limit %</b> | <b>Amount</b>                       | <b>% Chg.</b> | <b>Policy Limit %</b> |
| 2%                       | \$17,516      | -2.2                       | - 20                  | \$49,110                            | -10.7         | - 30                  |
| 1%                       | \$17,886      | -0.1                       | - 10                  | \$53,691                            | - 2.3         | - 15                  |
| 0%                       | \$17,910      | 0.0                        |                       | \$54,969                            | 0.0           |                       |
| -1%                      | \$17,796      | -0.6                       | - 10                  | \$54,515                            | - 0.8         | - 15                  |
| -2%                      | \$17,439      | -2.6                       | - 20                  | \$54,793                            | - 0.3         | - 30                  |

The tables show that the Bancorp has managed interest rate risk within the policy limits set by the Board of Directors. At September 30, 2003, an increase in interest rates of 2% would have resulted in a 3.0% decrease in net interest income and a 15.7% decrease in the net economic value of equity compared to decreases of 2.2% and 10.7% at December 31, 2002. During the nine months ended September 30, 2003, the Bancorp has managed interest rate risk by generally selling fixed rate loans with contractual maturities exceeding 15 years, investing cash equivalents in higher yielding interest earning assets and implementing net interest income pricing strategies.

#### **Item 4. Controls and Procedures**

(a) Evaluation of Disclosure Controls and Procedures.

The Bancorp maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed by the Bancorp in the reports that it files or submits under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. These disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed by the Bancorp in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Bancorp’s management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure. The Bancorp’s management, with the participation of its principal executive officer and principal financial officer, evaluates the effectiveness of the Bancorp’s disclosure controls and procedures as of the end of each quarter. Based on that evaluation as of September 30, 2003, the Bancorps’ principal executive officer and principal financial officer have concluded that such disclosure controls and procedures were effective as of that date.

(b) Changes in Internal Control Over Financial Reporting.

There was no change in the Bancorp’s internal control over financial reporting that occurred during the three months ended September 30, 2003 that has materially affected, or is reasonably likely to materially affect, the Bancorp’s internal control over financial reporting.

**PART II – Other Information**

Item 1. Legal Proceedings

The Bancorp is not party to any material legal proceedings. From time to time, the Bank is a party to ordinary routine litigation incidental to its business, including foreclosures.

Item 2. Changes in Securities and Use of Proceeds

There are no matters reportable under this item.

Item 3. Defaults Upon Senior Securities

There are no matters reportable under this item.

Item 4. Submission of Matters to a Vote of Security Holders

There are no matters reportable under this item.

Item 5. Other Information

There are no matters reportable under this item.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits.

| Exhibit<br>Number | Description   |
|-------------------|---|
| 31.1              | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer |
| 31.2              | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer |
| 32.1              | Section 1350 Certifications                                       |

(b) Reports on Form 8-K.

Results of Operations and Financial Condition — On July 25, 2003, the Bancorp issued a press release reporting its financial results for the quarter ended September 30, 2003 and filed a Report on Form 8-K including a copy of the press release and unaudited supplemental financial information for such quarter as exhibits thereto

**SIGNATURES**

Pursuant to the requirement of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 6, 2003

**NORTHWEST INDIANA BANCORP**

/s/ David A. Bochnowski

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David A. Bochnowski  
Chairman of the Board and Chief Executive Officer

Date: November 6, 2003

/s/ Edward J. Furticella

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Edward J. Furticella  
Executive Vice President, Chief Financial Officer  
and Treasurer

**INDEX TO EXHIBITS**

| <u>Exhibit<br/>Number</u> | <u>Description</u>  |
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| 32.1                      | Section 1350 Certifications                                       |