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1ST INDEPENDENCE FINANCIAL GROUP, INC.

Form 10-Q

May 07, 2008

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

FORM 10-Q

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

For the quarterly period ended March 31, 2008  
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 0-26570

1ST INDEPENDENCE FINANCIAL GROUP, INC.  
(Exact name of registrant as specified in its charter)

Delaware 61-1284899  
(State or other jurisdiction of (I.R.S. Employer Identification No.)  
incorporation or organization)

8620 Biggin Hill Lane 40220-4117  
Louisville, Kentucky (Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (502)753-0500

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer   
Non-accelerated filer  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

The registrant had 1,995,744 shares of common stock outstanding at April 28, 2008.

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1st INDEPENDENCE FINANCIAL GROUP, INC.  
FORM 10-Q  
For the Quarter Ended March 31, 2008

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## INDEX

### Part I - Financial Information

Item 1. Financial Statements	Page Number -----
Condensed Consolidated Balance Sheets as of March 31, 2008 (unaudited) and December 31, 2007	3
Condensed Consolidated Statements of Operations for the three months ended March 31, 2008 and 2007 (unaudited)	4
Condensed Consolidated Statements of Comprehensive Income for the three months ended March 31, 2008 and 2007 (unaudited)	5
Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2008 and 2007 (unaudited)	6
Notes to Condensed Consolidated Financial Statements (unaudited)	7-10
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	11-15
Item 3. Quantitative and Qualitative Disclosures About Market Risk	16
Item 4. Controls and Procedures	16

### Part II - Other Information

Item 1. Legal Proceedings	17
Item 6. Exhibits	17
Signatures	18

## PART I FINANCIAL INFORMATION

### Item 1. Financial Statements

#### 1ST INDEPENDENCE FINANCIAL GROUP, INC. Condensed Consolidated Balance Sheets (in thousands except share data)

	(Unaudited) March 31, 2008 -----	December 2007 -----
<b>Assets</b>		
Cash and due from banks	\$ 13,775	\$ 11,
Interest-bearing demand deposits	8,221	7,
Federal funds sold	3,558	13,
	-----	-----
Cash and cash equivalents	25,554	32,
Interest-bearing deposits	100	
Available-for-sale securities at fair value	14,689	15,

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Held-to-maturity securities, fair value of \$1,752 and \$1,750 at March 31, 2008 and December 31, 2007, respectively	1,703	1,
Loans held for sale	1,077	2,
Loans, net of allowance for loan losses of \$6,579 and \$7,140 at March 31, 2008 and December 31, 2007, respectively	266,925	268,
Premises and equipment, net	7,540	7,
Federal Home Loan Bank (FHLB) stock	2,341	2,
Bank owned life insurance	3,702	3,
Goodwill	8,286	8,
Other real estate owned	388	
Interest receivable and other assets	4,366	4,
	-----	-----
Total assets	\$ 336,671	\$ 347,
	=====	=====
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Demand	\$ 18,489	\$ 15,
Savings, NOW and money market	152,734	102,
Time	107,722	137,
	-----	-----
Total deposits	278,945	254,
Short-term borrowings	1,007	36,
Long-term debt	20,279	20,
Interest payable and other liabilities	1,226	1,
	-----	-----
Total liabilities	301,457	312,
	-----	-----
Commitments and contingencies	-	
Stockholders' equity		
Preferred stock, \$0.10 par value, 500,000 shares authorized, no shares issued or outstanding	-	
Common stock, \$0.10 par value, 5,000,000 shares authorized, 1,995,744 shares and 1,995,744 shares outstanding at March 31, 2008 and December 31, 2007, respectively	296	
Additional paid-in capital	39,922	39,
Retained earnings	9,506	9,
Unearned ESOP compensation	(134)	(
Accumulated other comprehensive (loss)	199	
Treasury stock, at cost, common, 969,835 shares and 969,835 shares at March 31, 2008 and December 31, 2007, respectively	(14,575)	(14,
	-----	-----
Total stockholders' equity	35,214	35,
	-----	-----
Total liabilities and stockholders' equity	\$ 336,671	\$ 347,
	=====	=====

See notes to condensed consolidated financial statements.

1ST INDEPENDENCE FINANCIAL GROUP, INC.  
Condensed Consolidated Statements of Operations  
(in thousands except per share data)

(Unaudited)  
Three months ended M

-----  
2008  
-----

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Interest and dividend income		
Interest and fees on loans		\$4,284
Interest on securities		
Taxable		160
Tax exempt		43
Interest on federal funds sold		152
Dividends		35
Interest on deposits with financial institutions		65
		-----
Total interest and dividend income		4,739
		-----
Interest expense		
Deposits		2,149
FHLB advances		266
Other		169
		-----
Total interest expense		2,584
		-----
Net interest income		2,155
Provision for loan losses		-
		-----
Net interest income after provision for loan losses		2,155
		-----
Noninterest income		
Service charges		146
Gain on loan sales		357
(Loss) on disposal of premises and equipment		(27)
Gain on disposal of other real estate owned		109
Increase in cash value of life insurance		55
Other		97
		-----
Total noninterest income		737
		-----
Noninterest expense		
Salaries and employee benefits		1,268
Net occupancy expense		456
Data processing fees		220
Professional fees		665
Marketing expense		20
Other		471
		-----
Total noninterest expense		3,100
		-----
Income (loss) before income taxes		(208)
Income tax expense (benefit)		(105)
		-----
Net income (loss)		\$ (103)
		=====
Net income (loss) per share		
Basic		(\$0.05)
Diluted		(0.05)
Weighted average shares outstanding		
Basic		1,980
Diluted		1,980
Cash dividends declared per share		\$0.08

See notes to condensed consolidated financial statements.

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1ST INDEPENDENCE FINANCIAL GROUP, INC.  
Condensed Consolidated Statements of Comprehensive Income  
(in thousands)

	Three m
	2008
Net income (loss)	\$ (
Other comprehensive income, net of tax	
Change in unrealized gains and losses on available-for-sale securities	
Less reclassification adjustment for realized gains (losses) included in net income	
Other comprehensive income	
Comprehensive income	\$

See notes to condensed consolidated financial statements.

1ST INDEPENDENCE FINANCIAL GROUP, INC.  
Condensed Consolidated Statements of Cash Flows  
(in thousands)

	(Unaudited)	
	Three months ended Ma	
	2008	-----
Cash Flows from Operating Activities:		
Net income (loss)	\$ (103)	\$
Adjustments to reconcile net income (loss) to net cash provided by operations:		
Depreciation	197	
Provision for loan losses	-	
Gain on loan sales	(357)	
Origination of loans held for sale	(17,830)	
Proceeds from loans held for sale	19,984	
Compensation expense on stock options	4	
ESOP compensation	43	
Amortization of unearned compensation on restricted stock	9	
Amortization of premiums and discounts on securities	5	
Loss on disposal of premises and equipment	27	
Deferred income tax expense	278	
FHLB stock dividend	(29)	
Amortization of loan fees	(30)	
Amortization of intangibles, net	10	
Increase in cash value of life insurance	(55)	
Changes in:		
Decrease (increase) in interest receivable and other assets	652	
(Decrease) in interest payable and other liabilities	(278)	
Net cash provided by operating activities	2,527	
Cash Flows from Investing Activities:		

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Purchases of available-for-sale securities	-	
Proceeds from maturities of available-for-sale securities	567	
Proceeds from maturities of held-to-maturity securities	40	
Net decrease (increase) in loans	619	
Purchases of premises and equipment	(15)	
	-----	-----
Net cash provided by (used in) investing activities	1,211	
	-----	-----
Cash Flows from Financing Activities:		
Net increase in deposits	24,360	
Net (decrease) in short-term borrowings	(35,004)	
Proceeds from issuance of long-term debt	-	
Repurchase and retirement of common stock	-	
Cash dividends paid	(158)	
	-----	-----
Net cash (used in) financing activities	(10,802)	
	-----	-----
Net (decrease) in cash and cash equivalents	(7,064)	
Cash and cash equivalents at beginning of period	32,618	
	-----	-----
Cash and cash equivalents at end of period	\$ 25,554	\$
	=====	=====
Supplemental Cash Flow Information:		
Interest paid	\$ 2,867	\$
Income taxes paid	45	
Real estate acquired in settlement of loans	935	
Premises and equipment donated to Town of Marengo, Indiana	155	

See notes to condensed consolidated financial statements.

### 1st INDEPENDENCE FINANCIAL GROUP, INC.

#### Notes to Condensed Consolidated Financial Statements (Unaudited)

#### 1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of 1st Independence Financial Group, Inc. (the "Company") are presented in accordance with the requirements of Form 10-Q and accounting principles generally accepted in the United States of America for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. These condensed consolidated financial statements and notes thereto included in this report should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Form 10-K annual report for the year ended December 31, 2007 filed with the United States Securities and Exchange Commission ("SEC"). In the opinion of management, all adjustments necessary to make the financial statements not misleading and to fairly present the financial position, results of operations and cash flows for the reporting interim periods have been made and were of a normal recurring nature. The results of operations for the period are not necessarily indicative of the results to be expected for the full year. The condensed consolidated balance sheet of the Company as of December 31, 2007 has been derived from the audited consolidated balance sheet of the Company as of that date.

The unaudited condensed financial statements include the accounts of the Company and its wholly-owned subsidiary, 1st Independence Bank, Inc. (the "Bank") and 1st Independence Mortgage, a division of the Bank.

#### 2. Stock-Based Compensation

For the three months ended March 31, 2008 and March 31, 2007, the Company recorded \$4,000 and \$31,000, respectively, in employee stock-based compensation

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expense, which is included in salaries and employee benefits. As of March 31, 2008 and March 31, 2007, there was \$17,000 and \$60,000, respectively, of unrecognized stock-compensation expense for previously granted unvested options that will be recognized over a weighted-average period of 1.3 and 1.7 years, respectively.

### 3. Allowance for Loan Losses

An analysis of the changes in the allowance for loan losses for the three months ended March 31 follows (in thousands):

	2008	2007
	----	----
Beginning balance	\$7,140	\$3,745
Provision for loan losses	-	175
Loans charged off	(565)	(983)
Recoveries	4	1
	-----	-----
Ending balance	\$6,579	\$2,938
	=====	=====

### 4. Net Income Per Share Computations

The following is a reconciliation of the numerator and denominator of the basic and diluted per share computations (in thousands except per share data):

	Three m Mar
	-----
	2008
	----
Income (numerator) amounts used for basic and diluted per share computations:	
Net income (loss)	(\$103)
	=====
Shares (denominator) used for basic per share computations:	
Weighted average shares of common stock outstanding	1,980
	=====
Shares (denominator) used for diluted per share computations:	
Weighted average shares of common stock outstanding	1,980
Plus: dilutive effect of stock options	-
	-----
Adjusted weighted average shares	1,980
	=====
Net income (loss) per share data:	
Basic	(\$0.05)
	=====
Diluted	(\$0.05)
	=====

Options to purchase 63,050 common shares, which equates to 8,338 incremental common equivalent shares for the three months ended March 31, 2008 were excluded from the diluted calculations above as their effect would have been antidilutive. In addition, options to purchase 17,000 common shares for the three months ended March 31, 2007 were excluded from the diluted calculations above because the exercise prices on the options were greater than the average market price for the period.

### 5. Merger Agreement

On February 27, 2008, the Company announced that it had entered into an Agreement and Plan of Merger with MainSource Financial Group, Inc. ("MainSource"). The Merger Agreement provides that the Company's stockholders

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would receive \$5.475 in cash and 0.881036 shares of MainSource common stock for each share of the Company's stock owned. Based on MainSource's February 26, 2008 closing price of \$14.60 per share, the transaction values the Company at \$18.34 per share or \$37.0 million in the aggregate, including the cashout value of the Company's in-the-money stock options. The stock portion of the consideration furnished to the Company's stockholders is intended to qualify as a tax-free transaction. The merger is currently expected to close in the third quarter of 2008, and is subject to the approval of the Company's stockholders, receipt of certain regulatory approvals, and certain other customary conditions. While the Company believes the transaction will occur, there can be no assurance. If the transaction is terminated, the Company could incur certain costs. Upon the closing of the proposed transaction, the Company will record a number of charges including certain change-in-control payments to certain officers that will have a material impact on the consolidated financial statements. At March 31, 2008, no accrual has been made for these charges.

### 6. Recently Issued Accounting Standards

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements," ("SFAS 157") which is effective for fiscal years beginning after November 15, 2007 and for interim periods within those years. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands the related disclosure requirements. This Statement applies under other accounting pronouncements that require or permit fair value measurements. The Statement indicates, among other things, that a fair value measurement assumes that the transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. SFAS 157 defines fair value based upon an exit price model. Relative to SFAS 157, in February 2008 the FASB issued FASB Staff Positions (FSP) 157-1, 157-2, and continued to redeliberate proposed FSP 157-c. FSP 157-1 amends SFAS 157 to exclude Financial Accounting Standards No. 13, "Accounting for Leases," and its related interpretive accounting pronouncements that address leasing transactions, while FSP 157-2 delays the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. FSP 157-c would clarify the principles in SFAS 157 on the fair value measurement of liabilities. Public comments on FSP 157-c were due in February 2008. The Company adopted this Standard in the first quarter of 2008 as required and the adoption did not have a material impact on the Company's financial position, results of operations or cash flows (see note 7 for additional information).

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"), which permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities using different measurement techniques. SFAS 159 requires additional disclosures related to the fair value measurements included in the entity's financial statements. This Statement was effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company adopted this Standard in the first quarter of 2008 as required and the adoption did not have a material impact on the Company's financial position, results of operations or cash flows.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), "Business Combinations" ("SFAS 141(R)"), which replaces Statement of Financial Accounting Standards No. 141, "Business Combinations" ("SFAS 141"). SFAS 141(R) retains the underlying concepts of SFAS 141 in that all business combinations are still required to be accounted for at fair value under the acquisition method of accounting but SFAS 141(R) changed the method of



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applying the acquisition method in a number of significant aspects. Acquisition costs will generally be expensed as incurred; noncontrolling interests will be valued at fair value at the acquisition date; in-process research and development will be recorded at fair value as an indefinite-lived intangible asset at the acquisition date; restructuring costs associated with a business combination will generally be expensed subsequent to the acquisition date; and changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date generally will affect income tax expense. SFAS 141(R) is effective on a prospective basis for all business combinations for which the acquisition date is on or after the beginning of the first annual period subsequent to December 15, 2008, with the exception of the accounting for valuation allowances on deferred taxes and acquired tax contingencies. SFAS 141(R) amends SFAS 109 such that adjustments made to valuation allowances on deferred taxes and acquired tax contingencies associated with acquisitions that closed prior to the effective date of SFAS 141(R) would also apply the provisions of SFAS 141(R). Early adoption is not permitted. The Company is currently evaluating the potential impact this Statement may have on the Company's future financial position, results of operations and cash flows.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, "Noncontrolling Interests in Consolidated Financial Statements--an amendment of ARB No. 51." ("SFAS 160"). SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, with earlier adoption prohibited. The Statement requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financial statements and separate from the parent's equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. The Statement also amends certain of ARB No. 51's consolidation procedures for consistency with the requirements of SFAS 141(R). This Statement also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. The Company is currently evaluating the potential impact this Statement may have on the Company's financial position, results of operations and cash flows, but does not believe the impact of the adoption will be material.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, "Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133." ("SFAS 161"). SFAS 161 requires companies to provide enhanced disclosures regarding derivative instruments and hedging activities. The Statement requires companies to better convey the purpose of derivative use in terms of the risks that such company is intending to manage. Disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect a company's financial position, financial performance, and cash flows are required. This Statement retains the same scope as SFAS No. 133 and is effective for fiscal years and interim periods beginning after November 15, 2008. The Company is currently evaluating the potential impact of this Statement but does not expect the adoption of SFAS No. 161 to have a material impact, if any, on the Company's financial position, results of operations and cash flows.

### 7. Fair Value Measurements

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

SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market

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participants at the measurement date. SFAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level 1 Quoted prices in active markets for identical assets or liabilities
- Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in active 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 used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy.

### Available-for-sale securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities include all of the Company's available-for-sale securities, consisting of mortgage-backed and municipal securities.

The following table presents the fair value measurements of assets and liabilities measured at fair value on a recurring basis and the level within the SFAS 157 fair value hierarchy in which the fair value measurements fall at March 31, 2008 (in thousands):

	Fair Value Measurements Us		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Available-for-sale securities	\$14,689	\$ -	\$14,689

### 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 in accordance with the provisions of Statement of Financial Accounting Standards No. 114, "Accounting by Creditors for Impairment of a Loan" ("SFAS 114").

If the impaired loan is identified as collateral dependent, then the fair value method of measuring the amount of impairment is utilized. This method requires obtaining a current appraisal of the collateral and applying a discount factor to the value based on management's overall assessment of the property.

Certain impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 2 inputs based on independent appraisals of

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the underlying collateral or using Level 3 inputs based on customized discounting criteria.

Management establishes a specific reserve for loans that have an estimated fair value that is below the carrying value. Impaired loans for which the specific reserve was adjusted in accordance with SFAS 114 during the first quarter of 2008 had a carrying amount of \$15,710,000 with specific loss exposures of \$1,952,000 an increase of \$1,112,000 from December 31, 2007. The increase in specific loss exposures was the result of several loans added to nonaccrual status which had impairments. During the first quarter of 2008, the Company charged-off \$565,000 of impaired loans to the allowance for loan losses.

The following table presents the fair value measurements of assets and liabilities measured at fair value on a nonrecurring basis and the level within the SFAS 157 fair value hierarchy in which the fair value measurements fall at March 31, 2008 (in thousands):

	Fair Value Measurements Us		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Impaired loans	\$13,758	\$ -	\$ -

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This section should be read in conjunction with the condensed consolidated financial statements and notes thereto included in Item 1 of Part I of this report in addition to the consolidated financial statements of the Company and the notes thereto included in the Company's Form 10-K for the year ended December 31, 2007, including note 1 which describes the Company's significant accounting policies including its use of estimates. See the caption entitled "Application of Critical Accounting Policies" in this section for further information.

#### Forward-Looking Statements

The following discussion contains statements which are forward-looking rather than historical fact. These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and involve known and unknown risks, uncertainties and other factors, which may cause the Company's actual results to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such statements are subject to certain risks and uncertainties including among other things, changes in general economic conditions; interest rates, deposit flows, loan demand, real estate values, competition and demand for financial services and loan, deposit, and investment products in the Company's local markets; changes in the quality and composition of the loan or investment portfolios; changes in accounting principles, policies, or guidelines; changes in legislation and regulation; changes in the monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board; war or terrorist activities; and other economic, competitive, governmental, regulatory, geopolitical, and technological factors affecting the Company's operations, pricing, and services, expected cost savings, synergies and other financial benefits from the Company's

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proposed merger with MainSource Financial Group, Inc. might not be realized within the expected time frames and costs or difficulties relating to integration matters might be greater than expected, the timing of the closing of the proposed merger, and other risks as detailed in the Company's various filings with the United States Securities and Exchange Commission. The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. Except as required by applicable law or regulation, the Company undertakes no obligation to update these forward-looking statements to reflect events or circumstances that occur after the date on which such statements were made.

### General

The Company provides commercial and retail banking services, including commercial real estate loans, one-to-four family residential mortgage loans via 1st Independence Mortgage, home equity loans and lines of credit and consumer loans as well as certificates of deposit, checking accounts, money-market accounts and savings accounts within its market area. At March 31, 2008, the Company had total assets, deposits and stockholders' equity of \$336.7 million, \$278.9 million, and \$35.2 million, respectively. The Company's business is conducted principally through the Bank. Unless otherwise indicated, all references to the Company refer collectively to the Company and the Bank.

### Application of Critical Accounting Policies

The discussion and analysis of the Company's financial condition and results of operation is based upon the Company's unaudited condensed consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America for interim financial information and with the instructions for Form 10-Q. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Company's most critical accounting policies require the use of estimates relating to other than temporary impairment of securities, the allowance for loan losses and the valuation of goodwill. See the caption entitled "Critical Accounting Policies" in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of the Company's Form 10-K for the year ended December 31, 2007 for additional information.

### Overview

The Company recorded a net loss for the quarter ended March 31, 2008 of (\$103,000) or (\$0.05) per diluted share compared to net income of \$110,000 or \$0.06 per diluted share for the comparable period in 2007. The decrease in net income and net income per diluted share for the three-month period was primarily due to a decrease in net interest income after taxes of \$166,000 and an increase in noninterest expenses after taxes of \$359,000 (including \$324,000 after taxes of legal and other professional fees relating to the proposed merger with MainSource) in the first three months of 2008 compared to the first three months of 2007. Partially offsetting these factors was an increase in noninterest income after taxes of \$188,000 and a decrease of \$116,000 after taxes in the provision for loan losses in the first three months of 2008 compared to the first three months of 2007.

### Results of Operations

#### Net Interest Income

Net interest income is the most significant component of the Company's revenues. Net interest income is the difference between interest income on interest-earning assets (primarily loans and investment securities) and interest expense on interest-bearing liabilities (deposits and borrowed funds). Net interest income depends on the volume and rate earned on interest-earning assets

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and the volume and rate paid on interest-bearing liabilities.

Net interest income was \$2.2 million for the three months ended March 31, 2008 a decrease of \$0.2 million or 10% from \$2.4 million for the comparable period of 2007. On an annualized basis, the net interest spread and net interest margin were 2.38% and 2.67% for the current quarter, compared to 2.75% and 3.19% for the same period of 2007. The decrease in the net interest margin was primarily due to the reversal of \$307,000 of interest income on certain loans which were placed on nonaccrual during the first quarter of 2008. This reversal more than offset the effects of the decreasing rate environment where we generally had a faster decrease in interest rates on interest-bearing liabilities compared to the rates on interest-earning assets and an increase in the volume of net earning assets. Changes in volume resulted in an increase in net interest income of \$42,000 for the first quarter of 2008 compared to the same period in 2007, and changes in interest rates and the mix including the reversals discussed above resulted in a decrease in net interest income of \$293,000 for the first quarter of 2008 versus the comparable period in 2007.

The Bank, like many other financial institutions, is vulnerable to an increase in interest rates to the extent that interest-bearing liabilities mature or reprice more rapidly than interest-earning assets. Historically, the lending activities of commercial banks emphasized the origination of short to intermediate term variable rate loans that are more closely matched with the deposit maturities and repricing of interest-bearing liabilities which occur closer to the same general time period. While having interest-bearing liabilities that reprice more frequently than interest-earning assets is generally beneficial to net interest income during periods of declining interest rates, it is generally detrimental during periods of rising interest rates.

To reduce the effect of interest rate changes on net interest income, the Bank has adopted various strategies to improve matching interest-earning asset maturities to interest-bearing liability maturities. The principal elements of these strategies include; originating variable rate commercial loans that include interest rate floors; originating one-to-four family residential mortgage loans with adjustable rate features, or fixed rate loans with short maturities; maintaining interest-bearing demand deposits, federal funds sold, and U.S. government securities with short to intermediate term maturities; maintaining an investment portfolio that provides stable cash flows, thereby providing investable funds in varying interest rate cycles; lengthening the maturities of our time deposits and borrowings when it would be cost effective; and attracting low cost checking and transaction accounts, which tend to be less interest rate sensitive when interest rates increase.

The Bank measures its exposure to changes in interest rates using an overnight upward and downward shift (shock) in the Treasury yield curve. As of March 31, 2008, if interest rates increased 200 basis points and decreased 200 points, respectively, the Bank's net interest income would increase by 6.3% and increase by 6.2%, respectively.

### Provision for Loan Losses

The Company had no provision for loan losses for the three months ended March 31, 2008 after recording a provision of \$4,323,000 in the fourth quarter of 2007 and a provision of \$175,000 in the first quarter of 2007. As discussed in the Company's 2007 Form 10-K, the increase in the provision in 2007 including the significant amount in the fourth quarter 2007 compared to 2006 reflects the increased risk in the loan portfolio related to the current economic weakness and the additional stress this places on borrowers. Nonperforming loans were \$16.0 million at March 31, 2008 and \$6.4 million at December 31, 2007, or 5.86% and 2.33%, respectively, of total loans. The increase in nonperforming loans continues to be primarily due to an increase in nonperforming real estate construction and development loans, primarily in the 1-4 family markets. While nonperforming loans increased during the first quarter of 2008, classified loans

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remained stable as the majority of new nonperforming loans had already been identified by the Company during the fourth quarter of 2007. The allowance for loan losses was \$6.6 million and \$7.1 million at March 31, 2008 and December 31, 2007, or 2.41% and 2.59%, respectively, of total loans. Net charge-offs were \$561,000 in the first quarter of 2008 compared to \$982,000 in the same period in 2007. The net charge-offs in 2008 were primarily due to real estate construction and development loans while the net charge-offs in 2007 were primarily due to three large borrowers in the residential construction and commercial and industrial portfolios. The charge-offs for both periods had been adequately reserved for in previous periods.

The Company maintains the allowance for loan losses at a level that it considers to be adequate to provide for credit losses inherent in its loan portfolio. Management determines the level of the allowance by performing a quarterly analysis that considers concentrations of credit, past loss experience, current economic conditions, the amount and composition of the loan portfolio (including nonperforming and potential problem loans), estimated fair value of underlying collateral, loan commitments outstanding, and other information relevant to assessing the risk of loss inherent in the loan portfolio. As a result of management's analysis, a range of the potential amount of the allowance for loan losses is determined.

The Company will continue to monitor the adequacy of the allowance for loan losses and make additions to the allowance in accordance with the analysis referred to above. Because of uncertainties inherent in estimating the appropriate level of the allowance for loan losses, actual results may differ from management's estimate of credit losses and the related allowance.

### Noninterest Income

Noninterest income was \$737,000 for the three months ended March 31, 2008, compared to \$452,000 for the same period in 2007. The gain on loan sales increased \$156,000 for the first quarter of 2008 versus the first quarter of 2007 as lower interest rates increased secondary market mortgage activity. The gain on loan sales was \$357,000 for the three months ended March 31, 2008, compared to \$201,000 for the comparable period in 2007. Service charge income was \$146,000 for the three months ended March 31, 2008, compared to \$120,000 for the comparable period in 2007. The Company continually evaluates its deposit product offerings with the intention of continuing to expand its offerings to the consumer and business depositor. Currently, the Company is pursuing a strategy to increase its core deposit base by expanding the Company's offering of remote deposit capture products as well as wholesale lockbox products for current and prospective business depositors. Other factors which contributed to the increase in noninterest income was a \$109,000 gain on the disposal of other real estate in the first quarter of 2008 which related to the donation of the Company's former Marengo, Indiana branch land and building to the Town of Marengo. The Bank opened its new Marengo branch in January 2008. A factor which limited the increase in noninterest income was a \$27,000 loss on the disposal of premises and equipment in the first quarter 2008 compared to a loss of \$1,000 in the comparable period in 2007. Other noninterest income increased \$17,000 to \$97,000 for the first quarter 2008.

### Noninterest Expense

Noninterest expense was \$3.1 million for the quarter ended March 31, 2008 compared to \$2.6 million for the same period in 2007. Contributing to the increase were increases in salaries and employee benefits due to management additions relating to the hiring of an experienced commercial lending team in the second quarter of 2007, increased health care costs and an increase in commissions related to the higher activity in mortgage loan sales. Partially offsetting these increases in salaries and employee benefits was a reduction in the accrual for incentive compensation and stock option expense. Additional factors contributing to the overall increase in noninterest expenses were an

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increase in net occupancy expenses primarily related to the opening of the new Marengo, Indiana branch in early January 2008, an increase in data processing expenses which was primarily due to the growth of the Bank's services and its continuing commitment to upgrade systems productivity and \$385,000 of legal and other professional fees recorded in the first quarter of 2008 relating to the proposed merger with MainSource. Another factor was additional professional audit fees related to the audit of the annual financial statements for the year ended December 31, 2007. Partially offsetting these increases was a decrease in marketing expenses.

### Income Tax Expense (Benefit)

The effective income tax rate on income (loss) before income taxes was (50.5%) for the three months ended March 31, 2008 compared to 13.4% for the same period in 2007. The change in the effective tax rate for the quarter is primarily due to the change in the income before taxes and the effect of nondeductible expenses relating to the proposed merger with MainSource.

### Financial Condition

The Company's total assets were \$336.7 million at March 31, 2008 compared to \$347.7 million at December 31, 2007, a decrease of 11.0 million or 3.2%. Cash and cash equivalents decreased \$7.0 million, loans held for sale went down \$1.8 million, net loans decreased \$1.5 million, investments decreased \$0.4 million, premises and equipment went down \$0.4 million and interest receivable and other assets decreased \$0.3 million, while other real estate owned went up \$0.3 million and bank owned life insurance increased \$0.1 million.

Loans gross of the allowance for loan losses were \$273.5 million at March 31, 2008, compared to \$275.6 million at December 31, 2007, a decrease of \$2.1 million or 0.1%. The decrease was primarily due to decreases in the real estate construction loan portfolio, real estate residential loan portfolio and the other consumer loan portfolio, which decreased \$6.7 million or 10.3%, \$1.3 million or 1.2% and \$1.3 million or 28.6%, respectively, coupled with a partially offsetting increase in commercial loans which increased \$7.3 million or 29.0%. All loan categories remained the same as a percentage of total loans, except commercial loans which increased from approximately 9% to 12% of total loans, real estate construction loans, which decreased from approximately 23% to 21% of total loans and other consumer loans which decreased from 2% to 1%. The Company has continued its practice of selling all qualifying originations of residential real estate loans in the secondary market through 1st Independence Mortgage, a division of the Bank, rather than being retained for the Company's loan portfolio. The Company continues to identify opportunities to cross sell its other products, including home equity and consumer loans for its loan portfolio resulting from customer relationships established through the origination of loans by 1st Independence Mortgage.

Deposits increased \$24.4 million or 9.6% to \$278.9 million at March 31, 2008 compared to \$254.6 million at December 31, 2007. This increase was attributable to an increase in savings, NOW and money market deposits of \$50.7 million and demand deposits of \$3.0 million which more than offset a decrease in time deposits of \$29.3 million. The increase in savings, NOW and money market deposits resulted primarily from the effects of a general marketing campaign promoting a more competitively priced NOW account product to municipalities in an effort to reduce the Company's dependency on higher costing time deposits.

Short-term borrowings decreased \$35.0 million to \$1.0 million at March 31, 2008, compared to \$36.0 million at December 31, 2007 while long-term debt was \$20.3 million both at March 31, 2008 and December 31, 2007. The decrease in short-term borrowings was due to the Company successfully attracting municipal deposits reducing the need for short-term FHLB advances. The Company uses short-term borrowings, primarily short-term FHLB advances, to fund short-term liquidity needs and manage net interest margin.

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### Off-Balance Sheet Arrangements

In the normal course of operations, the Company engages in financial transactions that contain credit, interest rate, and liquidity risk that are not recorded in the financial statements such as loan commitments and performance letters of credit. As of March 31, 2008, unused loan commitments and performance letters of credit were \$47,273,000 and \$2,836,000, respectively.

Since many of the unused loan commitments are expected to expire or be only partially used, the total amount of commitments does not necessarily represent future cash requirements.

### Liquidity and Capital Resources

Liquidity to meet borrowers' credit and depositors' withdrawal demands is provided by maturing assets, short-term liquid assets that can be converted to cash and the ability to attract funds from depositors. Additional sources of liquidity include brokered deposits, advances from the FHLB and other short-term borrowings, such as federal funds purchased and securities sold under repurchase agreements.

At March 31, 2008 and December 31, 2007, brokered deposits were \$14.5 million and \$38.2 million, respectively. The weighted average cost and maturity of brokered deposits were 4.85% and four months at March 31, 2008 compared to 4.67% and four months at December 31, 2007. The Company plans to continue using brokered deposits for the foreseeable future to support loan demand when pricing for brokered deposits is more favorable than short-term borrowings.

At March 31, 2008 and December 31, 2007, the Bank had total FHLB advances outstanding of \$11.0 million and \$46.0 million, respectively, with \$11.0 million and \$11.0 million, respectively, included in long-term debt in the accompanying condensed consolidated balance sheet and the remaining amount if any included in short-term borrowings. Additionally, the Bank had \$60.0 million of unused commitments under its line of credit with the FHLB and sufficient collateral to borrow an additional \$63.1 million.

The Company's liquidity depends primarily on dividends paid to it as sole shareholder of the Bank. At March 31, 2008, the Bank was no longer able to pay dividends to the Company without regulatory approval due to the net loss incurred in the Bank in the fourth quarter of 2007 primarily due to the substantial increase in the provision for loan losses and the goodwill impairment charge. At April 1, 2008 the Bank's retained net losses, less dividends declared during the preceding two years was approximately \$819,000. The Company currently has assets at the holding company to allow it to pay the quarterly dividend of \$0.08 per share which was declared on April 17, 2008 to be paid on May 15, 2008 and has requested regulatory approval for a dividend from the Bank to cover the additional cash flow needs of the holding company prior to closing the transaction with MainSource (see note 5 for additional information regarding the pending acquisition of the Company by MainSource). In addition, see subsequent paragraph discussing the Company's and the Bank's current risk based capital ratios.

The Company has \$9.3 million of subordinated debentures outstanding, which are included in long-term debt in the accompanying condensed consolidated balance sheet. Effective March 26, 2008, the entire \$9.3 million are now variable rate obligations as the \$5.2 million of debentures that had been at a fixed rate of 6.40% now switch to variable rate obligations. Thus all \$9.3 million of the debentures are now variable rate obligations with interest rates that reprice quarterly (March 26, June 26, September 26 and December 26), and are tied to the three-month London Interbank Offering Rate ("LIBOR") plus 3.15%. At March 31, 2008 the rate on the variable rate obligations was 5.76% compared to 8.50% at March 31, 2007 on the \$4.1 million of variable rate obligations and 6.40% for the \$5.2 million of fixed rate obligations. The weighted average rate on the



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entire \$9.3 million of subordinated debentures outstanding was 7.10% for the first quarter of 2008 compared to 7.34% for the same period in 2007.

Stockholders' equity was \$35.2 million at March 31, 2008 compared to \$35.3 million at December 31, 2007. The individual items within stockholders' equity that changed were a net loss of (\$103,000), cash dividends declared of \$158,000 (\$0.08 per share), an increase in other comprehensive income, net of tax of \$143,000 and an increase of \$56,000 relating to stock option, ESOP plan transactions and other miscellaneous equity transactions.

Bank holding companies and their subsidiary banks are required by regulators to meet risk based capital standards. These standards, or ratios, measure the relationship of capital to a combination of balance sheet and off-balance sheet risks. The following table presents these ratios as of March 31, 2008 and December 31, 2007 for the Consolidated Company and the Bank along with the regulator's minimum ratio to be considered well capitalized.

	March 31, 2008 -----	December 31, 2007 -----
Total risk-based capital to risk-weighted assets		
Consolidated company	14.4%	14.5%
Bank	14.1	13.9
Tier 1 capital to risk-weighted assets		
Consolidated company	13.1	13.2
Bank	12.8	12.6
Tier 1 capital to average assets		
Consolidated company	10.3	10.5
Bank	10.1	10.1

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

Information required by this item is included in Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

### Item 4. Controls and Procedures

#### (a) Evaluation of Disclosure Controls and Procedures

As required by Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the Company's management carried out an evaluation, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures as of the end of the quarter ended March 31, 2008. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in its reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the United States Securities and Exchange Commission's rules and forms.

#### (b) Changes in Internal Control over Financial Reporting

In response to the material weakness described in Item 9A of the Company's Form 10-K for the year ended December 31, 2007, the Company implemented the following actions: (1) sought to thoroughly understand the nature of the issues through discussions with the Company's independent registered accounting firm, with a

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third party firm who regularly consults with the Company regarding the quarterly calculation of the adequacy of the allowance for loan losses and with the Audit Committee of the Board of Directors, (2) implemented procedures requiring that any changes to the quarterly analysis of the adequacy in loan losses must be communicated in writing and approved by senior management and the Audit Committee of the Board of Directors, and (3) implemented more timely independent monitoring of the quarterly analysis of the adequacy in the allowance for loan losses. As a result of taking the above actions and evaluating the operating effectiveness of the added controls during the first quarter of 2008, management of the Company has concluded that it has remediated the material weakness described in Item 9A of the Company's Form 10-K for the year ended December 31, 2007.

Other than as described in the previous paragraph, there have not been any changes in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during the quarter ended March 31, 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

### PART II OTHER INFORMATION

#### Item 1. Legal Proceedings

The Company, from time to time, is a party to ordinary routine litigation, which arises in the normal course of business, such as claims to enforce liens, condemnation proceedings on properties in which the Company holds security interests, claims involving the making and servicing of real property loans, and other issues incident to its business. There were no potentially material lawsuits or other legal proceedings pending or known to be contemplated against the Company at March 31, 2008.

#### Item 6. Exhibits

##### (a) Exhibits

- 3.1 Certificate of Incorporation (incorporated by reference from the Exhibits to the Company's Form S-1 Registration Statement, initially filed on June 14, 1995, Registration No. 33-93458).
- 3.2 Amended Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Form 10-KSB filed on December 29, 2004).
- 3.3 Bylaws (incorporated by reference to Exhibit 3.2 to the Company's Form 8-K filed on August 21, 2007).
- 31.1 Rule 13a-14(a) / 15d-14(a) Certification of Principal Executive Officer ("Section 302 Certifications").
- 31.2 Rule 13a-14(a) / 15d-14(a) Certification of Principal Financial Officer ("Section 302 Certifications").
- 32.1 Section 1350 Certifications ("Section 906 Certifications").

### SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the

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registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

1st INDEPENDENCE FINANCIAL GROUP, INC.

Date: May 6, 2008

By: /s/ R. Michael Wilbourn

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R. Michael Wilbourn  
Executive Vice President  
and Chief Financial Officer

Exhibit Index

Exhibit Number	Description
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32.1	Section 1350 Certifications ("Section 906 Certifications").