

Home Financial Bancorp

Accountants' Report and Consolidated Financial Statements

June 30, 2007 and 2006



Independent Accountants' Report

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

We have audited the accompanying consolidated balance sheets of Home Financial Bancorp as of June 30, 2007 and 2006, and the related consolidated statements of income, stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Home Financial Bancorp as of June 30, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

BKD, LLP

Indianapolis, Indiana
September 25, 2007

Home Financial Bancorp
Consolidated Balance Sheets
June 30, 2007 and 2006

Assets

	<u>2007</u>	<u>2006</u>
Cash	\$ 534,225	\$ 691,153
Short-term interest-bearing deposits	<u>4,366,870</u>	<u>3,640,889</u>
Total cash and cash equivalents	4,901,095	4,332,042
Interest-bearing deposits	1,300,599	1,500,000
Investment securities - available for sale	1,886,730	2,049,510
Loans, net of allowance for loan losses of \$564,793 and \$499,995	61,036,866	62,618,621
Real estate acquired for development	431,778	525,474
Premises and equipment	2,056,799	2,077,345
Federal Home Loan Bank of Indianapolis stock	1,187,700	1,225,000
Interest receivable	416,811	423,635
Other assets	<u>1,681,808</u>	<u>1,648,251</u>
Total assets	<u>\$ 74,900,186</u>	<u>\$ 76,399,878</u>

Liabilities

Deposits		
Noninterest-bearing deposits	\$ 3,503,416	\$ 3,587,013
Interest-bearing deposits	<u>42,014,732</u>	<u>40,955,921</u>
Total deposits	45,518,148	44,542,934
Borrowings	21,500,000	24,000,000
Other liabilities	<u>402,278</u>	<u>428,375</u>
Total liabilities	<u>67,420,426</u>	<u>68,971,309</u>

Commitments and Contingencies

Stockholders' Equity

Preferred stock, without par value		
Authorized and unissued - 2,000,000 shares		
Common stock, without par value		
Authorized - 5,000,000 shares		
Issued and outstanding - 2007 - 1,360,769 shares and 2006 - 1,354,450 shares	3,090,415	3,056,034
Additional paid-in capital	68,719	54,079
Retained earnings	4,339,394	4,337,781
Accumulated other comprehensive loss	<u>(18,768)</u>	<u>(19,325)</u>
Total stockholders' equity	<u>7,479,760</u>	<u>7,428,569</u>
Total liabilities and stockholders' equity	<u>\$ 74,900,186</u>	<u>\$ 76,399,878</u>

Home Financial Bancorp

Consolidated Statements of Income

Years Ended June 30, 2007 and 2006

	2007	2006
Interest Income		
Loans	\$ 4,873,815	\$ 4,747,609
Deposits with financial institutions	177,675	154,436
Investment securities	171,820	163,781
Federal Home Loan Bank stock	<u>56,476</u>	<u>56,539</u>
Total interest and dividend income	<u>5,279,786</u>	<u>5,122,365</u>
Interest Expense		
Deposits	1,637,020	1,266,283
Federal Home Loan Bank advances	<u>910,879</u>	<u>861,505</u>
Total interest expense	<u>2,547,899</u>	<u>2,127,788</u>
Net Interest Income	2,731,887	2,994,577
Provision for loan losses	<u>260,000</u>	<u>421,400</u>
Net Interest Income After Provision for Loan Losses	<u>2,471,887</u>	<u>2,573,177</u>
Other Income		
Service charges on deposit accounts	392,902	365,879
Gain (loss) on sale of real estate acquired for development	(11,330)	31,690
Net gain on available-for-sale securities	42,939	28,718
Equity in losses of partnership	(25,900)	(83,500)
Other income	<u>181,483</u>	<u>190,534</u>
Total other income	<u>580,094</u>	<u>533,321</u>
Other Expenses		
Salaries and employee benefits	1,284,996	1,438,896
Net occupancy expenses	130,587	131,063
Equipment expenses	64,022	40,381
Computer processing fees	327,635	283,221
Printing and office supplies	54,468	66,883
Legal and professional fees	132,073	158,932
Director and committee fees	71,300	63,650
Advertising expense	74,305	75,392
Repossessed property expense	302,360	133,930
Other expenses	<u>398,946</u>	<u>432,620</u>
Total other expenses	<u>2,840,692</u>	<u>2,824,968</u>
Income Before Income Tax	211,289	281,530
Income tax expense	<u>36,055</u>	<u>22,280</u>
Net Income	<u>\$ 175,234</u>	<u>\$ 259,250</u>
Net Income Per Share		
Basic	\$.13	\$.20
Diluted	.13	.20

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Consolidated Statements of Stockholders' Equity
Years Ended June 30, 2007 and 2006

	Common Stock Shares	Stock Amount	Additional Paid-in Capital	Retained Earnings	Unearned ESOP Shares	Accumulated Other Comprehensive Income (Loss)	Total
Balances, July 1, 2005	1,355,950	\$ 3,058,909	\$ 455	\$ 4,227,075	\$ (26,457)	\$ 68,837	\$ 7,328,819
Comprehensive income							
Net income				259,250			259,250
Other comprehensive loss, net of tax							
Unrealized losses on securities, net of reclassification adjustment						(88,162)	(88,162)
Comprehensive income							<u>171,088</u>
Cash dividends (\$.12 per share)				(143,344)			(143,344)
ESOP shares earned			39,104		26,457		65,561
RRP shares earned			14,520				14,520
Issuance of stock	500	2,125					2,125
Purchase of stock	(2,000)	(5,000)		(5,200)			(10,200)
Balances, June 30, 2006	1,354,450	3,056,034	54,079	4,337,781	—	(19,325)	7,428,569
Comprehensive income							
Net income				175,234			175,234
Other comprehensive income, net of tax							
Unrealized gains on securities, net of reclassification adjustment						557	557
Comprehensive income							<u>175,791</u>
Cash dividends (\$.12 per share)				(162,366)			(162,366)
RRP shares earned			14,640				14,640
Issuance of stock	10,619	45,131					45,131
Purchase of stock	(4,300)	(10,750)		(11,255)			(22,005)
Balances, June 30, 2007	<u>1,360,769</u>	<u>\$ 3,090,415</u>	<u>\$ 68,719</u>	<u>\$ 4,339,394</u>	<u>\$ —</u>	<u>\$ (18,768)</u>	<u>\$ 7,479,760</u>

Home Financial Bancorp

Consolidated Statements of Cash Flows

Years Ended June 30, 2007 and 2006

	2007	2006
Operating Activities		
Net income	\$ 175,234	\$ 259,250
Items not requiring (providing) cash		
Provision for loan losses	260,000	421,400
Investment securities amortization, net	967	6,633
ESOP shares earned	—	65,561
RRP shares earned	14,640	14,520
Depreciation	88,234	88,481
Deferred income taxes	(25,389)	22,980
(Gain) loss on sale of real estate acquired for development	11,330	(31,690)
Foreclosed asset (gains) losses	107,824	(39,307)
Investment securities gains	(42,938)	(28,718)
Losses from partnership	25,900	83,500
Net change in interest receivable	6,824	(54,511)
Other adjustments	(207,701)	(28,122)
Net cash provided by operating activities	414,925	779,977
Investing Activities		
Proceeds from maturity of interest bearing deposits	199,401	—
Purchases of interest-bearing deposits	—	(1,200,000)
Proceeds from sales of securities available for sale	98,534	76,638
Proceeds from maturities and paydowns of securities available for sale	107,140	344,852
Net changes in loans	527,994	(8,420,448)
Proceeds from sale of foreclosed assets	939,908	1,515,843
Purchase of premises and equipment	(67,689)	(73,426)
Purchase of real estate acquired for development and development cost	(69,134)	(197,044)
Proceeds from sale of real estate acquired for development	44,700	81,043
Proceeds from sale of FHLB of Indianapolis stock	37,300	—
Purchase of FHLB of Indianapolis stock	—	(4,500)
Net cash provided by (used in) investing activities	1,818,154	(7,877,042)
Financing Activities		
Net change in		
Noninterest bearing deposits	(83,597)	474,212
Interest bearing deposits	1,058,811	(586,377)
Proceeds from other borrowings	7,500,000	17,500,000
Repayment of other borrowings	(10,000,000)	(10,500,000)
Issuance of stock	45,131	2,125
Purchase of stock	(22,005)	(10,200)
Dividends paid	(162,366)	(143,328)
Net cash provided by (used in) financing activities	(1,664,026)	6,736,432
Net Change in Cash and Cash Equivalents	569,053	(360,633)
Cash and Cash Equivalents, Beginning of Year	4,332,042	4,692,675
Cash and Cash Equivalents, End of Year	\$ 4,901,095	\$ 4,332,042
Additional Cash Flows and Supplementary Information		
Interest paid	\$ 2,551,080	\$ 2,123,350
Income tax paid, net of refunds	46,783	27,947
Transfers from loans to foreclosed assets	900,562	1,112,238

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Notes to Consolidated Financial Statements
June 30, 2007 and 2006
(Table Dollar Amounts in Thousands, Except Share Data)

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

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

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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

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

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

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

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

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

Amortization of premiums and accretion of discounts are recorded using the interest method as interest income from securities. Realized gains and losses are recorded as net security gains (losses). Gains and losses on sales of securities are determined on the specific-identification method.

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

Allowance for loan losses is maintained to absorb loan losses based on management's continuing review and evaluation of the loan portfolio and its judgment as to the impact of economic conditions on the portfolio. The evaluation by management includes consideration of past loss experience, changes in the composition of the portfolio, the current condition and amount of loans outstanding, and the probability of collecting all amounts due. Impaired loans are measured by the present value of expected future cash flows, or the fair value of the collateral of the loan, if collateral dependent. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. Management believes that as of June 30, 2007, the allowance for loan losses is adequate based on information currently available. A worsening or protracted economic decline in the area within which the Company operates would increase the likelihood of additional losses due to credit and market risks and could create the need for additional loss reserves.

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

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

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

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

Stock options - At June 30, 2007, the Company has a stock-based employee compensation plan, which is described more fully in Note 16. Prior to 2007, the Company accounted for this plan under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations. Accordingly, in 2006, no stock-based employee compensation cost is reflected in net income, as all options granted under this plan had an exercise price equal to the market value of the underlying common stock at the grant date. No options were granted during the two years in the period ended June 30, 2007 and all previously granted shares were fully vested prior to July 1, 2007.

Effective July 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123R, *Share-Based Payment*. The Company selected the modified prospective application. Accordingly, after July 1, 2006, the Company will begin expensing the fair value of stock options granted.

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

Earnings per share have been computed based upon the weighted-average common shares and potential common shares outstanding during the period. Unearned Employee Stock Ownership Plan (ESOP) shares and unvested RRP shares have been excluded from the computation of average common shares and potential common shares outstanding.

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Notes to Consolidated Financial Statements
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Note 2: Investment Securities

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

	2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
U. S. Treasury securities	\$ 484	\$ —	\$ (23)	\$ 461
Federal agencies	756	—	(36)	720
Mortgage-backed securities	621	1	(7)	615
Municipal bonds	132	—	—	132
Marketable equity securities	<u>89</u>	<u>33</u>	<u>—</u>	<u>122</u>
Total investment securities	<u>\$ 2,082</u>	<u>\$ 34</u>	<u>\$ (66)</u>	<u>\$ 2,050</u>

Maturities of available-for-sale investments at June 30, 2007:

	Amortized Cost	Approximate Fair Value
After five through ten years	\$ 1,360	\$ 1,320
Mortgage-backed and marketable equity securities not due on a single maturity date	<u>558</u>	<u>567</u>
	<u>\$ 1,918</u>	<u>\$ 1,887</u>

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Securities with a carrying value of \$1,725,000 and \$1,796,000 were pledged at June 30, 2007 and 2006 to secure FHLB advances.

Proceeds from sales of securities available for sale during 2007 and 2006 were \$99,000 and \$77,000, respectively. Gains realized from sales of securities during 2007 and 2006 totaled \$43,000 and \$29,000, respectively. There were no losses from sales of securities realized during 2007 and 2006. Net gains on security transactions for 2007 and 2006 resulted in a tax expense of \$17,000 and \$11,000.

Certain investments in debt and marketable equity securities are reported in the 2007 financial statements at an amount less than their historical cost. Total fair value of these investments at June 30, 2007 and 2006 was \$1,405,000 and \$1,425,000, which is approximately 74.5 and 69.5 percent of the Company's investment portfolio. These declines primarily resulted from increases in market interest rates and failure of certain investments to maintain consistent credit quality ratings or meet projected earnings targets.

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

The following tables show our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2007 and 2006.

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

Description of Securities	2006					
	Less than 12 Months Fair Value	12 Months or More Unrealized Losses	12 Months or More Fair Value	12 Months or More Unrealized Losses	Total Fair Value	Total Unrealized Losses
U. S. Treasury securities	\$ 461	\$ (23)	\$ —	\$ —	\$ 461	\$ (23)
Mortgage-backed securities	244	(7)	—	—	244	(7)
Federal agencies	720	(36)	—	—	720	(36)
Total temporarily impaired securities	\$ 1,425	\$ (66)	\$ —	\$ —	\$ 1,425	\$ (66)

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Notes to Consolidated Financial Statements
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Note 3: Loans and Allowance

	2007	2006
Real estate mortgage loans		
Residential	\$ 40,625	\$ 40,029
Mobile home and land	9,707	9,368
Nonresidential	6,935	8,118
Mobile home loans	4,411	5,273
Commercial and industrial	220	236
Consumer loans	<u>606</u>	<u>525</u>
	<u>62,504</u>	<u>63,549</u>
Undisbursed portion of loans	(855)	(390)
Deferred loan fees	(47)	(40)
Allowance for loan losses	<u>(565)</u>	<u>(500)</u>
	<u>(1,467)</u>	<u>(930)</u>
Total loans	<u>\$ 61,037</u>	<u>\$ 62,619</u>
	2007	2006
Allowance for loan losses		
Balances, July 1	\$ 500	\$ 390
Provision for loan losses	260	421
Recoveries	4	6
Loans charged off	<u>(199)</u>	<u>(317)</u>
Balances, June 30	<u>\$ 565</u>	<u>\$ 500</u>

At June 30, 2007 and 2006, there were no accruing loans delinquent 90 days or more. Non-accruing loans at June 30, 2007 and 2006 were \$1,009,000 and \$1,723,000, respectively.

Note 4: Premises and Equipment

	2007	2006
Land	\$ 348	\$ 348
Buildings	2,621	2,530
Construction in progress	4	72
Equipment	<u>1,043</u>	<u>997</u>
Total cost	4,016	3,947
Accumulated depreciation	<u>(1,959)</u>	<u>(1,870)</u>
Net	<u>\$ 2,057</u>	<u>\$ 2,077</u>

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Note 5: Investment in Limited Partnership

An investment in a limited partnership of \$379,000 and \$405,000 at June 30, 2007 and 2006 included in other assets represents a 99 percent equity in Cunot Apartments (Cunot), a limited partnership organized to build, own and operate a 24-unit apartment complex for senior living. In addition to recording its equity in the losses of Cunot, the Company has recorded the benefit of low income housing tax credits of \$107,000 and \$107,000 for the years ended June 30, 2007 and 2006. Condensed unaudited financial statements for Cunot at June 30, 2007 and 2006 and for the two years in the period ended June 30, 2007 are as follows:

	2007	2006
Condensed balance sheets		
Assets		
Cash	\$ 116	\$ 124
Land and property	1,178	1,216
Other assets	3	5
Total assets	\$ 1,297	\$ 1,345
Liabilities		
Notes payable	\$ 610	\$ 610
Other liabilities	301	310
Total liabilities	911	920
Partners' equity	386	425
Total liabilities and partners' equity	\$ 1,297	\$ 1,345
Condensed statements of operations		
Total revenue	\$ 75	\$ 71
Total expenses	(115)	(111)
Net loss	\$ (40)	\$ (40)

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Note 6: Deposits

	2007	2006
Noninterest-bearing demand	\$ 3,440	\$ 3,555
Interest-bearing demand	2,422	2,361
Money market deposits	2,598	2,144
Savings	6,243	5,870
Certificates of \$100,000 or more	10,098	9,998
Other certificates	20,717	20,615
Total deposits	\$ 45,518	\$ 44,543

Certificates maturing in years ending June 30:

2008	\$ 18,827
2009	4,445
2010	4,247
2011	1,751
2012	1,545
	\$ 30,815

Brokered deposits totaled approximately \$3.5 million and \$4.4 million at June 30, 2007 and 2006.

Note 7: Borrowings

FHLB advance maturities in years ending June 30:

2008	\$ 5,500
2009	4,000
2010	1,500
2011	1,500
2012	4,500
Thereafter	4,500
	\$ 21,500

The Federal Home Loan Bank advances are secured by mortgage loans and investment securities totaling \$43,524,000. Advances, at interest rates from 2.98 to 5.56 percent, are subject to restrictions or penalties in the event of prepayment. Advances totaling \$3,000,000 may, at certain dates, be converted to adjustable rate advances by the FHLB. If converted, the advances may be prepaid without penalty.

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Note 8: Income Tax

	2007	2006
Income tax expense		
Currently payable		
Federal	\$ 61	\$ (27)
State	1	26
Deferred		
Federal	(50)	22
State	<u>24</u>	<u>1</u>
Total income tax expense	<u>\$ 36</u>	<u>\$ 22</u>
	2007	2006
Reconciliation of federal statutory to actual tax expense		
Federal statutory income tax at 34%	\$ 72	\$ 96
Effect of state income taxes	16	18
Business tax credits	(107)	(107)
Tax-exempt interest	(2)	—
Valuation allowance	30	—
Other	<u>27</u>	<u>15</u>
Actual tax expense	<u>\$ 36</u>	<u>\$ 22</u>
Effective tax rate	17.1%	8.6%

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

	2007	2006
Assets		
Allowance for loan losses	\$ 239	\$ 211
Pension and employee benefit	9	9
Securities available for sale	12	12
Loan fees	20	17
Partnership investment	97	8
Unrealized capital loss carryforward	46	114
Total assets	423	371
Liabilities		
Depreciation	(81)	(74)
State income tax	(8)	(16)
FHLB stock	(49)	(51)
Prepaid expenses	(30)	(40)
Other	(30)	(20)
Total liabilities	(198)	(201)
Valuation Allowance		
Beginning balance	—	—
Increase during the period	30	—
Ending balance	(30)	—
Net deferred tax asset	\$ 195	\$ 170

Retained earnings at June 30, 2007, include approximately \$700,000 for which no deferred federal income tax liability has been recognized. This amount represents an allocation of income to bad debt deductions as of June 30, 1988 for tax purposes only. Reduction of amounts so allocated for purposes other than tax bad debt losses including redemption of bank stock or excess dividends, or loss of "bank status" would create income for tax purposes only, which income would be subject to the then-current corporate income tax rate. The unrecorded deferred federal income tax liability on the above amount was approximately \$240,000 at June 30, 2007.

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Note 9: Other Comprehensive Income (Loss)

	Before-Tax Amount	2007 Tax (Expense) Benefit	Net-of-Tax Amount
Unrealized losses on securities			
Unrealized holding gains arising during the year	\$ 44	\$ (17)	\$ 27
Less: reclassification adjustment for gains realized in net income	<u>43</u>	<u>(17)</u>	<u>26</u>
Other comprehensive income	<u>\$ 1</u>	<u>\$ —</u>	<u>\$ 1</u>
	Before-Tax Amount	2006 Tax (Expense) Benefit	Net-of-Tax Amount
Unrealized losses on securities			
Unrealized holding losses arising during the year	\$ (117)	\$ 47	\$ (70)
Less: reclassification adjustment for gains realized in net income	<u>29</u>	<u>(11)</u>	<u>18</u>
Other comprehensive loss	<u>\$ (146)</u>	<u>\$ 58</u>	<u>\$ (88)</u>

Note 10: Commitments and Contingent Liabilities

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

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

	2007	2006
Commitments to extend credit	\$ 2,771	\$ 2,058
Unused lines of credit	293	300

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Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation. Collateral held varies, but may include residential real estate, or other assets of the borrower.

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

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

Note 11: Stockholders' Equity

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

Note 12: Dividends and Capital Restrictions

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

Without prior approval, current regulations allow the Bank to pay dividends to the Company not exceeding retained net profits for the current calendar year to date plus those for the previous two calendar years. At June 30, 2007, total stockholder's equity of the Bank was \$7,081,000 of which \$6,408,000 was restricted from dividend distribution to the Company. Although well capitalized, under current regulations in effect, the Bank is required to apply to the Office of Thrift Supervision to pay dividends to the Company.

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Note 13: Regulatory Capital

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

There are five capital categories defined in the regulations, ranging from well capitalized to critically undercapitalized. Classification of a bank in any of the undercapitalized categories can result in actions by regulators that could have a material effect on a bank's operations. At June 30, 2007 and 2006, the Bank was categorized as well capitalized and met all subject capital adequacy requirements. There are no conditions or events since June 30, 2007 that management believes has changed the Bank's classification.

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

	Actual		2007 Required for Adequate Capital		Required To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total risk-based capital (to risk-weighted assets)	\$ 7,101	15.7%	\$ 3,610	8.0%	\$ 4,513	10.0%
Tier I capital (to risk-weighted assets)	6,536	14.5%	1,805	4.0%	2,708	6.0%
Core capital (to adjusted total assets)	6,536	8.8%	2,986	4.0%	3,733	5.0%
Core capital (to adjusted tangible assets)	6,536	8.8%	1,493	2.0%	—	—
Tangible capital (to adjusted total assets)	6,536	8.8%	1,120	1.5%	—	—

	Actual		2006 Required for Adequate Capital		Required To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total risk-based capital (to risk-weighted assets)	\$ 6,922	14.5%	\$ 3,810	8.0%	\$ 4,762	10.0%
Tier I capital (to risk-weighted assets)	6,422	13.5	1,905	4.0	2,857	6.0
Core capital (to adjusted total assets)	6,422	8.5	3,017	4.0	3,772	5.0
Core capital (to adjusted tangible assets)	6,422	8.5	1,509	2.0	N/A	N/A
Tangible capital (to adjusted total assets)	6,422	8.5	1,132	1.5	N/A	N/A

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Note 14: Employee Benefit Plans

The Bank is a participant in a pension fund known as the Pentegra Group. This plan is a multi-employer plan; separate actuarial valuations are not made with respect to each participating employer. On July 1, 2006, the Company elected to freeze the defined-benefit plan to stop accruing benefits to plan participants beyond what was already earned to that date and to prevent new participants from entering the plan. The plan required contributions in the amount of \$28,000 and \$127,000 for the years ended June 30, 2007 and 2006. The plan provides pension benefits for substantially all of the Bank's employees.

The Company has a Retirement Savings Section 401(k) plan in which substantially all employees may participate. The Company matches participant contributions at the rate of 50 percent of the first 6 percent of base salary contributed by participants. In addition, beginning in 2007, the Company contributes an additional 2 percent of participant base salary regardless of participant contributions. The Company's expense for the plan was \$40,000 and \$22,000 for the years ended June 30, 2007 and 2006.

The Company has an ESOP covering substantially all employees of the Bank. The ESOP acquired 161,896 shares of the Company's common stock at \$2.50 per share with funds provided by a loan from the Company. Accordingly, the unearned common stock acquired by the ESOP is shown as a reduction of stockholders' equity. Shares are released to participants proportionately as the loan is repaid. Dividends on allocated shares are recorded as dividends and charged to retained earnings. Dividends on unallocated shares, which may be distributed to participants or used to repay the loan, are treated as compensation expense. Compensation expense is recorded equal to the fair market value of the stock when contributions, which are determined annually by the Board of Directors of the Bank, are made to the ESOP. The expense under the ESOP was \$14,000 and \$66,000 for the years ended June 30, 2007 and 2006. At June 30, 2006, all 161,896 ESOP shares have been allocated. As of June 30, 2006, no unearned shares remained. The Company is obligated at the option of each beneficiary to repurchase shares of the ESOP upon the beneficiary's termination or after retirement.

The Company has a Recognition and Retention Plan and Trust (RRP). The RRP may acquire up to 130,948 shares of the Company's common stock for awards to management. Shares awarded to management under the RRP vest at a rate of 20 percent at the end of each full 12 months of service with the Bank after the date of grant. As of June 30, 2007, 90,048 shares of common stock have been awarded to management. Nonvested shares have been recorded as unearned compensation and shown as a reduction to stockholders' equity. Expense under the RRP was \$15,000 for the years ended June 30, 2007 and 2006.

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

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Note 15: Related Party Transactions

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

Balances, July 1, 2006	\$	411
New loans, including renewals		43
Payments, etc. including renewals		<u>(58)</u>
Balances, June 30, 2007	\$	<u>396</u>

Deposits from related parties held by the Bank at June 30, 2007 and 2006 totaled \$1,353,000 and \$856,000.

Note 16: Stock Option Plan

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

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

A summary of option activity under the Plan as of June 30, 2007, and changes during the year then ended, is presented below:

	Shares	Weighted- Average Exercise Price	2007 Weighted- Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, beginning of year	79,300	\$ 4.25		
Exercised	<u>(10,619)</u>	4.25		
Outstanding, end of year	<u>68,681</u>	\$ 4.25	<u>0.29</u>	\$ <u>45,003</u>
Exercisable, end of year	<u>68,681</u>	\$ 4.24	<u>0.29</u>	\$ <u>45,003</u>

The total intrinsic value of options exercised during the year ended June 30, 2007 was \$6,900.

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Note 17: Earnings Per Share

Earnings per share were computed as follows:

	Net Income	2007 Weighted- Average Shares	Per- Share Amount
Basic Earnings Per Share			
Income available to common stockholders	\$ 175	1,299,108	\$.13
Effect of Dilutive Stock Options	—	13,115	
Diluted Earnings Per Share			
Income available to common stockholders and assumed conversions	\$ 175	1,312,223	\$.13
	Net Income	2006 Weighted- Average Shares	Per- Share Amount
Basic Earnings Per Share			
Income available to common stockholders	\$ 259	1,292,396	\$.20
Effect of Dilutive Stock Options	—	15,947	
Diluted Earnings Per Share			
Income available to common stockholders and assumed conversions	\$ 259	1,308,343	\$.20

Note 18: Fair Values of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Cash and Cash Equivalents - The fair value of cash and cash equivalents approximates carrying value.

Interest-Bearing Deposits - The fair value of interest-bearing deposits approximates carrying value.

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Securities Available for Sale - Fair values are based on quoted market prices.

Loans - For both short-term loans and variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair value for other loans is estimated using discounted cash flow analyses using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

FHLB Stock - Fair value of FHLB stock is based on the price at which it may be resold to the FHLB.

Interest Receivable - The fair values of interest receivable approximate carrying values.

Deposits - The fair values of interest-bearing demand, NOW, money market deposit and savings accounts are equal to the amount payable on demand at the balance sheet date. The carrying amounts for variable rate, fixed-term certificates of deposit approximate their fair values at the balance sheet date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on such time deposits.

Borrowings - The fair value of borrowings is estimated using a discounted cash flow calculation, based on current rates for similar debt. Fair value approximates carrying value.

Off-Balance Sheet Commitments - Commitments include commitments to originate mortgage loans, and extend lines of credit and are generally of a short-term nature. The fair value of such commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

The estimated fair values of the Company's financial instruments are as follows:

	2007		2006	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets				
Cash and cash equivalents	\$ 4,901	\$ 4,901	\$ 4,332	\$ 4,332
Interest-bearing deposits	1,301	1,301	1,500	1,500
Securities available for sale	1,887	1,887	2,050	2,050
Loans, net	61,037	62,161	62,619	63,339
FHLB stock	1,188	1,188	1,225	1,225
Interest receivable	417	417	424	424
Liabilities				
Deposits	45,518	45,279	44,543	43,959
Borrowings	21,500	21,234	24,000	23,403
Off-Balance Sheet Assets				
Commitments to extend credit				

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Note 19: Condensed Financial Information (Parent Company Only)

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

Condensed Balance Sheets

	2007	2006
Assets		
Cash and cash equivalents	\$ 143	\$ 106
Securities available for sale	42	122
Premises and equipment	490	508
Investment in subsidiaries	7,089	6,958
Other assets	<u>318</u>	<u>284</u>
Total assets	<u>\$ 8,082</u>	<u>\$ 7,978</u>
Liabilities		
	\$ 602	\$ 549
Stockholders' Equity		
	<u>7,480</u>	<u>7,429</u>
Total liabilities and stockholders' equity	<u>\$ 8,082</u>	<u>\$ 7,978</u>

Condensed Statements of Income

	2007	2006
Income		
Dividends from Bank	\$ 131	\$ 74
Net gains on available-for-sale securities	43	29
Interest and other income	<u>54</u>	<u>—</u>
Total income	<u>228</u>	<u>103</u>
Expenses		
Salaries and employee benefits	20	64
Legal and professional fees	39	29
Other expenses	<u>82</u>	<u>97</u>
Total expenses	<u>141</u>	<u>190</u>
Income (loss) before income tax benefit and equity in undistributed income of Bank	87	(87)
Income tax (expense) benefit	<u>(13)</u>	<u>19</u>
Income (loss) before equity in undistributed income of Bank	74	(68)
Equity in undistributed income of Bank	<u>101</u>	<u>327</u>
Net Income	<u>\$ 175</u>	<u>\$ 259</u>

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Condensed Statements of Cash Flows

	2007	2006
Operating Activities		
Net income	\$ 175	\$ 259
Items not providing cash	<u>(98)</u>	<u>(188)</u>
Net cash provided by operating activities	<u>77</u>	<u>71</u>
Investing Activity - proceeds from sales of securities available for sale		
	<u>99</u>	<u>77</u>
Financing Activities		
Dividends paid	(162)	(143)
Issuance of stock	45	2
Purchase of stock	<u>(22)</u>	<u>(10)</u>
Net cash used in financing activities	<u>(139)</u>	<u>(151)</u>
Net Change in Cash and Cash Equivalents	37	(3)
Cash and Cash Equivalents at Beginning of Year	<u>106</u>	<u>109</u>
Cash and Cash Equivalents at End of Year	<u>\$ 143</u>	<u>\$ 106</u>