



**Indiana
Business BancorpSM**

Focused. Responsive. Experienced.

2006 ANNUAL REPORT

INDIANA BUSINESS BANCORP 2006 ANNUAL REPORT TO SHAREHOLDERS

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Profile

Indiana Business Bancorp is the holding company for Indiana Business Bank, a state-chartered, locally-owned and managed commercial bank formed in 2004 for the purpose of providing highly-personalized banking services for small to medium-sized businesses, their owners and professional services firms from a single location in Indianapolis, Indiana. Additional information concerning the Company or the Bank can be found on our website: <http://www.indianabb.com>.

Shareholder Information MARKET INFORMATION

<u>Quarterly Periods</u>	<u>High Bid</u>	<u>Low Bid</u>
Year Ended December 31, 2006:		
First quarter	\$ 10.50	\$ 9.50
Second quarter	\$ 10.55	\$ 8.35
Third quarter	\$ 9.95	\$ 9.25
Fourth quarter	\$ 11.25	\$ 9.80

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UBS Securities LLC
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Indiana Business BancorpSM

April 10, 2007

Dear Fellow Shareholders:

Our second full year of operations was very gratifying as we achieved our two stated goals from last year's shareholder letter, growth and our first month of profitability. Our third year goals are similar, growth and a full year of profitability.

Our assets grew 56%, from \$36,240,994 at December 31, 2005, to \$56,670,690 at year end. Net loans expanded by 83%, from \$24,271,742 at year end 2005, to \$44,549,595 at year end 2006. This asset growth, combined with an 84% increase in deposits and strong control of non-interest expenses, enabled our company to achieve its first profitable month, in December of 2006. This positive momentum continued into the first quarter of 2007.

We expect the same challenges in 2007 that Indiana Business Bank and other local banks faced during 2006: a highly competitive banking market for quality clients and quality employees, and a difficult interest rate environment. We can't change these obstacles, but we can continue to be focused, responsive, and more passionate than our much larger competitors. I am confident that this attitude and drive will result in a successful 2007 performance.

As I point out each year, the support of our investor base was obviously critical to the opening of our bank and is important to our ongoing success. If you are a business owner and would like to know how Indiana Business Bank could improve your banking relationship, please contact me directly at 317-218-2185, or via email at jyoung@indianabb.com.

Thank you for your continued support.

Sincerely,

James S. Young
President & CEO

Financial Summary for Indiana Business Bancorp

	As of and for the Twelve Months Ending December 31, 2006	
Operating Data	2006	2005
Net Interest Income	2,020,745	906,033
Provision for Loan Losses	477,923	360,967
Noninterest Income	61,134	29,291
Noninterest Expense	2,265,751	1,993,022
Net Income (Loss)	(661,795)	(1,418,665)
Per Share Data		
Net Earnings (Loss) – Basic	\$ (0.45)	\$ (0.96)
Weighted Average Shares Outstanding	1,484,100	1,484,100



Independent Accountants' Report

To the Audit Committee of the
Board of Directors
Indiana Business Bancorp
Indianapolis, Indiana

We have audited the accompanying consolidated balance sheets of Indiana Business Bancorp (Company) as of December 31, 2006 and 2005, and the related consolidated statements of operations, 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 Indiana Business Bancorp as of December 31, 2006 and 2005, 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
March 30, 2007

Indiana Business Bancorp
Balance Sheets
December 31, 2006 and 2005

Assets

	2006	2005
Cash and due from banks	\$ 1,325,899	\$ 1,397,344
Federal funds sold	5,537,000	6,932,000
Securities purchased under agreements to resell	2,759	5,947
Total cash and cash equivalents	6,865,658	8,335,291
Available-for-sale securities	4,499,999	2,972,499
Loans, net of allowance for losses of \$689,252 and \$369,620	44,549,595	24,271,742
Furniture and equipment, net of accumulated depreciation of \$268,989 and \$134,654	288,375	378,756
Interest receivable and other assets	467,063	282,706
Total assets	\$ 56,670,690	\$ 36,240,994

Liabilities and Stockholders' Equity

Liabilities

Deposits		
Demand	\$ 16,146,270	\$ 12,484,938
Savings	148,866	145,769
Time	29,307,268	12,132,519
Total deposits	45,602,404	24,763,226
Securities sold under agreements to repurchase	337,018	251,268
Interest payable and other liabilities	220,257	144,371
Total liabilities	46,159,679	25,158,865

Stockholders' Equity

Common stock, \$1 par value; authorized 2,000,000 shares; 1,484,100 shares issued and outstanding	1,484,100	1,484,100
Additional paid-in capital	12,360,705	12,288,705
Accumulated deficit	(3,331,870)	(2,670,075)
Accumulated other comprehensive loss	(1,924)	(20,601)
Total stockholders' equity	10,511,011	11,082,129
Total liabilities and stockholders' equity	\$ 56,670,690	\$ 36,240,994

Indiana Business Bancorp
Statements of Operations
Years Ended December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Interest Income		
Loans	\$ 2,798,377	\$ 808,662
Securities - taxable	159,659	111,807
Federal funds sold	346,660	264,456
Total interest income	<u>3,304,696</u>	<u>1,184,925</u>
Interest Expense - deposits	<u>1,283,951</u>	<u>278,892</u>
Net Interest Income	2,020,745	906,033
Provision for Loan Losses	<u>477,923</u>	<u>360,967</u>
Net Interest Income After Provision for Loan Losses	<u>1,542,822</u>	<u>545,066</u>
Noninterest Income	<u>61,134</u>	<u>29,291</u>
Noninterest Expense		
Salaries and employee benefits	1,203,031	1,140,571
Occupancy expense	131,141	124,538
Equipment expense	152,697	139,270
Data processing fees	164,078	140,628
Professional fees	176,797	122,931
Marketing expense	88,212	74,599
Stock option vesting	72,000	-
Other	277,795	250,485
Total noninterest expense	<u>2,265,751</u>	<u>1,993,022</u>
Net Loss	<u>\$ (661,795)</u>	<u>\$ (1,418,665)</u>

Indiana Business Bancorp

Statements of Stockholders' Equity

Years Ended December 31, 2006 and 2005

	Common Stock		Comprehensive Loss	Accumulated Paid- in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total
	Shares	Amount					
Balances, January 1, 2005	1,484,100	\$ 1,484,100		\$ 12,288,705	\$ (1,251,410)		\$ 12,521,395
Net loss			\$ (1,418,665)		(1,418,665)		(1,418,665)
Unrealized losses on available-for-sale securities			(34,113)			\$ (34,113)	
Tax benefit			13,512			13,512	
Comprehensive loss			<u>(20,601)</u>			<u>(20,601)</u>	(20,601)
Total other comprehensive loss			<u>\$ (1,439,266)</u>				
Balances, December 31, 2005	1,484,100	1,484,100		12,288,705	(2,670,075)	(20,601)	11,082,129
Net loss			\$ (661,795)		(661,795)		(661,795)
Unrealized gains on available-for-sale securities			47,152			47,152	
Tax expense			(28,475)			(28,475)	
Total other comprehensive income			<u>18,677</u>			<u>18,677</u>	18,677
Comprehensive loss			<u>\$ (643,118)</u>				
Stock option vesting				72,000			72,000
Balances, December 31, 2006	1,484,100	\$ 1,484,100		\$ 12,360,705	\$ (3,331,870)	\$ (1,924)	\$ 10,511,011

Indiana Business Bancorp
Statements of Cash Flows
Years Ended December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Operating Activities		
Net loss	\$ (661,795)	\$ (1,418,665)
Items not requiring (providing) cash		
Depreciation and amortization	134,335	124,950
Provision for loan losses	477,923	360,967
Discount accretion on securities	(6,513)	(47,688)
Share-based compensation	72,000	-
Changes in		
Interest receivable and other assets	(184,356)	(230,858)
Interest payable and other liabilities	75,886	108,812
Net cash used in operating activities	<u>(92,520)</u>	<u>(1,102,482)</u>
Investing Activities		
Purchases of available-for-sale securities	(4,502,310)	(12,331,668)
Proceeds from maturities of available-for-sale securities	3,000,000	18,735,000
Net change in loans	(20,755,776)	(24,064,495)
Purchases of premises and equipment	(43,954)	(49,537)
Net cash used in investing activities	<u>(22,302,040)</u>	<u>(17,710,700)</u>
Financing Activities		
Net increase in demand deposits and savings accounts	3,664,429	12,048,340
Net increase in certificates of deposit	17,174,749	11,977,475
Net increase in securities sold under purchase agreements	85,750	251,268
Net cash provided by financing activities	<u>20,924,928</u>	<u>24,277,083</u>
Increase (Decrease) in Cash and Cash Equivalents	(1,469,632)	5,463,901
Cash and Cash Equivalents, Beginning of Year	<u>8,335,291</u>	<u>2,871,390</u>
Cash and Cash Equivalents, End of Year	<u>\$ 6,865,659</u>	<u>\$ 8,335,291</u>
Supplemental Cash Flows Information		
Interest paid	\$ 1,337,210	\$ 243,722

Indiana Business Bancorp
Notes to Consolidated Financial Statements
December 31, 2006 and 2005

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

Nature of Operations

The consolidated financial statements include the accounts of Indiana Business Bancorp (Company) and its wholly-owned subsidiary, Indiana Business Bank (Bank). Indiana Business Bancorp was organized as of July 1, 2006, for the purpose of owning all of the outstanding stock of Indiana Business Bank.

The Bank commenced operations on November 17, 2004. The Bank is primarily engaged in providing a full range of banking and financial services to corporate customers in Marion and surrounding counties of Indiana. The Bank is subject to competition from other financial institutions. The Bank is subject to the regulation of certain federal and state agencies and undergoes periodic examinations by those regulatory authorities.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

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.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses. In connection with the determination of the allowance for loan losses, management obtains independent appraisals for significant properties.

Cash and Cash Equivalents

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

Securities

Available-for-sale securities, which include any security for which the Company has no immediate plan to sell, but which may be sold in the future, are carried at fair value. Unrealized gains and losses are recorded, net of related income tax effects, in other comprehensive income.

Amortization of premiums and accretion of discounts are recorded 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.

Indiana Business Bancorp
Notes to Consolidated Financial Statements
December 31, 2006 and 2005

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoffs are reported at their outstanding principal balances, adjusted for any charge-offs, the allowance for loan losses and unamortized premiums or discounts on purchased loans. Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the loan term. Generally, loans are placed on non-accrual status at ninety days past due, and interest is considered a loss, unless the loan is well-secured and in the process of collection.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to income. Loan losses are charged against the allowance when management believes the loan balance is uncollectible. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis, by management, and is based upon management's periodic review of the collectibility of the loans in light of the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The Company estimated its allowance for loan losses at December 31, 2006, at 1.5% of total loans outstanding. Management considers this to be a reasonable estimate at this time due to the lack of seasoning of the loan portfolio. In future years, management will incorporate historical loss and other information into its determination of the adequacy of the allowance for loan losses.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due, according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogenous loans will be collectively evaluated for impairment. Accordingly, the Company will not separately identify individual consumer and residential loans for impairment measurements.

Indiana Business Bancorp
Notes to Consolidated Financial Statements
December 31, 2006 and 2005

Furniture and Equipment

Depreciable assets are stated at cost less accumulated depreciation. Depreciation is charged to expense using the straight-line method over the estimated useful lives of the assets.

Stock Options

At December 31, 2006, the Company has a stock-based employee compensation plan, which is described more fully in Note 13. Prior to 2006, 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 2005, 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.

Effective January 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 January 1, 2006, the Company began expensing stock options.

The following table illustrates the effect on net income and earnings per common share if expense was measured using the fair value recognition provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation* as of December 31, 2005.

	2005
Net loss, as reported	\$ (1,418,665)
Plus: Total stock-based employee compensation cost determined under the fair value based method	(68,470)
Pro forma net loss	\$ (1,487,135)

Income Taxes

Deferred tax assets and liabilities are recognized for the tax effects of differences between the financial statement and tax bases of assets and liabilities. A valuation allowance is established to reduce deferred tax assets if it is more likely than not that a deferred tax asset will not be realized.

Indiana Business Bancorp

Notes to Financial Statements December 31, 2006 and 2005

Reclassifications

Certain reclassifications have been made to the 2005 financial statements to conform to the 2006 financial statement presentation. These reclassifications had no effect on net income.

Note 2: Restriction on Cash and Due From Banks

The Company is required to maintain reserve funds on deposit with the Federal Reserve Bank. The reserve required at December 31, 2006 was \$25,000.

Note 3: Securities

	2006			
Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Approximate Fair Value	
Available-for-sale Securities:				
December 31, 2006				
U. S. Government Agencies	\$ 4,501,923	\$ 3,262	\$ 5,186	\$ 4,499,999
2005				
Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Approximate Fair Value	
December 31, 2005				
U. S. Government Agencies	\$ 2,993,100	\$ -	\$ 20,601	\$ 2,972,499

The amortized cost and fair value of securities available for sale at December 31, 2006, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Within one year	\$ 499,746	\$ 495,950
One to five years	3,500,489	3,502,499
Five years or more	501,688	501,550
Totals	\$ 4,501,923	\$ 4,499,999

Indiana Business Bancorp
Notes to Consolidated Financial Statements
December 31, 2006 and 2005

The carrying value of securities pledged as collateral to secure repurchase agreements was \$500,300 at December 31, 2006. There were no securities pledged at December 31, 2005.

Certain investments in debt securities are reported in the financial statements at an amount less than their historical cost. Total fair value of these investments was \$1,996,250 at December 31, 2006, which is approximately 44% of the Company's available-for-sale investment portfolio. Total fair value of these investments was \$2,972,499 at December 31, 2005, which is approximately 100% of the Company's available-for-sale investment portfolio. These declines primarily resulted from recent increases in market interest rates.

Based on evaluation of available evidence, including recent changes in market interest rates, management believes the declines in fair value for these securities are temporary.

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 table shows 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 December 31, 2006 and 2005:

Description of Securities	2006					
	Less than 12 months		More than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Loss
U.S. Government Agencies	<u>\$ 1,500,300</u>	<u>\$ 1,390</u>	<u>\$ 495,950</u>	<u>\$ 3,796</u>	<u>\$ 1,996,250</u>	<u>\$ 5,186</u>

Description of Securities	2005					
	Less than 12 months		More than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Loss
U.S. Government Agencies	<u>\$ 2,972,499</u>	<u>\$ 20,601</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,972,499</u>	<u>\$ 20,601</u>

Indiana Business Bancorp
Notes to Consolidated Financial Statements
December 31, 2006 and 2005

Note 4: Securities Purchased Under Agreements to Resell

The Company enters into purchases of securities under agreements to resell. The amounts advanced under these agreements represent short-term loans and are reflected as a receivable in the balance sheet. The securities underlying the agreements are book-entry securities. During the period, the securities were delivered by appropriate entry into the Company's account maintained at a third-party custodian's account designated by the Company under a written custodial agreement that explicitly recognizes the Company's interest in the securities. At December 31, 2006 and 2005, these agreements matured daily. The Company's policy requires that all securities purchased under agreements to resell be fully collateralized.

Note 5: Loans and Allowance for Loan Losses

Loans at December 31 include:

	<u>2006</u>	<u>2005</u>
Commercial loans	\$ 40,051,001	\$ 22,693,236
Residential mortgage	3,210,162	-
Consumer	<u>1,977,684</u>	<u>1,948,126</u>
Total loans	45,238,847	24,641,362
Less: Allowance for loan losses	<u>(689,252)</u>	<u>(369,620)</u>
Net loans	<u>\$ 44,549,595</u>	<u>\$ 24,271,742</u>

Activity in the allowance for loan losses was as follows:

Balance, beginning of year	\$ 369,620	\$ 8,653
Provision charged to expense	477,923	360,967
Losses charged off, net of recoveries	<u>(158,291)</u>	<u>-</u>
Balance, end of year	<u>\$ 689,252</u>	<u>\$ 369,620</u>

Impaired loans totaled \$181,652 and \$0 at December 31, 2006 and 2005, respectively, for which there was no related allowance for loan loss.

Interest of \$23,105 and \$0 was recognized on average impaired loans of \$362,401 and \$0 for 2006 and 2005, respectively. Interest of \$3,447 and \$0 was recognized on impaired loans on a cash basis during 2006 and 2005, respectively.

At December 31, 2006 and 2005, there were no accruing loans delinquent 90 days or more. Non-accruing loans at December 31, 2006 and 2005 were \$181,652 and \$0, respectively.

Indiana Business Bancorp
Notes to Consolidated Financial Statements
December 31, 2006 and 2005

Note 6: Furniture and Equipment

	2006	2005
Autos	\$ 39,519	\$ 25,440
Furniture and equipment	511,565	481,690
Leasehold improvements	6,280	6,280
Total cost	557,364	513,410
Accumulated depreciation	(268,989)	(134,654)
Net furniture and equipment	\$ 288,375	\$ 378,756

Note 7: Interest-Bearing Time Deposits

Interest-bearing time deposits in denominations of \$100,000 or more were \$15,478,688 and \$5,539,439 on December 31, 2006 and 2005, respectively.

At December 31, 2006, the scheduled maturities of time deposits are as follows:

2007	\$ 22,579,831
2008	3,045,544
2009	3,644,840
2010	37,053
	\$ 29,307,268
	\$ 29,307,268

Note 8: Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase consist of an obligation of the Company to another party. The obligations are secured by various securities and such collateral is held by another financial institution. The maximum amount of outstanding agreements, at any month end during 2006 and 2005, totaled \$337,018 and \$402,217, respectively, and the average of such agreements totaled \$232,531 and \$201,674 for 2006 and 2005, respectively. The agreements at December 31, 2006 mature daily.

Indiana Business Bancorp
Notes to Consolidated Financial Statements
December 31, 2006 and 2005

Note 9: Income Taxes

During 2006 and 2005, the Company had no income taxes currently payable and generated a deferred tax asset of \$306 and \$548,380. An increase in the deferred tax asset valuation allowance of \$306,739 and \$548,380 was recorded in 2006 and 2005.

A reconciliation of income tax expense at the statutory rate to the Company's actual income tax expense is shown below:

	<u>2006</u>	<u>2005</u>
Computed at the statutory rate (34%)	\$ (225,010)	\$ (482,348)
Increase (decrease) resulting from		
Other	5,925	4,589
State income taxes	(32,820)	(70,620)
Deferred tax asset valuation allowance	<u>251,905</u>	<u>548,379</u>
Actual tax expense	<u>\$ -</u>	<u>\$ -</u>

The tax effects of temporary differences related to deferred taxes shown on the balance sheets were:

	<u>2006</u>	<u>2005</u>
Deferred tax assets		
Allowance for loan losses	\$ 110,508	\$ 101,997
Net operating loss carryforward	975,736	646,024
Organization costs	254,988	322,064
Stock options	30,036	-
Other	<u>26,402</u>	<u>11,211</u>
	<u>1,397,670</u>	<u>1,081,296</u>
Deferred tax liabilities		
Prepays	(12,586)	(25,470)
Depreciation	(17,064)	(47,826)
State income tax	<u>(53,281)</u>	<u>-</u>
	<u>(82,931)</u>	<u>(73,296)</u>
Valuation allowance		
Beginning balance	(1,008,000)	(459,620)
Increase during the period	<u>(306,739)</u>	<u>(548,380)</u>
Ending balance	<u>(1,314,739)</u>	<u>(1,008,000)</u>
	<u>\$ -</u>	<u>\$ -</u>

As of December 31, 2006 and 2005, the Company had approximately \$2,459,000 and \$1,743,000 of federal and state net operating loss carryforwards, which will begin to expire in 2023 and 2025, respectively.

Indiana Business Bancorp

Notes to Financial Statements

December 31, 2006 and 2005

Note 10: Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below). Management believes, as of December 31, 2006, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2006 and 2005, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well as capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Bank's actual capital amounts and ratios are also presented in the table.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2006						
Total capital (to risk-weighted assets)	\$ 11,048	25.8%	\$ 3,432	8.0%	\$ 4,290	10.0%
Tier I capital (to risk-weighted assets)	10,511	24.5	1,716	4.0	2,574	6.0
Tier I capital (to average assets)	10,511	19.8	2,121	4.0	2,652	5.0
As of December 31, 2005						
Total capital (to risk-weighted assets)	\$ 11,387	46.6%	\$ 1,956	8.0%	\$ 2,445	10.0%
Tier I capital (to risk-weighted assets)	11,082	45.3	978	4.0	1,467	6.0
Tier I capital (to average assets)	11,082	34.7	1,278	4.0	1,597	5.0

The Bank is subject to certain restrictions on the amount of dividends that it may declare without prior regulatory approval. The Bank is restricted from declaring dividends in its first three years of operation.

Indiana Business Bancorp

Notes to Financial Statements December 31, 2006 and 2005

Note 11: Defined Contribution Plan

The Company has a 401(k) profit-sharing plan covering substantially all employees. Employees may contribute up to 100% of their compensation with the Company matching 100% of the employee's contribution on the first 6% of the employees' compensation, which amounted to expense of \$55,677 and \$49,698 in 2006 and 2005, respectively. The Company may also provide a discretionary profit-sharing contribution to be determined annually by management. There was no discretionary profit-sharing contribution in 2006 and 2005.

Note 12: Stock Option Plan

The Company's Stock Option and Incentive Plan, which is shareholder approved, permits the grant of share options and shares to its directors and employees for up to 160,000 shares of common stock. The Company believes that such awards better align the interests of its employees with those of its shareholders. Option awards are generally granted with an exercise price intended equal to the market price of the Company's stock at the date of grant; those option awards generally vest based on 6 months to 3 years of continuous service, and have 10-year contractual terms. In 2006, the Company accelerated the vesting of certain previously granted options. Certain option awards provide for accelerated vesting if there is a change in control (as defined in the Plan).

The fair value of each option award is estimated on the date of grant using a closed form valuation model that uses the assumptions noted in the following table. Expected and weighted-average volatility is based on historical volatility of a similar industry sector index using daily historical closing values for a period of time prior to the grant date of options that equals the length of the expected term of options granted. The expected term of options granted represents the period of time that options granted are expected to be outstanding. The expected dividends are based on the dividend payout of similar financial institutions and anticipated future activity for the Company. The risk-free rate for options granted is based on the U.S. Treasury rate for a similar term as the average expected term of the option.

	2006	2005
Expected volatility	17.80-17.90%	1.00%
Weighted-average volatility	17.86%	1.00%
Expected dividends	1.50%	0.00%
Expected term (in years)	5	5
Risk-free rate	4.28-4.97%	3.85%

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A summary of option activity under the Plan as of December 31, 2006, and changes during the years then ended, is presented below:

	2006			
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, beginning of year	90,150	\$ 10.08		
Granted	20,800	10.56		
Forfeited	750	10.00		
	110,200	\$ 10.17	8.16	\$ 67,651
Options exercisable, end of year	101,267	\$ 10.16	8.11	\$ 63,371

The weighted-average grant-date fair value of options granted during the 2006 and 2005 was \$2.19 and \$2.02, respectively.

As of December 31, 2006, there was \$12,129 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plan. That cost is expected to be recognized over a weighted-average period of 1.8 years. During 2006, the Company recognized \$72,000 of compensation expense and \$30,036 of tax benefit related to the share-based compensation expense.

Note 13: Stock Warrants

The Company issued 90,000 stock warrants to certain organizers of the Company. The warrants, issued in 2004, entitled the holder to purchase additional shares of the Company's common stock at the offering price of \$10 per share for ten years, expiring September 2014.

Note 14: Lease

The Company leases the space that houses its present operations. The lease expires March 31, 2009. The Company has the option to renew this lease for two separate five-year periods. Rental expense for this lease was \$123,464 and \$120,198 for the years ended December 31, 2006 and 2005.

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Future minimum lease payments under operating leases are:

	Operating Leases
2007	\$ 117,982
2008	119,581
2009	29,995
Total minimum lease payments	\$ 267,558

Note 15: Related Party Transactions

At December 31, 2006 and 2005, the Company had loans outstanding to executive officers, directors, significant shareholders and their affiliates (related parties) in the amount of \$4,070,670 and \$2,601,791, respectively.

In management's opinion, such loans and other extensions of credit and deposits were made in the ordinary course of business, and were made substantially on the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons. All loan transactions to related parties were approved by the Board of Directors. Further, in management's opinion, these loans did not involve more than normal risk of collectibility, or present other unfavorable features.

Deposits from related parties held by the Company at December 31, 2006 and 2005 totaled \$1,510,022 and \$2,557,880, respectively.

Note 16: Significant Estimates and Concentrations

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Estimates related to the allowance for loan losses are reflected in the footnote regarding loans. Current vulnerabilities due to certain concentrations of credit risk are discussed in footnote 17 on commitments and credit risk.

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Note 17: Commitments and Credit Risk

Letters of Credit

Letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. At December 31, 2006 and 2005, there were \$267,991 and \$47,191 letters of credit outstanding, respectively.

Lines of Credit

Lines of credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Lines of credit generally have fixed expiration dates. Since a portion of the line may expire without being drawn upon, the total unused lines do not necessarily represent future cash requirements. Each customer's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if deemed necessary, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, commercial real estate and residential real estate. Management uses the same credit policies in granting lines of credit as it does for on-balance-sheet instruments.

At December 31, 2006 and 2005, the Company had granted unused lines of credit to borrowers aggregating approximately \$10,072,138 and \$6,724,569.

Salary Continuation Agreements

The Company has entered into agreements with two officers, which provide for salary continuation for a 12 month period under certain circumstances, primarily related to change of control of the Company, 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 terminate in November 2007.

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