



**Indiana
Business BancorpSM**

Focused. Responsive. Experienced.

2008 ANNUAL REPORT

INDIANA BUSINESS BANCORP 2008 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: indianabb.com.

Shareholder Information MARKET INFORMATION

<u>Quarterly Periods</u>	<u>High Bid</u>	<u>Low Bid</u>
Year Ended December 31, 2008:		
First quarter	\$ 10.50	\$ 7.30
Second quarter	\$ 8.75	\$ 6.60
Third quarter	\$ 8.00	\$ 6.40
Fourth quarter	\$ 6.40	\$ 3.60

<u>Quarterly Periods</u>	<u>High Bid</u>	<u>Low Bid</u>
Year Ended December 31, 2007:		
First quarter	\$ 11.00	\$ 9.75
Second quarter	\$ 10.50	\$ 9.00
Third quarter	\$ 10.20	\$ 8.50
Fourth quarter	\$ 10.50	\$ 8.50

TRANSFER AGENT CONTINENTAL STOCK TRANSFER

17 Battery Place
8th Floor
New York, NY 10004

LISTED ON OTC BULLETIN BOARD **SYMBOL: IBBI.OB**

MARKET MAKERS
Automated Trading Desk, a Citi Company
Knight Equity Markets, L.P.
Monroe Securities, Inc.
UBS Securities LLC



Indiana Business BancorpSM

April 6, 2009

Dear Fellow Shareholders:

Let me begin our 2009 Shareholder letter with a quote from last year's letter that stated...

"We expect 2008 to be a challenging year due to softness in the economy and uncertainties in the financial markets".

Obviously my comment proved to be quite an understatement. The Federal Reserve took aggressive steps to cut interest rates, which reduced asset yields while, at the same time, demand for liquidity by large financial institutions propped up funding costs. The net impact of this convergence was a compression of net interest margin for the entire banking industry, and we were no exception. Additionally, the current recession and high unemployment has adversely affected a few commercial and consumer clients in our loan portfolio.

Net interest income for 2008 was \$2,739,983, a 5% increase over 2007 results and is attributable to continued growth in the loan and investment portfolios. Non-interest income (comprised of service charges on deposit accounts and other fee income) totaled \$200,597, an 11% increase over 2007 results.

Non-interest expenses, generally salaries and other operating expenses, increased by 13%, year over year, from \$2,493,480 in 2007 to \$2,819,214 in 2008, due primarily to increased staffing levels.

The net loss for the year was \$898,673 compared to a 2007 profit of \$14,159. The 2008 loss is a result of previously reported repossessions, and \$627,000 in year-end write downs of two unrelated pieces of real estate. The properties include an owner-occupied retail facility and a multi-family housing project. We are currently carrying these assets as "other real estate owned" (OREO) at a combined value of \$1,200,000.

Additionally, we recorded provision expense of approximately \$210,000 for specific reserves designated for loans showing financial weakness and approximately \$164,000

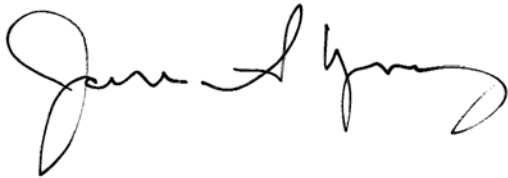
for normal loan portfolio growth. At December 31, 2008 our allowance for loan and lease loss was 1.71% of outstanding loans.

Assets increased almost 13% during 2008 from \$79,883,251 at year end 2007 to \$89,978,662 at December 31, 2008. Deposit growth and Federal Home Loan Bank advances funded asset growth. The Bank increased its use of long term FHLB advances because of the lower cost versus other funding alternatives.

At December 31, 2008, gross loans totaled \$78,460,697, up from \$67,504,846 at December 31, 2007. Deposits totaled \$71,382,245, up from \$64,892,600 at December 31, 2007. The Bank's capital ratios exceeded regulatory guidelines for "well capitalized institutions" at December 31, 2008.

Thank you for your continued support. If you should have any questions, please contact me directly at 317-218-2185, or via email at jyoung@indianabb.com.

Sincerely,

A handwritten signature in black ink, appearing to read "James S. Young". The signature is fluid and cursive, with a large initial "J" and a long, sweeping underline.

James S. Young
President & CEO

Financial Summary for Indiana Business Bancorp

AUDITED

	As of and for the Twelve Months Ending December 31, 2008	
Operating Data	2008	2007
Net Interest Income	2,739,983	2,608,857
Provision for Loan Losses	1,001,339	300,207
Noninterest Income	200,597	180,289
Noninterest Expense	2,819,214	2,493,480
Net Income (Loss)	(898,673)	14,159
Per Share Data		
Net Earnings (Loss) – Basic	(.61)	NM
Weighted Average Shares Outstanding	1,484,100	1,484,100

	As of December 31, 2008	As of December 31, 2007
Balance Sheet Data		
Total Assets	\$89,978,662	79,883,251
Total Loans	78,460,697	67,504,846
Allowance for Loan Losses	1,344,796	992,520
Investment Securities	7,146,900	6,515,420
Total Deposits	71,382,245	64,892,600
Total Shareholders' Equity	9,899,594	10,604,454

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 as of December 31, 2008 and 2007, 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, 2008 and 2007, 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.

As discussed in Note 20, the Company changed its method of accounting for fair value measurements in accordance with Statement of Financial Accounting Standards No. 157 in 2008.

BKD, LLP

Indianapolis, Indiana
April 3, 2009

Indiana Business Bancorp
Consolidated Balance Sheets
December 31, 2008 and 2007

Assets

	<u>2008</u>	<u>2007</u>
Cash and due from banks	\$ 1,227,559	\$ 1,656,900
Federal funds sold	1,921,000	4,116,000
Interest-bearing demand deposits	46,517	31,103
Securities purchased under agreements to resell	-	3,237
Total cash and cash equivalents	<u>3,195,076</u>	<u>5,807,240</u>
Available-for-sale securities	7,146,900	6,515,420
Loans, net of allowance for losses of \$1,344,796 and \$992,520	77,115,901	66,512,326
Furniture and equipment, net of accumulated depreciation of \$498,929 and \$407,969	262,684	258,700
Interest receivable and other assets	<u>2,258,101</u>	<u>789,565</u>
Total assets	<u>\$ 89,978,662</u>	<u>\$ 79,883,251</u>

Liabilities and Stockholders' Equity

Liabilities

Deposits		
Demand	\$ 16,096,833	\$ 19,673,801
Savings	154,432	174,093
Certificates of deposit	55,130,980	45,044,706
Total deposits	<u>71,382,245</u>	<u>64,892,600</u>
Securities sold under agreements to repurchase	-	130,144
Federal Home Loan Bank advances	8,500,000	3,500,000
Interest payable and other liabilities	<u>227,263</u>	<u>756,053</u>
Total liabilities	<u>80,109,508</u>	<u>69,278,797</u>

Stockholders' Equity

Common stock, \$1 par value; authorized 4,000,000 shares; 1,484,100 shares issued and outstanding	1,484,100	1,484,100
Additional paid-in capital	12,439,545	12,409,549
Accumulated deficit	(4,216,384)	(3,317,711)
Accumulated other comprehensive income	161,893	28,516
Total stockholders' equity	<u>9,869,154</u>	<u>10,604,454</u>
Total liabilities and stockholders' equity	<u>\$ 89,978,662</u>	<u>\$ 79,883,251</u>

Indiana Business Bancorp
Consolidated Statements of Operations
Years Ended December 31, 2008 and 2007

	2008	2007
Interest Income		
Loans	\$ 5,021,734	\$ 4,504,506
Securities - taxable	288,254	286,171
Federal funds sold	89,308	243,556
Other	14,144	561
Total interest income	5,413,440	5,034,794
Interest Expense		
Deposits	2,400,791	2,385,801
Other borrowings	272,666	40,136
	2,673,457	2,425,937
Net Interest Income	2,739,983	2,608,857
Provision for Loan Losses	1,001,339	300,207
Net Interest Income After Provision for Loan Losses	1,738,644	2,308,650
Noninterest Income		
Net gains and fees on sale of loans	102,589	133,574
Gain on sale of investments	17,066	-
Other	80,942	46,715
Total noninterest income	200,597	180,289
Noninterest Expense		
Salaries and employee benefits	1,651,422	1,404,035
Occupancy expense	139,273	135,219
Equipment expense	111,496	163,771
Data processing fees	242,563	193,002
Professional fees	183,961	139,998
Marketing expense	31,908	78,398
Travel and entertainment	62,923	45,265
FDIC assessment	61,500	41,950
Other real estate-owned expense	58,344	-
Other	275,824	291,842
Total noninterest expense	2,819,214	2,493,480
Provison (Credit) for Income Taxes	18,700	(18,700)
Net Income (Loss)	\$ (898,673)	\$ 14,159

Indiana Business Bancorp
Consolidated Statements of Stockholders' Equity
Years Ended December 31, 2008 and 2007

	Common Stock		Comprehensive Income (Loss)	Accumulated Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount					
Balances, January 1, 2007	1,484,100	\$ 1,484,100		\$ 12,360,705	\$ (3,331,870)	\$ (1,924)	\$ 10,511,011
Net income			\$ 14,159		14,159		14,159
Other comprehensive income (loss)							
Unrealized gains on available-for-sale securities			76,849			76,849	
Tax expense			(46,409)			(46,409)	
Total other comprehensive income			<u>30,440</u>			<u>30,440</u>	30,440
			<u>\$ 44,599</u>				
Stock option vesting				48,844			48,844
Balances, December 31, 2007	1,484,100	1,484,100		12,409,549	(3,317,711)	28,516	10,604,454
Net loss			\$ (898,673)		(898,673)		(898,673)
Other comprehensive income (loss)							
Unrealized gains on available-for-sale securities, net of reclassification adjustment			133,377			133,377	133,377
			<u>\$ (765,296)</u>				
Stock option vesting				29,996			29,996
Balances, December 31, 2008	<u>1,484,100</u>	<u>\$ 1,484,100</u>		<u>\$ 12,439,545</u>	<u>\$ (4,216,384)</u>	<u>\$ 161,893</u>	<u>\$ 9,869,154</u>

Indiana Business Bancorp
Consolidated Statements of Cash Flows
Years Ended December 31, 2008 and 2007

	2008	2007
Operating Activities		
Net income (loss)	\$ (898,673)	\$ 14,159
Items not requiring (providing) cash		
Depreciation and amortization	90,960	138,980
Provision for loan losses	1,001,339	300,207
Amortization on securities	36,793	1,259
Gain on sale of securities	(17,066)	-
Change in deferred tax valuation allowance	(18,700)	18,700
Share-based compensation	29,996	48,844
Changes in		
Interest receivable and other assets	(1,468,536)	(322,503)
Interest payable and other liabilities	(491,390)	498,396
Net cash provided by (used in) operating activities	(1,735,277)	698,042
Investing Activities		
Purchases of available-for-sale securities	(6,054,186)	(3,967,540)
Proceeds from maturities of available-for-sale securities	3,500,000	2,000,000
Proceeds from sales of available-for-sale securities	2,017,656	-
Net change in loans	(11,604,914)	(22,262,938)
Purchases of premises and equipment	(94,944)	(109,305)
Net cash used in investing activities	(12,236,388)	(24,339,783)
Financing Activities		
Net increase (decrease) in demand deposits and savings accounts	(3,596,629)	3,552,759
Net increase in certificates of deposit	10,086,274	15,737,437
Net increase in securities sold under purchase agreements	(130,144)	(206,874)
Proceeds from Federal Home Loan Bank advances	5,500,000	3,600,000
Repayment of Federal Home Loan Bank advances	(500,000)	(100,000)
Net cash provided by financing activities	11,359,501	22,583,322
Decrease in Cash and Cash Equivalents	(2,612,164)	(1,058,419)
Cash and Cash Equivalents, Beginning of Year	5,807,240	6,865,659
Cash and Cash Equivalents, End of Year	\$ 3,195,076	\$ 5,807,240
Supplemental Cash Flows Information		
Interest paid	\$ 2,697,333	\$ 2,396,637

Indiana Business Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

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, 2008 and 2007

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. Generally, loans are placed on non-accrual status at 90 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.

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.

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.

Indiana Business Bancorp

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

Dividend Restrictions

The Company and the Bank have never paid any dividends. If the Company were to begin paying dividends to its shareholders, the Company would depend upon dividends it would receive from the Bank. Banking laws and regulations restrict the amount of dividends the Bank could pay to the Company.

Stock-Based Compensation

At December 31, 2008, the Company has a share-based employee compensation plan, which is described more fully in Note 13. The Company accounts for this plan under the recognition and measurement principles of Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment*.

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.

Uncertain Tax Positions

In accordance with Financial Accounting Standards Board (FASB) Staff Position No. FIN 48-3, the Company has elected to defer the effective date of FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, until its fiscal year ended December 31, 2009. The Company has continued to account for any uncertain tax positions in accordance with literature that was authoritative immediately prior to the effective date of FIN 48, such as FASB Statement No. 109, *Accounting for Income Taxes*, and FASB Statement No. 5, *Accounting for Contingencies*.

Current Economic Conditions

The current economic environment presents financial institutions with unprecedented circumstances and challenges which in some cases have resulted in large declines in the fair values of investments and other assets, constraints on liquidity and significant credit quality problems, including severe volatility in the valuation of real estate and other collateral supporting loans. The consolidated financial statements have been prepared using values and information currently available to the Company.

Given the volatility of current economic conditions, the values of assets and liabilities recorded in the consolidated financial statements could change rapidly, resulting in material future adjustments in asset values, the allowance for loan losses and capital that could negatively impact the Company's ability to meet regulatory capital requirements and maintain sufficient liquidity.

Reclassifications

Certain reclassifications have been made to the 2007 financial statements to conform to the 2008 financial statement presentation. These reclassifications had no effect on net income.

Indiana Business Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

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, 2008 and 2007 was \$25,000.

Note 3: Securities

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Approximate Fair Value
Available-for-Sale Securities:				
December 31, 2008				
U.S. Government sponsored entities	\$ 6,985,007	\$ 161,893	\$ -	\$ 7,146,900
December 31, 2007				
U.S. Government sponsored entities	\$ 6,468,204	\$ 47,216	\$ -	\$ 6,515,420

The amortized cost and fair value of securities available for sale at December 31, 2008, 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
One to five years	\$ 2,011,505	\$ 2,040,300
Five years or more	4,973,502	5,106,600
Totals	\$ 6,985,007	\$ 7,146,900

The carrying value of securities pledged as collateral to secure repurchase agreements was \$0 and \$503,300 at December 31, 2008 and 2007.

Proceeds from sales of securities available for sale during 2008 were \$2,018,000. Gains of \$17,000 were recognized on these sales in 2008. There were no securities sold in 2007.

There were no debt securities reported at amounts less than historical cost at December 31, 2008 and 2007.

Indiana Business Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

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, 2008 and 2007, 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:

	2008	2007
Commercial loans	\$ 70,900,962	\$ 61,385,328
Residential mortgage	3,641,702	2,785,624
Consumer	<u>3,918,033</u>	<u>3,333,894</u>
Total loans	78,460,697	67,504,846
Less: allowance for loan losses	<u>(1,344,796)</u>	<u>(992,520)</u>
Net loans	<u><u>\$ 77,115,901</u></u>	<u><u>\$ 66,512,326</u></u>

Activity in the allowance for loan losses was as follows:

	2008	2007
Balance, beginning of year	\$ 992,520	\$ 689,252
Provision charged to expense	1,001,339	300,207
Charge-offs	(649,063)	-
Recoveries	<u>-</u>	<u>3,061</u>
Balance, end of year	<u><u>\$ 1,344,796</u></u>	<u><u>\$ 992,520</u></u>

Impaired loans totaled \$4,452,451 and \$2,196,796 at December 31, 2008 and 2007, respectively. A specific allowance for loan losses of \$389,751 relates to impaired loans of \$1,502,916 at December 31, 2008. At December 31, 2008 and 2007, impaired loans of \$3,034,076 and \$1,996,796, respectively, had no related specific allowance for loan losses.

Interest of \$332,401 and \$25,694 was recognized on average impaired loans of \$6,575,533 and \$1,206,395 for 2008 and 2007, respectively. Interest of \$42,586 and \$3,558 was recognized on impaired loans on a cash basis during 2008 and 2007, respectively.

Indiana Business Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

At December 31, 2008 and 2007, there were \$0 and \$474,346 of loans delinquent 90 days or more and still accruing interest. Non-accruing loans at December 31, 2008 and 2007 were \$1,318,266 and \$1,300,000, respectively.

Note 6: Furniture and Equipment

	2008	2007
Autos	\$ 65,838	\$ 65,838
Furniture and equipment	686,689	594,551
Leasehold improvements	9,086	6,280
Total cost	761,613	666,669
Accumulated depreciation	(498,929)	(407,969)
Net furniture and equipment	\$ 262,684	\$ 258,700

Note 7: Certificates of Deposit

Interest-bearing time deposits in denominations of \$100,000 or more were \$29,177,918 and \$25,170,735 on December 31, 2008 and 2007, respectively.

At December 31, 2008, the scheduled maturities of time deposits are as follows:

2009	\$ 36,148,980
2010	14,586,000
2011	4,396,000
	\$ 55,130,980

Note 8: Federal Home Loan Bank Advances

The Company has Federal Home Loan Bank advances with interest rates ranging from 2.89% to 4.99%, which are due at various dates through May 2013.

Indiana Business Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

The maturities of these borrowings at December 31, 2008 are as follows:

2009	\$ 2,500,000
2010	500,000
2011	3,500,000
2012	500,000
2013	<u>1,500,000</u>
	<u><u>\$ 8,500,000</u></u>

First commercial mortgage loans and investment securities totaling \$7,005,000 and \$1,525,000 respectively, were pledged as collateral for FHLB advances at December 31, 2008. Certain advances are subject to restrictions or penalties in the event of prepayment.

FHLB advances, totaling \$2,000,000, are subject to an option by the FHLB to convert the entire advance to a periodic adjustable rate at various times after the date of the advance and periodically thereafter. If the FHLB exercises its option to convert the advance to an adjustable rate, the advance will be prepayable at the Company's option, at par and without a penalty.

Note 9: 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 2008 and 2007, totaled \$103,355 and \$231,573, respectively, and the average of such agreements totaled \$64,404 and \$169,371 for 2008 and 2007, respectively. There were no agreements outstanding at December 31, 2008.

Note 10: Income Taxes

During 2008 and 2007, the Company had no income taxes currently payable and generated a deferred tax asset of \$1,635,061 and \$1,294,040. An increase in the deferred tax asset valuation allowance of \$320,322 and \$0 was recorded in 2008 and 2007.

Indiana Business Bancorp
Notes to Consolidated Financial Statements
December 31, 2008 and 2007

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

	<u>2008</u>	<u>2007</u>
Computed at the statutory rate (34%)	\$ (299,191)	\$ (1,544)
Increase (decrease) resulting from		
Other	(34,279)	3,543
Deferred tax asset valuation allowance	352,170	(1,999)
Reduction due to other comprehensive income	-	(18,700)
	<u> </u>	<u> </u>
Actual tax benefit	<u>\$ 18,700</u>	<u>\$ (18,700)</u>

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

	<u>2008</u>	<u>2007</u>
Deferred tax assets		
Allowance for loan losses	\$ 323,435	\$ 210,213
Net operating loss carryforward	1,293,696	959,076
Organization costs	78,020	165,992
Stock options	63,263	50,321
Non accrual of loan interest	2,726	-
Restricted stocks	2,097	-
Other	23,141	17,225
	<u>1,786,378</u>	<u>1,402,827</u>
Deferred tax liabilities		
Prepays	(37,434)	(30,158)
Depreciation	(13,205)	(6,385)
State income tax	(87,339)	(53,544)
Partnership investment	(2,190)	-
Unrealized gains on available-for-sale securities	-	(18,700)
	<u>(140,168)</u>	<u>(108,787)</u>
Net deferred tax asset before valuation allowance	<u>1,646,210</u>	<u>1,294,040</u>
Valuation allowance		
Beginning balance	(1,294,040)	(1,314,739)
(Increase) decrease during the period	(352,170)	20,699
Ending balance	<u>(1,646,210)</u>	<u>(1,294,040)</u>
	<u>\$ -</u>	<u>\$ -</u>

As of December 31, 2008 and 2007, the Company had approximately \$3,219,567 and \$2,413,311 of federal and \$2,506,693 and \$1,690,662 of state net operating loss carryforwards, which both will begin to expire in 2023. With a few exceptions, the Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years before 2006.

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Note 11: Other Comprehensive Income

Other comprehensive income components and related taxes were as follows:

	2008	2007
Unrealized gains on available-for-sale securities	\$ 150,443	\$ 76,849
Less: reclassification adjustment for realized gains included in net income	17,066	-
Tax expense	-	46,409
Other comprehensive income	\$ 133,377	\$ 30,440

Note 12: 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 Bank 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, 2008, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2008 and 2007, 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 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.

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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, 2008						
Total capital						
(to risk-weighted assets)	\$ 10,788	13.9%	\$ 6,210	8.0%	\$ 7,763	10.0%
Tier I capital						
(to risk-weighted assets)	9,813	12.6	3,105	4.0	4,658	6.0
Tier I capital						
(to average assets)	9,813	10.7	3,664	4.0	4,580	5.0
As of December 31, 2007						
Total capital						
(to risk-weighted assets)	\$ 11,415	17.1%	\$ 5,330	8.0%	\$ 6,663	10.0%
Tier I capital						
(to risk-weighted assets)	10,580	15.9	2,665	4.0	3,998	6.0
Tier I capital						
(to average assets)	10,580	14.2	2,976	4.0	3,720	5.0

The Bank is subject to banking laws and regulations that restrict the amount of dividends that it may pay without prior regulatory approval. The Bank was restricted from paying any dividends in its first three years of operation.

Note 13: 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 \$71,050 and \$58,097 in 2008 and 2007, 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 2008 and 2007.

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Note 14: Stock Option Plans

The Company's 2008 Equity Incentive Plan was approved by the Board of Directors to replace the previous 2004 Stock Option and Incentive Plan. The 2008 Plan permits the grant of awards in the form of options and restricted shares to its directors and employees for up to 150,000 shares of common stock. The terms of awarded restricted shares are determined at the grant date and need not be identical among individual participants. The Company believes that such awards better align the interests of its employees with those of its shareholders. Option awards for both plans are generally granted with an exercise price intended to be equal to the market price of the Company's stock at the date of grant; those option awards generally vest based on six months to three years of continuous service, and have ten-year contractual terms.

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.

	2008	2007
Expected volatility	19.85-21.56%	17.54-17.87%
Weighted-average volatility	20.65%	17.72%
Expected dividends	1.50%	1.00%
Expected term (in years)	5	5
Risk-free rate	2.82-3.24%	4.68-4.82%

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A summary of option activity under the Plan as of December 31, 2008, and changes during the year then ended, is presented below:

	2008		Weighted-Average Remaining Contractual Term
	Shares	Weighted-Average Exercise Price	
Outstanding, beginning of year	123,800	\$ 10.21	
Granted	18,850	8.94	
Forfeited	600	9.88	
	<u>142,050</u>	<u>\$ 10.04</u>	<u>8.31</u>
Outstanding, end of year	<u>142,050</u>	<u>\$ 10.04</u>	<u>8.31</u>
Options exercisable, end of year	<u>130,043</u>	<u>\$ 10.04</u>	<u>5.11</u>

The weighted-average grant-date fair value of options granted during 2008 and 2007 was \$1.77 and \$2.43, respectively.

As of December 31, 2008 and 2007, there was \$15,981 and \$15,991, respectively, of total unrecognized compensation cost related to share-based compensation arrangements granted under the Plan. That cost is expected to be recognized over a weighted-average period of 1.75 and 1.80 years for 2008 and 2007, respectively. The Company recognized \$29,996 of compensation expense related to share-based compensation expense in 2008. During 2007, the Company recognized \$48,844 of compensation expense related to the share-based compensation expense.

Note 15: 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.

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Note 16: 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 \$130,857 and \$126,865 for the years ended December 31, 2008 and 2007.

Future minimum lease payments under operating leases are:

	Operating Leases
2009	\$ 29,995

Subsequent to December 31, 2008, the Company agreed to a lease extension through March 31, 2011.

Note 17: Related Party Transactions

At December 31, 2008 and 2007, the Company had loans outstanding to executive officers, directors, significant shareholders and their affiliates (related parties) in the amount of \$2,666,840 and \$3,582,732, 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, 2008 and 2007 totaled \$2,909,572 and \$2,058,626, respectively.

Note 18: 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 Note 19 on commitments and credit risk.

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Note 19: 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, 2008 and 2007, there were \$457,291 and \$187,291 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, 2008 and 2007, the Company had granted unused lines of credit to borrowers aggregating approximately \$14,228,458 and \$10,263,891.

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 December 2010.

Note 20: Disclosures About Fair Values of Assets and Liabilities

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

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FAS 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 participants at the measurement date. FAS 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 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 assets and liabilities measured at fair value on a recurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such assets and liabilities 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 U.S. Government sponsored entities. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

The following table presents the fair value measurements of assets and liabilities recognized in the accompanying consolidated balance sheets measured at fair value on a recurring basis and the level within the FAS 157 fair value hierarchy in which the fair value measurements fall at December 31, 2008:

	Fair Value Measurements Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities	\$ 7,146,900	\$	-	\$ 7,146,900
				-

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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 Financial Accounting Standard No. 114 (FAS 114), *Accounting by Creditors for Impairment of a Loan*. Allowable methods for estimating fair value include using the fair value of the collateral for collateral dependent loans or, where a loan is determined not to be collateral dependent, using the discounted cash flow method.

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 independent appraisal of the collateral and applying a discount factor to the value.

If the impaired loan is determined not to be collateral dependent, then the discounted cash flow method is used. This method requires the impaired loan to be recorded at the present value of expected future cash flows discounted at the loan's effective interest rate. The effective interest rate of a loan is the contractual interest rate adjusted for any net deferred loan fees or costs, premiums or discount existing at origination or acquisition of the loan.

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 FAS 157 fair value hierarchy in which the fair value measurements fall at December 31, 2008:

	Fair Value Measurements Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	\$ 1,028,624	\$ -		\$ 1,028,624

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Note 21: Risks and Uncertainties

The Company's allowance for loan losses contains certain assumptions on the value of collateral dependent loans as well as certain economic and industry conditions which may be subject to change within the next year. These changes could have an adverse impact on the allowance for loan loss in the near term.

Note 22: Subsequent Event

In February 2009, the Board of Directors of the Federal Deposit Insurance Corporation (FDIC) voted to amend the restoration plan for the Deposit Insurance Fund (DIF). The amended restoration plan extended the period of time to raise the DIF reserve ratio to 1.15 percent from five to seven years. The amended restoration plan also includes a final rule that sets assessment rates. Under this final rule, beginning on April 1, 2009, the Company expects the FDIC premium assessed to the Company to increase.

The Board of the FDIC also adopted an interim rule imposing a 10 basis point special assessment on insured institutions as of June 30, 2009, which will be payable on September 30, 2009. The interim rule would also allow the assessment of additional special assessments of up to 10 basis points after June 30, 2009 as deemed necessary. Comments on the interim rule are due within 30 days of publication in the Federal Register.

While the Company has not fully evaluated the impact the increased assessment rates and the pending special assessment will have on the 2009 financial results, it is anticipated the impact will be material to the 2009 results of operations.

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