



**Indiana
Business BancorpSM**

Focused. Responsive. Experienced.

2010 ANNUAL REPORT

INDIANA BUSINESS BANCORP

2010 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</u>	<u>Low</u>
Year Ended December 31, 2010:		
First quarter ⁽¹⁾	\$ 4.00	\$ 4.00
Second quarter	\$ 10.01	\$ 4.10
Third quarter	\$ 6.10	\$ 3.90
Fourth quarter	\$ 3.90	\$ 2.25

<u>Quarterly Periods</u>	<u>High</u>	<u>Low</u>
Year Ended December 31, 2009:		
First quarter	\$ 4.95	\$ 2.25
Second quarter	\$ 4.75	\$ 2.00
Third quarter	\$ 4.00	\$ 3.25
Fourth quarter	\$ 4.00	\$ 3.90

⁽¹⁾ There were no trades during the first quarter of 2010.

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
Monroe Securities, Inc.



Indiana Business BancorpSM

April 5, 2011

Dear Fellow Shareholders:

We entered 2010 with the expectation of a challenging economy for our clients and, by extension, Indiana Business Bank. The magnitude of the decline in real estate values that we continue to experience, however, has been well beyond anything experienced by the Bank's management team in their twenty five year plus banking careers. Market conditions dictated that we liquidate or adjust the carrying values for a number of real estate loans at substantial discounts to the original appraised values. The result was a substantial loan loss provision for 2010. This obviously had a negative impact on earnings. We responded to the challenges of 2010 by taking steps to improve our net interest margin going forward and by adjusting our operating expense structure. While 2010 was a difficult year, we believe that we have taken the necessary steps to position the Company for profitable operations in 2011.

Net interest income for 2010 was essentially unchanged from 2009 at \$2,986,247. Although gross interest income decreased due to lower outstanding loan balances and decreasing yields in the investment portfolio, we were able to maintain net interest income because the cost of funds decreased throughout the year. Non-interest income (comprised of service charges, fees on sales of government guaranteed loans and income from other real estate owned) totaled \$536,483. This represented an increase of \$254,845 or a 90% increase over 2009. The 2010 results were positively impacted by a legal recovery and 2009 was negatively impacted by valuation write downs. These non-recurring events accounted for \$235,882 of the year over year increase.

Non-interest expenses, generally salaries and other operating expenses, decreased by 8% year over year, from \$2,978,708 in 2009 to \$2,739,338 in 2010, due primarily to decreases in salaries and employee benefits, professional fees and lower other real estate owned expense.

The net loss for the year was \$1,737,858, compared to a profit of \$17,139 in 2009. The loss was a result of our provision for loan loss expense of \$2,521,250 for 2010, compared

to an expense of \$278,888 during 2009. At December 31, 2010 our allowance for loan and lease loss was \$1,507,164, or 2.32% of gross loans.

Assets contracted 9% during 2010, from \$88,341,401 at December 31, 2009, to \$80,518,284 at the end of 2010. The bulk of this reduction followed from our decision to exit several commercial relationships, which resulted in a 9% decrease in loans, from \$70,184,239 at December 31, 2009 to \$63,582,087 at December 31, 2010. The proceeds from the loan portfolio allowed us to let higher cost certificate of deposits run off, thereby reducing the overall cost of funds, while still maintaining strong liquidity.

Total deposits decreased from \$72,385,956 at year end 2009 to \$65,560,836 at December 31, 2010. The entire decrease was from maturing certificate of deposits.

We will continue to support central Indiana small businesses and their owners. While we remain selective in our credit underwriting process, I am committed to Indiana Business Bank remaining a strong source of credit and other important banking services to Hoosier entrepreneurs.

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

Sincerely,

A handwritten signature in black ink, appearing to read "James S. Young". The signature is fluid and cursive, with the first name "James" being the most prominent part.

James S. Young
President & CEO

Financial Summary for Indiana Business Bancorp

AUDITED

	As of and for the Twelve Months Ending December 31, 2010	As of and for the Twelve Months Ending December 31, 2009
Operating Data		
Net Interest Income	2,986,247	2,993,097
Provision for Loan Losses	2,521,250	278,888
Noninterest Income	536,483	281,638
Noninterest Expense	2,739,338	2,978,708
Net Income (Loss)	(1,737,858)	17,139
Per Share Data		
Net Earnings (Loss) – Basic	(1.16)	N/A
Weighted Average Shares Outstanding	1,503,270	1,494,325

	As of December 31, 2010	As of December 31, 2009
Balance Sheet Data		
Total Assets	80,518,284	88,341,401
Net Loans	63,582,087	70,184,239
Allowance for Loan Losses	1,507,164	1,130,698
Investment Securities	7,061,850	6,535,600
Total Deposits	65,560,836	72,385,956
Total Shareholders' Equity	8,076,743	9,774,803

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, 2010 and 2009, 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, 2010 and 2009, 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 29, 2011

Indiana Business Bancorp
Consolidated Balance Sheets
December 31, 2010 and 2009

Assets

	2010	2009
Cash and due from banks	\$ 737,879	\$ 1,119,357
Interest-bearing demand deposits	6,173,807	6,784,155
Total cash and cash equivalents	6,911,686	7,903,512
Available-for-sale securities	7,061,850	6,535,600
Loans, net of allowance for losses of \$1,507,164 and \$1,130,698	63,582,087	70,184,239
Furniture and equipment, net of accumulated depreciation of \$694,932 and \$604,566	113,541	200,920
Federal Home Loan Bank stock	406,900	425,000
Prepaid FDIC assessment	495,392	669,144
Other real estate owned	1,480,887	1,277,212
Interest receivable and other assets	465,941	1,145,774
Total assets	\$ 80,518,284	\$ 88,341,401

Liabilities and Stockholders' Equity

Liabilities

Deposits		
Demand	\$ 18,975,955	\$ 18,426,043
Savings	418,435	131,406
Certificates of deposit	46,166,446	53,828,507
Total deposits	65,560,836	72,385,956
Borrowings	6,739,490	6,000,000
Interest payable and other liabilities	141,215	180,642
Total liabilities	72,441,541	78,566,598

Stockholders' Equity

Common stock, \$1 par value; authorized 4,000,000 shares; issued and outstanding 2010 - 1,503,270 shares, 2009 - 1,494,325 shares	1,484,100	1,484,100
Additional paid-in capital	12,492,394	12,458,394
Accumulated deficit	(5,937,103)	(4,199,245)
Accumulated other comprehensive income	37,352	31,554
Total stockholders' equity	8,076,743	9,774,803
Total liabilities and stockholders' equity	\$ 80,518,284	\$ 88,341,401

Indiana Business Bancorp
Consolidated Statements of Operations
Years Ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Interest Income		
Loans	\$ 4,207,391	\$ 4,678,757
Securities - taxable	177,618	307,850
Federal funds sold	-	989
Other	7,970	12,217
Total interest income	<u>4,392,979</u>	<u>4,999,813</u>
Interest Expense		
Deposits	1,206,910	1,719,025
Borrowings	199,822	287,691
	<u>1,406,732</u>	<u>2,006,716</u>
Net Interest Income	2,986,247	2,993,097
Provision for Loan Losses	<u>2,521,250</u>	<u>278,888</u>
Net Interest Income After Provision for Loan Losses	<u>464,997</u>	<u>2,714,209</u>
Noninterest Income		
Net gains and fees on sale of loans	159,280	207,922
Service charges and fees	102,408	105,853
Income from other real estate owned	146,787	65,767
Gain (loss) on other real estate owned	1,126	(58,000)
Realized loss on investments	-	(51,000)
Other	126,882	11,096
Total noninterest income	<u>536,483</u>	<u>281,638</u>
Noninterest Expense		
Salaries and employee benefits	1,324,559	1,427,038
Occupancy expense	139,580	131,558
Equipment expense	114,327	134,578
Data processing fees	240,717	241,371
Professional fees	235,417	326,677
Marketing expense	2,490	4,485
Travel and entertainment	27,082	33,902
FDIC assessment	186,636	198,684
Other real estate owned expense	129,845	189,923
Loan expense	120,705	76,129
Other	217,980	214,363
Total noninterest expense	<u>2,739,338</u>	<u>2,978,708</u>
Net Income (Loss)	<u>\$ (1,737,858)</u>	<u>\$ 17,139</u>

Indiana Business Bancorp
Consolidated Statements of Stockholders' Equity
Years Ended December 31, 2010 and 2009

	<u>Common Stock</u>		Comprehensive Loss	Accumulated Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total
	Shares	Amount					
Balances, January 1, 2009	1,484,100	\$ 1,484,100		\$ 12,439,545	\$ (4,216,384)	\$ 161,893	\$ 9,869,154
Net income			\$ 17,139		17,139		17,139
Other comprehensive loss							
Unrealized losses on available-for-sale securities, net of reclassification adjustment			(130,339)			(130,339)	(130,339)
Total other comprehensive loss			<u>\$ (113,200)</u>				
Issuance of restricted shares	10,225						
Amortization of unearned compensation expense				18,849			18,849
Balances, December 31, 2009	1,494,325	1,484,100		12,458,394	(4,199,245)	31,554	9,774,803
Net loss			\$ (1,737,858)		(1,737,858)		(1,737,858)
Other comprehensive income							
Unrealized gains on available-for-sale securities, net of reclassification adjustment			5,798			5,798	5,798
Total other comprehensive loss			<u>\$ (1,732,060)</u>				
Issuance of restricted shares	8,945						
Amortization of unearned compensation expense				34,000			34,000
Balances, December 31, 2010	<u>1,503,270</u>	<u>\$ 1,484,100</u>		<u>\$ 12,492,394</u>	<u>\$ (5,937,103)</u>	<u>\$ 37,352</u>	<u>\$ 8,076,743</u>

Indiana Business Bancorp
Consolidated Statements of Cash Flows
Years Ended December 31, 2010 and 2009

	2010	2009
Operating Activities		
Net income (loss)	\$ (1,737,858)	\$ 17,139
Items not requiring (providing) cash		
Depreciation and amortization	90,367	105,636
Provision for loan losses	2,521,250	278,888
Accretion on securities, net	(20,452)	(6,975)
Realized gain on securities	-	51,000
(Gain) loss on writedown of other real estate	(1,126)	58,000
Share-based compensation	34,000	18,849
Changes in		
Interest receivable and other assets	679,833	(563,674)
Prepaid FDIC assessment	173,752	(669,144)
Interest payable and other liabilities	(39,427)	(46,621)
Net cash provided by (used in) operating activities	1,700,339	(756,902)
Investing Activities		
Purchases of available-for-sale securities	(7,500,000)	(5,512,064)
Proceeds from maturities and calls of available-for-sale securities	7,000,000	6,000,000
Proceeds from sale of other real estate	573,874	-
Capitalized expenses on other real estate	(11,763)	(135,211)
Net change in loans	3,316,242	6,652,774
Purchases of premises and equipment	(2,988)	(43,872)
Redemption of Federal Home Loan Bank stock	18,100	-
Net cash provided by investing activities	3,393,465	6,961,627
Financing Activities		
Net increase in demand deposits and savings accounts	935,941	2,306,184
Net decrease in certificates of deposit	(7,761,061)	(1,302,473)
Net increase in secured borrowings	239,490	-
Proceeds from Federal Home Loan Bank advances	1,000,000	-
Repayment of Federal Home Loan Bank advances	(500,000)	(2,500,000)
Net cash used in financing activities	(6,085,630)	(1,496,289)
Increase (Decrease) in Cash and Cash Equivalents	(991,826)	4,708,436
Cash and Cash Equivalents, Beginning of Year	7,903,512	3,195,076
Cash and Cash Equivalents, End of Year	\$ 6,911,686	\$ 7,903,512
Supplemental Cash Flows Information		
Interest paid	\$ 1,388,783	\$ 2,039,727
Transfer of loans to other real estate owned	764,660	-

Indiana Business Bancorp
Notes to Consolidated Financial Statements
December 31, 2010 and 2009

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 and the Bank. 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, valuation of real estate acquired in connection with foreclosures or in satisfaction of loans and fair value of financial instruments. 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. At December 31, 2010 and 2009, cash equivalents consisted primarily of money market accounts.

The financial institutions holding the Company's cash accounts are participating in the FDIC's Transaction Account Guarantee Program. Under that program, through December 31, 2010, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account. Pursuant to legislation enacted in 2010, the FDIC will fully insure all noninterest-bearing transaction accounts beginning December 31, 2010 through December 31, 2012, at all FDIC-insured institutions.

Indiana Business Bancorp

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

Effective July 21, 2010, the FDIC's insurance limits were permanently increased to \$250,000. At December 31, 2010, the Company's interest-bearing cash accounts exceeded federally insured limits by approximately \$1,253,000. The Company also had uninsured accounts of approximately \$4,665,000 at the Federal Reserve and the Federal Home Loan Bank.

Interest-Bearing Demand Deposits

Interest-bearing deposits in banks mature within one year and are carried at cost.

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.

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 unearned income, charge-offs and the allowance for loan losses.

For loans amortized at cost, interest income is accrued based on the unpaid principal balance.

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged off are reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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 uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

Indiana Business Bancorp

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

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 historical experience, 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 allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired. For those loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers nonclassified loans and is based on historical charge-off experience and expected loss given default derived from the Company's internal risk rating process. Other adjustments may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss or risk rating data.

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.

Groups of loans with similar risk characteristics are collectively evaluated for impairment based on the group's historical loss experience adjusted for changes in trends, conditions and other relevant factors that affect repayment of the loans. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment measurements, unless such loans are the subject of a restructuring agreement due to financial difficulties of the borrower.

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, 2010 and 2009

Foreclosed Assets Held for Sale

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net income or expense from foreclosed assets.

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. The Bank has agreed with its regulators that it will not declare or pay any dividends without prior written approval.

Stock-Based Compensation

At December 31, 2010, the Company has a share-based employee compensation plan, which is described more fully in Note 12.

Income Taxes

The Company accounts for income taxes in accordance with income tax accounting guidance (ASC 740, *Income Taxes*). The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur. Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized. 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 Consolidated Financial Statements

December 31, 2010 and 2009

Uncertain tax positions are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances and information available at the reporting date and is subject to management's judgment.

The Company recognizes interest and penalties on income taxes as a component of income tax expense. The Company files consolidated income tax returns with its subsidiary.

Current Economic Conditions

The current protracted economic decline continues to present financial institutions with circumstances and challenges, which in some cases have resulted in large and unanticipated declines in the fair values of investments and other assets, constraints on liquidity and capital and significant credit quality problems, including severe volatility in the valuation of real estate and other collateral supporting loans.

At December 31, 2010, the Company held \$35,469,000 in commercial real estate loans. Due to national, state and local economic conditions, values for commercial and development real estate have declined significantly, and the market for these properties is depressed.

The accompanying 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 2009 consolidated financial statements to conform to the 2010 consolidated 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, 2010 was \$25,000.

Indiana Business Bancorp
Notes to Consolidated Financial Statements
December 31, 2010 and 2009

Note 3: Securities

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-Sale Securities:				
December 31, 2010				
U.S. Government agency securities	\$ 7,024,498	\$ 43,192	\$ (5,840)	\$ 7,061,850
December 31, 2009				
U.S. Government agency securities	\$ 6,504,046	\$ 41,205	\$ (9,651)	\$ 6,535,600

The amortized cost and fair value of securities available for sale at December 31, 2010, 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	\$ 5,501,436	\$ 5,519,650
Five years or more	1,523,062	1,542,200
Totals	\$ 7,024,498	\$ 7,061,850

Realized losses recognized on available-for-sale securities during 2010 and 2009 amounted to \$0 and \$51,000, respectively. There were no securities sold in 2010 and 2009.

Certain investment securities are reported in the consolidated financial statements at an amount less than their historical cost. Total fair value of these investments at December 31, 2010 and 2009 was \$3,003,800 and \$1,003,000, which is approximately 42% and 15%, respectively, of the Company's available-for-sale portfolio. U.S. Government agency securities unrealized losses at December 31, 2010 totaled approximately \$6,000 and were held at this position for a period of less than 12 months. U.S Government agency securities at an unrealized loss position at December 31, 2009 totaled approximately \$9,700 and were held at this position for a period of less than 12 months.

The unrealized losses on the Company's investments in direct obligations of U.S. Government agencies were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Company does not intend to sell the investments and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2010.

Indiana Business Bancorp
Notes to Consolidated Financial Statements
December 31, 2010 and 2009

Note 4: Loans and Allowance for Loan Losses

Loans at December 31 include:

	2010	2009
Construction and development	\$ 4,609,874	\$ 6,630,636
Farmland	1,465,299	1,438,449
Commercial real estate	35,468,550	37,442,255
Multi-family	1,642,652	1,721,974
Home equity loans	4,864,391	4,500,918
Residential loans	5,728,513	6,260,949
Commercial and industrial	10,455,922	12,506,971
Loans to individuals	854,050	812,785
Total loans	<u>65,089,251</u>	<u>71,314,937</u>
Less: allowance for loan losses	<u>(1,507,164)</u>	<u>(1,130,698)</u>
Net loans	<u><u>\$ 63,582,087</u></u>	<u><u>\$ 70,184,239</u></u>

Activity in the allowance for loan losses was as follows:

	2010	2009
Balance, beginning of year	\$ 1,130,698	\$ 1,344,796
Provision charged to expense	2,521,250	278,888
Charge-offs	(2,160,742)	(494,199)
Recoveries	15,958	1,213
Balance, end of year	<u><u>\$ 1,507,164</u></u>	<u><u>\$ 1,130,698</u></u>

Indiana Business Bancorp

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

The following tables present the balance in the allowance for loan losses and the recorded investment in loans based on the portfolio segment and impairment method as of December 31, 2010:

	Construction and Development	Farmland	Commercial Real Estate	Multi-family	Home Equity	Residential	Commercial and Industrial	Loans to Individuals	Total
Allowance Balances:									
Individually evaluated for impairment	\$ -	\$ -	\$ 400,000	\$ -	\$ 50,000	\$ -	\$ 75,000	\$ -	\$ 525,000
Collectively evaluated for impairment	261,998	15,999	426,718	33,676	82,969	108,409	43,403	8,992	982,164
Total allowance for loan losses	\$ 261,998	\$ 15,999	\$ 826,718	\$ 33,676	\$ 132,969	\$ 108,409	\$ 118,403	\$ 8,992	\$ 1,507,164
Loan Balances:									
Individually evaluated for impairment	\$ 2,254,639	\$ -	\$ 2,658,731	\$ 691,912	\$ 367,345	\$ 940,097	\$ 596,290	\$ -	\$ 7,509,014
Collectively evaluated for impairment	2,355,235	1,465,299	32,809,819	950,740	4,497,046	4,788,416	9,859,632	854,050	57,580,237
Total loan balances	\$ 4,609,874	\$ 1,465,299	\$ 35,468,550	\$ 1,642,652	\$ 4,864,391	\$ 5,728,513	\$ 10,455,922	\$ 854,050	\$ 65,089,251

The following tables present the credit risk profile of the Company's loan portfolio based on rating category and payment activity as of December 31, 2010:

	Construction and Development	Farmland	Commercial Real Estate	Multi-family	Home Equity	Residential	Commercial and Industrial	Loans to Individuals	Total
Grade:									
Pass (1-5)	\$ 2,355,235	\$ 1,465,299	\$ 32,809,819	\$ 950,740	\$ 4,497,046	\$ 4,920,732	\$ 9,571,170	\$ 854,050	\$ 57,424,091
Special mention (6)	-	-	-	-	-	-	372,107	-	372,107
Substandard (7)	2,254,639	-	2,658,731	691,912	367,345	807,781	512,645	-	7,293,053
Doubtful (8)	-	-	-	-	-	-	-	-	-
Loss (9)	-	-	-	-	-	-	-	-	-
Total	\$ 4,609,874	\$ 1,465,299	\$ 35,468,550	\$ 1,642,652	\$ 4,864,391	\$ 5,728,513	\$ 10,455,922	\$ 854,050	\$ 65,089,251

Loan grades are numbered 1 through 9. Grades 1-5 are "pass" credits, grades 6 (Other Assets Especially Mentioned) are "special mention" credits, 7 (Substandard), 8 (Doubtful) and 9 (Loss) are "classified" assets. The use and application of these grades by the bank will be uniform and shall conform to the bank's policy.

Prime (1) Loans are of superior quality with excellent credit strength and repayment ability proving a nominal credit risk.

Excellent (2) Loans are of above average credit strength and repayment ability providing only a minimal credit risk.

Good (3) Loans are of good credit strength and repayment ability proving a modest credit risk.

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Satisfactory (4) Loans of reasonable credit strength and repayment ability proving an average credit risk due to one or more underlying weaknesses.

Monitored (5) Loans of the lowest acceptable credit strength and weakened repayment ability providing a cautionary credit risk due to one or more underlying weaknesses. New borrowers are typically not underwritten within this classification.

Special Mention (6) A special mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. Ordinarily, special mention credits have characteristics which corrective management action would remedy.

Substandard (7) loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful (8) Loans classified as doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of current known facts, conditions and values, highly questionable and improbable.

Loss (9) Loans classified as loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off even though partial recovery may be affected in the future.

The following tables present the Company's loan portfolio aging analysis as of December 31, 2010:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans
Loans Secured by Real Estate:						
Construction and development	\$ 1,190,358	\$ -	\$ -	\$ 1,190,358	\$ 3,419,516	\$ 4,609,874
Farmland	-	-	-	-	1,465,299	1,465,299
Commercial real estate	-	209,766	-	209,766	35,258,784	35,468,550
Multi-family	-	-	-	-	1,642,652	1,642,652
Home equity loans	77,339	-	191,961	269,300	4,595,091	4,864,391
Residential	-	-	672,941	672,941	5,055,572	5,728,513
Commercial and industrial	-	283,814	-	283,814	10,172,108	10,455,922
Loans to individuals	-	-	-	-	854,050	854,050
	<u>\$ 1,267,697</u>	<u>\$ 493,580</u>	<u>\$ 864,902</u>	<u>\$ 2,626,179</u>	<u>\$ 62,463,072</u>	<u>\$ 65,089,251</u>
Total loans						

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The following table presents the Company's nonaccrual loans at December 31, 2010:

	2010
Construction and development	\$ 65,918
Commercial real estate	2,044,287
Multi-family	691,912
Home equity loans	367,346
Residential	672,941
Commercial and industrial	329,141
Total nonaccrual loans	\$ 4,171,545

A loan is considered impaired, in accordance with the impairment accounting guidance (ASC 310-10-35-16), when based on current information and events, it is probable the Company will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Impaired loans include nonperforming commercial loans but also include loans modified in troubled debt restructurings where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection.

The following tables present impaired loans for the years ended December 31, 2010:

	Recorded Balance	Unpaid Principal Balance	Specific Allowance	Average Investment in Impaired Loans	Interest Income Recognized
Loans without a specific valuation allowance:					
Construction and development	\$ 2,254,639	\$ 2,598,918	\$ -	\$ 1,571,697	\$ 131,952
Commercial real estate	1,440,857	1,579,450	-	1,841,354	31,462
Multi-family	691,912	1,369,774	-	669,758	-
Home equity loans	269,299	699,916	-	450,954	-
Residential	940,097	953,080	-	712,277	-
Commercial and industrial	267,149	310,918	-	268,980	16,085
Loans to individuals	-	5,923	-	3,851	-
Total impaired loans with no related specific reserve	\$ 5,863,953	\$ 7,517,979	\$ -	\$ 5,518,872	\$ 179,498
Impaired loans with a specific valuation allowance:					
Commercial real estate	\$ 1,217,874	\$ 1,306,630	\$ 400,000	\$ 866,854	\$ 420
Home equity loans	98,046	100,000	50,000	39,409	-
Commercial and industrial	329,141	334,126	75,000	285,940	853
Total impaired loans with an allowance recorded	\$ 1,645,061	\$ 1,740,756	\$ 525,000	\$ 1,192,203	\$ 1,273
Total impaired loans	\$ 7,509,014	\$ 9,258,735	\$ 525,000	\$ 6,711,075	\$ 180,771

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Impaired loans totaled \$5,648,000 at December 31, 2009. A specific allowance for loan losses of \$327,000 relates to impaired loans of \$718,000 at December 31, 2009. At December 31, 2009, impaired loans of \$4,931,000, had no related specific allowance for loan losses.

Interest of \$190,000 was recognized on average impaired loans of \$4,292,000 for 2009. Interest of \$41,000 was recognized on impaired loans on a cash basis during 2009.

At December 31, 2010 and 2009, there were no loans delinquent 90 days or more and still accruing interest. Nonaccruing loans at December 31, 2009 were \$4,615,000.

Note 5: Furniture and Equipment

	<u>2010</u>	<u>2009</u>
Autos	\$ 65,838	\$ 65,838
Furniture and equipment	733,549	730,562
Leasehold improvements	9,086	9,086
Total cost	<u>808,473</u>	<u>805,486</u>
Accumulated depreciation	<u>(694,932)</u>	<u>(604,566)</u>
Net furniture and equipment	<u>\$ 113,541</u>	<u>\$ 200,920</u>

Note 6: Certificates of Deposit

Interest-bearing time deposits in denominations of \$100,000 or more were \$19,159,000 and \$19,530,000 on December 31, 2010 and 2009, respectively.

At December 31, 2010, the scheduled maturities of time deposits are as follows:

2011	\$ 25,843,614
2012	15,005,832
2013	4,278,000
2015	<u>1,039,000</u>
	<u>\$ 46,166,446</u>

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Note 7: Borrowings

Borrowings consisted of the following components:

	2010	2009
Federal Home Loan Bank advances	\$ 6,500,000	\$ 6,000,000
Secured borrowings - SBA loans	239,490	-
Total borrowings	\$ 6,739,490	\$ 6,000,000

The Company has Federal Home Loan Bank advances with interest rates ranging from 1.93% to 3.78%, which are due at various dates through May 2013.

The maturities of the advances at December 31, 2010 are as follows:

2011	\$ 3,500,000
2012	500,000
2013	2,500,000
	\$ 6,500,000

First commercial mortgage loans and investment securities totaling \$10,731,000 and \$11,683,000, respectively, were pledged as collateral for FHLB advances at December 31, 2010 and 2009. 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 8: Income Taxes

During 2010 and 2009, the Company had no income taxes currently payable and generated a deferred tax asset of approximately \$2,315,000 and \$1,638,000, respectively. An increase (decrease) in the deferred tax asset valuation allowance of approximately \$678,000 and \$(9,000) was recorded in 2010 and 2009, respectively.

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

	<u>2010</u>	<u>2009</u>
Computed at the statutory rate (34%)	\$ (590,872)	\$ 5,827
Increase (decrease) resulting from		
State income tax	(91,759)	905
Other	4,821	1,941
Deferred tax asset valuation allowance	<u>677,810</u>	<u>(8,673)</u>
Actual tax benefit	<u>\$ -</u>	<u>\$ -</u>

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

	<u>2010</u>	<u>2009</u>
Deferred tax assets		
Allowance for loan losses	\$ 424,343	\$ 315,702
Net operating loss carryforward	1,848,829	1,307,340
Stock options	81,334	78,719
Nonaccrual of loan interest	89,413	29,787
Restricted stocks	7,619	2,097
Other real estate owned write-down	-	14,790
Capital loss	21,430	21,390
Other	36,736	25,674
	<u>2,509,704</u>	<u>1,795,499</u>
Deferred tax liabilities		
Prepays	(48,058)	(48,709)
Depreciation	(8,432)	(19,206)
State income tax	(134,014)	(87,339)
Other real estate owned write-down	(1,587)	-
Partnership investment	(2,266)	(2,708)
	<u>(194,357)</u>	<u>(157,962)</u>
Net deferred tax asset before valuation allowance	<u>2,315,347</u>	<u>1,637,537</u>
Valuation allowance		
Beginning balance	(1,637,537)	(1,646,210)
(Increase) decrease during the period	(677,810)	8,673
Ending balance	<u>(2,315,347)</u>	<u>(1,637,537)</u>
	<u>\$ -</u>	<u>\$ -</u>

As of December 31, 2010 and 2009, the Company had approximately \$4,521,000 and \$3,207,000 of federal and \$3,888,000 and \$2,735,000 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 9: Other Comprehensive Income (Loss)

Other comprehensive income components and related taxes were as follows:

	2010	2009
Unrealized gains (losses) on available-for-sale securities	\$ 5,798	\$ (181,339)
Less: reclassification adjustment for realized losses included in net income	-	(51,000)
Other comprehensive income (loss)	\$ 5,798	\$ (130,339)

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 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, 2010, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2010 and 2009, 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. The Bank has agreed with its regulators to maintain Tier 1 capital and Total Risk-Based capital ratios equal to or exceeding 9% and 12%.

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

	Actual		Minimum Required for Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2010						
Total capital						
(to risk-weighted assets)	\$ 8,852	13.7%	\$ 5,152	8.0%	\$ 6,440	10.0%
Tier I capital						
(to risk-weighted assets)	8,039	12.5	2,576	4.0	3,864	6.0
Tier I capital						
(to average assets)	8,039	9.4	3,417	4.0	4,271	5.0
As of December 31, 2009						
Total capital						
(to risk-weighted assets)	\$ 10,641	14.9%	\$ 5,271	8.0%	\$ 7,140	10.0%
Tier I capital						
(to risk-weighted assets)	9,745	13.6	2,856	4.0	4,284	6.0
Tier I capital						
(to average assets)	9,745	10.7	3,649	4.0	4,562	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.

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. In 2009, the Company discontinued 401k matching provision. Before suspending the contribution, the Company matched 100% of the employee's contribution on the first 6% of the employees' compensation, which amounted to expense of \$19,000 in 2009. The Company may also provide a discretionary profit-sharing contribution to be determined annually by management. There was no discretionary profit-sharing contribution in 2010 and 2009.

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Note 12: 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. Share awards will ratably vest over three years.

The fair value of each option award is estimated on the date of grant using the Black-Scholes. There were no options issued or exercised in 2010.

A summary of option activity under the Plan as of December 31, 2010, and changes during the year then ended, is presented below:

	2010		
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term
Outstanding, beginning of year	141,750	\$ 10.04	
Forfeited	(1,500)	10.10	
Outstanding, end of year	<u>140,250</u>	<u>\$ 10.04</u>	<u>4.72</u>
Options exercisable, end of year	<u>138,685</u>	<u>\$ 10.05</u>	<u>2.37</u>

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A summary of the status of the Company's nonvested shares (restricted shares) as of December 31, 2010, and changes during the year then ended, is presented below:

	Shares	2010 Weighted- Average Grant Date Fair Value
Outstanding, beginning of year	10,225	\$ 2.96
Granted	8,945	10.01
Outstanding, end of year	19,170	\$ 7.20

As of December 31, 2010 and 2009, there was \$85,000 and \$30,000, 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 2.42 years for 2010 and 2009. The Company recognized \$34,000 and \$19,000 of compensation expense related to share-based compensation expense in 2010 and 2009, respectively.

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 June 30, 2014. Rental expense for this lease was \$133,000 and \$129,000 for the years ended December 31, 2010 and 2009, respectively.

Future minimum lease payments under operating leases are:

	Operating Leases
2011	\$ 119,155
2012	122,263
2013	124,316
2014	66,309
	\$ 432,043

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Note 15: Related Party Transactions

At December 31, 2010 and 2009, the Company had loans outstanding to executive officers, directors, significant shareholders and their affiliates (related parties) in the amount of approximately \$3,480,000 and \$3,500,000, 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, 2010 and 2009 totaled approximately \$3,700,000 and \$2,007,000, respectively.

Note 16: 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, 2010 and 2009, there were \$56,000 and \$318,000 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, 2010 and 2009, the Company had granted unused lines of credit to borrowers aggregating approximately \$8,777,000 and \$12,187,000, respectively.

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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 and are renewed for a successive term of 1 year unless written notice is provided of termination 60 days before the scheduled expiration.

Note 17: Disclosures About Fair Values of Assets and Liabilities

ASC Topic 820, *Fair Value Measurements*, 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. Topic 820 also specifies 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 and inputs used for assets 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 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 agency securities.

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Level 2 securities are valued by a third-party pricing service commonly used in the banking industry, utilizing observable inputs. Observable inputs include dealer quotes, market spreads, cash flow analysis, the U.S. Treasury curve, trade execution data, market consensus prepayment spreads and available credit information. The pricing provider utilizes evaluated pricing models that are based on asset class. These models incorporate available market information including quoted prices of securities with similar characteristics and, because many fixed income securities do not trade on a daily basis, apply available information through processes such as matrix pricing.

In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

The following tables present the fair value measurements of assets recognized in the accompanying consolidated balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2010 and 2009:

	2010			
	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)	
U.S. Government agency securities	<u>\$ 7,061,850</u>	<u>\$ -</u>	<u>\$ 7,061,850</u>	<u>\$ -</u>

	2009			
	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)	
U.S. Government agency securities	<u>\$ 6,535,600</u>	<u>\$ -</u>	<u>\$ 6,535,600</u>	<u>\$ -</u>

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Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a nonrecurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy.

Impaired Loans (Collateral Dependent)

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. Allowable methods for estimating fair value include using the fair value of the collateral for collateral dependent loans.

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.

Impaired loans that are collateral dependent are classified within Level 3 of the fair value hierarchy when impairment is determined using the fair value method.

Other Real Estate Owned

The fair value of real estate is generally determined based on appraisals by qualified licensed appraisers. The appraisers typically determine the value of the real estate by utilizing an income or market valuation approach. If an appraisal is not available, the fair value may be determined by using a cash flow analysis.

The following tables present the fair value measurements of assets and liabilities measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2010 and 2009:

	2010			
	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	\$ 854,545	\$ -	\$ -	\$ 854,545

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	2009			
	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	\$ 720,506	\$ -	\$ -	\$ 720,506
Other real estate owned	542,000	-	-	542,000
	\$ 1,262,506	\$ -	\$ -	\$ 1,262,506

Note 18: Subsequent Events

Subsequent events have been evaluated through March 29, 2011, which is the date the consolidated financial statements were available to be issued

BOARD OF DIRECTORS

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Real Estate Professional

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Partner, Baker & Daniels, LLP

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Corporation

Patrick J. Early
President, Somerset CPA's

Gregory G. Gault
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President, Godby Heating & Air Conditioning

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Chief Executive Officer

EXECUTIVE OFFICERS

James S. Young
Chief Executive Officer

Gregory G. Gault
Secretary

Dana H. Dillard
Chief Financial Officer

INDEPENDENT ACCOUNTANTS

BKD, LLP

