

THIRD CENTURY BANCORP  
Form 10QSB  
November 14, 2005

**SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-QSB**

(Mark one)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2005

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934 FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

Commission file number: 000-50828

**THIRD CENTURY BANCORP**

(Exact name of small business issuer as specified in its charter)

Indiana  
(State or other jurisdiction of  
incorporation or organization)

20-0857725  
(I.R.S. Employer  
Identification Number)

80 East Jefferson Street  
Franklin, Indiana 46131  
(Address of principal executive offices)

(317) 736-7151  
(Issuer's telephone number)

**APPLICABLE ONLY TO CORPORATE ISSUERS**

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: October 31, 2005 - 1,653,125 common shares

Transitional Small Business Disclosure Format (Check one): Yes  No

THIRD CENTURY BANCORP  
FORM 10-QSB

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**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

**THIRD CENTURY BANCORP**  
Consolidated Condensed Balance Sheets

	As of September 30, 2005 (Unaudited)	As of December 31, 2004
	(in thousands)	
<b>Assets</b>		
Cash and due from banks	\$ 514	\$ 734
Interest-bearing demand deposits	5,445	11,323
Cash and cash equivalents	5,959	12,057
Interest-bearing time deposits	200	200
Held to maturity securities	10,272	10,455
Loans, net of allowance for loan losses of \$939 and \$1,012	103,520	98,822
Premises and equipment	2,750	2,136
Federal Home Loan Bank stock	1,041	1,019
Interest receivable	620	483
Other assets	1,131	991
<b>Total assets</b>	<b>\$ 125,493</b>	<b>\$ 126,163</b>
<b>Liabilities</b>		
Deposits		
Demand	\$ 9,042	\$ 11,164
Savings, NOW and money market	40,737	39,672
Time	34,668	35,572
Total deposits	84,447	86,408
Federal Home Loan Bank Advances	17,500	16,500
Other liabilities	667	358
<b>Total liabilities</b>	<b>102,614</b>	<b>103,266</b>
<b>Commitments and Contingencies</b>		
<b>Equity Contributed by ESOP</b>	169	64
<b>Stockholders' Equity</b>		
Preferred stock, without par value, authorized and unissued 2,000,000 shares		-
Common stock, without par value		
Authorized - 20,000,000 shares		
Issued and outstanding - 1,653,125 shares	14,290	14,290
Unearned RRP shares	(283)	-
Retained earnings	8,703	8,543
<b>Total stockholders' equity</b>	<b>22,710</b>	<b>22,833</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 125,493</b>	<b>\$ 126,163</b>

See notes to consolidated condensed financial statements.



**THIRD CENTURY BANCORP**  
Consolidated Condensed Statements of Income  
(Unaudited)

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
	(in thousands, except share data)			
<b>Interest income</b>				
Loans receivable	\$ 1,615	\$ 1,437	\$ 4,702	\$ 4,333
Investment securities	103	18	248	22
Federal Home Loan Bank stock	11	11	31	37
Interest-bearing deposits	32	47	132	79
<b>Total interest income</b>	<b>1,761</b>	<b>1,513</b>	<b>5,113</b>	<b>4,471</b>
<b>Interest expense</b>				
Deposits	396	291	1,071	865
Federal Home Loan Bank advances	167	176	490	530
<b>Total interest expense</b>	<b>563</b>	<b>467</b>	<b>1,561</b>	<b>1,395</b>
<b>Net interest income</b>	<b>1,198</b>	<b>1,046</b>	<b>3,552</b>	<b>3,076</b>
Provision for loan losses	-	12	(20)	36
<b>Net interest income after provision for loan losses</b>	<b>1,198</b>	<b>1,034</b>	<b>3,572</b>	<b>3,040</b>
<b>Other income</b>				
Service charges on deposit accounts	57	56	155	164
Other service charges and fees	63	49	192	153
Net gains on loan sales	22	36	64	174
Other income	73	49	136	186
<b>Total other income</b>	<b>215</b>	<b>190</b>	<b>547</b>	<b>677</b>
<b>Other expenses</b>				
Salaries and employee benefits	734	590	2,190	1,688
Net occupancy and equipment expenses	116	110	340	331
Data processing fees	88	103	287	303
Professional Services	9	20	110	61
ATM Expense	30	16	82	48
Other expenses	189	160	530	446
<b>Total other expenses</b>	<b>1,166</b>	<b>999</b>	<b>3,539</b>	<b>2,877</b>
<b>Income before income tax</b>	<b>247</b>	<b>225</b>	<b>580</b>	<b>840</b>
Income tax expense	102	91	234	335
<b>Net income</b>	<b>\$ 145</b>	<b>\$ 134</b>	<b>\$ 346</b>	<b>\$ 505</b>
<b>Weighted average common shares -</b>				
basic	1,518	1,522	1,525	n/a
	1,519	1,522	1,525	n/a

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Weighted average common shares-  
diluted

Earnings per share - basic	\$	0.10	\$	0.09	\$	0.23	n/a
Earnings per share - diluted	\$	0.10	\$	0.09	\$	0.23	n/a

See notes to consolidated condensed financial statements.

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**THIRD CENTURY BANCORP**  
Consolidated Condensed Statement of Stockholders' Equity  
(Unaudited)  
(Dollar amounts in thousands)

	<b>Common Stock</b>		<b>Unearned RRP shares</b>	<b>Retained Earnings</b>	<b>Total</b>
	<b>Shares Outstanding</b>	<b>Amount</b>			
<b>Balances, January 1, 2005</b>	1,653,125	\$ 14,290	\$ -	\$ 8,543	22,833
Net and comprehensive income		-	-	346	346
Contributions to RRP			(328)		(328)
Amortization of RRP			45		45
Dividends paid (\$.12 per share outstanding)		-	-	(186)	(186)
<b>Balances, September 30, 2005</b>	1,653,125	\$ 14,290	(283)	\$ 8,703	22,710

See notes to consolidated condensed financial statements.

**THIRD CENTURY BANCORP**  
Consolidated Condensed Statements of Cash Flows  
(Unaudited)

	<b>Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
	(in thousands)	
<b>Operating Activities</b>		
Net income	\$ 346	\$ 505
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	(20)	36
Depreciation	138	137
Investment securities (accretion) amortization, net	(17)	(11)
Gain on sale of loans	(64)	(174)
Loans originated for sale in the secondary market	(1,661)	(6,646)
Proceeds from sale of loans in the secondary market	1,725	6,820
FHLB stock dividend	-	(34)
RRP compensation expense	45	-
ESOP compensation expense	104	-
Net change in		
Interest receivable	(137)	(39)
Other assets	(140)	(106)
Other liabilities	310	212
Net cash provided (used) by operating activities	629	700
<b>Investing Activities</b>		
Purchases of FHLB stock	(22)	-
Purchases of securities held to maturity	(8,256)	(6,977)
Proceeds from maturities of securities held to maturity	8,456	1,985
Purchase of interest-bearing time deposits	(200)	(200)
Proceeds from maturities of interest-bearing time deposits	200	-
Net changes in loans	(4,678)	336
Purchases of premises and equipment	(751)	(160)
Net cash provided (used) by investing activities	(5,251)	(5,016)
<b>Financing Activities</b>		
Net change in		
Demand and savings deposits	(1,057)	3,155
Certificate of deposits	(905)	(516)
Paid cash dividend on Common Stock	(186)	-
Purchase of ESOP shares	-	(1,467)
Purchase of RRP shares	(328)	-
Net proceeds from stock conversion	-	15,741
Proceeds from FHLB advances	2,000	1,500
Payments on FHLB advances	(1,000)	(4,000)
Net cash provided (used) by financing activities	(1,476)	14,413
<b>Net Change in Cash and Equivalents</b>	<b>(6,098)</b>	<b>10,097</b>
<b>Cash and Cash Equivalents, Beginning of Period</b>	<b>12,057</b>	<b>4,739</b>



<b>Cash and Cash Equivalents, End of Period</b>	<b>\$</b>	<b>5,959</b>	<b>\$</b>	<b>14,836</b>
<b>Additional Cash Flows Information</b>				
Interest paid	\$	1,536	\$	1,401
Income tax paid (net of refunds)	\$	113	\$	258

See notes to consolidated condensed financial statements.

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**THIRD CENTURY BANCORP**

Notes to Unaudited Consolidated Condensed Financial Statements

Third Century Bancorp (Third Century) is an Indiana corporation that was formed on March 15, 2004 for the purpose of owning all of the capital stock of Mutual Savings Bank (Mutual or Bank) following the completion of Mutual Savings Bank's mutual-to-stock conversion. Third Century offered for sale 1,653,125 shares of its common stock at \$10.00 per share in a public offering to eligible depositors that was completed on June 14, 2004. On June 29, 2004, Third Century purchased all of the capital stock issued by Mutual Savings Bank. Prior to that date, Third Century had no assets or liabilities.

The activities of Third Century are primarily limited to holding the stock of Mutual Savings Bank. Mutual Savings Bank conducts business primarily in Johnson County and surrounding counties. Mutual Savings Bank attracts deposits from the general public and originates loans for consumer, residential and commercial purposes. Mutual Savings Bank's profitability is significantly dependent on net interest income, which is the difference between interest income generated from interest-earning assets (i.e. loans and investments) and the interest expense paid on interest-bearing liabilities (i.e. customer deposits and borrowed funds). Net interest income is affected by the relative amount of interest-earning assets and interest-bearing liabilities and the interest received or paid on these balances. The level of interest paid or received by Mutual Savings Bank can be significantly influenced by a number of factors, such as governmental monetary policy, competition within our market area and the performance of the national and local economies.

Mutual Savings Bank also owns one subsidiary, Mutual Financial Services, Inc. (Financial), which is engaged primarily in mortgage life insurance sales and servicing.

Note 1: Basis of Presentation

The accompanying unaudited consolidated condensed financial statements were prepared in accordance with instructions for Form 10-QSB and, therefore, do not include information or footnotes necessary for a complete presentation of financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America. Accordingly, these financial statements should be read in conjunction with the consolidated financial statements and notes thereto of Mutual Savings Bank for the fiscal year ended December 31, 2004 included in Third Century's Annual Report filed as an attachment to its 10-KSB. However, in the opinion of management, all adjustments (consisting of only normal recurring accruals) which are necessary for a fair representation of the financial statements have been included. The results of operations for the nine-month period ended September 30, 2005, are not necessarily indicative of the results which may be expected for the entire year.

The consolidated condensed balance sheet of Third Century as of December 31, 2004 has been derived from the audited consolidated balance sheet of Third Century as of that date.

*Stock Compensation.* Employee compensation expense under stock options is reported using the intrinsic value method. Stock-based compensation cost for options granted employees with an exercise price less than the market price of the underlying common stock at the date of the grant if material, is reflected in net income. No stock-based compensation cost for options granted employees and directors with an exercise price equal to or greater than the market price of the underlying common stock at the date of grant is reflected in net income.

The following table illustrates the effect on net income and earnings per share if expense was measured for options granted using the fair value recognition provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation*. Amounts are in thousands, except for per share data.



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	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Net income as reported	\$ 145	\$ 346
Deduct: Stock-based compensation expense determined under fair value based method	(571)	(571)
Pro forma net loss	\$ (426)	\$ (225)
Basic earnings per share as reported	\$ .10	\$ .23
Pro forma basic earnings per share	\$ (.28)	\$ (.15)
Diluted earnings per share as reported	\$ .10	\$ .23
Pro forma diluted earnings per share	\$ (.28)	\$ (.15)

The pro forma effects are computed using option pricing models, using the following weighted-average assumptions as of grant date for grants issued during the nine month period ended September 30, 2005:

	2005
Risk-free interest rate	4.17%
Expected option life	10 years
Expected stock price volatility	25.10%
Dividend yield	1.27%

Note 2: Principles of Consolidation

The consolidated financial statements include the accounts of Third Century, Mutual Savings Bank and Financial. All significant intercompany balances and transactions have been eliminated in the accompanying consolidated financial statements.

Note 3: Earnings Per Share

Earnings per share is computed based upon the weighted average common shares outstanding during the period subsequent to Mutual Savings Bank's conversion to a stock savings bank on June 29, 2004. Net income per share for the periods prior to the conversion is not meaningful. Unearned ESOP shares and unearned RRP shares are not considered outstanding for the earnings per share calculation. The following table presents the factors used in the earnings per share computation for the three and nine months ending September 30, 2005 and September 30, 2004:

	<b>Three Months Ended September 30, 2005</b>	<b>Three Months Ended September 30, 2004</b>	<b>Nine Months Ended September 30, 2005</b>	<b>Nine Months Ended September 30, 2004</b>
Basic:				
Net income	\$ 145	\$ 134	\$ 346	\$ 505
Weighted average common shares outstanding	1,518	1,522	1,525	n/a
Basic earnings per common share	\$ 0.10	\$ 0.09	\$ 0.23	\$ n/a
Diluted:				

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Net Income	\$	145	\$	134	\$	346	\$	505
Weighted average common shares outstanding		1,518		1,522		1,525		n/a
Add: Dilutive effects of assumed exercises of stock options		1		-		-		-
Average shares and dilutive potential common shares		1,519		1,522		1,525		n/a
Diluted earnings per common share	\$	0.10	\$	0.09	\$	0.23	\$	n/a

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Note 4: Effect of Recent Accounting Pronouncements

In June, 2005 the FASB Board decided not to provide additional guidance on the meaning of other-than-temporary impairment, but directed the FASB staff to issue a staff position (FSP) which is retitled FSP 115-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. The final FSP supersedes EITF Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, and EITF Topic No. D-44, *Recognition of Other-Than-Temporary Impairment upon the Planned Sale of a Security Whose Cost Exceeds Fair Value*. FSP 115-1 replaced guidance in EITF 03-1 on loss recognition with references to existing other-than-temporary impairment guidance, such as SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. FSP 115-1 clarifies that an investor should recognize an impairment loss no later than when the impairment is deemed other than temporary, even if a decision to sell has not been made.

FSP 115-1 will be effective for other-than-temporary impairment analysis conducted in periods beginning after September 15, 2005. The Company has consistently followed the loss recognition guidance in SFAS No. 115, so the adoption of FSP 115-1 will not have any significant impact on the Company's financial condition or results of operation.

In April 2005, the SEC issued a new rule amending the compliance dates for observing SFAS 123R, which allows companies to implement SFAS 123R at the beginning of their next fiscal year, instead of the next reporting period, that begins after June 15, 2005, or, in the case of a small business issuer like Third Century, after December 15, 2005. The new rule does not change the accounting required by SFAS 123R; it only changes the dates for compliance with the standard. Early adoption is permitted in periods in which financial statements have not yet been issued. Third Century expects to adopt SFAS 123R on January 1, 2006. We are currently evaluating the effect of the recognition and measurement provisions of SFAS 123R, but we currently believe the adoption of SFAS 123R will not result in a material impact on Third Century's results of operations or financial condition.

Note 5. Employee Stock Option Plan and Recognition and Retention Plan and Trust

On July 20, 2005, the stockholders of Third Century Bancorp approved the Third Century Bancorp Stock Option Plan ("Plan"). The Plan provides for the issuance of options to employees and directors of the Company to acquire up to 165,312 shares of Company common stock. Additionally, the stockholders approved the Mutual Savings Bank Recognition and Retention Plan and Trust ("RRP"). The RRP provides for the awarding of up to 66,125 shares of Company common stock to employees and directors of the Company.

Note 6. Stock Option Plan

Pursuant to the Plan, options may be issued which are defined as incentive stock options or as non-qualified stock options. Incentive stock options are intended to qualify under the provisions of Internal Revenue Code Section 422 ("IRC"), which include, among other things, a requirement that the option price is not less than the fair value of the shares as of the date of grant. Non-qualified stock options are those that do not meet the requirements of the provisions of the IRC, and, accordingly, may contain terms that are different from those in place for incentive stock options. The Plan is currently accounted for in accordance with Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock Issued to Employees," and related interpretations, although SFAS 123R, which will be effective for Third Century as of January 1, 2006, eliminates the ability to account for share-based compensation transactions using APB No. 25. As of January 1, 2006, SFAS 123R will apply to all awards granted thereafter and to awards modified, repurchased, or cancelled after that date.

During the third quarter of 2005, Third Century awarded 146,300 options to employees and non-employee directors at an exercise price of \$13.10 which equaled the market price for the stock as of the date of the grant. These options were immediately vested.



A summary of the activity in the Plan for the nine month period ended September 30, 2005 is as follows:

	Shares	2005 Weighted Average Exercise Price
Outstanding at beginning of year	-	\$ -
Granted	146,300	13.10
Exercised	-	-
Forfeited	-	-
Outstanding at end of period	146,300	\$ 13.10
Options exercisable at end of period	146,300	\$ 13.10
Weighted average fair value of options granted during year	\$ 4.76	

#### Note 7. Construction of Franklin Central Branch

In August 2005, Mutual Savings Bank closed on the purchase of land in Franklin Township, which is located in southeastern Marion County, for \$407,550. Construction of a new branch, to be known as the Franklin Central Branch, is scheduled to begin in the fourth quarter of 2005. The board of Mutual Savings Bank has awarded a contract to Waugh Company for the construction of the Franklin Central Branch in southeast Marion County. In addition, the Bank has entered into contracts with Diebold, Inc., a vendor who provides ATM, vault and teller equipment, and PrinceAlexander, an architectural firm, to perform work for and provide services to the Franklin Central Branch project. These contracts represent estimated construction costs to the Bank as follows:

Land acquisition	\$ 407,550
Waugh & Company	\$ 766,322
Diebold, Inc.	\$ 92,179
PrinceAlexander	\$ 67,688
Total	\$ 1,333,739

## **Item 2. Management's Discussion and Analysis or Plan of Operation**

### **Forward Looking Statements**

This Quarterly Report on Form 10-QSB ("Form 10-QSB") contains statements which constitute forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements appear in a number of places in this Form 10-QSB and include statements regarding the intent, belief, outlook, estimate or expectations of Third Century (as defined in the notes to the consolidated condensed financial statements), its directors or its officers primarily with respect to future events and the future financial performance of Third Century. Readers of the Form 10-QSB are cautioned that any such forward looking statements are not guarantees of future events or performance and involve risks and uncertainties, and that actual results may differ materially from those in the forward looking statements as a result of various factors. The accompanying information contained in this Form 10-QSB identifies important factors that could cause such differences. These factors include changes in interest rates; loss of deposits and loan demand to other financial institutions; substantial changes in financial markets; changes in real estate values and the real estate market; or regulatory changes, as discussed further below:





(a) **Regulatory Risk.** The banking industry is heavily regulated. These regulations are intended to protect depositors, not shareholders. Third Century and Mutual are subject to regulation and supervision by the Indiana Department of Financial Institutions, Federal Deposit Insurance Corporation, and the Board of Governors of the Federal Reserve System. The burden imposed by federal and state regulations puts banks at a competitive disadvantage compared to less regulated competitors such as finance companies, mortgage banking companies and leasing companies. The banking industry continues to lose market share to competitors.

(b) **Legislation.** Because of concerns relating to the competitiveness and the safety and soundness of the industry, Congress continues to consider a number of wide-ranging proposals for altering the structure, regulation, and competitive relationships of the nation's financial institutions. Management cannot predict whether or in what form any of these proposals will be adopted or the extent to which the business of Third Century or Mutual may be affected thereby.

(c) **Credit Risk.** One of the greatest risks facing lenders is credit risk, that is, the risk of losing principal and interest due to a borrower's failure to perform according to the terms of a loan agreement. While management attempts to provide an allowance for loan losses at a level adequate to cover probable incurred losses based on loan portfolio growth, past loss experience, general economic conditions, information about specific borrower situations, and other factors (all as discussed below in Critical Accounting Policies--Allowance for Loan Losses), future adjustments to reserves may become necessary, and net income could be significantly affected, if circumstances differ substantially from assumptions used with respect to such factors.

(d) **Exposure to Local Economic Conditions.** Mutual's primary market area for deposits and loans encompasses Johnson County, in central Indiana. A substantial percent of the Bank's business activities are within this area. This concentration exposes the Bank to risks resulting from changes in the local economy. A dramatic drop in local real estate values would, for example, adversely affect the quality of the Bank's loan portfolio.

(e) **Interest Rate Risk.** Third Century's earnings depend to a great extent upon the level of net interest income, which is the difference between interest income earned on loans and investments and the interest expense paid on deposits and other borrowings. Interest rate risk is the risk that the earnings and capital will be adversely affected by changes in interest rates.

(f) **Competition.** The activities of Third Century and Mutual in the geographic market served involve competition with other banks as well as with other financial institutions and enterprises, many of which have substantially greater resources than those available to Third Century. In addition, non-bank competitors are generally not subject to the extensive regulation applicable to Third Century and Mutual.

### **Critical Accounting Policies**

Generally accepted accounting principles are complex and require management to apply significant judgments to various accounting, reporting and disclosure matters. Management of Third Century must use assumptions and estimates to apply these principles where actual measurement is not possible or practical. For a complete discussion of Third Century's significant accounting policies, see Note 1 to the Consolidated Financial Statements as of December 31, 2004. Certain policies are considered critical because they are highly dependent upon subjective or complex judgments, assumptions and estimates. Changes in such estimates may have a significant impact on the financial statements. Management has reviewed the application of these policies with the Audit Committee of Third Century's Board of Directors. Those policies include the following:

### **Allowance for Loan Losses**

The allowance for loan losses represents management's estimate of probable losses inherent in the Bank's loan portfolios. In determining the appropriate amount of the allowance for loan losses, management makes numerous assumptions, estimates and assessments.

The strategy also emphasizes diversification on an industry and customer level, regular credit quality reviews and quarterly management reviews of large credit exposures and loans experiencing deterioration of credit quality.

Mutual's allowance consists of three components: probable losses estimated from individual reviews of specific loans, probable losses estimated from historical loss rates, and probable losses resulting from economic or other deterioration above and beyond what is reflected in the first two components of the allowance.

Larger commercial loans that exhibit probable or observed credit weaknesses are subject to individual review. Where appropriate, reserves are allocated to individual loans based on management's estimate of the borrower's ability to repay the loan given the availability of collateral, other sources of cash flow and legal options available to Mutual. Included in the review of individual loans are those that are impaired as provided in SFAS No. 114, Accounting by Creditors for Impairment of a Loan. Any allowances for impaired loans are determined by the present value of expected future cash flows discounted at the loan's effective interest rate or fair value of the underlying collateral. Mutual evaluates the collectibility of both principal and interest when assessing the need for a loss accrual. Historical loss rates are applied to other commercial loans not subject to specific reserve allocations.

Homogenous smaller balance loans, such as consumer installment and residential mortgage loans are not individually risk graded. Reserves are established for each pool of loans based on the expected net charge-offs for one year. Loss rates are based on the average net charge-off history by loan category.

Historical loss rates for commercial and consumer loans may be adjusted for significant factors that, in management's judgment, reflect the impact of any current conditions on loss recognition. Factors which management considers in the analysis include the effects of the national and local economies, trends in the nature and volume of loans (delinquencies, charge-offs and nonaccrual loans), changes in mix, asset quality trends, risk management and loan administration, changes in the internal lending policies and credit standards, collection practices and examination results from bank regulatory agencies and the Bank's internal loan review.

An unallocated reserve is maintained to recognize the imprecision in estimating and measuring loss when evaluating reserves for individual loans or pools of loans. Allowances on individual loans are reviewed quarterly and historical loss rates are reviewed annually and adjusted as necessary based on changing borrower and/or collateral conditions and actual collection and charge-off experience.

Mutual's primary market area for lending is Johnson County, Indiana. When evaluating the adequacy of allowance, consideration is given to this regional geographic concentration and the closely associated effect changing economic conditions have on Mutual's customers.

## **Mortgage Servicing Rights**

Mortgage servicing rights (MSRs) associated with loans originated and sold, where servicing is retained, are capitalized and included in other intangible assets in the consolidated balance sheet. The value of the capitalized servicing rights represents the present value of the future servicing fees arising from the right to service loans in the portfolio. Critical accounting policies for MSRs relate to the initial valuation and subsequent impairment tests. The methodology used to determine the valuation of MSRs requires the development and use of a number of estimates, including anticipated principal amortization and prepayments of that principal balance. Events that may significantly affect the estimates used are changes in interest rates, mortgage loan prepayment speeds and the payment performance of the underlying loans. The carrying value of the MSRs is periodically reviewed for impairment based on a determination of fair value. For purposes of measuring impairment, the servicing rights are compared to a valuation prepared based on a discounted cash flow methodology, utilizing current prepayment speeds and discount rates. Impairment, if any, is recognized through a valuation allowance and is recorded as amortization of intangible assets.

## **Comparison of Financial Condition at September 30, 2005 and December 31, 2004**

Total assets decreased \$670,000 or 0.53% to \$125.5 million at September 30, 2005 from \$126.2 million at December 31, 2004. Cash and cash equivalents decreased \$6.1 million or 50.58% during the quarter. Total net loans outstanding grew by \$4.7 million or 4.75% from \$98.8 million as of December 31, 2004 to \$103.5 million as of September 30, 2005. The majority of this loan growth is secured by commercial real estate (\$2.3 million or 48.92%). In addition, Mutual Savings Bank wired \$900,000 to the trustee of its Recognition and Retention Plan and Trust (RRP). These funds will be used toward the purchase of the 66,125 shares approved by the shareholders at the annual meeting on July 20, 2005. As of September 30, 2005, the trustee had purchased 24,900 shares for \$327,680.

Total liabilities decreased \$652,000 or 0.63% to \$102.6 million at September 30, 2005 from \$103.3 million at December 31, 2004. During the year, balances in the demand deposit accounts, savings accounts, including money market and NOW accounts, and time deposits decreased by an aggregate total of \$2.0 million or 2.27% to \$84.4 million at September 30, 2005.

Since December 31, 2004, balances in the demand deposit accounts declined \$2.1 million or 19.01% and outstanding advances from Federal Home Loan Bank of Indianapolis (FHLBI) increased \$1.0 million or 6.06%. The decline in demand deposit accounts was due to a withdrawal by a business customer, in the normal course of its business, in January of approximately \$2.0 million, previously on deposit as of December 31, 2004, from its non-interest-bearing checking account. The increase in advances from FHLBI was due to a short-term cash-flow need at the end of August due to loan disbursements in excess of loan payments received, the wire to the RRP trustee and a decline in total deposits.

Total equity decreased from \$22.8 million at December 31, 2004 to \$22.7 million at September 30, 2005, representing a decrease of \$123,000 or 0.54%. The equity contributed by the ESOP increased \$105,000 from \$64,000 at December 31, 2004 to \$169,000 at September 30, 2005. Third Century paid year-to-date cash dividends of \$186,000 from its net income of \$346,000.

## **Comparison of Operating Results for the Three Months Ended September 30, 2005 and 2004**

*General.* Net income for the quarter ended September 30, 2005 was \$145,000 compared to net income of \$134,000 for the quarter ended September 30, 2004. Net interest income and other income increased in aggregate by \$177,000 while other expenses increased by \$167,000. See the following subsections for further discussion of these changes.



*Interest Income.* Interest income for the quarter ended September 30, 2005 was \$1.8 million compared to \$1.5 million for the quarter ended September 30, 2004. The change between these reporting periods was an increase of \$248,000, which consisted primarily of an increase in loan interest income by \$178,000. Additionally, investment income increased by \$85,000, or 472.22%, from \$18,000 at September 30, 2004 to \$103,000 at September 30, 2005. Average interest-bearing assets for the quarter ended September 30, 2005 was \$123.8 million, which represented an increase of \$10.4 million or 9.15%, from the quarter ended September 30, 2004. The yield on those assets increased from 5.34% at September 30, 2004 to 5.69% at September 30, 2005. The average yield on loans increased by 17 basis points and the average yield on investments increased 192 basis points. The average balances for loans increased \$9.0 million to \$105.0 million and the average balances for investments increased \$7.4 million to \$11.6 million at September 30, 2005.

*Interest Expense.* Interest expense for the quarter ended September 30, 2005 was \$563,000 compared to \$467,000 for the quarter ended September 30, 2004, an increase of \$96,000 or 20.56%. Average interest-bearing liabilities increased to \$95.2 million at September 30, 2005 from \$90.2 million at September 30, 2004, with the average interest rate increasing from 2.07% at September 30, 2004 to 2.37% at September 30, 2005.

*Net Interest Income.* Net interest income of \$1.2 million for the quarter ended September 30, 2005 reflects an increase of \$152,000 or 14.53% from the net interest income for the quarter ended September 30, 2004.

*Provision for Loan Losses.* Mutual Savings Bank recorded no provision for loan losses during the quarter ended September 30, 2005, while a \$12,000 provision was made during the quarter ended September 30, 2004. In evaluating the adequacy of loan loss allowances, management considers factors such as delinquency trends, portfolio composition, past loss experience and other factors such as general economic conditions. During the past year, Mutual Savings Bank's level of nonperforming assets increased from \$25,000 at September 30, 2004, to \$85,000 at September 30, 2005, and the percentage of nonperforming assets to total assets increased from 0.02% to 0.07% for the same respective time periods. For the quarter ended September 30, 2005, Mutual Savings Bank charged off loans net of recoveries of \$39,468 which represents an increase of \$34,897 from the quarter ended September 30, 2004. These losses were previously provided for and therefore required no further adjustment.

*Other Income.* Total other income was \$215,000 for the quarter ended September 30, 2005 and \$190,000 for the quarter ended September 30, 2004, which represented an increase of \$25,000 or 13.16% between the reporting periods. The income category "other income" increased \$24,000 or 48.98% from \$49,000 at September 30, 2004 to \$73,000 at September 30, 2005. Within this category, income contributed from fiduciary services increased by \$29,000 during the third quarter of 2005 due to collection of fees on an estate settlement in process.

*Other Expense.* Total other expense for the quarter ended September 30, 2005 was \$1.2 million compared to \$999,000 for the same period last year, an increase of \$167,000 or 16.72%. Salaries and employee benefits increased \$144,000, or 24.41%, from \$590,000 at September 30, 2004 to \$734,000 at September 30, 2005. Officer and employee salaries increased approximately \$56,000, or 11.59%, from \$414,000 at September 30, 2004 to \$470,000 at September 30, 2005. The increase was due to merit pay increases awarded in December 2004 effective January 1, 2005 and additions to staff. In addition, Mutual Savings Bank started to expense the earned shares of its RRP during the third quarter of 2005. As of September 30, 2005, the Bank recognized \$45,000 of RRP expense.

*Income Taxes.* Mutual Savings Bank recognized income tax expense of \$102,000 for the quarter ended September 30, 2005, as compared to \$91,000 for the quarter ended September 30, 2004, which represents an increase in the effective tax rate from 40.44% at September 30, 2004 to 41.30% at September 30, 2005.

**Comparison of Operating Results for the Nine Months Ended September 30, 2005 and 2004**

*General.* Net income for the nine months ended September 30, 2005 was \$346,000 compared to net income of \$505,000 for the nine months ended September 30, 2004. The decrease of \$159,000 was primarily the result of increased salaries and employee benefits. This category increased \$502,000 from \$1.7 million for the nine months ended September 30, 2004 to \$2.2 million for the nine months ended September 30, 2005, or 29.74%.

The pension plan expense increased \$87,000, or 114.57% from \$77,000 at September 30, 2004 to \$164,000 at September 30, 2005. The increasing cost of the defined benefit plan was a contributing factor in the Board's decision to freeze the Bank's plan as of May 1, 2005. The ESOP expense for the Bank increased \$80,000, or 262.26% from \$31,000 at September 30, 2004 to \$111,000 at September 30, 2005. The officer and employee salaries increased approximately \$190,000, or 10.85%, from \$1.2 million at September 30, 2004 to \$1.4 million at September 30, 2005. The increase was due to merit pay increases awarded in December 2004 effective January 1, 2005 and additions to staff. In addition, Mutual Savings Bank started to expense the earned shares of its RRP during the third quarter of 2005. As of September 30, 2005, the Bank recognized \$45,000 of RRP expense.

*Interest Income.* Interest income for the nine months ended September 30, 2005 was \$5.1 million compared to \$4.5 million for the nine months ended September 30, 2004. The change between these reporting periods was an increase of \$642,000, which consisted primarily of an increase in loan interest income by \$369,000. Additionally, investment income increased by \$226,000, or 1,027.27%, from \$22,000 at September 30, 2004 to \$248,000 at September 30, 2005. Average interest-bearing assets for the nine months ended September 30, 2005 was \$122.3 million, which represented an increase of \$16.1 million, or 15.12%, from the nine months ended September 30, 2004. The yield on those assets decreased from 5.61% at September 30, 2004 to 5.58% at September 30, 2005. The yield declined because average investments, which yielded 3.14% at September 30, 2005, as a percent of total average assets increased from 0.02% for the nine months ended September 30, 2004 to 0.09% for the nine months ended September 30, 2005. Investments as a percentage of total assets grew faster than average loans outstanding, which yielded 6.12% at September 30, 2005, as a percent of total average assets, which declined from 90.00% for the nine months ended September 30, 2004 to 83.79% for the nine months ended September 30, 2005. The average yield on loans increased by 8 basis points and the average yield on investments increased 159 basis points. The average balances for loans increased \$6.9 million to \$102.4 million and the average balances for investments increased \$8.6 million to \$10.5 million at September 30, 2005.

*Interest Expense.* Interest expense for the nine months ended September 30, 2005 was \$1.6 million compared to \$1.4 million for the nine months ended September 30, 2004, an increase of \$166,000 or 11.90%. Average interest-bearing liabilities increased to \$94.4 million at September 30, 2005 from \$91.9 million at September 30, 2004, with the average interest rate increasing from 2.02% at September 30, 2004 to 2.20% at September 30, 2005.

*Net Interest Income.* Net interest income of \$3.6 million for the nine months ended September 30, 2005 reflects an increase of \$476,000 or 15.47% from the net interest income for the nine months ended September 30, 2004.

*Provision for Loan Losses.* Mutual Savings Bank recorded a negative provision for loan losses of \$20,000 during the nine months ended September 30, 2005, while a \$36,000 provision was made during the nine months ended September 30, 2004. In evaluating the adequacy of loan loss allowances, management considers factors such as delinquency trends, portfolio composition, past loss experience and other factors such as general economic conditions. During the past year, Mutual Savings Bank's level of nonperforming assets increased from \$25,000 at September 30, 2004, to \$85,000 at September 30, 2005, and the percentage of nonperforming assets to total assets increased from 0.02% to 0.07% for the same respective time periods. For the nine months ended September 30, 2005, Mutual Savings Bank charged off loans net of recoveries of \$53,371 which represents a decrease of \$13,857 from the nine months ended September 30, 2004.





*Other Income.* Total other income was \$547,000 for the nine months ended September 30, 2005 and \$677,000 for the nine months ended September 30, 2004, which represented a decrease of \$130,000 or 19.20% between the reporting periods. The decline of \$110,000 in net gains on loan sales from \$174,000 at September 30, 2004 to \$64,000 at September 30, 2005, was due to the reduction in loans sold during the comparative reporting periods. During the first nine months of 2004, Mutual Savings Bank sold \$6.6 million of loans to the secondary market as compared to \$1.7 million during the first nine months of 2005.

*Other Expense.* Other expense for the nine months ended September 30, 2005 was \$3.5 million compared to \$2.9 million for the same period last year, an increase of \$662,000 or 23.01%. As previously explained, the salaries and employee benefits increased during this period by \$502,000, or 29.74%. Professional service fees increased \$49,000, or 80.33%, from \$61,000 at September 30, 2004 to \$110,000 at September 30, 2005. Fees paid to attorneys for general services in the ordinary course of business increased from \$3,000 to \$80,000, or 2,611.11%, due primarily to the costs related to operating as a public company.

In addition, total ATM expense for the nine months ended September 30, 2005 was \$82,000 compared to \$48,000 for the same period last year, an increase of \$34,000 or 70.83%. Mutual Savings Bank changed ATM service providers during the last quarter of 2004 in order to enhance its ATM processing system. These upgrades resulted in additional fees paid to the new service provider.

*Income Taxes.* Mutual Savings Bank recognized income tax expense of \$234,000 for the nine months ended September 30, 2005, as compared to \$335,000 for the nine months ended September 30, 2004, which represents an increase in the effective tax rate from 39.88% at September 30, 2004 to 40.34% at September 30, 2005.

## **Other**

The Securities and Exchange Commission maintains a Web site that contains reports, proxy information statements, and other information regarding registrants that file electronically with the Commission, including Third Century. The address is <http://www.sec.gov>.

## **Item 3. Controls and Procedures**

A. Evaluation of disclosure controls and procedures. Third Century's chief executive officer and chief financial officer, after evaluating the effectiveness of Third Century's disclosure controls and procedures (as defined in Sections 13a-15(e) and 15d-15(e) of regulations promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as of the end of the most recent fiscal quarter covered by this quarterly report (the "Evaluation Date"), have concluded that as of the Evaluation Date, Third Century's disclosure controls and procedures were effective in ensuring that information required to be disclosed by Third Century in reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

B. Changes in internal control over financial reporting. There were no changes in Third Century's internal control over financial reporting identified in connection with Third Century's evaluation of controls that occurred during Third Century's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, Third Century's internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

Third Century, from time to time, is a party to routine litigation, which arises in the normal course of business, such as claims to enforce liens, condemnation proceedings on properties in which Mutual Savings Bank holds security interests, claims involving the making and servicing of real property loans, and other issues incident to the business of Third Century. There were no lawsuits pending or known to be contemplated against Third Century at September 30, 2005 that would have a material effect on Third Century's operations or income.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Submission of Matters to a Vote of Security Holders**

None.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

The exhibits filed as part of this Form 10-QSB are listed in the Exhibit Index, which is incorporated by this reference.

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**Signatures**

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**THIRD CENTURY BANCORP**

Date: November 14, 2005

By: /s/ Robert D. Heuchan  
Robert D. Heuchan  
President and Chief Executive Officer

By: /s/ Debra K. Harlow  
Debra K. Harlow  
Chief Financial Officer

**Exhibit Index**

<b>Exhibit No.</b>	<b>Description</b>
31.1	Rule 13a-14(a) Certification of Robert D. Heuchan, President and Chief Executive Officer
31.2	Rule 13a-14(a) Certification of Debra K. Harlow, Vice President and Chief Financial Officer
32.1	Section 1350 Certification of Robert D. Heuchan
32.2	Section 1350 Certification of Debra K. Harlow

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