

THIRD CENTURY BANCORP  
Form 10KSB  
March 28, 2006

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

**FORM 10-KSB**

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
**For the Fiscal Year Ended December 31, 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**  
(Name of Small Business Issuer 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**  
(Address of Principal Executive  
Office)

**46131**  
(Zip Code)

(317) 736-7151  
(Issuer's Telephone Number including  
area code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(B) OF THE ACT:

**None**

Securities Registered Pursuant to Section 12(g) of the Act:

**Common Stock, no par value per share**  
(Title of Class)

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past twelve months (or for such shorter period that the Registrant was required to file reports) and (2) has been subject to such requirements for the past 90 days. (1) YES  . NO .

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of Registrant's knowledge, in definitive proxy or information

statements incorporated by reference in Part III of this Form 10-KSB or any amendments to this Form 10-KSB.  [Confirm]

The Registrant's revenues for the fiscal year ended December 31, 2005 were \$6.3 million.

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
 YES  NO

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act.

As of February 28, 2006, there were 1,653,125 shares issued and outstanding of the Registrant's Common Stock. The aggregate value of the voting stock held by non-affiliates of the Registrant, computed by reference to the closing price of the Common Stock as of February 28, 2006 was \$16,048,361 million.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

1. Proxy Statement for the 2006 Annual Meeting of Stockholders (Part III)
  2. 2005 Annual Report (parts II and IV)
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## PART I

### FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-KSB (“**Form 10-KSB**”) contains statements that 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-KSB and include statements regarding the intent, belief, outlook, estimates or expectations of Third Century Bancorp, its directors, or its officers primarily with respect to future events and the future financial performance of Third Century Bancorp. Readers of this Form 10-KSB 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-KSB identifies important factors that could cause such differences. These factors include but are not limited to changes in interest rates; loss of deposits and loan demand to other savings and financial institutions; substantial changes in financial markets; changes in real estate values and the real estate market; regulatory changes; or unanticipated results in pending legal proceedings.

#### ITEM 1. DESCRIPTION OF BUSINESS.

Third Century Bancorp (“**Third Century**” and, together with Mutual Savings Bank, the “**Company**” or “**we**”) was formed on March 15, 2004, as an Indiana corporation to be the holding company for Mutual Savings Bank (“**Mutual**” or the “**Bank**”). On June 29, 2004, Third Century acquired the common stock of Mutual upon the conversion of Mutual from a state mutual savings bank to a state stock savings bank.

Mutual was originally organized in 1890 as the Mutual Building and Loan Association. In 1994, Mutual became an Indiana savings bank and changed its name to “Mutual Savings Bank.” Mutual currently conducts its business from five offices in Johnson County, Indiana. Its main office and two other offices are in Franklin and it also has offices in Trafalgar and Nineveh. Mutual’s principal business consists of attracting deposits from the general public, originating long-term, fixed-rate loans secured primarily by first mortgage liens on one- to four-family real estate and other commercial and consumer loans. Its deposit accounts are insured up to applicable limits by the Savings Association Insurance Fund of the FDIC.

#### LENDING ACTIVITIES

Mutual has historically concentrated its lending activities on the origination of loans secured by first mortgage liens for the purchase, construction or refinancing of one- to four-family residential real property. One- to four-family residential mortgage loans continue to be the major focus of its loan origination activities, representing 51.53% of its total loan portfolio at December 31, 2005. Mutual also offers commercial real estate loans, commercial loans and consumer loans. Mortgage loans secured by commercial real estate totaled approximately 17.41% of Mutual’s total loan portfolio at December 31, 2005, while commercial loans totaled approximately 13.21%, and consumer loans totaled approximately 10.11% of its total loans at December 31, 2005. To a limited extent, Mutual also offers multi-family (0.29%) and construction loans (4.21%), which include both residential and commercial.

Under Indiana law, the total loans and extensions of credit by an Indiana-chartered savings bank to a borrower outstanding at one time and not fully secured may not exceed 15% of the bank’s capital and unimpaired surplus. At December 31, 2005, 15% of Mutual’s capital and unimpaired surplus was \$2.2 million. An additional amount up to 10% of capital and unimpaired surplus may be loaned to the same borrower if such loan is fully secured by readily marketable collateral having a market value, as determined by reliable and continuously available price quotations, at least equal to the amount of such additional loans outstanding.

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**LOAN PORTFOLIO DATA.** The following table sets forth the composition of Mutual's loan portfolio by loan type and security type as of the dates indicated, including a reconciliation of gross loans receivable after consideration of the allowance for loan losses and loans in process.

|                                    | At December 31, |            |           |            |
|------------------------------------|-----------------|------------|-----------|------------|
|                                    | 2005            | Percent of | 2004      |            |
|                                    | Amount          | Total      | Amount    | Percent of |
|                                    | (In Thousands)  |            |           |            |
| <b>TYPE OF LOAN</b>                |                 |            |           |            |
| <u>Real Estate Mortgage Loans:</u> |                 |            |           |            |
| Land                               | \$ 1,385        | 3.24%      | \$ 1,368  | 1.37%      |
| One-to-Four-Family                 | 54,894          | 51.53      | 52,125    | 52.19      |
| Multi-Family                       | 314             | 0.29       | 338       | 0.34       |
| Commercial                         | 20,604          | 17.41      | 21,629    | 21.66      |
| Construction                       | 4,481           | 4.21       | 4,765     | 4.77       |
| Consumer Loans:                    |                 |            |           |            |
| Home Equity                        | 4,175           | 3.92       | 3,813     | 3.82       |
| Automobiles                        | 3,801           | 3.57       | 3,876     | 3.88       |
| Lines of Credit                    | 2,036           | 1.91       | 3,563     | 3.57       |
| Other                              | 752             | 0.71       | 419       | 0.42       |
| Commercial Loans                   | 14,078          | 13.21      | \$ 7,982  | 7.98       |
| Gross Loans Receivable             | \$ 106,520      | 100.00%    | \$ 99,878 | 100.00%    |
| <b>TYPE OF SECURITY</b>            |                 |            |           |            |
| Land                               | \$ 1,385        | 3.24%      | \$ 1,368  | 1.37%      |
| One-to-four-family                 | 54,894          | 51.53      | 52,125    | 52.19      |
| Multi-family                       | 314             | 0.29       | 338       | 0.34       |
| Commercial Real Estate             | 20,604          | 17.41      | 21,629    | 21.66      |
| Automobiles                        | 3,801           | 3.57       | 3,876     | 3.88       |
| Other Security                     | 23,429          | 21.99      | 18,583    | 18.60      |
| Unsecured                          | 2,093           | 1.97       | 1,959     | 1.96       |
| Gross Loans Receivable             | 106,520         | 100.00%    | 99,878    | 100.00%    |
| <b>DEDUCT:</b>                     |                 |            |           |            |
| Deferred Loan Fees                 | 37              |            | 44        |            |
| Allowance for Loan Losses          | 926             |            | 1,012     |            |
| Net Loans Receivable               | \$ 105,557      |            | \$ 98,822 |            |
| <b>MORTGAGE LOANS:</b>             |                 |            |           |            |
| Adjustable-Rate                    | \$ 32,457       |            | \$ 27,955 |            |
| Fixed-Rate                         | 44,740          |            | 47,505    |            |
| Total                              | \$ 77,197       |            | \$ 75,460 |            |

The following table sets forth certain information at December 31, 2005, regarding the dollar amount of loans maturing in Mutual's loan portfolio based on the contractual terms to maturity. Demand loans having no stated schedule of repayments and no stated maturity and overdrafts are reported as due in one year or less. This schedule does not reflect the effects of possible prepayments or enforcement of due-on-sale clauses. Management expects prepayments will cause actual maturities to be shorter.

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|                                    | Balance Outstanding at December 31, 2005 |              | Due During Years Ended December 31, |              |              |                    |           |
|------------------------------------|--|--------------|-------------------------------------|--------------|--------------|--------------------|-----------|
|                                    | 2006                                     | 2007 to 2008 | 2009 to 2010                        | 2011 to 2015 | 2016 to 2025 | 2026 and Following |           |
| (In Thousands)                     |  |              |                                     |              |              |                    |           |
| <u>Real Estate Mortgage Loans:</u> |  |              |                                     |              |              |                    |           |
| Land                               | \$ 1,385                                 | \$ 317       | \$ 108                              | \$ 35        | \$ 269       | \$ 656             | \$ --     |
| One- to Four-Family                | 54,894                                   | 3,813        | 392                                 | 823          | 7,110        | 21,837             | 20,919    |
| Multi-Family                       | 314                                      | 1            | --                                  | --           | 63           | 250                | --        |
| Commercial                         | 20,604                                   | 1,152        | 1,421                               | 191          | 1,380        | 13,989             | 2,471     |
| Construction                       | 4,481                                    | 3,704        | 777                                 | --           | --           | --                 | --        |
| <u>Consumer Loans:</u>             |  |              |                                     |              |              |                    |           |
| Home Equity                        | 4,175                                    | 129          | 219                                 | 251          | 2,632        | 944                | --        |
| Automobiles                        | 3,801                                    | 67           | 1,097                               | 2,356        | 281          | --                 | --        |
| Lines of Credit                    | 2,036                                    | 2,036        | --                                  | --           | --           | --                 | --        |
| Other                              | 752                                      | 318          | 191                                 | 223          | 20           | --                 | --        |
| Commercial Loans                   | 14,078                                   | 3,662        | 2,946                               | 1,734        | 2,474        | 2,345              | 917       |
| Total                              | \$ 106,520                               | \$ 15,199    | \$ 7,151                            | \$ 5,613     | \$ 14,229    | \$ 40,021          | \$ 24,307 |

The following table sets forth as of December 31, 2005, the dollar amount of all loans due after one year that have fixed interest rates or adjustable rates.

|                                    | Due After December 31, 2006 |                | Total    |
|------------------------------------|-----------------------------|----------------|----------|
|                                    | Fixed Rates                 | Variable Rates |          |
| (In Thousands)                     |                             |                |          |
| <u>Real Estate Mortgage Loans:</u> |                             |                |          |
| Land                               | \$ 760                      | \$ 307         | \$ 1,067 |
| One- to Four-Family                | 36,643                      | 14,401         | 51,044   |
| Multi-Family                       | --                          | 313            | 313      |
| Commercial                         | 3,128                       | 16,324         | 19,452   |
| Construction                       | --                          | 777            | 777      |
| <u>Consumer Loans:</u>             |                             |                |          |
| Home Equity                        | --                          | 4,046          | 4,046    |
| Automobiles                        | 3,735                       | --             | 3,735    |
| Lines of Credit                    | --                          | --             | --       |
| Other                              | 434                         | --             | 434      |
| Commercial Loans                   | 3,300                       | 7,115          | 10,415   |



|       |    |        |    |        |    |        |
|-------|----|--------|----|--------|----|--------|
| Total | \$ | 48,000 | \$ | 43,283 | \$ | 91,283 |
|-------|----|--------|----|--------|----|--------|

**ONE- TO FOUR-FAMILY RESIDENTIAL LOANS.** Mutual’s primary lending activity consists of the origination of one- to four-family residential mortgage loans secured by property located in its primary market area. Mutual generally does not originate one- to four-family residential mortgage loans if the ratio of the loan amount to the lesser of the current cost or appraised value of the property exceeds 95%. Mutual generally requires private mortgage insurance on loans with a loan-to-value ratio in excess of 80%. The cost of such insurance is factored into the annual percentage rate on such loans. All properties also have title and, to the extent applicable, flood insurance.

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Mutual also offers second mortgages on one- to four-family residential properties at a fixed rate. Second mortgages are generally written for up to 80% of the available equity (the appraised value of the property less any first mortgage amount).

Mutual's current underwriting criteria for one- to four-family residential loans focus on the collateral securing the loan, income, debt-to-income ratio, stability of earnings and credit history of a potential borrower, in making credit decisions. Mutual also has incorporated uniform underwriting criteria based on Freddie Mac lending criteria, recognizing that the sale of mortgage loans has become an important tool in liquidity and interest rate risk management. In 2005, we partnered with a larger financial institution which enabled us to offer products and pricing to individuals seeking non-conventional loans (more than 80% financing) and first-time home buyers. These loans comply with the underwriting standards required by the other financial institution, which wholly owns the loan at closing. Mutual originates fixed-rate loans which provide for the payment of principal and interest over a period of up to 30 years.

In addition, Mutual offers loans that are fixed for the first one, three, five or seven years and then have an adjustable rate for subsequent years. The adjustable-rate mortgage loans that it originates provide for a maximum interest rate adjustment of 2% over a one-year period and a maximum adjustment of 5% over the life of the loan. Mutual's residential adjustable-rate mortgages are amortized for terms up to 30 years. Although Mutual would generally prefer to originate mortgage loans that have adjustable rather than fixed interest rates, the current low-interest rate environment has reduced borrower demand for adjustable-rate mortgage loans. Mutual also offers fixed-rate second mortgages.

All of the fixed-rate loans that Mutual originates for sale are written to Freddie Mac standards or to the standards required by the financial institution with whom we have a contract to sell loans. Mutual generally sells any owner-occupied mortgages that are for terms of more than 12 years. It retains the servicing rights on the loans that it sells to Freddie Mac.

Adjustable-rate mortgage loans decrease the risk associated with changes in interest rates by periodically re-pricing, but involve other risks because, as interest rates increase, the underlying payments by the borrower also increase, thus increasing the potential for default by the borrower. At the same time, the marketability of the underlying collateral may be adversely affected by higher interest rates. Upward adjustment of the contractual interest rate is also limited by the maximum periodic and lifetime interest rate adjustment permitted by the loan documents, and, therefore, is potentially limited in effectiveness during periods of rapidly rising interest rates. Mutual retains all adjustable-rate mortgage loans that it originates and, at December 31, 2005, approximately 42.04% of its one- to four-family residential loans had adjustable rates of interest.

All of the one- to four-family residential mortgage loans that Mutual originates include "due-on-sale" clauses, which give it the right to declare a loan immediately due and payable in the event that, among other things, the borrower sells or otherwise disposes of the real property subject to the mortgage and the loan is not repaid. However, Mutual occasionally permits assumptions of existing residential mortgage loans on a case-by-case basis.

At December 31, 2005, approximately \$54.9 million, or 51.53% of Mutual's portfolio of loans, consisted of one- to four-family residential loans. Approximately \$181,000, or 0.33% of total one- to four-family residential loans, was included in non-performing loans as of that date.

**COMMERCIAL REAL ESTATE LOANS.** Our commercial real estate loans at December 31, 2005, were secured by churches, office buildings and other commercial properties (\$20.6 million), and apartments consisting of five or more units (\$314,000). Mutual typically originates commercial real estate loans with terms no greater than 20 years. Mutual generally requires a loan-to-value ratio of no more than 80% on commercial real estate loans. Mutual originates both fixed-rate and adjustable-rate commercial loans.

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Commercial real estate loans generally are larger than one- to four-family residential loans and involve a greater degree of risk. Commercial real estate loans often involve large loan balances to single borrowers or groups of related borrowers. Payments on these loans depend to a large degree on results of operations and management of the properties and may be affected to a greater extent by adverse conditions in the real estate market or the economy in general. Accordingly, the nature of the loans makes them more difficult for management to monitor and evaluate. In addition, balloon loans may involve a greater degree of risk to the extent the borrower is unable to obtain financing or cannot repay the loan when the loan matures or a balloon payment is due.

At December 31, 2005, approximately \$20.6 million, or 17.41% of Mutual's total loan portfolio, consisted of commercial real estate loans. On the same date, no commercial real estate loans were included in non-performing assets.

At December 31, 2005, approximately \$314,000, or 0.29% of Mutual's total loan portfolio, consisted of mortgage loans secured by multi-family dwellings. Multi-family residential real estate loans generally are secured by multi-family rental properties, such as walk-up apartments. At December 31, 2005, one multi-family loan for less than \$1,000 was included in non-performing loans.

Multi-family loans, like commercial real estate loans, involve greater risk than do residential loans and carry larger loan balances. This increased credit risk is a result of several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income producing properties, and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by multi-family real estate typically depends upon the successful operation of the related real estate property. If the cash flow from the project is reduced, the borrower's ability to repay the loan may be impaired. Also, the loans-to-one-borrower limitation limits Mutual's ability to make loans to developers of apartment complexes and other multi-family units.

**CONSTRUCTION LOANS.** Mutual offers construction loans to individuals for the purpose of constructing one- to four-family residences, but only where the borrower commits to permanent financing on the finished project with Mutual or another qualified lender. During the construction phase, the loan agreement requires monthly interest payments by the borrower on the amount drawn on the loan. When the construction of the residence is completed, the construction rider terminates and the loan converts into a one- to four-family residential mortgage loan.

Mutual also offers construction loans to builders or developers who are on Mutual's approved list for the construction of residential properties on a speculative basis (*i.e.*, before the builder/developer obtains a commitment from a buyer), or for the construction of commercial or multi-family properties. In such cases, Mutual typically structures the loan as a short-term loan with a fixed interest rate, with interest payable quarterly. Construction loans to builders or developers typically have a higher interest rate than residential construction loans to individuals unless Mutual has the long-term commitment for financing. Mutual also offers construction loans to businesses and organizations for the purpose of constructing business-related facilities, including, but not limited to, the new construction and remodeling of small office buildings and church facilities. At December 31, 2005, approximately \$3.0 million or 2.80% of Mutual's total loan portfolio consisted of residential construction loans and \$1.5 million or 1.41% of its total loan portfolio consisted of commercial construction loans. At December 31, 2005, there were no construction loans included in non-performing assets.

The maximum loan-to-value ratio for a construction loan is based upon the nature of the construction project. For example, a construction loan to an individual for the construction of a one- to four-family residence may be written with a maximum loan-to-value ratio of 95%, while a construction loan for a commercial project may be written with a maximum loan-to-value ratio of 80%. Inspections generally are made prior to any disbursement under a construction loan, and Mutual normally charges a commitment fee for construction loans.

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While providing Mutual with a comparable, and in some cases higher, yield than conventional mortgage loans, construction loans sometimes involve a higher level of risk. For example, if a project is not completed and the borrower defaults, Mutual may have to hire another contractor to complete the project at a higher cost. Also, a project may be completed, but may not be salable, resulting in the borrower defaulting and Mutual's taking title to the project.

**CONSUMER LOANS.** Mutual's consumer loans at December 31, 2005, consisted primarily of variable- and fixed-rate home equity loans (\$4.2 million representing 3.92% of our total loan portfolio) and lines of credit (\$2.0 million representing 1.91% of our total loan portfolio) and automobile loans (\$3.8 million representing 3.57% of our total loan portfolio). Consumer loans tend to have shorter terms and higher yields than permanent residential mortgage loans. At December 31, 2005, Mutual's consumer loans aggregated approximately \$10.7 million, or 10.11%, of its total loan portfolio. At December 31 2005, two consumer loans for less than \$1,000 were included in non-performing loans.

Home equity lines of credit are generally written for up to 80% of the appraised value less any first mortgage amount. Mutual generally will write automobile loans for up to 100% of the acquisition price for a new automobile and the lower of the purchase price or the trade-in value for a used automobile. The repayment schedule of loans covering both new and used vehicles is consistent with the expected life and normal depreciation of the vehicle.

Consumer loans may entail greater risk than residential mortgage loans, particularly in the case of consumer loans that are unsecured or are secured by rapidly depreciable assets, such as automobiles. Further, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance. In addition, consumer loan collections depend on the borrower's continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.

**COMMERCIAL LOANS.** Mutual offers commercial loans, which consist primarily of loans to businesses that are secured by assets other than real estate, with examples of such assets being equipment, inventory and receivables. In some cases the loans are unsecured. As of December 31, 2005, commercial loans amounted to \$14.1 million, or 13.21%, of Mutual's total loan portfolio. Commercial loans tend to bear somewhat greater risk than residential mortgage loans, depending on the ability of the underlying enterprise to repay the loan. As of December 31, 2005, no commercial loans were included in non-performing loans.

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The following table shows Mutual's loan origination and repayment activity during the periods indicated. During the years presented no loans were purchased.

|   | <b>Year Ended December 31,</b> |                 |
|---|--------------------------------|-----------------|
|   | <b>2005</b>                    | <b>2004</b>     |
|   | <b>(In Thousands)</b>          |                 |
| <b><u>Loans Originated:</u></b>           |                                |                 |
| <b>Real Estate Mortgage Loans:</b>        |                                |                 |
| Land                                      | \$ 723                         | \$ 337          |
| One-to-Four-Family                        | 4,954                          | 3,065           |
| Commercial                                | 10,770                         | 9,950           |
| Construction                              | 8,749                          | 8,181           |
| <b><u>Consumer Loans:</u></b>             |                                |                 |
| Home Equity and Home Improvement          | 753                            | 776             |
| Other                                     | 7,748                          | 7,415           |
| Commercial Loans                          | 11,206                         | 5,871           |
| <b>Total Originations</b>                 | <b>44,903</b>                  | <b>35,595</b>   |
| <b><u>Reductions:</u></b>                 |                                |                 |
| Principal Loan Repayments                 | 38,141                         | 33,600          |
| Transfers from Loans to Real Estate Owned | 120                            | 170             |
| <b>Total Reductions</b>                   | <b>38,261</b>                  | <b>33,770</b>   |
| Decrease in Other Items                   | (93)                           | (42)            |
| <b>Net Increase</b>                       | <b>\$ 6,735</b>                | <b>\$ 1,867</b> |

**ORIGINATION AND OTHER FEES.** Mutual realizes income from origination fees, late charges, checking account service charges and fees for other miscellaneous services. Late charges are generally assessed if payment is not received within a specified number of days after it is due. The grace period depends on the individual loan documents.

#### **NON-PERFORMING AND PROBLEM ASSETS**

Mutual reviews loans on a regular basis and loans are placed on a non-accrual status when the loans become contractually past due 90 days or more. Mutual's policy is that all earned but uncollected interest on all loans be reviewed monthly to determine if any portion thereof should be classified as uncollectible for any loan past due less than 90 days. Mutual sends a written notice when loans are 30 days past due and sends a letter or makes verbal contact when loans are 60 days past due. Loans that reach 90 days past due are brought before the Asset Classification Committee. The Asset Classification Committee discusses all delinquent loans at its monthly meetings and decides what additional actions should be taken with respect to each delinquent loan. Management is authorized to commence foreclosure proceedings for any loan upon making a determination that it is prudent to do so. All loans for which foreclosure proceedings have been commenced are placed on non-accrual status.

**NON-PERFORMING ASSETS.** At December 31, 2005, \$303,000, or 0.24% of Mutual's total assets, were non-performing assets (loans delinquent more than 90 days, non-accruing loans and foreclosed assets) compared to \$195,000, or 0.15%, of our total assets at December 31, 2004.

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The table below sets forth the amounts and categories of our non-performing assets.

|                                       | Year Ended December 31, |        |
|---------------------------------------|-------------------------|--------|
|                                       | 2005                    | 2004   |
| (In Thousands)                        |                         |        |
| <b>Non-Performing Assets:</b>         |                         |        |
| Non-Performing Loans                  | \$ 183                  | \$ 25  |
| Foreclosed Assets                     | 120                     | 170    |
| Total Non-Performing Assets           | \$ 303                  | \$ 195 |
| Non-Performing Loans to Total Loans   | 0.28%                   | 0.20%  |
| Non-Performing Assets to Total Assets | 0.24%                   | 0.15%  |

At December 31, 2005, Mutual held loans delinquent from 30 to 89 days totaling \$1.3 million.

There was one loan for \$25,000 and five loans totaling \$183,000 past due 90 days or more and still accruing interest at December 31, 2004 and 2005, respectively, for which interest was fully reserved. No loans at December 31, 2004 or 2005 were on non-accrual status.

The following table reflects the amount of loans in a delinquent status as of the dates indicated:

|                                  | At December 31, 2005 |           |                 |           | At December 31, 2004 |           |                 |           |
|----------------------------------|----------------------|-----------|-----------------|-----------|----------------------|-----------|-----------------|-----------|
|                                  | 30 - 89 Days         |           | 90 Days or More |           | 30 - 89 Days         |           | 90 Days or More |           |
|                                  | Number               | Principal | Number          | Principal | Number               | Principal | Number          | Principal |
|                                  | of                   | of        | of              | of        | of                   | of        | of              | of        |
| Loans                            | Loans                | Loans     | Loans           | Loans     | Loans                | Loans     | Loans           |           |
| (In Thousands)                   |                      |           |                 |           |                      |           |                 |           |
| <b>Real Estate Mortgage</b>      |                      |           |                 |           |                      |           |                 |           |
| <b>Loans:</b>                    |                      |           |                 |           |                      |           |                 |           |
| One-to-Four-Family               | 4                    | \$ 248    | 2               | \$ 181    | 5                    | \$ 303    | 1               | \$ 25     |
| Multi-Family                     | --                   | --        | 1               | 1         | 1                    | 4         | --              | --        |
| Construction                     | 1                    | 280       | --              | --        | --                   | --        | --              | --        |
| Home Equity and Home Improvement | 1                    | 20        | --              | --        | 1                    | 23        | --              | --        |
| Other Consumer Loans             | 11                   | 97        | 2               | 1         | 9                    | 96        | --              | --        |
| Commercial Loans                 | 7                    | 693       | --              | --        | 4                    | 1,456     | --              | --        |
| Total                            | 24                   | \$ 1,338  | 5               | \$ 183    | 20                   | \$ 1,883  | 1               | \$ 25     |
| Delinquent Loans to Total Loans  | 1.18%                | 1.26%     | 0.25%           | 0.17%     | 1.02%                | 1.89%     | 0.05%           | 0.03%     |

**CLASSIFIED ASSETS.** Mutual's Asset Classification Policy provides for the classification of loans and other assets such as debt and equity securities considered to be of lesser quality as "substandard," "doubtful" or "loss" assets. An asset is considered "substandard" if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. "Substandard" assets include those characterized by the "distinct possibility" that the institution will sustain "some loss" if the deficiencies are not corrected. Assets classified as "doubtful" have all of the weaknesses inherent in those classified "substandard," with the added characteristic that the weaknesses present make "collection or liquidation in full," on the basis of currently existing facts, conditions, and values, "highly questionable and improbable." Assets classified as "loss" are those considered "uncollectible" and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted.

An insured institution is required to establish general allowances for loan losses in an amount deemed prudent by management for loans classified substandard or doubtful, as well as for other problem loans. General allowances represent loss allowances which have been established to recognize the inherent risk associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. When an insured institution classifies problem assets as “loss,” it is

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required either to establish a specific allowance for losses equal to 100% of the amount of the asset so classified or to charge off such amount.

At December 31, 2005 and 2004, the aggregate amount of Mutual's classified loans, and of its general and specific loss allowances were as follows:

|                         | Year Ended December 31, |          |
|-------------------------|-------------------------|----------|
|                         | 2005                    | 2004     |
|                         | (In Thousands)          |          |
| Substandard Loans       | \$ 1,961                | \$ 299   |
| Doubtful Loans          | --                      | 10       |
| Loss Loans              | 1                       | --       |
| Total Classified Loans  | \$ 1,962                | \$ 309   |
| General Loss Allowance  | \$ 604                  | \$ 859   |
| Specific Loss Allowance | 322                     | 153      |
| Total Allowances        | \$ 926                  | \$ 1,012 |

Substandard loans increased to \$2.0 million at December 31, 2005 from \$299,000 at December 31, 2004 as a result of management's decision to classify a \$1.5 million commercial real estate loan. Management decided to classify this loan due to concerns over the financial performance of the borrower.

Assets that do not currently expose the insured institution to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are required to be designated "special mention" by management. At December 31, 2005 and 2004, Mutual classified \$532,000 and \$2.1 million of loans as "special mention." The "special mention" classification refers to assets that do not currently expose Mutual to a significant degree of risk but do possess credit deficiencies or potential weakness deserving management's close attention.

Third Century charges off loans that are identified as losses in the period the loans are deemed uncollectible.

Mutual regularly reviews its loan portfolio to determine whether any loans require classification in accordance with applicable regulations. Not all of Mutual's classified assets constitute non-performing assets.

#### ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is maintained to absorb losses inherent in the loan portfolio. The allowance is based on ongoing, quarterly assessments of the probable estimated losses inherent in the loan portfolio. The allowance is increased by the provision for loan losses, which is charged against current period operating results and decreased by the amount of charge-offs, net of recoveries. Mutual's methodology for assessing the appropriateness of the allowance consists of several key elements, which include the general allowance, specific allowances for identified problem loans, and the unallocated allowance.

The general allowance is calculated by applying loss factors to outstanding loans based upon Mutual's historical loss experience and may be adjusted for significant factors that, in management's judgment, affect the collectibility of the portfolio as of the evaluation date. The general allowance is utilized to estimate incurred losses on Mutual's homogeneous unclassified loan pools.

Specific allowances are established in cases where management has identified significant conditions or circumstances related to a credit that management believes indicate the probability that a loss has been incurred in excess of the

amount determined by the application of the formula allowance. The loans that are reviewed for specific allowances are generally those loans internally classified as substandard, doubtful or loss.

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The unallocated allowance is based upon management's evaluation of various conditions, the effects of which are not directly measured in the determination of the formula and specific allowances. The evaluation of the inherent loss with respect to these conditions is subject to a higher degree of uncertainty because they are not identified with specific credits. The conditions evaluated in connection with the unallocated allowance may include existing general economic and business conditions affecting Mutual's key lending areas, credit quality trends, collateral values, loan volumes and concentrations, seasoning of the loan portfolio, specific industry conditions within portfolio segments, recent loss experience in particular segments of the portfolio, duration of the current business cycle, bank regulatory examination results, and findings of an independent third party conducting reviews of the loan portfolio.

**SUMMARY OF LOAN LOSS EXPERIENCE.** The following table analyzes changes in the allowance for loan losses during the years ended December 31, 2005 and 2004.

|   | <b>Year Ended December 31,</b> |             |
|---|--------------------------------|-------------|
|   | <b>2005</b>                    | <b>2004</b> |
|   | <b>(In Thousands)</b>          |             |
| Balance at Beginning of Period                                    | \$ 1,012                       | \$ 1,055    |
| Charge-Offs:  |                                |             |
| One-to-Four-Family Mortgage Loans                                 | 15                             | --          |
| Consumer Loans  | 43                             | 37          |
| Commercial Loans  | 43                             | 74          |
| Total Charge-Offs   | 101                            | 111         |
| Recoveries:   |                                |             |
| One-to-Four-Family Mortgage Loans                                 | --                             | 2           |
| Consumer Loans  | 14                             | 2           |
| Commercial Loans  | 1                              | 28          |
| Total Recoveries  | 15                             | 32          |
| Net Charge-Offs   | 86                             | 79          |
| Provision for Losses on Loans                                     | --                             | 36          |
| Balance End of Period   | \$ 926                         | \$ 1,012    |
| Allowance for Loan Losses as a Percent of Total Loss Outstanding  | 0.87%                          | 1.01%       |
| Ratio of Net Charge-Offs during year to Average Loans Outstanding | 0.08%                          | 0.08%       |

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**ALLOCATION OF ALLOWANCE FOR LOAN LOSSES.** The following table presents an analysis of the allocation of Mutual's allowance for loan losses at the dates indicated.

|   | At December 31, |  |          |  |
|---|-----------------|--|----------|--|
|   | 2005            | Percent of<br>Loans in<br>Each<br>Category to<br>Total Loans<br>(In Thousands) | 2004     | Percent of<br>Loans in<br>Each<br>Category to<br>Total Loans |
|   | Amount          |  | Amount   |  |
| Balance at End of Period Applicable to: |                 |  |          |  |
| Land                                    | \$ --           | 1.30%  | \$ --    | 1.37%  |
| Real Estate Mortgage Loans:             |                 |  |          |  |
| One- to Four-Family                     | 127             | 51.53  | 170      | 52.19  |
| Commercial and Multi-Family             | 202             | 19.64  | 226      | 22.00  |
| Construction Loans                      | 21              | 4.21   | 30       | 4.77   |
| Home Equity and Home Improvements       | 1               | 3.92   | --       | 3.82   |
| Other Consumer Loans                    | 151             | 6.19   | 140      | 7.87   |
| Commercial Loans                        | 391             | 13.21  | 104      | 7.98   |
| Unallocated                             | 33              | --   | 342      | --   |
| Total                                   | \$ 926          | 100.00%  | \$ 1,012 | 100.00%  |

## OTHER SOURCES OF REVENUE

**TRUST SERVICES.** Mutual's Trust Department provides agency services, trust services, guardianships and estate services to individuals and families. The Trust Department establishes and manages trusts, administers estates, establishes power of attorney arrangements and offers individual retirement accounts in addition to other products and services. As of December 31, 2005, the Trust Department had 141 accounts representing \$7.9 million, including funeral trusts. For the year ended December 31, 2005, revenues generated by the Trust Department totaled \$65,000.

**CREDIT CARD UNDERWRITING.** Mutual also issues Mutual Savings Bank Credit Cards, which are personal unsecured lines of credit in amounts from \$2,500 to \$50,000. The annual percentage rate is 9.90%, which is recognized as loan interest income. There is no annual fee. The Bank recognized interchange income of \$76,000 as of December 31, 2005 and \$109,000 as of December 31, 2004.

**OTHER FEES.** Mutual also realizes income from checking account service charges, safe deposit fees and fees for other miscellaneous services.

## INVESTMENTS AND FEDERAL HOME LOAN BANK STOCK

Mutual's investment policy is designed primarily to maximize the yield on the investment portfolio subject to minimal liquidity risk, default risk, interest rate risk, and prudent asset/liability management. Mutual has retained an investment advisor registered with the Securities and Exchange Commission to provide it with investment and financial advice including recommendations regarding risk strategies and risk assessment, investment purchases and sales, and dealer selection.

Mutual's investment portfolio consists of U.S. government agency securities, state revenue bonds, mortgage backed securities, corporate obligations and Federal Home Loan Bank stock. At December 31, 2005 approximately \$10.3 million or 8.00% of its total assets, consisted of such investments. All of Mutual's securities, except for Federal Home Loan Bank stock, were classified as held to maturity at December 31, 2005.

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The following table sets forth the carrying value and market value of Mutual's investments at the dates indicated.

|                                    | At December 31,   |                  |                   |                  |
|------------------------------------|-------------------|------------------|-------------------|------------------|
|                                    | 2005              |                  | 2004              |                  |
|                                    | Amortized<br>Cost | Fair Value       | Amortized<br>Cost | Fair Value       |
|                                    | (In Thousands)    |                  |                   |                  |
| <b>Held to Maturity:</b>           |                   |                  |                   |                  |
| Agency and Treasury Securities     | \$ 5,289          | \$ 5,256         | \$ 10,455         | \$ 10,445        |
| State and Municipal                | 400               | 394              | -                 | -                |
| Mortgage Backed Securities         | 2,580             | 2,538            | -                 | -                |
| Corporate Obligations              | 941               | 936              | -                 | -                |
| FHLB Stock <sup>(1)</sup>          | 1,041             | 1,041            | 1,020             | 1,020            |
| <b>Total Investment Securities</b> | <b>\$ 10,251</b>  | <b>\$ 10,165</b> | <b>\$ 11,475</b>  | <b>\$ 11,465</b> |

<sup>(1)</sup> Market value is based on the price at which the stock may be resold to the FHLB of Indianapolis.

At December 31, 2005, investment securities, excluding Federal Home Loan Bank stock, which has no stated maturity, will mature as follows: \$5.4 million by December 31, 2006, \$1.6 million by December 31, 2007, \$1.8 million by December 31, 2008 and \$400,000 by December 31, 2010. At December 31, 2005, the weighted average yield on agency securities and FHLB stock was 3.27% and 4.24%, respectively.

## SOURCES OF FUNDS

**GENERAL.** Deposits have traditionally been Mutual's primary source of funds for use in lending and investment activities. In addition to deposits, Mutual derives funds from scheduled loan payments, loan prepayments, retained earnings and income on earning assets. While scheduled loan payments and income on earning assets are relatively stable sources of funds, deposit inflows and outflows can vary widely and are influenced by prevailing interest rates, market conditions and levels of competition. Mutual can use borrowings from the Federal Home Loan Bank of Indianapolis in the short-term to compensate for reductions in deposits or deposit inflows at less than projected levels. Mutual occasionally borrows on a longer-term basis, for example to assist in asset/liability management.

**DEPOSITS.** Mutual attracts deposits principally from within Johnson County through the offering of a broad selection of deposit instruments including fixed-rate certificates of deposit, NOW and other transaction accounts, and savings accounts. Mutual does not actively solicit or advertise for deposits outside of Johnson County. Substantially all of its depositors are residents of Johnson County. Deposit account terms vary, with the principal differences being the minimum balance required, the amount of time the funds remain on deposit and the interest rate. Mutual does not pay a fee for any deposits it receives.

Mutual establishes the interest rates paid, maturity terms, service fees and withdrawal penalties on a periodic basis. Determination of rates and terms are predicated on funds acquisition and liquidity requirements, rates paid by competitors, growth goals, and applicable regulations. Mutual relies, in part, on customer service and long-standing relationships with customers to attract and retain its deposits. Mutual also closely prices its deposits in relation to rates offered by its competitors.

The flow of deposits is influenced significantly by general economic conditions, changes in money market and prevailing interest rates and competition. The variety of deposit accounts Mutual offers has allowed it to be



competitive in obtaining funds and to respond with flexibility to changes in consumer demand. Mutual has become more susceptible to short-term fluctuations in deposit flows as

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customers have become more interest rate sensitive. Mutual manages the pricing of its deposits in keeping with its asset/liability management and profitability objectives. Based on its experience, Mutual's management believes that Mutual's passbook, NOW, money market savings and non-interest-bearing checking accounts are relatively stable sources of deposits. However, Mutual's ability to attract and maintain certificates of deposit, and the rates paid on these deposits, has been and will continue to be significantly affected by market conditions.

An analysis of Mutual's deposit accounts by type, maturity, and rate at December 31, 2005, is as follows:

| Type of Account                       | Balance at<br>December 31, 2005 | % of Deposits<br>(In Thousands) | Weighted<br>Average Rate |
|---------------------------------------|---------------------------------|---------------------------------|--------------------------|
| <b>Withdrawable:</b>                  |                                 |                                 |                          |
| Non-Interest Bearing Demand           | \$ 10,215                       | 11.53%                          | 0.00%                    |
| Savings, NOW and Money Market         | 44,264                          | 49.95                           | 1.62                     |
| <b>Total Withdrawable</b>             | <b>\$ 54,479</b>                | <b>61.48%</b>                   | <b>1.48%</b>             |
| <b>Certificates (Original Terms):</b> |                                 |                                 |                          |
| 91 Day                                | \$ 432                          | 0.49%                           | 2.53%                    |
| 182 Day                               | 1,786                           | 2.02                            | 2.97                     |
| Short Term                            | 54                              | 0.06                            | 3.72                     |
| 12 Month                              | 6,170                           | 6.96                            | 3.30                     |
| 15 Month                              | 2,153                           | 2.43                            | 2.62                     |
| 18 Month                              | 3,726                           | 4.20                            | 3.04                     |
| 24 Month                              | 6,293                           | 7.10                            | 3.06                     |
| 30 Month                              | 2,153                           | 2.43                            | 3.05                     |
| 36 Month                              | 2,251                           | 2.54                            | 3.37                     |
| 42 Month                              | 13                              | 0.01                            | 2.28                     |
| 48 Month                              | 875                             | 0.99                            | 3.94                     |
| 60 Month                              | 4,102                           | 4.63                            | 4.39                     |
| IRA                                   | 4,121                           | 4.65                            | 3.05                     |
| <b>Total Certificates</b>             | <b>\$ 34,129</b>                | <b>38.52%</b>                   | <b>3.26%</b>             |
| <b>Total Deposits</b>                 | <b>\$ 88,608</b>                | <b>100.00%</b>                  | <b>2.13%</b>             |

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The following table sets forth by various interest rate categories the composition of Mutual's term deposits at the dates indicated.

|                | <b>At December 31,</b> |                  |
|----------------|------------------------|------------------|
|                | <b>2005</b>            | <b>2004</b>      |
|                | <b>(In Thousands)</b>  |                  |
| 1.00% to 1.99% | \$ 414                 | \$ 11,056        |
| 2.00% to 2.99% | 12,455                 | 13,743           |
| 3.00% to 3.99% | 15,741                 | 6,557            |
| 4.00% to 4.99% | 4,590                  | 2,752            |
| 5.00% to 5.99% | 865                    | 985              |
| 6.00% to 8.00% | 63                     | 479              |
| <b>Total</b>   | <b>\$ 34,129</b>       | <b>\$ 35,572</b> |

The following table represents, by various interest rate categories, the amounts of term deposits maturing during each of the three years following December 31, 2005, and the total amount maturing thereafter. Matured certificates that have not been renewed as of December 31, 2005, have been allocated based on certain rollover assumptions.

|                | <b>Amounts at December 31, 2005</b> |                      |                        |   |
|----------------|-------------------------------------|----------------------|------------------------|---|
|                | <b>One Year<br/>or Less</b>         | <b>Two<br/>Years</b> | <b>Three<br/>Years</b> | <b>Greater<br/>Than Three<br/>Years</b> |
|                | <b>(In Thousands)</b>               |                      |                        |   |
| 1.00% to 1.99% | \$ 413                              | \$ 1                 | \$ --                  | \$ --                                   |
| 2.00% to 2.99% | 11,050                              | 1,324                | 76                     | 5                                       |
| 3.00% to 3.99% | 8,718                               | 4,799                | 1,296                  | 928                                     |
| 4.00% to 4.99% | 1,255                               | 1,461                | 976                    | 898                                     |
| 5.00% to 5.99% | 138                                 | 332                  | 7                      | 388                                     |
| 6.00% to 8.00% | 63                                  | --                   | --                     | --                                      |
| <b>Total</b>   | <b>\$ 21,637</b>                    | <b>\$ 7,917</b>      | <b>\$ 2,355</b>        | <b>\$ 2,219</b>                         |

The following table indicates the amount of Mutual's certificates of deposit of \$100,000 or more by time remaining until maturity as of December 31, 2005.

|   | <b>At December 31, 2005</b> |
|---|-----------------------------|
|   | <b>(In Thousands)</b>       |
| <b>Maturity Period</b>                        |                             |
| Three Months or Less                          | \$ 1,019                    |
| Greater than Three Months through Six Months  | 1,006                       |
| Greater than Six Months through Twelve Months | 1,414                       |
| Over Twelve Months                            | 3,003                       |
| <b>Total</b>                                  | <b>\$ 6,442</b>             |

The following table indicates the change in time deposit balances during the years indicated.

|                   | <b>Year Ended December 31,</b> |             |
|-------------------|--------------------------------|-------------|
|                   | <b>2005</b>                    | <b>2004</b> |
|                   | <b>(In Thousands)</b>          |             |
| Beginning Balance | \$ 35,572                      | \$ 35,940   |

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|                          |           |           |
|--------------------------|-----------|-----------|
| Net Deposits             | (2,971)   | (1,301)   |
| Interest Credited        | 1,528     | 933       |
| Net Increase in Deposits | (1,443)   | (368)     |
| Ending Balance           | \$ 34,129 | \$ 35,572 |

In the unlikely event that Mutual would liquidate, all claims of creditors (including those of deposit account holders, to the extent of their deposit balances) would be paid first and followed by

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distribution of the liquidation account (created in connection with Mutual's conversion from mutual to stock form) to certain deposit account holders, with any assets remaining thereafter distributed to Third Century as the sole shareholder of Mutual's capital stock.

**BORROWINGS.** Mutual focuses on generating high quality loans and then seeks the best source of funding from deposits, investments or borrowings. At December 31, 2005, Mutual had \$16.5 million in borrowings from the Federal Home Loan Bank of Indianapolis. Mutual had approximately \$50.1 million in eligible assets available as collateral for advances from the Federal Home Loan Bank of Indianapolis as of December 31, 2005. Based on Mutual's blanket collateral agreements, advances from the Federal Home Loan Bank of Indianapolis must be collateralized by 145% of eligible assets. Therefore, Mutual's eligible collateral would have supported approximately \$34.6 million in advances from the Federal Home Loan Bank of Indianapolis as of December 31, 2005. Mutual's Board of Directors has adopted a resolution that limits the amount of authorized borrowings. As of December 31, 2005, authorized borrowings are limited to \$40 million. Mutual does not anticipate any difficulty in obtaining advances appropriate to meet its requirements in the future.

The following tables present certain information relating to Mutual's borrowings at or for the years ended December 31, 2005 and 2004.

|   | <b>Year Ended December 31,</b> |             |
|---|--------------------------------|-------------|
|   | <b>2005</b>                    | <b>2004</b> |
|   | <b>(Dollars in Thousands)</b>  |             |
| <b>FHLB Advances</b>  |                                |             |
| Outstanding at End of Period                                  | \$ 16,500                      | \$ 16,500   |
| Average Balance Outstanding for Period                        | 16,581                         | 17,404      |
| Maximum Amount Outstanding at any Month-End During the Period | 18,000                         | 19,500      |
| Weighted Average Interest Rate During the Period              | 4.02%                          | 4.06%       |
| Weighted Average Interest Rate at End of Period               | 3.95%                          | 3.99%       |

**Amounts at December 31, 2005 which are due during**

|                | <b>2006</b>           | <b>2007</b>     | <b>2008</b>     | <b>2009</b>     | <b>2010</b>     | <b>2011<br/>thru<br/>2014</b> |
|----------------|-----------------------|-----------------|-----------------|-----------------|-----------------|-------------------------------|
|                | <b>(In Thousands)</b> |                 |                 |                 |                 |                               |
| 1.00% to 1.99% | \$ --                 | \$ --           | \$ --           | \$ --           | \$ --           | \$ --                         |
| 2.00% to 2.99% | --                    | --              | --              | --              | --              | --                            |
| 3.00% to 3.99% | 4,000                 | 3,000           | 500             | 2,500           | 1,000           | 1,000                         |
| 4.00% to 4.99% | --                    | --              | 1,500           | --              | 1,000           | 1,000                         |
| 5.00% to 5.99% | --                    | --              | --              | --              | --              | 1,000                         |
| Above 5.99%    | --                    | --              | --              | --              | --              | --                            |
| <b>Total</b>   | <b>\$ 4,000</b>       | <b>\$ 3,000</b> | <b>\$ 2,000</b> | <b>\$ 2,500</b> | <b>\$ 2,000</b> | <b>\$ 3,000</b>               |

**SERVICE CORPORATION SUBSIDIARY**

Mutual's service corporation subsidiary, Mutual Financial Services, Inc. ("Mutual Financial Services"), was organized in 1991 and has historically engaged in mortgage life insurance sales and servicing. All of Mutual's loan officers who solicit and sell mortgage loans have limited agent licenses issued by the Indiana Department of Insurance. Mutual sells mortgage insurance products in affiliation with American General Financial Group, Inc. The Company's President and Chief Executive Officer, Mr. Heuchan, receives a nominal management fee for the services he provides

for Mutual Financial Services.

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## **EMPLOYEES**

As of December 31, 2005, Mutual employed 41 persons on a full-time basis and 6 persons on a part-time basis. None of its employees is represented by a collective bargaining group. Management considers employee relations to be good.

Mutual's employee benefits for full-time employees include, among other things, the Financial Institutions Retirement Fund defined contribution pension plan and the Financial Institutions Thrift Plan 401(k) plan, both of which are managed by Pentegra Group. Other benefits include medical, dental, and short-term and long-term disability insurance.

Employee benefits are considered by management to be competitive with those offered by other financial institutions and major employers in the area.

## **COMPETITION**

Mutual originates most of its loans to and accepts most of its deposits from residents of Johnson County, Indiana, and the counties surrounding Johnson County. Mutual is subject to competition from various financial institutions, including state and federal banks and a federal savings association, and credit unions and certain nonbanking consumer lenders that provide similar services in those counties with significantly greater resources than are available to us. Fourteen banks, one savings association and two credit unions are located in Johnson County. We also compete with money market funds with respect to deposit accounts and with insurance companies with respect to individual retirement accounts.

The primary factors influencing competition for deposits are interest rates, service and convenience of office locations. Mutual competes for loan originations primarily through the efficiency and quality of the services that it provides borrowers and through interest rates and loan fees charged. Competition is affected by, among other things, the general availability of lendable funds, general and local economic conditions, current interest rate levels, and other factors that we cannot readily predict.

## **REGULATION**

### **BANK HOLDING COMPANY REGULATION**

Third Century is a registered bank holding company and is subject to the regulations of the Federal Reserve Board under the Bank Holding Company Act of 1956, as amended. Bank holding companies are required to file periodic reports with, and are subject to periodic examination by, the Federal Reserve Board. The Federal Reserve Board has issued regulations under the Bank Holding Company Act requiring a bank holding company to serve as a source of financial and managerial strength to its subsidiary banks. It is the policy of the Federal Reserve Board that, pursuant to this requirement, a bank holding company should stand ready to use its resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity. Additionally, under the Federal Deposit Insurance Corporation Improvement Act of 1991, a bank holding company is required to guarantee the compliance of any insured depository institution subsidiary that may become "undercapitalized" (as defined in the statute) with the terms of any capital restoration plan filed by such subsidiary with its appropriate federal banking agency up to the lesser of (i) an amount equal to 5% of the institution's total assets at the time the institution became undercapitalized, or (ii) the amount that is necessary (or would have been necessary) to bring the institution into compliance with all applicable capital standards as of the time the institution fails to comply with such capital restoration plan. Under the Bank Holding Company Act, the Federal Reserve Board has the authority to require a bank holding company to terminate any activity or relinquish control of a nonbank subsidiary (other than a nonbank subsidiary of a bank) upon the

Federal Reserve Board's determination that such activity or control constitutes a serious risk to the financial soundness and stability of any bank subsidiary of the bank holding company.

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Third Century is prohibited by the Bank Holding Company Act from acquiring direct or indirect control of more than 5% of the outstanding shares of any class of voting stock or substantially all of the assets of any bank or merging or consolidating with another bank holding company without prior approval of the Federal Reserve Board. Additionally, Third Century is prohibited by the Bank Holding Company Act from engaging in or from acquiring ownership or control of more than 5% of the outstanding shares of any class of voting stock of any company engaged in a nonbanking business unless such business is determined by the Federal Reserve Board to be so closely related to banking as to be a proper incident thereto.

## **CAPITAL ADEQUACY GUIDELINES FOR BANK HOLDING COMPANIES**

The Federal Reserve Board is the federal regulatory and examining authority for bank holding companies. The Federal Reserve Board has adopted capital adequacy guidelines for bank holding companies.

Bank holding companies are required to comply with the Federal Reserve Board's risk-based capital guidelines which require a minimum ratio of total capital to risk-weighted assets (including certain off-balance sheet activities such as standby letters of credit) of 8%. At least half of the total required capital must be "Tier I capital," consisting principally of common stockholders' equity, noncumulative perpetual preferred stock, a limited amount of cumulative perpetual preferred stock and minority interests in the equity accounts of consolidated subsidiaries, less certain goodwill items. The remainder, called Tier II capital, may consist of a limited amount of subordinated debt and intermediate-term preferred stock, certain hybrid capital instruments and other debt securities, cumulative perpetual preferred stock, and a limited amount of the general loan loss allowance. In addition to the risk-based capital guidelines, the Federal Reserve Board has adopted a Tier I (leverage) capital ratio under which a bank holding company must maintain a minimum level of Tier I capital to average total consolidated assets of 3% in the case of bank holding companies which have the highest regulatory examination ratings and are not contemplating significant growth or expansion. All other bank holding companies are expected to maintain a ratio of at least 1% to 2% above the stated minimum.

## **BANK REGULATION**

Mutual is organized under the laws of Indiana and as such is subject to the supervision of the Indiana Department of Financial Institutions (the "DFI"), whose examiners conduct periodic examinations of state banks. We are not a member of the Federal Reserve System, so our principal federal regulator is the FDIC, which also conducts periodic examinations of Mutual. Mutual's deposits are insured by the Savings Association Insurance Fund administered by the FDIC and are subject to FDIC's rules and regulations respecting the insurance of deposits.

Both federal and state law extensively regulate various aspects of the banking business such as reserve requirements, truth-in-lending and truth-in-savings disclosure, equal credit opportunity, fair credit reporting, trading in securities and other aspects of banking operations. Current federal law also requires banks, among other things, to make deposited funds available within specified time periods.

Insured state-chartered banks are prohibited under the FDIC Improvement Act from engaging as principal in activities that are not permitted for national banks, unless: (i) the FDIC determines that the activity would pose no significant risk to the appropriate deposit insurance fund, and (ii) the bank is, and continues to be, in compliance with all applicable capital standards.

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## **FEDERAL HOME LOAN BANK SYSTEM**

We are a member of the Federal Home Loan Bank System, which consists of 12 regional banks. The Federal Home Loan Bank System provides a central credit facility primarily for member savings and loan associations and savings banks and other member financial institutions. At December 31, 2005, our investment in stock of the Federal Home Loan Bank of Indianapolis was \$1.0 million. For the year ended December 31, 2005, dividends paid to us by the Federal Home Loan Bank of Indianapolis totaled \$44,000.

All 12 Federal Home Loan Banks are required by law to provide funds to establish affordable housing programs through direct loans or interest subsidies on advances to members to be used for lending at subsidized interest rates for low- and moderate-income, owner-occupied housing projects, affordable rental housing, and certain other community projects. These contributions and obligations could adversely affect the value of the Federal Home Loan Bank stock in the future. A reduction in the value of such stock may result in a corresponding reduction in our capital.

The Federal Home Loan Bank of Indianapolis serves as a reserve or central bank for member institutions within its assigned region. It is funded primarily from proceeds derived from the sale of consolidated obligations of the Federal Home Loan Bank System. It makes advances to members in accordance with policies and procedures established by the Federal Home Loan Bank and the Board of Directors of the Federal Home Loan Bank of Indianapolis.

All Federal Home Loan Bank advances must be fully secured by sufficient collateral as determined by the Federal Home Loan Bank. Eligible collateral includes first mortgage loans less than 60 days delinquent or securities evidencing interests therein, securities (including mortgage-backed securities) issued, insured or guaranteed by the federal government or any agency thereof, Federal Home Loan Bank deposits and, to a limited extent, real estate with readily ascertainable value in which a perfected security interest may be obtained. Other forms of collateral may be accepted as over collateralization or, under certain circumstances, to renew outstanding advances. All long-term advances are required to provide funds for residential home financing and the Federal Home Loan Bank has established standards of community service that members must meet to maintain access to long-term advances.

Interest rates charged for advances vary depending upon maturity, the cost of funds to the Federal Home Loan Bank of Indianapolis and the purpose of the borrowing.

## **INSURANCE OF DEPOSITS**

### ***DEPOSIT INSURANCE.***

The FDIC is an independent federal agency that insures the deposits, up to prescribed statutory limits, of banks and thrifts and safeguards the safety and soundness of the banking and thrift industries. The FDIC administers two separate insurance funds, the Bank Insurance Fund for commercial banks and state savings banks and the Savings Association Insurance Fund for savings institutions and banks that have acquired deposits from savings institutions or that previously were savings institutions.

On February 15, 2006, federal legislation to reform federal deposit insurance was signed into law. This law requires, among other things, the merger of the Savings Association Insurance Fund and the Bank Insurance Fund into a unified insurance deposit fund, an increase in the amount of federal deposit insurance coverage from \$100,000 to \$130,000 (with a cost of living adjustment to become effective in five years), and the reserve ratio to be modified to provide for a range between 1.15% and 1.50% of estimated insured deposits. The law requires the FDIC to issue implementing regulations and the changes required by the law will not become effective until final regulations have been issued, which must be no later than 270 days from February 15, 2006.

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## **BANK REGULATORY CAPITAL**

The FDIC has adopted risk-based capital ratio guidelines to which Mutual generally is subject. The guidelines establish a systematic analytical framework that makes regulatory capital requirements more sensitive to differences in risk profiles among banking organizations. Risk-based capital ratios are determined by allocating assets and specified off-balance sheet commitments to four risk weighted categories, with higher levels of capital being required for the categories perceived as representing greater risk.

Like the capital guidelines established by the Federal Reserve Board for Third Century, these guidelines divide a bank's capital into two tiers. The first tier ("Tier I") includes common equity, certain noncumulative perpetual preferred stock (excluding auction rate issues) and minority interests in equity accounts of consolidated subsidiaries, less goodwill and certain other intangible assets (except mortgage servicing rights and purchased credit card relationships, subject to certain limitations). Supplementary capital ("Tier II") includes, among other items, cumulative perpetual and long-term limited-life preferred stock, mandatory convertible securities, certain hybrid capital instruments, term subordinated debt and the allowance for loan and lease losses, subject to certain limitations, less required deductions. Banks are required to maintain a total risk-based capital ratio of 8%, of which 4% must be Tier I capital. The FDIC may, however, set higher capital requirements when a bank's particular circumstances warrant. Banks experiencing or anticipating significant growth are expected to maintain capital ratios, including tangible capital positions, well above the minimum levels.

In addition, the FDIC established guidelines prescribing a minimum Tier I leverage ratio (Tier I capital to adjusted total assets as specified in the guidelines). These guidelines provide for a minimum Tier I leverage ratio of 3% for banks that meet certain specified criteria, including that they have the highest regulatory rating and are not experiencing or anticipating significant growth. All other banks are required to maintain a Tier I leverage ratio of 3% plus an additional cushion of at least 100 to 200 basis points.

## **PROMPT CORRECTIVE REGULATORY ACTION**

The Federal Deposit Insurance Corporation Improvement Act requires, among other things, federal bank regulatory authorities to take "prompt corrective action" with respect to banks that do not meet minimum capital requirements. For these purposes, the Federal Deposit Insurance Corporation Improvement Act establishes five capital tiers: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. At December 31, 2005, Mutual was categorized as "well capitalized," meaning that its total risk-based capital ratio exceeded 10%, its Tier I risk-based capital ratio exceeded 6%, its leverage ratio exceeded 5%, and it was not subject to a regulatory order, agreement or directive to meet and maintain a specific capital level for any capital measure.

The FDIC may order savings banks that have insufficient capital to take corrective actions. For example, a savings bank that is categorized as "undercapitalized" would be subject to growth limitations and would be required to submit a capital restoration plan, and a holding company that controls such a savings bank would be required to guarantee that the savings bank complies with the restoration plan. "Significantly undercapitalized" savings banks would be subject to additional restrictions. Savings banks deemed by the FDIC to be "critically undercapitalized" would be subject to the appointment of a receiver or conservator.

## **DIVIDEND LIMITATIONS**

Under Federal Reserve Board supervisory policy, a bank holding company generally should not maintain its existing rate of cash dividends on common shares unless (i) the organization's net income available to common shareholders over the past year has been sufficient to fully fund the dividends and

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(ii) the prospective rate of earnings retention appears consistent with the organization's capital needs, asset quality, and overall financial condition. The FDIC also has authority under the Financial Institutions Supervisory Act to prohibit a bank from paying dividends if, in its opinion, the payment of dividends would constitute an unsafe or unsound practice in light of the financial condition of the bank. Under Indiana law, Third Century is precluded from paying cash dividends if, after giving effect to such dividends, Third Century would be unable to pay its debts as they become due or Third Century's total assets would be less than its liabilities and obligations to preferential shareholders.

Pursuant to the plan of conversion, Mutual established a liquidation account for the benefit of Eligible Account Holders and Supplemental Eligible Account Holders. Mutual is not permitted to pay dividends to Third Century if its net worth would be reduced below the amount required for the liquidation account.

Under Indiana law, Mutual may pay dividends without the approval of the DFI so long as its capital is unimpaired and those dividends in any calendar year do not exceed its net profits for that year plus its retained net profits for the previous two years. Dividends may not exceed undivided profits on hand (less losses, bad debts and expenses). Additional stringent regulatory requirements affecting dividend payments by Mutual, however, are established by the prompt corrective action provisions of the Federal Deposit Insurance Corporation Improvement Act, which are discussed above. Mutual's capital levels at December 31, 2005 exceeded the criteria established to be designated as a "well capitalized" institution. Such institutions are required to have a total risk-based capital ratio of 10% or greater, a Tier I risk-based capital ratio of 6% or greater and a leverage ratio of 5% or greater.

#### **REPURCHASE LIMITATIONS**

Regulations promulgated by the Federal Reserve Board provide that a bank holding company must file written notice with the Federal Reserve Board prior to any repurchase of its equity securities if the gross consideration for the purchase, when aggregated with the net consideration paid by the bank holding company for all repurchases during the preceding 12 months, is equal to 10% or more of the holding company's consolidated net worth. This notice requirement is not applicable, however, to a bank holding company that exceeds the thresholds established for a well capitalized bank and that satisfies certain other regulatory requirements.

Under Indiana law, Third Century will be precluded from repurchasing its equity securities if, after giving effect to such repurchase, Third Century would be unable to pay its debts as they become due or Third Century's assets would be less than its liabilities and obligations to preferential shareholders.

#### **LOANS-TO-ONE BORROWER**

Under Indiana law, the total loans and extension of credit by an Indiana-chartered savings bank to a borrower outstanding at one time and not fully secured may not exceed 15% of such bank's capital and unimpaired surplus. An additional amount up to 10% of the bank's capital and unimpaired surplus may be loaned to the same borrower if such loan is fully secured by readily marketable collateral having a market value, as determined by reliable and continuously available price quotations, at least equal to the amount of such additional loans outstanding.

As of December 31, 2005, the principal amount of the largest aggregate amount of loans which Mutual had to any one borrower was approximately \$1.8 million. Mutual had no loans outstanding which management believes violate the applicable loans-to-one borrower limits. Mutual does not believe that the loans-to-one borrower limits have a significant impact on its business, operations and earnings.

#### **LIMITATIONS ON RATES PAID FOR DEPOSITS**

Regulations promulgated by the FDIC pursuant to the Federal Deposit Insurance Corporation Improvement Act place limitations on the ability of insured depository institutions to accept, renew or roll

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over deposits by offering rates of interest which are significantly higher than the prevailing rates of interest on deposits offered by other insured depository institutions having the same type of charter in such depository institution's normal market area. Under these regulations, "well-capitalized" depository institutions may accept, renew or roll such deposits over without restriction, "adequately capitalized" depository institutions may accept, renew or roll such deposits over with a waiver from the FDIC (subject to certain restrictions on payments of rates) and "undercapitalized" depository institutions may not accept, renew or roll such deposits over. The regulations contemplate that the definitions of "well capitalized," "adequately capitalized" and "undercapitalized" will be the same as the definition adopted by the agencies to implement the prompt corrective action provisions of the Federal Deposit Insurance Corporation Improvement Act. Mutual does not believe that these regulations will have a materially adverse effect on its current operations.

### **FEDERAL RESERVE SYSTEM**

Federal Reserve Board regulations require savings institutions and savings banks to maintain reserves against their transaction accounts (primarily negotiable order of withdrawal accounts) and certain nonpersonal time deposits. The reserve requirements are subject to adjustment by the Federal Reserve Board. As of December 31, 2005, Mutual was in compliance with the applicable reserve requirements of the Federal Reserve Board.

### **ADDITIONAL LIMITATIONS ON ACTIVITIES**

Laws and regulations of the FDIC generally provide that Mutual may not engage as principal in any type of activity, or in any activity in an amount, not permitted for national banks, or directly acquire or retain any equity investment of a type or in an amount not permitted for national banks. The FDIC has authority to grant exceptions from these prohibitions (other than with respect to non-service corporation equity investments) if it determines no significant risk to the insurance fund is posed by the amount of the investment or the activity to be engaged in, and if Mutual is and continues to be in compliance with fully phased-in capital standards. National banks are generally not permitted to hold equity investments other than shares of service corporations and certain federal agency securities. Moreover, the activities in which service corporations are permitted to engage are limited to those of service corporations for national banks.

### **OTHER INDIANA REGULATIONS**

As an Indiana-chartered savings bank, Mutual derives its authority from, and is regulated by, the DFI. The DFI has the right to promulgate rules and regulations necessary for the supervision and regulation of Indiana-chartered savings banks under its jurisdiction and for the protection of the public investing in such institutions. The regulatory authority of the DFI includes, but is not limited to, the establishment of reserve requirements; the regulation of the payment of dividends; the regulation of stock repurchases; the regulation of incorporators, shareholders, directors, officers and employees; the establishment of permitted types of withdrawable accounts and types of contracts for savings programs, loans and investments; and the regulation of the conduct and management of savings banks, chartering and branching of institutions, mergers, conversions and conflicts of interest.

The DFI generally conducts regular annual examinations of Indiana-chartered savings banks such as Mutual. The purpose of such examination is to assure that institutions are being operated in compliance with applicable Indiana law and regulations and in a safe and sound manner. In addition, the DFI is required to conduct an examination of any institution as often as it deems necessary. The DFI has the power to issue cease and desist orders if any person or institution is engaging in, or has engaged in, any unsafe or unsound practice in the conduct of its business or has or is violating any other law, rule or regulation and, as to officers and directors of an Indiana savings bank, breached his fiduciary duty as an officer or director.



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With the approval of the DFI, a savings bank may merge or consolidate with another savings bank, a state bank, a national bank, or a federal or state savings association. In considering whether to approve or disapprove such a merger or consolidation, the DFI is to consider the following factors: (i) whether the institutions are operated in a safe, sound and prudent manner; (ii) whether the financial conditions of any of the institutions will jeopardize the financial stability of the other institutions; (iii) whether the proposed merger or consolidation will result in an institution that has inadequate capital, unsatisfactory management or poor earnings prospects; (iv) whether the management or other principals of the resulting institution are qualified by character and financial responsibility to control and operate in a legal and proper manner the resulting institution; (v) whether the interests of the depositors and creditors of the institutions and the public generally will be jeopardized by the transaction; and (vi) whether the institutions furnish all of the information the DFI requires in reaching its decision.

Acquisitions of control of Mutual by a bank or bank holding company would require the prior approval of the DFI. Control is defined as the power, directly or indirectly, (i) to vote 25% or more of the voting stock of an Indiana-chartered savings bank or (ii) to exercise a controlling influence over the management or policies of a savings bank.

## **SAFETY AND SOUNDNESS STANDARDS**

In 1995, the federal banking agencies adopted final safety and soundness standards for all insured depository institutions. The standards, which were issued in the form of guidelines rather than regulations, relate to internal controls, information systems, internal audit systems, loan underwriting and documentation, compensation and interest rate exposure. In general, the standards are designed to assist the federal banking agencies in identifying and addressing problems at insured depository institutions before capital becomes impaired. If an institution fails to meet these standards, the appropriate federal banking agency may require the institution to submit a compliance plan. Failure to submit a compliance plan may result in enforcement proceedings.

## **TRANSACTIONS WITH AFFILIATES**

Mutual is subject to Sections 22(h), 23A and 23B of the Federal Reserve Act, which restrict financial transactions between banks and affiliated companies. The statute limits credit transactions between a bank and its executive officers and its affiliates, prescribes terms and conditions for bank affiliate transactions deemed to be consistent with safe and sound banking practices, and restricts the types of collateral security permitted in connection with a bank's extension of credit to an affiliate.

## **FEDERAL SECURITIES LAW**

The shares of common stock of Third Century are registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934 (the "1934 Act"). Third Century is subject to the information, proxy solicitation, insider trading restrictions and other requirements of the 1934 Act and the rules of the Securities and Exchange Commission issued under the 1934 Act. After three years following Mutual's conversion to stock form, if Third Century has fewer than 300 shareholders of record, it may deregister its shares under the 1934 Act and cease to be subject to the foregoing requirements.

Shares of common stock held by persons who are affiliates of Third Century may not be resold without registration unless sold in accordance with the resale restrictions of Rule 144 under the Securities Act of 1933 as amended (the "1933 Act"). If Third Century meets the current public information requirements under Rule 144, each affiliate of Third Century who complies with the other conditions of Rule 144 (including those that require the affiliate's sale to be aggregated with those of certain other persons) would be able to sell in the public market, without registration, a number of shares not to exceed, in any three-month period, the greater of (i) 1% of the outstanding shares of Third

Century or (ii) the average weekly volume of trading in such shares during the preceding four calendar weeks.

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## **COMMUNITY REINVESTMENT ACT MATTERS**

Federal law requires disclosures of depository institutions' ratings under the Community Reinvestment Act of 1977. The disclosure includes both a four-unit descriptive rating — outstanding, satisfactory, needs to improve, and substantial noncompliance — and a written evaluation of each institution's performance. Each Federal Home Loan Bank is required to establish standards of community investment or service that its members must maintain for continued access to long-term advances from the Federal Home Loan Banks. The standards take into account a member's performance under the Community Reinvestment Act and its record of lending to first-time home buyers. The examiners have determined that Mutual has a satisfactory record of meeting community credit needs.

## **SARBANES-OXLEY ACT OF 2002**

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act). The Sarbanes-Oxley Act's stated goals include enhancing corporate responsibility, increasing penalties for accounting and auditing improprieties at publicly traded companies and protecting investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. The Sarbanes-Oxley Act generally applies to all companies that file or are required to file periodic reports with the Securities and Exchange Commission under the 1934 Act.

Among other things, the Sarbanes-Oxley Act creates the Public Company Accounting Oversight Board as an independent body subject to SEC supervision with responsibility for setting auditing, quality control and ethical standards for auditors of public companies. The Sarbanes-Oxley Act also requires public companies to make faster and more-extensive financial disclosures, requires the chief executive officer and chief financial officer of public companies to provide signed certifications as to the accuracy and completeness of financial information filed with the SEC, and provides enhanced criminal and civil penalties for violations of the federal securities laws.

The Sarbanes-Oxley Act also addresses functions and responsibilities of audit committees of public companies. The statute makes the audit committee directly responsible for the appointment, compensation and oversight of the work of the company's outside auditor, and requires the auditor to report directly to the audit committee. The Sarbanes-Oxley Act authorizes each audit committee to engage independent counsel and other advisors, and requires a public company to provide the appropriate funding, as determined by its audit committee, to pay the company's auditors and any advisors that its audit committee retains. The Sarbanes-Oxley Act also requires public companies to include an internal control report and assessment by management, along with an attestation to this report prepared by the company's registered public accounting firm, in their annual reports to stockholders.

Although the Company will incur additional expense in complying with the provisions of the Sarbanes-Oxley Act and the resulting regulations, management does not expect that such compliance will have a material impact on the Company's results of operations or financial condition.

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## TAXATION

### FEDERAL TAXATION

Historically, savings institutions, such as Mutual, have been permitted to compute bad debt deductions using either the bank experience method or the percentage of taxable income method. However, for years beginning after December 31, 1995, no savings institution could use the percentage of taxable income method of computing its allowable bad debt deduction for tax purposes. Instead, all savings institutions are required to compute their allowable deduction using the experience method. As a result of the repeal of the percentage of taxable income method, reserves taken after 1987 using the percentage of taxable income method generally must be included in future taxable income over a six-year period, although a two-year delay may be permitted for associations meeting a residential mortgage loan origination test. We do not have any reserves taken after 1987 that must be recaptured. However, our pre-1988 reserve, for which no deferred taxes have been recorded, must be recaptured into income if (i) Mutual no longer qualifies as a bank under the Internal Revenue Code, or (ii) it pays out excess dividends or distributions. Although we do have some reserves from before 1988, we are not required to recapture these reserves.

Depending on the composition of its items of income and expense, a savings institution may be subject to the alternative minimum tax. A savings institution must pay an alternative minimum tax on the amount (if any) by which 20% of alternative minimum taxable income, as reduced by an exemption varying with alternative minimum taxable income, exceeds the regular tax due. Alternative minimum taxable income equals regular taxable income increased or decreased by certain tax preferences and adjustments, including depreciation deductions in excess of that allowable for alternative minimum tax purposes, tax-exempt interest on most private activity bonds issued after August 7, 1986 (reduced by any related interest expense disallowed for regular tax purposes), the amount of the bad debt reserve deduction claimed in excess of the deduction based on the experience method and 75% of the excess of adjusted current earnings over alternative minimum taxable income (before this adjustment and before any alternative tax net operating loss). Alternative minimum taxable income may be reduced only up to 90% by net operating loss carryovers, but alternative minimum tax paid can be credited against regular tax due in later years.

For federal income tax purposes, we have been reporting our income and expenses on the accrual method of accounting. Our federal income tax returns have not been audited in recent years.

The Company and Mutual have not and do not anticipate electing to file a consolidated federal income tax return for 2005. Accordingly, the Company will be taxed separately on its earnings as an ordinary corporation.

### STATE TAXATION

The Company, Mutual and Mutual Financial Services are subject to Indiana's Financial Institutions Tax, which is imposed at a flat rate of 8.5% on "adjusted gross income." "Adjusted gross income," for purposes of the Financial Institutions Tax, begins with taxable income as defined by Section 63 of the Internal Revenue Code and, thus, incorporates federal tax law to the extent that it affects the computation of taxable income. Federal taxable income is then adjusted by several Indiana modifications. Other applicable state taxes include generally applicable sales and use taxes and real and personal property taxes. Mutual's state income tax returns have not been audited in recent years.

### ITEM 2. DESCRIPTION OF PROPERTY.

The Company conducts its business from its main office at 80 East Jefferson Street, Franklin, Indiana 46131. In addition to its main office, it has two other offices in Franklin: on North Main Street and at the Franklin United Methodist Community (retirement community). It also has an office in

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Trafalgar and an office in Nineveh. All of its offices are in Johnson County. The Company owns its main office, its office on North Main Street in Franklin and its Trafalgar office and it leases its other offices.

The Company currently operates three automatic teller machines, with one ATM located at its office on North Main Street in Franklin and one located at each of its offices in Trafalgar and Nineveh. Mutual's ATMs participate in the STAR<sup>®</sup> network.

The following table provides certain information with respect to the Company's offices as of December 31, 2005:

| Description and Address    | Owned or Leased | Lease Expiration Date | Year Opened | Net Book Value of Property, Furniture & Fixtures <sup>(3)</sup> |
|----------------------------|-----------------|-----------------------|-------------|---|
| <b>Main Office</b>         |                 |                       |             |   |
| 80 East Jefferson Street   | Owned           | N/A                   | 1890        | \$ 860,912  |
| <b>Main Street Office</b>  |                 |                       |             |   |
| 1124 North Main Street     | Owned           | N/A                   | 1995        | \$1,006,574   |
| <b>Methodist Community</b> |                 |                       |             |   |
| 1070 West Jefferson Street | Leased          | 2009 <sup>(1)</sup>   | 1997        | \$ 10,280   |
| <b>Trafalgar Office</b>    |                 |                       |             |   |
| 2 Trafalgar Square         | Owned           | N/A                   | 1993        | \$ 348,664  |
| <b>Nineveh Office</b>      |                 |                       |             |   |
| 7459 South Nineveh Road    | Leased          | 2007 <sup>(2)</sup>   | 2001        | \$ 33,318   |

(1) The lease is for a term of five years commencing on September 1, 2004.

(2) The lease is for a term of five years commencing on January 1, 2002.

(3) The above table excludes \$637,068 for facilities under construction and the Bank's data processing equipment.

Management believes that the Company's properties are in good condition and are suitable and adequate for continuing to conduct its business as it is now being conducted. In addition to these branches, the Company purchased a building adjacent to its main office in Franklin and a building site in southeastern Marion County. The Company renovated the 72 East Jefferson Street building to house its administrative, trust and audit operations. As for the building site in southeastern Marion County, the Company invested \$529,000 in 2005 towards the construction of a new facility, known as its Franklin Central Branch. The Company's newest branch is scheduled to open in the spring of 2006.

The Company owns the computer and data processing equipment that it uses for transaction processing, loan origination, and accounting. The net book value of this equipment was approximately \$99,000 at December 31, 2005. The Company also has contracted for the data processing and reporting services of Intrieve Incorporated in Cincinnati, Ohio. The cost of these data processing services is approximately \$28,000 per month.

### ITEM 3. LEGAL PROCEEDINGS.

The Company is not a party to any pending legal proceedings, other than routine litigation incidental to the business.

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**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.**

No matter was submitted to a vote of Third Century's shareholders during the quarter ended December 31, 2005.

**ITEM 4.5. EXECUTIVE OFFICERS OF THE REGISTRANT.**

The executive officers of Third Century are identified below. The executive officers of Mutual are elected annually by Third Century's Board of Directors.

| <b>Name</b>       | <b>Position with Third Century</b>                   | <b>Position with Mutual</b>                          |
|-------------------|--|--|
| Robert D. Heuchan | President and Chief Executive Officer                | President and Chief Executive Officer                |
| David A. Coffey   | Executive Vice President and Chief Operating Officer | Executive Vice President and Chief Operating Officer |
| Debra K. Harlow   | Chief Financial Officer                              | Chief Financial Officer                              |

**Robert D. Heuchan** (age 52) has served as the President, Chief Executive Officer and director of Third Century since its formation in March 2004 and of Mutual since 1991. He has served as Vice Chairman of the Mutual Board of Directors since 1999. He also has been President of Mutual Financial Services since its formation in 1991. Mr. Heuchan is a graduate of Franklin College and has an MBA from the University of Indianapolis.

**David A. Coffey** (age 43) has served as Executive Vice President, Chief Operating Officer and a director of Third Century since its formation in March 2004 and of Mutual since 1999. He began serving Mutual as the Chief Operating Officer in 1998, and was a Senior Vice President prior to being named Executive Vice President. Mr. Coffey is a graduate of Franklin College.

**Debra K. Harlow** (age 54) has served as Chief Financial Officer of Third Century since its formation in March 2004 and of Mutual since January 2004. Prior to that time she served Mutual as the EDP Coordinator.

**PART II**

**ITEM 5. MARKET FOR COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND SMALL BUSINESS ISSUER PURCHASES OF EQUITY SECURITIES.**

The information required by this item is incorporated by reference to the material under the heading "Market Price of Third Century's Common Shares and Related Shareholder Matters" on page 43 of Third Century's 2005 Shareholder Annual Report in the form attached to this report as Exhibit 13 (the "**Shareholder Annual Report**").

The Company repurchased no shares of its common stock during the fourth quarter of 2005.

**ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION.**

The information required by this item is incorporated by reference to pages 3 through 18 of the Shareholder Annual Report.



## **ASSET/LIABILITY MANAGEMENT**

Mutual, like other financial institutions, is subject to interest rate risk to the extent that its interest-earning assets reprice differently than its interest-bearing liabilities. As part of its effort to monitor and manage interest rate risk, Mutual uses the net portfolio value (“**NPV**”) methodology. Mutual utilizes the services of an outside consulting firm to assist management in the monitoring and management of its interest rate sensitivity.

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Generally, NPV is the difference between discounted present value of incoming cash flows on interest-earning assets and the present value of outgoing cash flows on interest-bearing liabilities. Interest rate risk is evaluated by stressing the balance sheet by applying hypothetical instantaneous parallel shifts in market interest rates of plus and minus 300 basis points ("b.p.") (one basis point equals .01%). Due to the recent low level of market interest rates, the minus 300 b.p. case was temporarily limited to minus 200 b.p. for 2004, but is back to 300 b.p. for 2005. The resulting NPVs are compared with the NPV in a base case of no change in market rates. Management uses this information to determine what actions should be taken to maximize profits within the guidelines of an acceptable level of interest rate risk.

Federally chartered thrifts are required to provide standardized asset liability management data on their call reports and are provided asset liability management reports by their regulator using interest rate scenarios of minus 300 b.p. to plus 300 b.p. in increments of 100 b.p. However, as a state chartered, FDIC insured savings bank, there is no standard set of rate scenarios required, nor provided, by our regulators. All of our asset/liability management policies, reports, and analyses typically use an instantaneous, parallel shift in the yield curve of plus and minus 300 b.p. We believe that these extreme cases are most important in evaluating our interest rate risk, and that the intermediate cases would provide little additional information about our risk while adding significant complexity and cost.

During 2004, the very low interest rates necessitated a temporary adjustment in the minus 300 b.p. scenario. Since short-term interest rates used in our asset/liability management model, *e.g.* the 3-month Treasury bills, were below 3%, it was impossible to evaluate a parallel shift in the entire yield curve of minus 3% or more. So out of necessity we temporarily reduced our down rate case to minus 200 b.p. In 2005, we returned to the use of the minus 300 b.p. scenario once rates arose to the level which accommodated such a parallel shift.

If estimated changes in NPV exceed the guidelines established by the Board, management implements a program to adjust Mutual's asset and liability mix to bring interest rate risk within the Board's guidelines. The current Board approved limit is a 2.50% decrease in NPV relative to assets for a 300 b.p. instantaneous change in interest rates. Presented below, as of December 31, 2005 and 2004, are analyses prepared by the outside consulting firm of Mutual's interest rate risk as measured by changes in NPV for instantaneous and sustained parallel shifts of +300/-300 b.p. and +300/-200 b.p. changes in market interest rates for 2005 and 2004, respectively.

| 2005<br>Change in<br>Rates | 2005<br>Net Portfolio Value |            | 2005<br>% Change | 2005<br>NPV as % of PV of Assets |        |
|----------------------------|-----------------------------|------------|------------------|----------------------------------|--------|
|                            | \$ Amount                   | \$ Change  |                  | NPV Ratio                        | Change |
| +300<br>b.p.*              | \$ 9,769                    | \$ (2,250) | -18.7%           | 8.51%                            | -1.83% |
| 0 b.p.                     | 12,019                      |            |                  | 9.78                             |        |
| -300<br>b.p.               | 10,593                      | (-1,426)   | -11.9            | 8.25                             | -1.16  |

| 2004<br>Change in<br>Rates | 2004<br>Net Portfolio Value |           | 2004<br>% Change | 2004<br>NPV as % of PV of Assets |        |
|----------------------------|-----------------------------|-----------|------------------|----------------------------------|--------|
|                            | \$ Amount                   | \$ Change |                  | NPV Ratio                        | Change |
| +300<br>b.p.*              | \$11,043                    | \$(2,511) | -18.5%           | 9.76%                            | -2.06% |
| 0 b.p.                     | 13,553                      |           |                  | 11.11                            |        |
| -200<br>b.p.               | 12,068                      | (1,486)   | -11.0            | 9.58                             | -1.22  |

\*Basis Points

As with any method of measuring interest rate risk, certain shortcomings are inherent in the methods of analysis presented above. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rate. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates.

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Additionally, certain assets, such as adjustable-rate loans, have features which restrict changes in interest rates on a short-term basis and over the life of the asset. Further, in the event of a change in interest rates, expected rates of prepayments on loans and early withdrawals from certificates could likely deviate significantly from those assumed in calculating the table.

Based upon the December 31, 2005 estimation, Mutual's NPV would decrease by 1.83% of assets in the event of an immediate 300 b.p. increase in interest rates and decrease 1.16% in the event of an immediate 300 b.p. decrease in interest rates.

The data in the above table are based, in part, upon assumptions about the future behavior of borrowers, depositors and investors. While these assumptions are reasonable based upon past behavior, it is important to be mindful that any such projections are subject to error.

## ITEM 7. FINANCIAL STATEMENTS.

The Company's Consolidated Financial Statements and Notes to Consolidated Financial Statements contained on the pages in the Shareholder Annual Report set forth below are incorporated herein by reference.

| <b>Financial Statements</b>  | <b>Annual Report<br/>Page No.</b> |
|--|-----------------------------------|
| Report of Independent Registered Public Accounting Firm  | <b>19</b>                         |
| Consolidated Balance Sheets at December 31, 2005 and 2004                                      | <b>20</b>                         |
| Consolidated Statements of Income for the Years Ended December 31, 2005 and 2004               | <b>21</b>                         |
| Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2005 and 2004 | <b>22</b>                         |
| Consolidated Statements of Cash Flows for the Years Ended December 31, 2005 and 2004           | <b>23</b>                         |
| Notes to Consolidated Financial Statements   | <b>24</b>                         |

All schedules are omitted as the required information either is not applicable or is included in the Consolidated Financial Statements or related notes.

## ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

## ITEM 8A. 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 the Company's disclosure controls and procedures (as defined in Sections 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended), as of the end of the most recent fiscal quarter covered by this annual report (the "**Evaluation Date**"), have concluded that as of the Evaluation Date, the Company's disclosure controls and procedures are adequate and are designed to ensure that material information relating to the Company would be made known to such officers by others within the Company on a timely basis.

(b) **Changes in internal controls.** There were no significant changes in the Company's internal control over financial reporting identified in connection with the Company's evaluation of controls that occurred during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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**ITEM 8B. OTHER INFORMATION.**

None.

**PART III**

**ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS;  
COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT.**

The information required by this item is incorporated by reference from the definitive proxy statement for the 2006 Annual Meeting of Shareholders.

**ITEM 10. EXECUTIVE COMPENSATION.**

The information required by this item is incorporated by reference from the definitive proxy statement for the 2006 Annual Meeting of Shareholders.

**ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND  
RELATED STOCKHOLDER MATTERS.**

The information required by this item is incorporated by reference from the definitive proxy statement for the 2006 Annual Meeting of Shareholders.

**ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.**

The information required by this item is incorporated by reference from the definitive proxy statement for the 2006 Annual Meeting of Shareholders.

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**ITEM 13. EXHIBITS.**

| <b>EXHIBIT NO.</b> | <b>DESCRIPTION</b>  |
|--------------------|---|
| 3(1)               | Registrant's Articles of Incorporation are incorporated by reference to Exhibit 3(1) to the Registration Statement on Form SB-2 (Registration No. 333-113691) (the "Registration Statement"). |
| 3(2)               | Registrant's Amended Code of By-Laws is incorporated by reference to Exhibit 3(1) to the Registrant's Form 10-QSB for the quarter ended September 30, 2004.                                   |
| 10(1)              | Third Century Stock Option Plan is incorporated by reference to Exhibit 10(1) to the Registration Statement.  |
| 10(2)              | Mutual Savings Bank Recognition and Retention Plan and Trust is incorporated by reference to Exhibit 10(2) to the Registration Statement.   |
| 10(3)              | Employment Agreement between Mutual Savings Bank and Robert D. Heuchan is incorporated by reference to Exhibit 10(3) to the Registration Statement.   |
| 10(4)              | Employment Agreement between Mutual Savings Bank and David A. Coffey is incorporated by reference to Exhibit 10(4) to the Registration Statement.   |
| 10(5)              | Third Century Bancorp Employee Stock Ownership Plan and Trust Agreement is incorporated by reference to Exhibit 10(5) to the Registration Statement.  |
| 10(6)              | Service Agreement with Intrieve, Incorporated is incorporated by reference to Exhibit 10(6) to the Registration Statement.  |
| 10(7)              | Exempt Loan and Share Purchase Agreement (incorporated by reference to the Annual Report on Form 10-KSB for the year ended December 31, 2004).  |
| 13                 | 2005 Shareholder Annual Report  |
| 14                 | Code of Ethics (incorporated by reference to the Annual Report on Form 10-KSB for the year ended December 31, 2004).  |
| 21                 | Subsidiaries of the Registrant  |
| 23                 | Consent of BKD, LLP   |
| 31(1)              | Chief Executive Officer Certification   |
| 31(2)              | Chief Financial Officer Certification   |
| 32                 | Section 906 Certification   |

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.**

Incorporated by reference into the definitive proxy statement of the Company for the 2006 Annual Meeting of Shareholders.

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**SIGNATURES**

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

THIRD CENTURY BANCORP

Date: March 16, 2006

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

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signatures                                       | Title  | Date           |
|--|--|----------------|
| /s/ Robert D. Heuchan<br>Robert D. Heuchan       | President, Chief Executive Officer<br>and Director                         | March 16, 2006 |
| /s/ Debra K. Harlow<br>Debra K. Harlow           | Chief Financial Officer<br>(Principal Financial and<br>Accounting Officer) | March 16, 2006 |
| /s/ David A. Coffey<br>David A. Coffey           | Director   | March 16, 2006 |
| /s/ Robert L. Ellett<br>Robert L. Ellett         | Director   | March 16, 2006 |
| /s/ Jerry D. Petro<br>Jerry D. Petro             | Director   | March 16, 2006 |
| /s/ Robert D. Schafstall<br>Robert D. Schafstall | Director   | March 16, 2006 |

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