

Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

1ST INDEPENDENCE FINANCIAL GROUP, INC.

Form 10-K

March 28, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13
or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2006
Commission file number: 0-26570

1ST INDEPENDENCE FINANCIAL GROUP, INC.
(Exact name of registrant as specified in its charter)

Delaware 61-1284899
(State or other jurisdiction of (I.R.S. Employer Identification No.)
incorporation or organization)

8620 Biggin Hill Lane 40220-4117
Louisville, Kentucky (Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (502)753-0500

Securities registered pursuant to Section 12(b) of the Act:

Table with 2 columns: Title of Class, Name of each exchange on which registered. Row 1: Common Stock, par value \$0.10 per share, The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [ ] No [X]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes [ ] No [X]

Indicate by check mark whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not 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-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

# Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

The aggregate market value of the voting common stock held by non-affiliates of the registrant was approximately \$27,977,262 as of June 30, 2006.

The number of shares outstanding of the registrant's common stock as of March 15, 2007 was 1,995,594.

## DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of this Report on Form 10-K, to the extent not set forth herein, is incorporated herein by reference to the registrant's definitive proxy statement to be filed in connection with the annual meeting of stockholders to be held May 17, 2007.

=====

1ST INDEPENDENCE FINANCIAL GROUP, INC.  
FORM 10-K  
For the Year Ended December 31, 2006

## INDEX

	Page
PART I	
Item 1. Business.....	3
Item 1A. Risk Factors.....	13
Item 1B. Unresolved Staff Comments.....	17
Item 2. Properties.....	18
Item 3. Legal Proceedings.....	18
Item 4. Submission of Matters to a Vote of Security Holders.....	18
PART II	
Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.....	19
Item 6. Selected Financial Data.....	21
Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation.....	22
Item 7A. Quantitative and Qualitative Disclosures About Market Risk....	29
Item 8. Financial Statements and Supplementary Data.....	30
Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.....	58
Item 9A. Controls and procedures.....	58
Item 9B. Other Information.....	58
PART III	
Item 10. Directors, Executive Officers and Corporate Governance.....	58
Item 11. Executive Compensation.....	58
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.....	58
Item 13. Certain Relationships and Related Transactions, and Director Independence.....	58
Item 14. Principal Accounting Fees and Services.....	58

## PART IV

# Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

Item 15. Exhibits, Financial Statement Schedules.....	59
Signatures.....	61

## PART I

### Item 1. Business.

#### General

1st Independence Financial Group, Inc. (the "Company") was organized as a Delaware corporation in June 1995 and is a bank holding company based in Louisville, Kentucky which owns 1st Independence Bank, Inc. (the "Bank"). During 2004, the Company merged with Independence Bancorp, New Albany, Indiana. The Bank currently serves its customers through a network of eight branch offices located in Harrodsburg, Lawrenceburg and Louisville (Stony Brook main office branch and St. Matthews branch office), Kentucky and New Albany, Jeffersonville, Marengo and Clarksville, Indiana. The Bank also operates a mortgage division, 1st Independence Mortgage, which originates one-to-four family residential mortgage loans. 1st Independence Mortgage operates throughout the Bank's branch network. The Bank also offers limited trust services. On November 1, 2004, the Bank formed a title insurance company, Foundation Title Company, LLC, located in Jeffersonville, Indiana. The Company decided to exit the title insurance business at the end of November 2005 and sold the title insurance company at its carrying value.

The Company provides commercial and retail banking services, with an emphasis on commercial real estate loans, one-to-four family residential mortgage loans via 1st Independence Mortgage, home equity loans and lines of credit and consumer loans as well as certificates of deposit, checking accounts, money-market accounts and savings accounts within its market area. At December 31, 2006, the Company had total assets, deposits and equity of \$342.8 million, \$254.1 million, and \$40.3 million, respectively. The Company's business is conducted principally through the Bank. Unless otherwise indicated, all references to the Company refer collectively to the Company and the Bank and its subsidiaries.

In January 2005, the Company completed the sale of its entire interest in its majority owned subsidiary, Citizens Financial Bank, Inc., Glasgow, Kentucky ("Citizens") to another financial institution for \$2.3 million. The sale of Citizens reflected the Company's revised strategic plan to exit the south central Kentucky market and to focus on the growing markets of southern Indiana, central Kentucky, and greater Louisville, Kentucky. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets", the financial position and results of operations of Citizens prior to the sale were removed from the detail line items in the Company's financial statements and presented separately as "subsidiary held for disposal." In a related transaction the Bank purchased in January 2005 a commercial building located in Louisville, Kentucky, for \$2.3 million from an affiliate of the financial institution which purchased Citizens. The Bank moved its finance and accounting, loan and deposit operations, and mortgage banking operations into the building in April 2005. The Bank also received regulatory approval during the second quarter of 2005 to establish a full service branch at this location which it opened in November 2005. See note 3 to the Company's consolidated financial statements, presented herein, for additional information. Additionally, the financial tables also presented herein, have been revised to reflect the discontinued operations of Citizens prior to the sale.

#### Market Area and Competition

The competition for deposit products comes from other insured financial institutions such as commercial banks, thrift institutions, credit unions, and multi-state regional banks in the Company's market area of Anderson, Jefferson, and Mercer Counties in Kentucky and Floyd, Clark and Crawford Counties in Indiana. Deposit competition also includes a number of insurance products sold

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

by local agents and investment products such as mutual funds and other securities sold by local and regional brokers. Loan competition varies depending upon market conditions and comes from other insured financial institutions such as commercial banks, thrift institutions, credit unions, multi-state regional banks, and mortgage bankers.

Analysis of Loan Portfolio. The following table (in thousands except percentages) sets forth information concerning the composition of the Company's loan portfolio in dollar amounts and in percentages of the total loan portfolio as of the dates indicated. Loan balances related to the discontinued operations of Citizens have been eliminated.

	December 31,							
	2006		2005		2004		2003	
	Amount	Percent of Total loans	Amount	Percent of Total loans	Amount	Percent of Total loans	Amount	Percent of Total loans
Real estate:								
Commercial	\$ 49,943	18%	\$ 46,731	17%	\$ 35,746	15%	\$13,128	
Residential	121,216	45	128,949	48	125,433	53	61,495	
Construction	64,244	23	51,877	19	33,600	14	2,977	
Commercial	20,393	7	23,757	9	21,040	9	3,365	
Consumer								
Home equity	14,026	5	16,615	6	16,672	7	1,963	
Other	4,401	2	1,960	1	3,706	2	1,327	
Total loans	274,223	100%	269,889	100%	236,197	100%	84,255	
Less: allowance for loan losses	3,745		2,911		2,549		391	
Loans, net	\$270,478		\$266,978		\$233,648		\$83,864	
Loans held for sale	\$1,227		\$1,278		\$2,344		\$ -	

### Loan Maturity Tables

The following table (in thousands) sets forth the maturity of the Company's loan portfolio at December 31, 2006. The table does not include prepayments or scheduled principal repayments. Adjustable-rate mortgage loans are shown as maturing based on contractual maturities.

	Due within 1	Due after 1	Due after 5	Total
	year	through 5	years	
	-----	-----	-----	-----
Real estate:				
Commercial	\$16,156	\$13,421	\$ 20,366	\$ 49,943
Residential	19,637	13,292	88,287	121,216
Construction	47,899	13,512	2,833	64,244
Commercial	11,156	3,760	5,477	20,393
Consumer	2,100	14,154	2,173	18,427
Total	\$96,948	\$58,139	\$119,136	\$274,223

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

The following table (in thousands) sets forth as of December 31, 2006 the dollar amount of all loans that are due after December 31, 2007 and have either fixed rates of interest or floating or adjustable interest rates.

	Fixed rates -----	Floating or adjustable rates -----	Total -----
Real estate:			
Commercial	\$ 7,745	\$ 26,042	\$ 33,787
Residential	28,428	73,150	101,578
Construction	1,354	14,992	16,346
Commercial	5,725	3,512	9,237
Consumer	3,194	13,133	16,327
	-----	-----	-----
Total	\$46,446 =====	\$130,829 =====	\$177,275 =====

Commercial Real Estate Loans. The commercial real estate loans originated are generally made to individuals, small businesses and partnerships located in the Company's primary market area. Such loans are generally secured by first mortgages on apartment buildings, office buildings, churches and other properties. Adjustable-rate loans for this type of lending have a margin that is 50 to 150 basis points higher than the margin added to single-family owner-occupied property loans. Commercial real estate loans are typically adjustable-rate loans with terms of 25 years or less and loan-to-value ratios typically not exceeding 80%. At December 31, 2006, commercial real estate loans totaled approximately \$49.9 million or 18% of the total loan portfolio.

Commercial real estate lending entails significant additional risks as compared to one- to four-family residential lending. For example, such loans typically involve large loans to single borrowers or related borrowers, the payment experience on such loans is typically dependent on the successful operation of the project, and these risks can be significantly affected by the supply and demand conditions in the market for commercial property.

Loans secured by commercial real estate generally involve a greater degree of risk than residential mortgage 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. If the cash flow from the project is reduced, the borrower's ability to repay the loan may be impaired. To minimize these risks, the Company generally limits loans of this type to its market area and to borrowers with which it has substantial experience and expertise in the commercial real estate market. The Company's underwriting procedures require verification of the borrower's credit history, income, financial statements, banking relationships, credit references, and income projections for the property. It is their current practice to obtain personal guarantees from all principals obtaining this type of loan. The Company also obtains appraisals on each property.

Included in the commercial real estate loan category are agricultural loans. At December 31, 2006, agricultural loans totaled \$2.1 million, or less than 1% of the Company's loan portfolio.

Residential Loans. The Company's residential loans consist of one- to four-family residential mortgage loans that are secured by property located in its primary market area. The Company generally originates one- to four-family residential mortgage loans without private mortgage insurance in amounts up to 85% of the lesser of the appraised value or selling price of the mortgaged property. Loans in excess of 89.9% of the value of the mortgaged property typically carry higher rates commensurate with the higher risk associated with this type of loan. At December 31, 2006, one-to four-family residential mortgage loans totaled approximately \$121.2 million, or 45% of the total loan portfolio.

The Company offers three types of residential adjustable rate mortgage

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

loans, all of which use the index value of the Weekly Average Yield on United States Treasury Securities Adjusted to a Constant Maturity of One Year plus a set margin added to it. The interest rates on these loans have an initial adjustment period of between one and five years, and generally adjust annually thereafter, with a maximum adjustment of 2% per year and a maximum increase of 5% over the life of the loan. The index margin on a non owner-occupied one- to four-family property loan is generally 50 basis points higher than on an owner-occupied property loan. The Company's adjustable-rate one-to- four family and multi-family mortgage loans are for terms of up to 30 years, amortized on a monthly basis, with principal and interest due each month. Borrowers may refinance or prepay loans at their option without penalty. All fixed rate one-to-four family loans with a term of ten to thirty years are originated and sold on the secondary market through 1st Independence Mortgage. At December 31, 2006, loans held for sale totaled approximately \$1.2 million.

Loan originations are generally obtained from existing and walk-in customers, members of the local community, and referrals from realtors, builders, depositors and borrowers within the Company's market area. Mortgage loans originated and held by the Company in its portfolio generally include due-on-sale clauses which gives it the contractual right to deem the loan immediately due and payable in the event that the borrower sells or otherwise transfers an interest in the property to a third party.

During periods of rising interest rates, the risk of default on adjustable-rate loans may increase due to increases in interest costs to borrowers. Further, adjustable-rate loans that provide for initial rates of interest below the fully indexed rates may be subject to increased risk of delinquency or default as the higher, fully indexed rate of interest subsequently replaces the lower, initial rate.

**Construction and Land Development Loans.** The Company engages in construction lending involving loans to qualified borrowers for construction of one- to four-family dwellings, multi-family residential units, commercial buildings and churches, and single family subdivision land development loans with the intent of such loans converting to permanent financing upon completion of construction. All construction and development loans are secured by a first lien on the property under construction. Loan proceeds are disbursed in increments as construction progresses and as inspections warrant. At December 31, 2006, construction loans totaled approximately \$64.2 million, or 23%, of the Company's total loan portfolio.

Construction/permanent loans generally have adjustable or fixed interest rates and are underwritten in accordance with the same terms and requirements as permanent mortgages, except the loans generally provide for disbursement in stages during a construction period of up to twelve months, during which the borrower is not required to make monthly principal payments. Accrued interest must be paid at completion of construction to the first day of the following month, and monthly payments start the first day of the following month if the loan is converted to permanent financing. Borrowers must satisfy all credit requirements that would apply to permanent mortgage loan financing for the subject property and must execute a construction loan agreement.

Construction financing generally is considered to involve a higher degree of risk of loss than long term financing on improved, occupied real estate. Risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property's value at completion of construction or development and the estimated cost (including interest) of construction. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction cost proves to be inaccurate, the Company may be required to advance funds beyond the amount originally committed to permit completion of the development. The Company has sought to minimize this risk by requiring precise construction cost estimates, specifications, and drawing plans from qualified borrowers in their market area along with tighter underwriting guidelines relating to borrower cash flow and net worth.

**Commercial Loans.** The Company originates fixed-rate and adjustable-rate commercial loans secured by commercial properties. These loans are typically

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

originated with maximum loan-to-value ratios of 80% of the value of the respective property. At December 31, 2006, commercial loans totaled approximately \$20.4 million, or 7%, of the total loan portfolio.

Loans secured by commercial properties generally have larger balances and involve a greater degree of risk than one- to four-family residential mortgage loans. Of primary concern in commercial lending are the borrower's creditworthiness and the feasibility and cash flow potential of the project. Payments on loans secured by income properties often depend on successful operation and management of the properties. As a result, repayment of such loans may be subject to a greater extent than residential real estate loans to adverse conditions in the real estate market or the economy. To monitor cash flows on income properties, the Company requires borrowers and loan guarantors, if any, to provide annual financial statements on commercial loans. In reaching a decision on whether to make a commercial loan, the Company considers the net operating income of the property, the borrower's expertise, credit history and profitability and the value of the underlying property. The Company generally requires an environmental survey for all commercial loans over \$500,000.

**Consumer Lending.** The Company originates consumer loans on either a secured or unsecured basis with revolving home equity lines of credit composing the majority of the consumer loan portfolio. The Company generally makes certificate of deposit loans for terms of up to the terms of the certificate of deposit collateralizing the loan and up to the face amount of the certificate. The interest rate charged on these loans is typically up to 2% higher than the rate paid on the certificate. These loans generally mature concurrently with the certificate of deposit on demand and the account must be assigned to the Company as collateral for the loan. At December 31, 2006, consumer loans totaled approximately \$18.4 million, or 7%, of the total loan portfolio.

Consumer loans may entail greater risk than residential loans, particularly in the case of consumer loans that are unsecured or secured by assets that depreciate rapidly. Repossessed collateral for a defaulted consumer loan may not be sufficient for repayment of the outstanding loan, and the remaining deficiency may not be collectible.

**Loan Approval Authority and Underwriting.** The Company has established various lending limits for its officers and maintains a loan committee that consists of the President and Chief Executive Officer, the Executive Vice President and Chief Lending Officer, the Executive Vice President and Chief Credit Officer and other officers of the Bank. The loan committee approves loans that exceed the limits established for individual officers. In January 2005, the loan policy was amended to provide for two classes of secured loans. Class I loans are those secured by investment grade securities, securities listed on the major stock exchanges, deposit accounts, life insurance cash surrender value, and real estate mortgages meeting certain loan to value ratios. Class II loans consist of all other asset-based lending. The loan committee may approve Class I and Class II loans of \$3,000,000 and \$2,000,000, respectively. At the same time, approval limits for unsecured loans were increased to \$25,000. The Bank's directors' loan committee, which consists of six outside Bank directors, must approve all loans that exceed the lending limits of the loan committee.

For all loans originated by the Company, upon receipt of a completed loan application from a prospective borrower, a credit report is generally ordered, income and certain other information is verified and, if necessary, additional financial information is requested. An appraisal of the real estate intended to be used as security for the proposed loan is obtained. All appraisals are reviewed by the Bank's loan officers designated by the Bank's Board of Directors. An independent appraiser designated and approved by the Bank's Board of Directors is utilized for all real estate mortgage loans. For construction/permanent loans, the funds advanced during the construction phase are disbursed based upon various stages of completion in accordance with the results of inspection reports that are based upon physical inspection of the construction by an independent contractor hired by the Bank or in some cases by an officer of the Bank. For real estate loans, the Bank requires either title insurance or a title opinion. Borrowers must also obtain fire and casualty, hazard or flood insurance (for loans on property located in a flood zone, flood

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

insurance is required) prior to the closing of the loan.

Loan Commitments. The Company issues written commitments to prospective borrowers on all approved commercial real estate loans in excess of \$500,000. Generally, the commitment requires acceptance within 20 days of the date of issuance. At December 31, 2006, the Company had approximately \$71 million of commitments to cover originations and unused lines of credit.

### Nonperforming and Problem Assets

Loan Delinquencies. The Company's collection procedures provide that when a loan is 10 days past due, a notice of nonpayment is sent. Delinquent notices are sent if the loan becomes delinquent for more than 30 days and generally the borrower will receive a letter or be personally contacted by an officer of the Bank. If payment is still delinquent after 60 days, the customer will again receive a letter and/or telephone call and may receive a visit from an officer representative of the Bank. If the delinquency continues, similar subsequent efforts are made to eliminate the delinquency. If the loan continues in a delinquent status for 90 days past due and no repayment plan is in effect, management will generally initiate legal proceedings.

Loans are reviewed on a monthly basis by management and are generally placed on a non-accrual status when the loan becomes more than 90 days delinquent and, in the opinion of management, the collection of additional interest is doubtful. Interest accrued and unpaid at the time a loan is placed on non-accrual status is charged against interest income. Subsequent interest payments are applied to the outstanding principal balance.

Nonperforming Assets. The following table (in thousands except percentages) sets forth information regarding nonaccrual loans, other real estate owned and certain other repossessed assets and loans. Nonperforming asset balances related to the discontinued operations of Citizens have been eliminated. Additionally, as of the dates indicated, the Company had no loans categorized as troubled debt restructurings within the meaning of Statement of Financial Accounting Standards ("SFAS") No. 15 and impaired loans within the meaning of SFAS No. 114, as amended by SFAS No. 118, were approximately \$3.4 million at December 31, 2006.

	December, 31			
	2006	2005	2004	2003
Nonaccrual loans	\$3,698	\$1,140	\$893	\$ -
Accruing loans past due 90 days or more	31	130	332	472
Total nonperforming loans	3,729	1,270	1,225	472
Other real estate owned	433	-	-	-
Total nonperforming assets	\$4,162	\$1,270	\$1,225	\$472
Total nonperforming loans to total loans	1.36%	0.47%	0.52%	0.56%
Total nonperforming assets to total assets	1.21%	0.38%	0.41%	0.36%

In addition to the nonperforming loans discussed above, there were loans for which payments were current or less than 90 days past due where borrowers are experiencing financial difficulties. At December 31, 2006, these loans totaled approximately \$11.1 million. These loans are monitored by management and considered in determining the level of the allowance for loan losses. Management does not believe these loans represent a significant exposure



## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

to loss.

Classified Assets. Federal regulations provide for a classification system for problem assets of insured institutions that covers all problem assets. Under this classification system, problem assets of insured institutions are classified as "substandard," "doubtful," or "loss." 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 insured 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. Assets may be designated "special mention" because of potential weaknesses that do not currently warrant classification in one of the aforementioned categories.

When an insured institution classifies problem assets as either substandard or doubtful, it may establish general allowances for loan losses in an amount deemed prudent by management. 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 required either to establish a specific allowance for losses equal to 100% of that portion of the asset so classified or to charge off such amount. The Company's determination as to the classification of its assets and the amount of its valuation allowances is subject to review by the Federal Deposit Insurance Corporation ("FDIC") and the Kentucky Office of Financial Institutions which may order the establishment of additional general or specific loss allowances. A portion of general loss allowances established to cover possible losses related to assets classified as substandard or doubtful may be included in determining an institution's regulatory capital, while specific valuation allowances for loan losses generally do not qualify as regulatory capital.

Allowance for Loan Losses. It is management's policy to provide for losses on loans in its loan portfolio. A provision for loan losses is charged to operations based on management's evaluation of the losses that may be incurred in the Company's loan portfolio. Such evaluation, which includes a review of all loans of which full collectibility of interest and principal may not be reasonably assured, considers the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, current economic conditions, and the relationship of the allowance for loan losses to outstanding loans.

The following table (in thousands except percentages) sets forth information with respect to the Company's allowance for loan losses at the dates and for the periods indicated below. Balances related to the discontinued operations of Citizens have been eliminated.

	Year ended December 31, ----- 2006 ----	Year ended December 31, ----- 2005 ----	Three months ended December 31, ----- 2004 ----
Allowance for loan losses			
Balance at beginning of period	\$2,911	\$2,549	\$2,560

Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

Allowance of acquired company	-	-	-
Provision for loan losses	847	354	-
Net charge-offs (recoveries):			
Residential	16	(11)	9
Commercial	1	2	-
Consumer	(4)	1	2
	-----	-----	-----
Balance at end of period	\$3,745	\$2,911	\$2,549
	=====	=====	=====
Total loans outstanding	\$274,223	\$269,889	\$236,197
	=====	=====	=====
Average loans outstanding	\$276,629	\$257,333	\$224,201
	=====	=====	=====
Allowance for loan losses to period-end loans	1.37%	1.08%	1.08%
	=====	=====	=====
Net loans charged off to average loans	0.00%	0.00%	0.00%
	=====	=====	=====

Management will continue to review the entire loan portfolio to determine the extent, if any, to which further additional loss provisions may be deemed necessary. There can be no assurance that the allowance for loan losses will be adequate to cover losses that may in fact be realized in the future and that additional provisions for losses will not be required.

Analysis of the Allowance for Loan Losses

The following table (in thousands except percentages) sets forth the allocation of the allowance by category, which management believes can be allocated only on an approximate basis. The allocation of the allowance to each category is not necessarily indicative of future loss and does not restrict the use of the allowance to absorb losses in any category. Balances related to the discontinued operations of Citizens have been eliminated.

	December 31,							
	2006		2005		2004		2003	
	Amount	Percent of Total loans	Amount	Percent of Total loans	Amount	Percent of Total loans	Amount	Percent Total l
	-----	-----	-----	-----	-----	-----	-----	-----
Real estate:								
Commercial	\$1,508	18%	\$ 715	17%	\$ 651	15%	\$ 61	16%
Residential	832	45	581	48	255	53	285	73
Construction	358	23	153	19	358	14	14	3
Commercial	856	7	859	9	957	9	16	4
Consumer	191	7	603	7	328	9	15	4
	-----	---	-----	---	-----	---	-----	---
Total allowance for loan losses	\$3,745	100%	\$2,911	100%	\$2,549	100%	\$391	100%
	=====	===	=====	===	=====	===	=====	===

Return on Equity and Assets Ratios

Ratios have been adjusted to reflect the discontinued operations of Citizens.

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

	Year ended December 31, 2006 ----	Year ended December 31, 2005 ----	Three months ended December 31, 2004 ----
Average equity to average assets	11.57%	11.59%	12.76%
Return on average equity	4.93	11.92	2.51
Return on average assets	0.57	1.38	0.32
Dividend payout ratio	31.96	16.83	0.00

### Investment Activities

The Company is required under federal regulations to maintain a sufficient amount of liquid assets that may be invested in specified short-term securities and certain other investments. However, the Federal Deposit Insurance Corporation ("FDIC") does not prescribe by regulation to a minimum or percentage of liquid assets. The level of liquid assets varies depending upon several factors, including: (i) the yields on investment alternatives, (ii) management's judgment as to the attractiveness of the yields then available in relation to other opportunities, (iii) expectation of future yield levels, and (iv) management's projections as to the short-term demand for funds to be used in loan origination and other activities. Investment securities, including mortgage-backed securities, are classified at the time of purchase, based upon management's intentions and abilities, as securities held to maturity or securities available for sale. Debt securities acquired with the intent and ability to hold to maturity are classified as held to maturity and are stated at cost and adjusted for amortization of premium and accretion of discount, which are computed using the level yield method and recognized as adjustments of interest income. All other debt securities are classified as available for sale to serve principally as a source of liquidity.

Current regulatory and accounting guidelines regarding investment securities (including mortgage backed securities) require the Company to categorize securities as "held to maturity," "available for sale" or "trading." As of December 31, 2006, the Company had securities (including mortgage-backed securities) classified as "held to maturity" and "available for sale" in the amount of \$1.9 million and \$16.4 million, respectively and had no securities classified as "trading." Securities classified as "available for sale" are reported for financial reporting purposes at the fair market value with net changes in the fair market value from period to period included as a separate component of stockholders' equity, net of income taxes. At December 31, 2006, the Company's securities available for sale had an amortized cost of \$16.5 million and fair market value of \$16.4 million. Changes in the fair market value of securities available for sale do not affect the Company's net income. In addition, changes in the fair market value of securities available for sale do not affect the Bank's regulatory capital requirements or its loan-to-one borrower limit.

At December 31, 2006, the Company's investment portfolio policy allowed investments in instruments such as: (i) U.S. Treasury obligations, (ii) U.S. federal agency or federally sponsored agency obligations, (iii) local municipal obligations, (iv) mortgage-backed securities, (v) banker's acceptances, (vi) certificates of deposit, (vii) equity investments, and (viii) investment grade corporate bonds and commercial paper. The board of directors may authorize additional investments.

As a source of liquidity and to supplement the Company's lending activities, the Company has invested in residential mortgage-backed securities. Mortgage-backed securities can serve as collateral for borrowings and, through repayments, as a source of liquidity. Mortgage-backed securities represent a participation interest in a pool of single-family or other type of mortgages. Principal and interest payments are passed from the mortgage originators, through intermediaries (generally quasi-governmental agencies) that pool and repackage the participation interests in the form of securities to investors.

Mortgage-backed securities typically are issued with stated principal amounts. The securities are backed by pools of mortgages that have loans with

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

interest rates that are within a set range and have varying maturities. The underlying pool of mortgages can be composed of either fixed rate or adjustable rate mortgage loans. Mortgage-backed securities are generally referred to as mortgage participation certificates or pass-through certificates. The interest rate risk characteristics of the underlying pool of mortgages (i.e., fixed rate or adjustable rate) and the prepayment risk, are passed on to the certificate holder. The life of a mortgage-backed pass-through security is equal to the life of the underlying mortgages. Expected maturities will differ from contractual maturities due to scheduled repayments and because borrowers may have the right to call or prepay obligations with or without prepayment penalties. Mortgage-backed securities issued by quasi-governmental agencies, make up a majority of the pass-through certificates market.

At December 31, 2006, the Company's securities portfolio did not contain securities of any issuer, other than those issued by U.S. government or its agencies, with an aggregate book value in excess of 10% of the Company's equity.

Investment Portfolio. The following table (in thousands) sets forth the carrying value of the Company's investment securities at the dates indicated. Balances related to the discontinued operations of Citizens have been eliminated.

	December 31,		
	2006	2005	2004
Investment securities available for sale:			
Mortgage-backed	\$11,795	\$11,556	\$18,011
U.S. government and federal agencies	1,985	1,974	2,525
Municipal bonds	2,641	2,610	505
Equity	-	-	5,682
Total	\$16,421	\$16,140	\$26,723
Investment securities held to maturity:			
Mortgage-backed	\$ -	\$ -	\$ 2
Municipal bonds	1,900	1,975	2,148
Total	\$ 1,900	\$ 1,975	\$ 2,150
Total investment securities	\$18,321	\$18,115	\$28,873

Investment Portfolio Maturities. The following table sets forth information regarding the scheduled maturities, carrying values, market value and weighted average yields for the Company's investment securities portfolio at December 31, 2006. The following table does not take into consideration the effects of scheduled repayments or the effects of possible prepayments.

	December 31, 2006						
	One Year or Less		More Than One to Five Years		More Than Five to Ten Years		More Than Ten Years
	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value
Available-for-sale securities:							
Mortgage-backed securities	\$ 24	5.00%	\$ 76	7.01%	\$3,806	4.78%	\$7,88
U.S government and federal							

Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

agencies	986	3.07	998	5.24	-	-	
Municipal bonds	184	2.15	-	-	820	3.57%	1,63
	-----	-----	-----	-----	-----	-----	-----
Total	\$1,194	2.97%	\$1,074	5.37%	\$4,626	4.57%	\$9,52
	=====	=====	=====	=====	=====	=====	=====
Held-to-maturity securities:							
Mortgage-backed securities	\$ -	-%	\$ -	-%	\$ -	-%	\$ -
Municipal bonds	90	4.92	50	5.12	1,504	4.35	25
	-----	-----	-----	-----	-----	-----	-----
Total	\$ 90	4.92%	\$ 50	5.12%	\$1,504	4.35%	\$ 25
	=====	=====	=====	=====	=====	=====	=====

Sources of Funds

General. Deposits are the major external source of the Company's funds for lending and other investment purposes. The Company derives funds from amortization and prepayment of loans and, to a much lesser extent, maturities of investment securities, borrowings, mortgage-backed securities and operations. Scheduled loan principal repayments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are significantly influenced by general interest rates and market conditions.

Deposits. Consumer and commercial deposits are attracted principally from within the Company's primary market area through the offering of a selection of deposit instruments including regular savings accounts, money market accounts, and term certificate accounts. Deposit account terms vary according to the minimum balance required, the time period the funds must remain on deposit, and the interest rate, among other factors. At December 31, 2006, the Company had brokered deposits totaling \$23.7 million.

The following table (in thousands) sets forth the amount of the Company's certificates of deposit of \$100,000 or more by time remaining until maturity as of December 31, 2006.

	Amount
	-----
3 months or less	\$26,206
Over 3 through 6 months	6,899
Over 6 through 12 months	22,571
Over 12 months	5,253
	-----
Total	\$60,929
	=====

The following table (in thousands except rates) sets forth the Company's average balances and interest rates for interest-bearing demand deposits and time deposits for the periods indicated. Balances related to the discontinued operations of Citizens have been eliminated.

	Year ended		Year ended		Three months	
	December 31, 2006		December 31, 2005		ended December 31, 2004	
	Average balance	Average rate	Average balance	Average rate	Average balance	Average rate
	-----	----	-----	----	-----	----
Demand and savings	\$ 61,710	2.96%	\$ 59,520	1.85%	\$ 48,633	1.15%
Time	187,463	4.39	177,801	3.24	155,491	2.61
	-----	-----	-----	-----	-----	-----
	\$249,173	4.04	\$237,321	2.89	\$204,124	2.27

# Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

=====

=====

=====

Short-Term Borrowings. Deposits are the primary source of funds for the Company's lending and investment activities and for its general business purposes. The Company can also obtain advances from the Federal Home Loan Bank of Cincinnati ("FHLB") and other short-term borrowings, such as federal funds purchased and issuance of securities sold under repurchase agreements to supplement its supply of lendable funds and to also supplement short-term liquidity. A pledge of the Bank's stock in the FHLB and a portion of its first mortgage loans typically secure FHLB advances. At December 31, 2006, the Company's short-term borrowings totaled \$36.5 million; of which \$35.0 million were short-term FHLB advances. See note 10 to the consolidated financial statements for additional information.

Information regarding short-term FHLB advances follows:

	Year ended December 31, 2006 ----	Year ended December 31, 2005 ----	Three months ended December 31, 2004 ----
Amount outstanding:			
Period end	\$35,000	\$18,000	\$22,500
Maximum month end balance during period	35,000	28,000	22,500
Average balance during Period	18,216	16,541	19,575
Weighted average interest rate:			
Period end	5.44%	4.33%	2.42%
During the period	5.20	3.43	2.14

## Personnel

As of December 31, 2006, the Company had 85 full-time equivalent employees. None of the Company's employees are represented by a collective bargaining group. The Company believes that its relationship with its employees is good.

## Regulation of the Company

General. The Company is a registered bank holding company subject to regulation under the Bank Holding Company Act of 1956, as amended (the "BHC Act"). In addition, the Company is subject to the provisions of Kentucky's banking laws regulating bank acquisitions and various activities of controlling bank shareholders. As a bank holding company, the Company is subject to regulation, supervision, and examination by the Board of Governors of the Federal Reserve System (the "FRB") and is required to file periodic reports with the FRB. The Kentucky Office of Financial Institutions ("KOFI") may also conduct examinations of the Company to determine whether it is in compliance with applicable Kentucky banking laws and regulations. In addition, the FRB has enforcement authority over the Company and any of its non-financial institution subsidiaries. This regulation and oversight is intended primarily for the protection of the depositors of the Bank and not for the benefit of the Company's stockholders.

The Gramm-Leach-Bliley Act, which became effective in March 2001, permits greater affiliation among banks, securities firms, insurance companies, and other companies under a new type of financial services company known as a "financial holding company." A financial holding company essentially is a bank holding company with significantly expanded powers. Financial holding companies are authorized by statute to engage in a number of financial activities previously impermissible for bank holding companies, including securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; and merchant banking activities.

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

The act also permits the FRB and the Treasury Department to authorize additional activities for financial holding companies if they are "financial in nature" or "incidental" to financial activities. A bank holding company may become a financial holding company if each of its subsidiary banks is well capitalized, well managed, and has at least a "satisfactory" CRA rating. A financial holding company must provide notice to the FRB within 30 days after commencing activities previously determined by statute or by the FRB and the Department of the Treasury to be permissible. The Company has not submitted notice to the FRB of its intent to be deemed a financial holding company.

**Regulatory Capital Requirements.** The FRB has adopted capital adequacy guidelines pursuant to which it assesses the adequacy of capital in examining and supervising a bank holding company and in analyzing applications to it under the Bank Holding Company Act. The FRB's capital adequacy guidelines are similar to those imposed on the Bank. See "Regulation of the Bank - Regulatory Capital Requirements."

**Restrictions on Dividends.** The FRB has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the FRB's view that a bank holding company should pay cash dividends only to the extent that the holding company's net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the holding company's capital needs, asset quality and overall financial condition. The FRB also indicated that it would be inappropriate for a company experiencing serious financial problems to borrow funds to pay dividends. Accordingly, the Company's ability to pay dividends is dependent on the Bank's ability to pay dividends to the Company. Furthermore, under the federal prompt corrective action regulations, the FRB may prohibit a bank holding company from paying any dividends if the holding company's bank subsidiary is classified as "undercapitalized."

**Acquisition of Banks.** The BHC Act also requires a bank holding company to obtain prior approval from the FRB before acquiring direct or indirect ownership or control of more than 5% of the voting shares of any bank which is not already majority owned or controlled by that bank holding company. Acquisition of any additional banks would require prior approval from both the FRB and the KOFI.

**Non-Banking Activities.** A bank holding company is generally prohibited from engaging in, or acquiring, direct or indirect control of more than 5% of the voting securities of any company engaged in non-banking activities. One of the principal exceptions to this prohibition is for activities found by the FRB to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Some of the principal activities that the FRB has determined by regulation to be so closely related to banking are: (i) making or servicing loans; (ii) performing certain data processing services; (iii) providing discount brokerage services; (iv) acting as fiduciary, investment or financial advisor; (v) leasing personal or real property; (vi) making investments in corporations or projects designed primarily to promote community welfare; and (vii) acquiring a savings and loan association.

### Regulation of the Bank

**General.** Set forth below is a brief description of certain laws that relate to the regulation of the Bank. The description does not purport to be complete and is qualified in its entirety by reference to applicable laws. The Bank is a Kentucky state-chartered stock-form commercial bank and its deposit accounts are insured under the Deposit Insurance Fund ("DIF"). The Bank is subject to extensive regulation and supervision by the KOFI as its chartering agency, and by the FDIC, as its deposit insurer. The Bank must file reports with the KOFI and the FDIC concerning its activities and financial condition, in addition to obtaining regulatory approvals prior to entering into certain transactions such as mergers with, or acquisitions of, other depository institutions. The deposits of the Bank are insured by the FDIC to the maximum extent provided by law.

Federal and Kentucky banking laws and regulations control, among other things, the Bank's required reserves, investments, loans, mergers and

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

consolidations, issuance of securities, payment of dividends and other aspects of the Bank's operations. The regulatory structure also gives the respective regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Supervision, regulation and examination of the Bank by the bank regulatory agencies are intended primarily for the protection of depositors rather than for holders of the Company's stock or for the Company as the holder of the stock of the Bank.

**Insurance of Deposit Accounts.** The FDIC has adopted a risk-based insurance assessment system. The FDIC assigns an institution to one of three capital categories, consisting of (1) well capitalized, (2) adequately capitalized, or (3) undercapitalized, and one of three supervisory subcategories within each capital group, based on the institution's financial information, as of the reporting period ending seven months before the assessment period. The supervisory subgroup to which an institution is assigned is based on the supervisory evaluation provided to the FDIC by the institution's primary federal regulator, and information which the FDIC determines to be relevant to the institution's financial condition and the risk posed to the deposit insurance funds. An institution's assessment rate depends on the capital category and supervisory category to which it is assigned. Assessment rates are determined semiannually by the FDIC.

Under the Federal Deposit Insurance Act, insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order, or condition imposed by the FDIC. The Bank does not know of any practice, condition, or violation that might lead to the termination of deposit insurance.

**Regulatory Capital Requirements.** The FDIC has adopted regulations requiring institutions under their respective jurisdictions to maintain specified minimum ratios of capital to total assets and capital to risk-weighted assets. Specifically, all savings institutions and banks must maintain the following ratios: (1) Tier 1 or core capital equal to at least 4% (3% if the institution has received the highest rating on its most recent examination) of total adjusted assets; and (2) total capital (defined as Tier 1 capital plus supplementary Tier 2 capital) equal to 8% of total risk-weighted assets. At December 31, 2006, the Bank was in compliance with the capital requirements of the FDIC.

**Dividend and Other Capital Distribution Limitations.** The KOFI imposes restrictions on the ability of Kentucky commercial banks to pay dividends and to make other capital distributions. In general, banks are prohibited from paying any dividends or other capital distributions if, after the distribution, they would be undercapitalized under applicable federal law.

In addition, under applicable provisions of Kentucky law, the prior approval of the KOFI is required if the total of all dividends declared by the Bank in any calendar year exceeds its respective net profits, as defined, for that year combined with its retained net profits for the preceding two calendar years, less any required transfers to surplus or a fund for the retirement of any preferred stock. At January 1, 2007, the Bank could pay dividends to the Company of approximately \$7,883,000, without regulatory approval.

**Federal Home Loan Bank System.** The Bank is a member of the FHLB of Cincinnati, which is one of twelve (12) regional federal home loan banks that administer the home financing credit function of savings associations. Each FHLB serves as a reserve or central bank for its members within its assigned region. It is funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB System. It makes loans to members (i.e., advances) in accordance with policies and procedures established by the Board of Directors of the FHLB.

As a member, the Bank is required to purchase and maintain stock in the FHLB of Cincinnati in an amount equal to at least 1% of aggregate unpaid residential mortgage loans, home purchase contracts or similar obligations at the beginning of each year.



## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

Federal Reserve System. The FRB requires all depository institutions to maintain non-interest bearing reserves at specified levels against their transaction accounts (primarily checking, NOW, and Super NOW checking accounts) and non-personal time deposits. At December 31, 2006, the Bank was in compliance with these FRB requirements.

### Transactions with Affiliates

Under current federal law, transactions between depository institutions, such as the Bank, and their affiliates are governed by Sections 23A and 23B of the Federal Reserve Act. An affiliate is any company or entity that controls, is controlled by, or is under common control with the financial institution, other than a subsidiary. Generally, a bank's subsidiaries are not treated as affiliates unless they are engaged in activities as principal that are not permissible for national banks. In a holding company context, at a minimum, the parent holding company of a bank, and any companies that are controlled by such parent holding company, are affiliates of the bank. Generally, Section 23A limits the extent to which the bank or its subsidiaries may engage in "covered transactions" with any one affiliate to an amount equal to 10% of such bank's capital stock and surplus, and contains an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus. The term "covered transaction" includes the making of loans or other extensions of credit to an affiliate; the purchase of assets from an affiliate; the purchase of, or an investment in, the securities of an affiliate; the acceptance of securities of an affiliate as collateral for a loan or extension of credit to any person; or issuance of a guarantee, acceptance, or letter of credit on behalf of an affiliate. Section 23A also establishes specific collateral requirements for loans or extensions of credit to, or guarantees, or acceptances on letters of credit issued on behalf of an affiliate. Section 23B requires that covered transactions and a broad list of other specified transactions be on terms substantially the same as or no less favorable to, the bank or its subsidiary as similar transactions with non-affiliates.

The Sarbanes-Oxley Act of 2002 generally prohibits loans by the Company to its executive officers and directors. However, the Sarbanes-Oxley Act contains a specific exemption for loans made by the Bank to its executive officers and directors in compliance with federal banking laws. Section 22(h) of the Federal Reserve Act governs a bank's loans to directors, executive officers, and principal shareholders. Under Section 22(h), loans to directors, executive officers, and shareholders who control, directly or indirectly, 10% or more of voting securities of a bank, and certain related interests of any of the foregoing, may not exceed, together with all other outstanding loans to such persons and affiliated entities, the bank's total capital and surplus. Section 22(h) also prohibits loans above amounts prescribed by the appropriate federal banking agency to directors, executive officers, and shareholders who control 10% or more of voting securities of a bank, and their respective related interests, unless such loan is approved in advance by a majority of the board of directors of the bank. Any "interested" director may not participate in the voting. The loan amount (which includes all other outstanding loans to such person) as to which such prior board of director approval is required, is the greater of \$25,000 or 5% of capital and surplus or any loans over \$500,000. Further, pursuant to Section 22(h), loans to directors, executive officers, and principal shareholders must be made on terms substantially the same as those offered in comparable transactions to other persons. There is an exception for loans made pursuant to a benefit or compensation program that is widely available to all employees of the institution and does not give preference to executive officers over other employees. Section 22(g) of the Federal Reserve Act places additional limitations on loans to executive officers.

### Available Information

The Company files annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports with the United States Securities and Exchange Commission (the "SEC") pursuant to Section

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

13(a) or 15(d) of the Securities Exchange Act of 1934. Such reports can be read and copied at the public reference facilities maintained by the SEC at the Public Reference Room, 100 F Street, NE, Washington, D. C. 20549. Information regarding the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-732-0330. These reports are also available at the SEC's website at [www.sec.gov](http://www.sec.gov). You also may obtain electronic or paper copies of our reports free of charge by contacting John F. Barron, Senior Vice President and Controller, 1st Independence Financial Group, Inc., 8620 Biggin Hill Lane, Louisville, Kentucky 40220-4117.

### Item 1A. Risk Factors.

#### Risks Related to our Business

We are subject to extensive regulation that could limit or restrict our activities and impose financial requirements or limitations on the conduct of our business, which limitations or restrictions could adversely affect our profitability.

As a bank holding company, we are primarily regulated by the Board of Governors of the Federal Reserve System. Our subsidiary is primarily regulated by the FDIC and the Kentucky Office of Financial Institutions. Our compliance with Federal Reserve Board, FDIC and Kentucky banking regulations is costly. A failure to comply with the banking regulations may limit our growth and restrict certain of our activities, including payment of dividends, mergers and acquisitions, investments, loans and interest rates charged, interest rates paid on deposits and locations of offices. We are also subject to the capital requirements of our regulators.

The laws and regulations applicable to the banking industry could change at any time, and we cannot predict the effects of these changes on our business and profitability. Because government regulation greatly affects our business and financial results, our cost of compliance could adversely affect our ability to operate profitably and a failure to comply could limit our ability to implement our business strategy. See the caption entitled "Regulatory Matters" included in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of this report, which is Part II, Item 7 of this report, for further information.

Our business strategy includes the continuation of growth plans, and our financial condition and results of operations could be negatively affected if we fail to grow.

We have grown rapidly in terms of branch expansion, total assets, net loans, and deposits. We may not be able to continue to grow at the same rate that we have grown in the past. We currently serve our customers through a network of eight banking offices, consisting of two full-service banking locations in Louisville, Kentucky, and one full-service banking location in each of New Albany, Jeffersonville, and Clarksville, Indiana. We also have one full-service banking location in Harrodsburg, Kentucky, Lawrenceburg, Kentucky, and Marengo, Indiana. Our business strategy calls for continued expansion and the opening of additional branches during the next three to five years. We have not yet attempted to establish branches in any of the other counties in Kentucky or southern Indiana. Our branch expansion strategy entails other risks, including:

- o the entrance into new markets where we lack experience;
- o the experience of unexpected competition;
- o the introduction of new products and services into our business with which we have no prior experience;
- o the time and costs of evaluating new markets, hiring experienced local management and opening new offices;

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

- o the ability to implement and improve our operational, credit, financial, management and other internal risk controls and processes and our reporting systems and procedures;
- o the ability to manage a growing number of client relationships;
- o the ability to recruit and retain additional experienced bankers to accommodate growth;
- o the ability to maintain controls and procedures sufficient to accommodate an increase in expected loan volume and infrastructure;
- o the diversion of our management's attention from our existing businesses as a result of our growth strategy;
- o the additional expenditures our asset growth may require to expand our administrative and operational infrastructure; and
- o the ability to maintain cost controls and asset quality while attracting additional loans and deposits on favorable terms.

The occurrence of any of these factors could have an adverse effect on our financial condition. We can provide no assurance that we will be able to overcome the risks associated with growth or any other problems encountered in executing our growth strategy.

Our recent results do not indicate our future results, and may not provide guidance to assess the risk of an investment in our common stock.

We are unlikely to sustain our historical rate of growth, and may not even be able to expand our business at all. Further, our recent growth may distort some of our historical financial ratios and statistics. In the future, we may not have the ability to find suitable expansion opportunities. Various factors, such as economic conditions, regulatory and legislative considerations and competition, may also impede or prohibit our ability to expand our market presence. If we are not able to successfully grow and expand our business, our financial condition and results of operations could be adversely affected.

Our business would be harmed if we lost the services of any of our senior management team and are unable to recruit or retain suitable replacements.

We believe that our success to date and our prospects for future success depend significantly on the efforts of our senior management team, which includes N. William White, our President and Chief Executive Officer, R. Michael Wilbourn, our Executive Vice President and Chief Financial Officer, Gregory A. DeMuth, our Executive Vice President and Chief Lending Officer of the Bank, David M. Hall, our Executive Vice President-Retail Banking of the Bank, Kathy L. Beach, our Executive Vice President and Chief Operations Officer, Alan D. Shepard, our Executive Vice President and Chief Credit Officer of the Bank and certain of our senior bankers. We have \$0.5 million of key-man life insurance on both Mr. White and Mr. Wilbourn. There is no assurance, however, that \$0.5 million would be enough to compensate us for the loss of Mr. White or Mr. Wilbourn. We do not have key-man insurance on any other officer of the Company or the Bank. In addition to their skills and experience as bankers, these persons provide us with extensive community ties upon which our competitive strategy is based.

A significant portion of our loan portfolio is secured by real estate, and events that negatively impact the real estate market could hurt our business.

A significant portion of our loan portfolio is secured by real estate. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. A weakening of the real estate market in our market areas could result in an increase in the number of borrowers who default on their loans and a reduction in the value of the collateral securing their loans, which in turn could have an adverse effect

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

on our profitability and asset quality. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values, our earnings and capital could be adversely affected. Acts of nature, including hurricanes, tornados, earthquakes, fires and floods, which may cause uninsured damage and other loss of value to real estate that secures these loans, may also negatively impact our financial condition. Additionally, a slowdown in real estate activity in the markets we serve may also negatively impact our financial condition.

An economic downturn, either nationally or in the local market area, could adversely affect our financial condition, results of operations and cash flows.

Deterioration in local, regional, national or global economic conditions could result in, among other things, an increase in loan delinquencies, a change in the housing turnover rate or a reduction in the level of available wholesale deposits. If the communities in which we operate do not grow, or if the prevailing local or national economic conditions are unfavorable, our business strategy may not succeed. A weakening of the employment market in our primary market area could result in an increase in the number of borrowers who default on their loans. Further, the banking industry is affected by general economic conditions such as inflation, interest rates, recession, unemployment and other factors beyond our control. Moreover, we cannot give any assurance that we will benefit from any market growth or favorable economic conditions in our primary market areas even if they do occur.

Our cost of funds for banking operations may increase as a result of general economic conditions, interest rates and competitive pressures.

In the past, the Bank has relied heavily on brokered certificates of deposits and borrowings for the funds necessary for banking operations. As a general matter, deposits are a cheaper source of funds than brokered certificates of deposit or borrowings, because interest rates paid for deposits are typically less than interest rates charged for brokered certificates of deposit or borrowings. Our business strategy includes funding more of our operations with deposits; however, we cannot provide any assurances that we will be able attract sufficient deposits.

Competition from other financial institutions and others may adversely affect our profitability.

The banking business generally, and because of its desirability and the opportunities for growth, the Louisville, Kentucky and southern Indiana market area in particular, is highly competitive, and we experience strong competition from many other financial institutions. We compete with commercial banks, credit unions, savings and loan associations, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market funds and other financial institutions, which operate in our primary market area and elsewhere.

We compete with these institutions to make loans and to attract new customers and in pricing loans and deposits. Many of our competitors are well-established and much larger financial institutions and can offer customers more attractive pricing terms. While we believe we can and do successfully compete with these other financial institutions in our markets, we may face a competitive disadvantage as a result of our smaller size.

We also compete with private lenders, mezzanine and venture capital firms and angel investors in some of our lending divisions, including our community redevelopment lending and mezzanine financing divisions. Many of these competitors are subject to minimal or no regulation and may be able

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

to make accommodations for customers that we are unable to make.

We are currently subject to claims regarding the merger of Independence Bancorp with Harrodsburg First Financial Bancorp, Inc. that could result in substantial defense, judgment or settlement costs.

On or about May 28, 2004, a complaint was filed in the Circuit Court of Anderson County in the Commonwealth of Kentucky by Larry Sutherland, Judy Sutherland, John Henry Disponett, Brenda Disponett, Todd Hyatt, Lois Ann Disponett, Sue Saufley, and Hugh Coomer. Soon thereafter, an amended complaint was filed which added Lois Hawkins and Norma K. Barnett as plaintiffs. The lawsuit arises from offers to purchase securities made by us in connection with an offer to purchase up to 300,000 shares of our stock in a tender offer on or about May 28, 2003. The Plaintiffs allege that we made certain material misrepresentations in connection with certain statements made in the tender offer. The Plaintiffs are seeking to recover compensatory and punitive damages in connection with the shares they sold in the tender offer and their attorneys' fees.

On April 14, 2006 a partial summary judgment was entered against the plaintiffs. In the partial summary judgment, the Circuit Court held that the only remedy available to the plaintiffs is the return of the stock upon the tender of the consideration received by the Plaintiffs in exchange for the stock. Subsequent to the partial summary judgment, the plaintiffs amended their complaint to allege certain additional material misrepresentations had been made by the Company. This matter is currently scheduled for trial in July 2007. If we are ultimately unsuccessful in this litigation, it may have a negative effect on our results of operations or cash flows.

### Risks Related to Our Industry

Our profitability is vulnerable to interest rate fluctuations.

Most of our assets and liabilities are monetary in nature, and thus subject us to significant risks from changes in interest rates. Consequently, our results of operations can be significantly affected by changes in interest rates and our ability to manage interest rate risk. Changes in market interest rates, or changes in the relationships between short-term and long-term market interest rates, or changes in the relationship between different interest rate indices can affect the interest rates charged on interest-earning assets differently than the interest paid on interest-bearing liabilities. This difference could result in an increase in interest expense relative to interest income or a decrease in interest rate spread. In addition to affecting our profitability, changes in interest rates can impact the valuation of our assets and liabilities. A discussion of how we measure our exposure to interest rate changes is provided in Part II, Item 7 of this report.

We could suffer loan losses from a decline in credit quality.

We could sustain losses if borrowers, guarantors or related parties fail to perform in accordance with the terms of their loans. We have adopted underwriting and credit monitoring procedures and policies, including the establishment and review of the allowance for credit losses, that we believe are appropriate to minimize this risk by assessing the likelihood of nonperformance, tracking loan performance and diversifying our credit portfolio. These policies and procedures, however, may not prevent unexpected losses that could materially adversely affect our results of operations and financial condition.

If our allowance for loan losses is not sufficient to cover actual loan losses,

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

our earnings could decrease.

We manage our credit exposure through careful monitoring of loan applicants and loan concentrations in particular industries, and through loan approval and review procedures. We have established an evaluation process designed to determine the adequacy of our allowance for loan losses. While this evaluation process uses historical and other objective information, the classification of loans and the establishment of loan losses is an estimate based on experience, judgment and expectations regarding our borrowers, the economies in which we and our borrowers operate, as well as the judgment of our regulators.

There is no precise method of predicting loan losses, so we cannot assure you that our loan loss allowance will be sufficient to absorb future loan losses or prevent a material adverse effect on our business, financial condition or results of operations.

Failure to achieve and maintain effective internal controls in accordance with Section 404 of the Sarbanes-Oxley Act could have a material adverse effect on our ability to report our financial results timely and accurately and on our stock price.

Section 404 of the Sarbanes-Oxley Act requires annual assessments of the effectiveness of our internal control over financial reporting and a report by our independent registered public accounting firm regarding their opinion of the effectiveness of our internal control over financial reporting based upon their audit. We are required to complete our initial assessment by the filing of our Form 10-K for the year ended December 31, 2007 and to obtain the opinion of our independent registered public accounting firm by the filing of our Form 10-K for the year ended December 31, 2008. During the course of our assessment, we may identify deficiencies in our internal controls over financial reporting which we may not be able to remediate in time to meet this deadline. A failure to maintain adequate internal controls may result in material misstatements in our financial statements and a failure to meet our reporting obligations. As a result investors may lose confidence in our reported financial information and our stock price could decline.

Our operations could be interrupted if our network or computer systems fail or experience a security breach.

Our computer systems and network infrastructure could be vulnerable to unforeseen problems. Our operations are dependent upon our ability to protect our computer equipment against damage from fire, power loss, telecommunications failure or a similar catastrophic event. Any damage or failure that causes an interruption in our operations could result in a loss of customers and thereby have a material adverse effect on our business, operating results and financial condition.

### Risks Relating to an Investment in Our Common Stock

Additional growth may require us to raise additional capital in the future, but that capital may not be available when it is needed, which could adversely affect our financial condition and results of operations.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. We anticipate that our current capital resources will satisfy our capital requirements for the foreseeable future. We may at some point, however, need to raise additional capital to support our continued growth. Our ability to raise capital, if needed, will depend on conditions in the capital markets at that time, which are outside our control, and on our financial performance.

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

Accordingly, we cannot assure you of our ability to raise capital, if needed, on terms acceptable to us. If we cannot raise capital when needed, our ability to implement our business strategy could be materially impaired.

Our stock price may fluctuate and be volatile.

The prices at which our common stock has traded may not be indicative of future market prices. The trading price of our common stock has, in the past, and could continue in the future to fluctuate significantly. Volatility in our stock price could result from the following factors, among others:

- o variations in quarterly operating results;
- o changes in financial estimates by securities analysts;
- o the operating and stock price performance of other companies in the banking industry; and
- o general stock market or economic conditions.

The stock market in recent years has experienced price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of affected companies.

Our ability to pay dividends is limited, and we may be unable to pay future dividends if we decide to do so.

Our ability to continue our current dividends is limited by regulatory restrictions, by the bank's ability to pay dividends to us based on its capital position and profitability, and by our need to maintain sufficient capital to support the bank's operations. The ability of the bank to pay dividends to us is limited by its obligations to maintain sufficient capital and by other restrictions on its dividends that are applicable to banks that are regulated by the FDIC. If the bank does not satisfy these regulatory requirements it will be unable to pay dividends to us and we will be unable to pay dividends on our common stock to you.

The holders of our junior subordinated debentures have rights that are senior to those of our common shareholders.

As of December 31, 2006 we had \$9.3 million of trust preferred securities outstanding. Payments of the principal and interest on the trust preferred securities are conditionally guaranteed by us. Further, the junior subordinated debentures are senior to our shares of common stock. We have the right to defer payment of interest on the junior subordinated debentures for a period not exceeding 20 consecutive quarters. If we defer, or fail to make, interest payments on the junior subordinated debentures, we will be prohibited, subject to certain exceptions, from paying cash dividends on our common stock until we pay all deferred interest and resume interest payments on the junior subordinated debentures.

We have implemented anti-takeover devices that could make it more difficult for another company to purchase us, even though such a purchase may increase shareholder value.

In many cases, shareholders would receive a premium for their shares if we were purchased by another company. However, state and federal law and our certificate of incorporation and bylaws make it difficult for anyone to purchase us without approval of our board of directors. For example, our articles of incorporation divide the board of directors into three classes of directors serving staggered three-year terms with approximately one-third of the board of directors elected at each annual meeting of shareholders. The classification of directors makes it more difficult for

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

shareholders to change the composition of the board of directors. As a result, at least two annual meetings of shareholders would be required for the shareholders to change a majority of the directors, whether or not a change in the board of directors would be beneficial and whether or not a majority of shareholders believe that such a change would be desirable. In addition, our certificate of incorporation provides that in no event shall any record owner of any outstanding common stock which is beneficially owned, directly or indirectly, by a person who beneficially owns in excess of 10% of the then outstanding shares of common stock be entitled or permitted to any vote with respect to the shares held in excess of the 10% limit. Consequently, a takeover attempt may prove difficult, and shareholders may not realize the highest possible price for their securities.

### Item 1B. Unresolved Staff Comments.

None.

### Item 2. Properties.

The Company's corporate office is located at 8620 Biggin Hill Lane in Louisville, Kentucky where the Company's finance and accounting, loan and deposit operations, mortgage operations and a full service banking office (Stony Brook Branch) are located. The Company conducts its banking business through eight full service banking offices located in Harrodsburg, Lawrenceburg and two locations in Louisville, Kentucky (St. Matthews Branch and Stony Brook Branch) and Jeffersonville, New Albany, Marengo and Clarksville, Indiana. 1st Independence Mortgage conducts its business throughout the Bank's branch network.

The location of the Company's properties, the approximate square footage and whether owned or leased is described in the following table:

Location -----	Nature -----	Square Feet -----	Status -----
Harrodsburg, Kentucky 104 South Chiles Street	Branch banking facility	12,636	Owned
Lawrenceburg, Kentucky 1015 Crossroad Drive	Branch banking facility	2,550	Owned
Louisville, Kentucky (Stony Brook Branch) 8620 Biggin Hill Lane	Corporate office (including finance and accounting, loan and deposit operations), mortgage operations and branch banking facility	14,190	Owned
Louisville, Kentucky (St. Matthews Branch) 4220 Shelbyville Road	Branch banking facility	3,606	Leased
Clarksville, Indiana 1325 Veterans Parkway	Branch banking facility	2,817	Leased
Jeffersonville, Indiana 1711 East 10th Street	Branch banking facility	3,562	Leased
Marengo, Indiana 309 South Bradley Street	Branch banking facility	5,856	Owned



# Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

New Albany, Indiana  
3801 Charlestown Road

Branch banking facility

11,200

Leased

See note 8 to the Company's consolidated financial statements herein for additional information. The New Albany, Indiana branch is leased from Chalfant Industries, Inc., a company owned by the Company's Chairman of the Board of Directors.

## Item 3. Legal Proceedings.

The Company, from time to time, is a party to ordinary routine litigation, which arises in the normal course of business, such as claims to enforce liens, condemnation proceedings on properties in which the Company holds security interests, claims involving the making and servicing of real property loans, and other issues incident to its business. Except as discussed below, there were no potentially material lawsuits or other legal proceedings pending or known to be contemplated against the Company at December 31, 2006.

On or about May 28, 2004, a complaint was filed in the Circuit Court of Anderson County in the Commonwealth of Kentucky by Larry Sutherland, Judy Sutherland, John Henry Disponett, Brenda Disponett, Todd Hyatt, Lois Ann Disponett, Sue Saufley, and Hugh Coomer. Soon thereafter, an amended complaint was filed which added Lois Hawkins and Norma K. Barnett as plaintiffs. The lawsuit arises from offers to purchase securities made by the Company in connection with an offer to purchase up to 300,000 shares of its stock in a tender offer on or about May 28, 2003. The Plaintiffs allege that the Company made certain material misrepresentations in connection with certain statements made in the tender offer. The Plaintiffs are seeking to recover compensatory and punitive damages in connection with the shares it sold in the tender offer and their attorneys' fees. On April 14, 2006 a partial summary judgment was entered against the plaintiffs. In the partial summary judgment, the Circuit Court held that the only remedy available to the plaintiffs is the return of the stock upon the tender of the consideration received by the plaintiffs in exchange for the stock. Subsequent to the partial summary judgment, the plaintiffs amended their complaint to allege certain additional material misrepresentations had been made by the Company. This matter is currently scheduled for trial in July 2007. Based upon the advice of counsel, management records an estimate of the amount of ultimate expected loss for litigation, if any. Management, after discussion with legal counsel, believes the ultimate result of this litigation will not have a material adverse effect on the Company's financial position, results of operations or cash flows. However, events could occur that could cause any estimate of ultimate loss to differ materially in the near term.

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

No matters were submitted to a vote of security holders during the fourth quarter ended December 31, 2006.

## PART II

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Since its issuance in October 1995, the Company's common stock has traded on the NASDAQ Global Market System. The Company's trading symbol is FIFG. The quarterly high and low sales prices for the Company's common stock as reported by NASDAQ and any dividends declared during the quarter are set forth in the table below.

	Quarter Ended			
	3/31	6/30	9/30	12/31
2006	-----	-----	-----	-----
----	----	----	----	----

Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

High	\$19.00	\$18.80	\$18.00	\$17.90
Low	17.49	16.20	15.67	16.40
Cash dividend declared per share	0.08	0.08	0.08	0.08

Quarter Ended

2005	3/31	6/30	9/30	12/31
High	\$19.99	\$23.05	\$20.50	\$20.00
Low	18.21	17.41	19.00	18.00
Cash dividend declared per share	0.16	0.08	0.08	0.08

The number of shareholders of record of common stock as of December 31, 2006, was approximately 410. This does not reflect the number of persons or entities who held stock in nominee or "street" name through various brokerage firms. At December 31, 2006, there were 1,995,594 shares outstanding. The Company's ability to pay dividends to stockholders is dependent upon the dividends it receives from the Bank. The payment of cash dividends by the Bank is limited by regulations of the FDIC. See "Regulations of the Bank - Dividend and Other Capital Distribution Limitations."

Set forth below is information as of December 31, 2006 with respect to compensation plans under which equity securities of the Company are authorized for issuance.

Equity Compensation Plan Information

	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of remaining future iss equity comp [excluding reflected
Equity compensation plans approved by stockholders:			
2004 Omnibus Stock Option Plan	51,550	\$ 11.83	223
1996 Stock Option Plan	81,000	16.50	30
Restricted Stock Plan	-	-	76
Equity compensation plans not approved by stockholders	n/a	n/a	
Total	132,550	\$ 14.69	329

(1) No longer eligible for grant as of January 28, 2007.

Performance Graph

The following Performance Graph and related information shall not be deemed "soliciting material" or to be "filed" with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or Securities Exchange Act of

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

1934, each as amended, except to the extent that the Company specifically incorporates it by reference into such filing.

### Comparative Stock Performance Graph

The following performance graph compares the performance of the Company's Common Stock to the NASDAQ Market Index (U.S.) and the NASDAQ Financial Stocks Index for the five year period ended December 31, 2006. The graph assumes an investment of \$100 in each of the Company's Common Stock, the NASDAQ Market Index (U.S.) and the NASDAQ Financial Stocks Index on December 31, 2001 and that all dividends were reinvested.

[GRAPHIC OMITTED]

	12/31/01 -----	12/31/02 -----	12/31/03 -----	12/31/04 -----	12/31/05 -----
1st Independence Financial Group, Inc.	\$100.00	\$121.29	\$221.53	\$187.85	\$186.9
NASDAQ Market Index (U.S.)	100.00	69.13	103.36	112.49	114.8
NASDAQ Financial Stocks Index	100.00	102.98	139.28	162.56	166.4

### Item 6. Selected Financial Data.

Selected Consolidated Financial Data  
(in thousands except per share data)

	Year ended December 31,		Three months ended December 31,		Year ended
	2006	2005	2004	2004	2003
	-----	-----	-----	-----	-----
<b>Results of operations:</b>					
Net interest income	\$ 10,623	\$ 10,252	\$ 2,330	\$ 4,678	\$ 4,678
Provision for loan losses	847	354	-	1,203	1,203
Noninterest income	1,791	6,957	538	682	682
Noninterest expense	8,839	10,093	2,537	6,026	6,026
Net income (loss)	1,940	4,481	240	(1,093)	(1,093)
<b>Per Share Data:</b>					
Income (loss) from continuing operations					
Basic	\$ 1.00	\$ 2.38	\$ 0.13	\$ (0.84)	\$ (0.84)
Diluted	0.99	2.33	0.12	(0.84)	(0.84)
Income from subsidiary held for disposal					
Basic	0.00	0.00	0.00	0.02	0.02
Diluted	0.00	0.00	0.00	0.02	0.02
Net income (loss)					
Basic	1.00	2.37	0.13	(0.83)	(0.83)
Diluted	0.99	2.32	0.13	(0.83)	(0.83)
<b>Weighted average shares outstanding</b>					
Basic	1,941	1,889	1,864	1,318	1,318
Diluted	1,957	1,929	1,917	1,318	1,318
Book value - end of period	\$ 20.20	\$ 19.61	\$ 19.68	\$ 19.38	\$ 19.38
Market value - end of period	16.40	18.50	18.98	20.00	20.00
Cash dividends declared	0.32	0.40	0.00	0.38	0.38
Dividend payout ratio	31.96%	16.83%	0.00%	(47.30)%	(47.30)%

Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

Balance Sheet Data:	At December 31,			At S
	2006	2005	2004	2004
Total assets	\$342,806	\$336,187	\$337,191	\$320,032
Securities	18,321	18,115	28,873	29,478
Loans, excluding held for sale	274,223	269,889	236,197	213,719
Allowance for loan losses	3,745	2,911	2,549	2,560
Deposits	254,077	264,323	223,308	219,817
Short-term borrowings	36,526	18,747	23,233	7,121
Long-term borrowings	10,279	13,279	14,247	14,234
Stockholders' equity	40,303	38,261	37,706	37,081
Shares outstanding at end of period	1,996	1,951	1,916	1,913
			Three months ended	
	Year ended December 31,		December 31,	Year end
Financial Performance Ratios:	2006	2005	2004	2004
Return on average assets	0.57%	1.38%	0.32%	(0.68)%
Return on average stockholders' equity	4.93	11.92	2.51	(4.58)
Net interest margin	3.40	3.44	3.45	3.13
Efficiency ratio (1)	71.20	81.88	88.46	112.28
Asset Quality Ratios (2):				
Nonperforming loans to total loans	1.36%	0.47%	0.52%	0.57%
Nonperforming assets to total assets	1.21	0.38	0.41	0.44
Net charge-offs (recoveries) to average loans	0.00	0.00	0.00	0.07
Allowance for loans losses to total loans (excluding held for sale)	1.37	1.08	1.08	1.20
Allowance for loans losses to nonperforming loans (3)	100.43	229.21	208.08	210.01
Liquidity and Capital Ratios:				
Loans to deposits	107.93%	102.11%	105.77%	97.23%
Average stockholders' equity to average total assets	11.57	11.59	12.76	14.79
Tangible equity to assets (4)	8.47	8.01	7.81	8.01
Leverage ratio	11.60	10.20	9.60	9.90
Tier 1 risk-based capital ratio	14.60	13.10	13.30	13.90
Total risk-based capital ratio	15.90	15.10	15.60	16.20

(1) Efficiency ratio is noninterest expense divided by net interest income plus noninterest income gains and losses).

(2) At period end, except for net charge-offs to average loans.

(3) Nonperforming loans consist of nonaccrual loans, loans contractually past due 90 days or more

(4) Calculated by dividing stockholders' equity less goodwill and core deposit intangibles by total

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation.

The following is a discussion of the consolidated financial condition and results of operations of the Company for the periods presented, and certain factors that may affect the Company's prospective financial condition. This section should be read in conjunction with the consolidated financial statements and the notes thereto appearing elsewhere or incorporated by reference in this Annual Report on Form 10-K including note 1 which describes the Company's significant accounting policies including its use of estimates. See the caption entitled "Critical Accounting Policies and Estimates" in this section for

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

further information. The following discussion contains statements which are forward-looking rather than historical fact. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies, and expectations of the Company, are generally identified by use of the words "plan," "believe," "expect," "intend," "anticipate," "estimate," "project," or similar expressions. These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and involve risks and uncertainties that could render them materially different, including, but not limited to, changes in general economic conditions; interest rates, deposit flows, loan demand, real estate values, competition and demand for financial services and loan, deposit, and investment products in the Company's local markets; changes in the quality and composition of the loan or investment portfolios; changes in accounting principles, policies, or guidelines; changes in legislation and regulation; changes in the monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board; war or terrorist activities; and other economic, competitive, governmental, regulatory, geopolitical, and technological factors affecting the Company's operations, pricing, and services, and other risks as detailed in the Company's various Securities and Exchange Commission filings.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this filing. Except as required by applicable law or regulation, the Company undertakes no obligation to update these forward-looking statements to reflect events or circumstances that occur after the date on which such statements were made.

### General

The Company provides commercial and retail banking services, including commercial real estate loans, one-to-four family residential mortgage loans via 1st Independence Mortgage, home equity loans and lines of credit and consumer loans as well as certificates of deposit, checking accounts, money-market accounts and savings accounts within its market area. At December 31, 2006, the Company had total assets, deposits and stockholders' equity of \$342.8 million, \$254.1 million, and \$40.3 million, respectively. The Company's business is conducted principally through the Bank. Unless otherwise indicated, all references to the Company refer collectively to the Company and the Bank.

The Company is currently a defendant in a lawsuit that asserts that the Company made certain material misrepresentations in connection with its offer to purchase up to 300,000 shares of stock in a tender offer in May 2003. The plaintiffs are seeking to recover damages in connection with the shares they sold in the tender offer and attorneys fees. This matter is currently scheduled for trial in July 2007. Based upon the advice of counsel, management records an estimate of the amount of ultimate expected loss for litigation, if any. Management has not recorded a loss provision for this litigation as, after discussion with legal counsel, management believes the ultimate result of this litigation will not have a material adverse effect on the Company's financial position, results of operations or cash flows. Events could occur that could cause the estimate of ultimate loss to differ materially in the near term.

In January 2005, the Company sold its interest in Citizens Financial Bank, Inc., Glasgow, Kentucky ("Citizens") to another financial institution for \$2.3 million. The sale of Citizens reflected the Company's revised strategic plan to exit the south central Kentucky market and to focus on the growing markets of southern Indiana, central Kentucky, and greater Louisville, Kentucky.

The Bank also purchased property and a building, located in Louisville, Kentucky, that was previously used as an operations center and retail branch of an affiliate of the financial institution that purchased Citizens. The purchase price of the building and property was \$2.3 million. The Bank moved its finance and accounting, loan and deposit operations, and mortgage banking operations into the building in April 2005. The Bank also received regulatory approval during the second quarter of 2005 to establish a full service branch at this location and subsequently opened the branch in November 2005.

### Critical Accounting Policies and Estimates

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

The discussion and analysis of the Company's financial condition and results of operations is based upon the Company's consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

On an ongoing basis, management evaluates the Company's accounting policies and estimates it uses to prepare the consolidated financial statements. In general, management's estimates are based on historical experience, on information from regulators and third party professionals and other assumptions believed to be reasonable under the circumstances. Actual results could differ from those estimates.

The following critical accounting policies affect the Company's more significant judgements and estimates used to prepare the consolidated financial statements:

**Other Than Temporary Impairment of Securities.** Securities are evaluated periodically to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent. It indicates that the prospects for a near term recovery of value are not necessarily favorable, or that there is a lack of evidence to support fair values equal to, or greater than, the carrying value of the investment. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding charge to earnings is recognized.

**Allowance for Loan Losses.** Determining the amount of the allowance for loan losses necessarily involves a high degree of judgment. To assess the adequacy of the allowance, management uses historical information as well as the prevailing business environment, as it is affected by changing economic conditions and various external factors, which may impact the portfolio in ways currently unforeseen. The allowance is increased by provisions for loan losses and by recoveries of loans previously charged-off and reduced by loans charged-off. For a full discussion of the methodology of assessing the adequacy of the allowance for loan losses, see the "Provision for Loan Losses" section elsewhere within this Management's Discussion and Analysis of Financial Condition and Results of Operations and note 5 to the Company's consolidated financial statements.

**Goodwill.** Acquisitions accounted for under the purchase method of accounting require that assets acquired and liabilities assumed be recorded at their fair value which is an estimate determined by the use of internal or other valuation techniques. These valuation estimates result in goodwill and other intangible assets with goodwill representing the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Goodwill is subject to an annual impairment test and is evaluated using various fair value techniques. See note 7 to the Company's consolidated financial statements for further information.

### Overview

Net income for the year ended December 31, 2006 was \$1,940,000 or \$0.99 per diluted share compared to net income of \$4,481,000 or \$2.32 per diluted share for the year ended December 31, 2005. The decreases in net income and net income per diluted share for the year ended December 31, 2006 were primarily due to after tax securities gains of \$3,308,000 taken in the first quarter of 2005 and the increase of \$325,000 after taxes in the provision for loan losses in the year 2006 compared to the year 2005. Partially offsetting these factors was an increase in net interest income of \$245,000 after taxes and an after tax charge of \$235,000 recorded in the first quarter of 2005 for severance expenses related to the retirement of the Company's former Chairman and Chief Executive Officer.

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

Other factors were decreased incentive expense, employee benefit expense, marketing expense, professional fees and other noninterest expense items. Partially offsetting these factors were increased net occupancy expense and data processing expense.

Net income for the year ended December 31, 2005 was \$4,481,000 or \$2.32 per diluted share compared to a loss of (\$1,036,000) or (\$0.69) per diluted share for the twelve months ended December 31, 2004. The Company changed its fiscal year from September 30 to December 31, effective December 31, 2004. Accordingly, results of operations and related statistical information set forth in this Management's Discussion and Analysis of Financial Condition and Results of Operations for the twelve months ended December 31, 2004 is unaudited and is derived by taking the (audited) twelve months ended September 30, 2004 amount and adding the (audited) three months ended December 31, 2004 amount and subtracting the (unaudited) three months ended December 31, 2003 amount. The increases in net income and net income per diluted share for the year ended December 31, 2005 were primarily due to after tax securities gains of \$3,308,000 taken in the first quarter of 2005 which was previously mentioned and the significance of the Company's July 2004 merger with Independence Bancorp (the "Merger") to the Company's operations including an after tax charge of approximately \$526,000 recorded in the second quarter of 2004 in connection with the termination of a data processing contract. Other factors which contributed to the increase were a decrease of \$560,000, after taxes, in the provision for loan losses taken in the twelve months ended December 31, 2005 compared to the same period in 2004, an after tax charge of \$158,000 relating to the Bank's termination of its pension plan in the third quarter of 2004, a \$356,000 goodwill writeoff recorded in the third quarter of 2004 in regards to the Citizens disposal and certain merger-related expenses also taken in the third quarter of 2004. Partially offsetting these factors was the after tax charge of \$235,000 recorded in the first quarter 2005 for severance expenses related to the retirement of the Company's former Chairman and CEO which was previously mentioned.

### Results of Operations

#### Net Interest Income

Net interest income is the most significant component of the Company's revenues. Net interest income is the difference between interest income on interest-earning assets (primarily loans and investment securities) and interest expense on interest-bearing liabilities (deposits and borrowed funds). Net interest income depends on the volume and rate earned on interest-earning assets and the volume and rate paid on interest-bearing liabilities.

Net interest income was \$10.6 million for the year ended December 31, 2006, an increase of \$0.3 million or 4% from \$10.3 million for the year ended December 31, 2005. Net interest spread and net interest margin were 2.98% and 3.40%, respectively, for the year ended December 31, 2006, compared to 3.14% and 3.44% for the year ended December 31, 2005. The decrease in net interest spread and net interest margin for the year 2006 compared to the year 2005 was primarily due to the reversal of \$57,000 of interest income on a \$2.6 million loan which was placed on nonaccrual in August 2006 and a faster increase in interest rates on interest-bearing liabilities, including the effect of the increasing rate on the \$4.1 million of variable rate subordinated debentures, compared to the rates on interest-earning assets. Partially offsetting these factors were increases in the volume of net earning assets. Changes in volume resulted in an increase in net interest income of \$0.7 million for the year of 2006 compared to the year 2005, and changes in interest rates and the mix resulted in a decrease in net interest income of \$0.4 million for the year 2006 versus the year 2005.

Net interest income was \$10.3 million for the year ended December 31, 2005, an increase of \$4.1 million or 67% from \$6.2 million for the twelve months ended December 31, 2004. Net interest spread and net interest margin were 3.14% and 3.44%, respectively, for the year ended December 31, 2005, compared to 3.07% and 3.30% for the twelve months ended December 31, 2004. The increase in the net interest margin was due to an increase in the volume of net interest bearing

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

assets, primarily resulting from the Merger and due to loan growth since the Merger. Changes in volume resulted in an increase in net interest income in 2005 of \$4.4 million and changes in interest rates and the mix resulted in a decrease in net interest income of \$0.3 million versus the comparable periods in 2004.

For a detailed analysis of interest income and interest expense, see "Average Balance Sheets" and "Rate/Volume Analysis" below.

### Average Balance Sheets

The following table set forth certain information relating to the Company for the periods indicated. The average yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods presented.

	Year ended December 31, 2006			Year ended December 31, 2005 (1)		
	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Co
(in thousands except percentages)						
<b>Earning assets:</b>						
Loan, net of unearned income	\$277,974	\$20,798	7.48%	\$259,119	\$17,009	6.56%
Investment securities and other (2)	34,060	1,640	4.82	38,827	1,437	3.70
	-----	-----		-----	-----	
Total earning assets	312,034	22,438	7.19	297,946	18,446	6.19
		-----			-----	
Less allowance for loan losses	3,157			2,747		
	-----			-----		
	308,877			295,199		
<b>Assets of discontinued operations</b>						
<b>Non-earning assets:</b>						
Cash and due from banks	5,462			4,604		
Premises and equipment, net	8,259			7,856		
Other assets	17,584			16,431		
	-----			-----		
Total assets	\$340,182			\$324,090		
	=====			=====		
<b>Interest bearing liabilities:</b>						
Deposits	\$249,173	10,060	4.04	\$237,321	6,852	2.89
Borrowings	31,433	1,755	5.58	31,302	1,342	4.29
	-----	-----		-----	-----	
Total interest bearing liabilities	280,606	11,815	4.21	268,623	8,194	3.05
		-----			-----	
<b>Liabilities of discontinued operations</b>						
<b>Non-earning liabilities:</b>						
Non-interest bearing deposits	18,539			16,016		
Other liabilities	1,674			1,861		
	-----			-----		
Total liabilities	300,819			286,500		
				-----		
Minority interests	-			13		
Stockholders' equity	39,363			37,577		
	-----			-----		
Total liabilities and stockholders' equity	\$340,182			\$324,090		
	=====			=====		



Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

Net interest income	\$10,623 =====	\$10,252 =====
Net interest spread (3)	2.98% =====	3.14% =====
Net interest margin (4)	3.40% =====	3.44% =====
Ratio of average interest-earning assets to average interest-bearing liabilities	111.20% =====	110.92% =====

- (1) Average balances and interest income and interest expense related to the discontinued operations of Citizens have been eliminated.
- (2) Includes interest-earning overnight deposits and term deposits with the FHLB.
- (3) Net interest spread represents the difference between the average yield on earning assets and the average cost of interest bearing liabilities.
- (4) Net interest margin represents net interest income as a percentage of average earning assets.

Rate/Volume Analysis

The following table below sets forth certain information regarding changes in interest income and interest expense of the Company for the periods indicated. For each category of earning assets and interest bearing liabilities, information is provided on changes attributable to (i) changes in volume (change in average volume multiplied by old rate); and (ii) changes in rates (change in rate multiplied by old average volume). Changes in rate/volume (change in rate multiplied by the change in volume) have been allocated to the changes due to volume and rate in proportion to the absolute value of the changes due to volume and rate prior to the allocation.

	Year ended December 31, 2006 vs. 2005 (1)			Year ended D 2005 vs.	
	Increase (decrease) due to change in			Increase (decrease)	
	Volume	Rate	Net	Volume	Rate
(in thousands)					
Interest income					
Loans	\$1,294	\$2,495	\$3,789	\$7,241	\$ 610
Investment securities and other (2)	(192)	395	203	42	157
Total interest income	1,102	2,890	3,992	7,283	767
Interest expense					
Deposits	358	2,850	3,208	2,377	919
Borrowings	6	407	413	539	113
Total interest expense	364	3,257	3,621	2,916	1,032
Net interest income	\$ 738 =====	\$ (367) =====	\$ 371 =====	\$4,367 =====	\$ (265) =====

- (1) Average balances and changes in interest income and interest expense related to the discontinued operations of Citizens have been eliminated.
- (2) Includes interest-earning overnight deposits and term deposits with the FHLB.

#### Provision for Loan Losses

The provision for loan losses was \$847,000 for the year ended December 31, 2006, compared to \$354,000 for the year 2005. Nonperforming loans were \$3.7 million at December 31, 2006 and \$1.3 million at December 31, 2005, or 1.36% and 0.47%, respectively, of total loans. The increase in the level of nonperforming loans was primarily due to the result of one loan of \$2.6 million that was placed on nonaccrual status in August 2006 in addition to several other smaller loans totaling \$0.9 million placed on nonaccrual status during the third quarter of 2006 and a \$0.4 million increase in loans delinquent over 90 days but still accruing at December 31, 2006 compared to the amount at December 31, 2005. A softening in the 1-4 family residential real estate and real estate construction markets contributed to the increase in nonperforming loans. The allowance for loan losses was \$3.7 million and \$2.9 million at December 31, 2006 and December 31, 2005, or 1.37% and 1.08%, respectively, of total loans.

The provision for loan losses was \$354,000 for the year ended December 31, 2005, compared to \$1,203,000 for the twelve months ended December 31, 2004. Nonperforming loans were \$1.3 million at December 31, 2005 and \$1.2 million at December 31, 2004, or 0.47% and 0.52%, respectively, of total loans. The allowance for loan losses was \$2.9 million and \$2.5 million at December 31, 2005 and December 31, 2004, or 1.08% and 1.08%, respectively, of total loans. The higher amount of provision for loan losses in 2004 compared to 2005 was primarily attributable to the changes in the loan mix as a result of the Merger, as described below.

The Company maintains the allowance for loan losses at a level that it considers to be adequate to provide for credit losses inherent in its loan portfolio. Management determines the level of the allowance by performing a quarterly analysis that considers concentrations of credit, past loss experience, current economic conditions, the amount and composition of the loan portfolio (including nonperforming and potential problem loans), estimated fair value of underlying collateral, loan commitments outstanding, and other information relevant to assessing the risk of loss inherent in the loan portfolio. As a result of management's analysis, a range of the potential amount of the allowance for loan losses is determined.

Prior to the acquisition of Independence Bancorp in July 2004, the Company operated as a thrift and provided primarily residential real estate loan products in its markets in central Kentucky. As a result of the Merger and the Bank's conversion to a state-chartered commercial bank, management made the decision to no longer originate long-term residential real estate loans for its loan portfolio. The Company's loan growth since the Merger has primarily consisted of shorter-term construction loans, commercial real estate loans, other commercial loans and other loan types traditional to the banking industry. The Company therefore has different risk characteristics including but not limited to higher individual loan amounts and increased exposure to economic conditions.

The Company will continue to monitor the adequacy of the allowance for loan losses and make additions to the allowance in accordance with the analysis referred to above. Because of uncertainties inherent in estimating the appropriate level of the allowance for loan losses, actual results may differ from management's estimate of credit losses and the related allowance.

#### Noninterest Income

Noninterest income was \$1.8 million for the year ended December 31, 2006, compared to \$7.0 million for the year 2005. The significant decrease in noninterest income for the year 2006 compared to the year 2005 resulted primarily from a \$5.0 million gain on sale of Federal Home Loan Mortgage Corporation ("FHLMC") preferred stock recorded in the first quarter of 2005. The gain on loan sales decreased for the year 2006 compared to the year 2005 due to a slow down in secondary market mortgage activity and lower margins in 2006. The gain on loan sales was \$892,000 for the year 2006 compared to \$1,041,000 for the

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

year 2005. Service charge income was \$518,000 for the year 2006 compared to \$391,000 for the year 2005. The Company continues to evaluate its deposit product offerings with the intention of continuing to expand its offerings to the consumer and business depositor. During March 2005, the Bank began offering products which include overdraft privileges on certain individual deposit products and cash management services for business depositors. Both of these products are fee-based and should result in further increases in service charge income. Other factors which primarily offset each other was a reduction of the loss on sale of premises and equipment which decreased from \$156,000 in 2005 to \$32,000 in 2006 which offset a loss of \$120,000 in 2006 relating to other real estate owned compared to no activity in 2005. Factors contributing to the decrease in other noninterest income for the year 2006 was the Company's decision to exit the title insurance business at the end of November 2005 and a decrease in fees due to reduced activity relating to secondary market mortgage lending and a one time gain of \$32,000 on long-term portfolio loans sold in the first quarter of 2005. The Company's title insurance company had approximately \$264,000 of title insurance revenue for the year ended December 31, 2005.

Noninterest income was \$7.0 million for the year ended December 31, 2005, compared to \$1.2 million for the twelve months ended December 31, 2004. Significant increases in noninterest income for the year ended December 31, 2005 resulted from the \$5.0 million gain on sale of FHLMC preferred stock recorded in the first quarter of 2005 which was previously mentioned and gains on loan sales. The gains on loan sales represented a new source of noninterest income to the Company after the Merger as the Company did not previously engage in significant secondary market sales prior to the Merger. Service charge income was \$391,000 for the year ended December 31, 2005, compared to \$195,000 for the twelve months ended December 31, 2004. The increase was primarily attributable to the Merger. Traditionally, the Company did not have significant service charge income since the vast majority of their deposit accounts were consumer accounts. Contributing to the increase in other noninterest income were the effects of the Merger and approximately \$264,000 of title insurance revenue for the year ended December 31, 2005 from the Company's title insurance company which began operations in November 2004. As previously mentioned, the Company decided to exit the title insurance business at the end of November 2005 and sold the title insurance company at its carrying value.

### Noninterest Expense

Noninterest expense was \$8.8 million for the year ended December 31, 2006 compared to \$10.1 million for the year ended 2005. Contributing to the decrease was a decrease in salaries and employee benefits due to the \$356,000 which the Company accrued during the first quarter of 2005 for the severance expense relating to the retirement of the Company's former Chairman and Chief Executive Officer, a reduction in the commissions related to reduced activity in mortgage loan sales, a reduction in incentive accruals and a decrease in employee benefit expense due to a plan revision and a lower amount of ESOP contributions. Additional factors contributing to the decrease were reduced marketing expense and a reduction in professional fees in the year 2006 compared to the year 2005 due to a reduced amount of services required. Other factors included a higher level of other noninterest expenses in the first quarter of 2005 primarily related to integration items associated with the Merger, the Citizens disposal in January 2005 and the expenses relating to the title insurance company that was sold which was previously mentioned. Partially offsetting those factors was an increase in net occupancy expense due to the Bank's purchase of a building, located in Louisville, Kentucky to accommodate expansion. In April 2005, the Bank moved its finance and accounting, loan and deposit operations, and mortgage banking operations into the building and in November 2005 established a full service branch at this location. An additional factor offsetting the overall decrease in noninterest expense was an increase in data processing expense which was primarily due to the growth of the Bank's services and its commitment to upgrade systems productivity and the effects of a refund received in the first quarter of 2005 from a previous third party data processing company of the Bank.

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

Noninterest expense was \$10.1 million for the year ended December 31, 2005 compared to \$7.8 million for the twelve months ended December 31, 2004. All categories of noninterest expense for the year ended December 31, 2005 increased significantly over the comparable period in 2004 as a result of the Merger which was effective on July 9, 2004 except for other noninterest expense which was flat due to several items recorded in 2004 that did not recur in 2005. In addition, contributing to the increase in salaries and employee benefits was \$356,000 which the Company accrued during the first quarter of 2005 for the severance expense relating to the retirement of the Company's former Chairman and CEO. Factors limiting the increase were \$797,000 of charges recorded in the second quarter of 2004 in connection with the termination of a data processing contract, \$239,000 relating to the Bank's termination of its pension plan in the third quarter of 2004, and items effecting other noninterest expense were a \$356,000 goodwill writeoff recorded in the third quarter of 2004 in regards to the Citizens disposal and certain merger-related expenses also taken in the third quarter of 2004.

### Income Tax Expense (Benefit)

The effective income tax rate on income from continuing operations was 28.9% for the year ended December 31, 2006 compared to 33.6% for the year 2005. The decrease in the effective tax rate is primarily due to an increase in the percentage of tax exempt interest income compared to income from continuing operations.

The effective income tax rate on income (loss) from continuing operations was 33.6% for the year ended December 31, 2005 compared to (41.8%) for the twelve months ended December 31, 2004. The change in the effective income tax rate was primarily due to the change in income from continuing operations.

### Financial Condition

The Company's total assets were \$342.8 million at December 31, 2006 compared to \$336.2 million at December 31, 2005, an increase of \$6.6 million or 2.0%. Net loans increased \$3.5 million, cash and cash equivalents increased \$2.0 million, interest receivable and other assets increased \$1.0 million, investments increased \$0.2 million while Federal Home Loan Bank ("FHLB") stock went down \$0.4 million and all other assets increased \$0.3 million.

Net loans were \$270.5 million at December 31, 2006, compared to \$267.0 million at December 31, 2005, an increase of \$3.5 million or 1.3%. The increases in loans were in the real estate construction and real estate commercial loan portfolios, which increased \$12.4 million or 24% and \$3.2 million or 7%, respectively. The increases were primarily a result of lending activity in the Kentucky markets. All loan categories increased or remained the same as a percentage of total loans, except residential real estate loans, which decreased from approximately 48% to 45% of total loans and commercial loans which decreased from 9% to 7% of total loans. The decrease in residential real estate loans as a percentage of total loans is primarily due to those loans now being sold in the secondary market through 1st Independence Mortgage, a division of the Bank, rather than being retained for the Company's loan portfolio. The Company continues to identify opportunities to cross sell its other products, including home equity and consumer loans for its loan portfolio resulting from customer relationships established through the origination of loans by 1st Independence Mortgage.

Deposits decreased \$10.2 million or 3.9% to \$254.1 million at December 31, 2006 compared to \$264.3 million at December 31, 2005. This decrease was largely attributable to a decrease in time deposits of \$39.8 million which more than offset increases in savings, NOW and money market deposits of \$26.9 million and demand deposits of \$2.7 million. The decrease in time deposits was primarily due to a \$35.9 million decrease in brokered deposits. The increase in savings, NOW and money market deposits resulted primarily from the effects of a general marketing campaign during the first nine months of 2005 focusing on existing products and print advertisements only.

Short-term borrowings increased \$17.8 million or 94.8% to \$36.5 million

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

at December 31, 2006, compared to \$18.7 million at December 31, 2005. The Company uses short-term borrowings, primarily short-term FHLB advances, to fund short-term liquidity needs and manage net interest margin.

### Liquidity

Liquidity to meet borrowers' credit and depositors' withdrawal demands is provided by maturing assets, short-term liquid assets that can be converted to cash and the ability to attract funds from depositors. Additional sources of liquidity include brokered deposits, advances from the FHLB and other short-term borrowings, such as federal funds purchased and securities sold under repurchase agreements.

At December 31, 2006 and December 31, 2005, brokered deposits were \$23.7 million and \$59.6 million, respectively. The weighted average cost and maturity of brokered deposits were 4.86% and six months at December 31, 2006 compared to 3.90% and nine months at December 31, 2005. The Company plans to continue using brokered deposits for the foreseeable future to support loan demand in its market area when pricing for brokered deposits is more favorable than short-term borrowings.

At December 31, 2006 and December 31, 2005, the Bank had total FHLB advances outstanding of \$36.0 million and \$22.0, respectively. Additionally, the Bank had \$25.0 million of unused commitments under its line of credit with the FHLB and sufficient collateral to borrow an additional \$48.1 million.

The Company's liquidity depends primarily on dividends paid to it as sole shareholder of the Bank. As discussed in note 13 to the consolidated financial statements, the Bank may pay \$7.9 million in dividends to the Company without regulatory approval, subject to the ongoing capital requirements of the Bank.

The Company has \$9.3 million of subordinated debentures outstanding, which are included in long-term debt in the accompanying consolidated balance sheets. Approximately \$4.1 million of the debentures are variable rate obligations with interest rates that reprice quarterly, and are tied to the three-month London Interbank Offering Rate ("LIBOR") plus 3.15%. At December 31, 2006, the rate on these debentures was 8.52%. The remaining \$5.2 million of debentures carry a fixed interest rate of 6.4% until March 26, 2008 when the debentures become variable rate obligations that reprice quarterly at the three-month LIBOR plus 3.15%. At the rates that were in effect at December 31, 2006, the Company's cash requirement to service interest on the debentures for 2007 was \$686,000.

### Sources and Uses of Cash

The Company derives most of its cash flow from the Bank's activities. Cash flow of the Bank is provided primarily through financing activities, which include net increases in deposits and short-term borrowings. These funds are used to fund investing activities, which include making loans and increasing the investment portfolio.

### Off-Balance Sheet Arrangements

In the normal course of operations, the Company engages in financial transactions that contain credit, interest rate, and liquidity risk that are not recorded in the financial statements. Such transactions include traditional off-balance sheet credit-related financial instruments, and commitments under long-term debt and operating lease agreements.

The Company provides customers with off-balance sheet credit support through loan commitments, unused lines of credit, letters of credit, and commitments to sell loans. A summary of these financial instruments at December 31, 2006 follows:

Total	Less than one year	1 to 3 years	3 - 5 years	Over years
-----	-----	-----	-----	-----

# Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

(in thousands)

Off- balance sheet items:

Commitments to make loans	\$21,385	\$21,385	\$ -	\$ -	\$ -
Unused lines of credit	43,983	25,075	8,263	5,356	5,289
Performance letters of credit	2,405	1,202	1,153	50	-
Mortgage banking rate-lock	5,773	5,773	-	-	-

Since many of the commitments and unused lines of credit are expected to expire or be only partially used, the total amount of commitments does not necessarily represent future cash requirements.

Contractual Obligations

The Company is required to make future payments on long-term debt, which includes long-term FHLB advances and subordinated debentures. In addition to owned banking facilities, the Company has entered into long-term leases to support its activities. A summary of these aggregate contractual obligations at December 31, 2006 follows:

	Payments Due by Period				
	Total	Less than one year	1 to 3 years	3 -5 years	Ove rea
	-----	-----	-----	-----	-----
	(in thousands)				
Aggregate contractual obligations:					
FHLB borrowings	\$ 1,000	\$ -	\$ -	\$1,000	\$ -
Subordinated debentures	9,279	-	-	-	9,279
Operating lease commitments	2,878	290	483	520	1,500
Total	\$13,157	\$290	\$483	\$1,520	\$10,850
	=====	=====	=====	=====	=====

Asset/Liability Management

The Bank, like many other financial institutions, is vulnerable to an increase in interest rates to the extent interest-bearing liabilities mature or reprice more rapidly than interest-earning assets. Historically, the lending activities of commercial banks emphasized the origination of short to intermediate term variable rate loans that are more closely matched with the deposit maturities and repricing of interest-bearing liabilities which occur closer to the same general time period. While having interest-bearing liabilities that reprice more frequently than interest-earning assets is generally beneficial to net interest income during periods of declining interest rates, it is generally detrimental during periods of rising interest rates.

To reduce the effect of interest rate changes on net interest income, the Bank has adopted various strategies to improve matching interest-earning asset maturities to interest-bearing liability maturities. The principal elements of these strategies include; originating variable rate commercial loans that include interest rate floors; originating one-to-four family residential mortgage loans with adjustable rate features, or fixed rate loans with short maturities; maintaining interest-bearing demand deposits, federal funds sold, and U.S. government securities with short to intermediate term maturities; maintaining an investment portfolio that provides stable cash flows, thereby providing investable funds in varying interest rate cycles; lengthening the maturities of our time deposits and borrowings when it would be cost effective; and attracting low cost checking and transaction accounts, which tend to be less

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

interest rate sensitive when interest rates increase.

The Bank measures its exposure to changes in interest rates using an overnight upward and downward shift (shock) in the Treasury yield curve. As of December 31, 2006, if interest rates increased 200 basis points and decreased 200 points, respectively, the Bank's net interest income would increase by 0.4% and decrease by 0.9%, respectively. The risk position of the Bank is within the Bank's policy limits.

### Regulatory Matters

On July 20, 2006, the Bank received its most recent Community Reinvestment Act ("CRA") Performance Evaluation prepared as of May 15, 2006. The Bank was assigned a "Needs to Improve" rating due in part to the Bank's low level of residential lending to low and moderate income borrowers within the Louisville, Kentucky Metropolitan Statistical Area. Management has taken appropriate steps to improve the residential lending issues cited by the Federal Deposit Insurance Corporation ("FDIC") during the CRA Performance Evaluation. By statute, a bank with a "less than satisfactory" CRA rating has limitations on certain future business activities until the CRA rating improves. Management does not believe these limitations will have any material affect on the Bank's current business plan.

### Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Information required by this item is included in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operation" under the caption "Asset/Liability Management."

### Item 8. Financial Statements and Supplementary Data.

The following report of independent registered public accounting firm and the consolidated financial statements of the Company are included below:

Report of Independent Registered Public Accounting Firm  
Consolidated Balance Sheets  
Consolidated Statements of Income  
Consolidated Statements of Comprehensive Income  
Consolidated Statements of Changes in Stockholders' Equity  
Consolidated Statements of Cash Flows  
Notes to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

Audit Committee, Board of Directors and Stockholders  
1st Independence Financial Group, Inc.  
Louisville, Kentucky

We have audited the accompanying consolidated balance sheets of 1st Independence Financial Group, Inc. (Company) as of December 31, 2006 and 2005, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for the years ended December 31, 2006 and 2005, and the three-month period ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2006 and 2005, and the results of its operations and its cash flows for the years ended December 31, 2006 and 2005, and the three-month period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

/s/ BKD, LLP

Louisville, Kentucky  
March 23, 2007

### 1ST INDEPENDENCE FINANCIAL GROUP, INC. Consolidated Balance Sheets (in thousands except share data)

	December 31, 2006
	-----
<b>Assets</b>	
Cash and due from banks	\$ 16,678
Interest-bearing demand deposits	6,370
Federal funds sold	531
	-----
Cash and cash equivalents	23,579
Interest-bearing deposits	100
Available-for-sale securities at fair value	16,421
Held-to-maturity securities, fair value of \$1,930 and \$1,974 at December 31, 2006 and 2005, respectively	1,900
Loans held for sale	1,227
Loans, net of allowance for loan losses of \$3,745 and \$2,911 at December 31, 2006 and 2005, respectively	270,478
Premises and equipment, net	8,322
Federal Home Loan Bank (FHLB) stock	2,313
Bank owned life insurance	3,435
Goodwill	11,142
Interest receivable and other assets	3,889
	-----
Total assets	\$342,806
	=====
<b>Liabilities and Stockholders' Equity</b>	
<b>Liabilities</b>	
<b>Deposits</b>	
Demand	\$ 18,261
Savings, NOW and money market	78,083
Time	157,733
	-----
Total deposits	254,077
Short-term borrowings	36,526
Long-term debt	10,279
Interest payable and other liabilities	1,621
	-----
Total liabilities	302,503



Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

Commitments and contingencies	-----	-
Stockholders' equity		
Preferred stock, \$0.10 par value, 500,000 shares authorized, no shares issued or outstanding		-
Common stock, \$0.10 par value, 5,000,000 shares authorized, 1,995,594 shares and 1,951,408 shares outstanding at December 31, 2006 and 2005, respectively		296
Additional paid-in capital		39,775
Retained earnings		15,169
Unearned ESOP compensation		(291)
Unearned compensation on restricted stock		-
Accumulated other comprehensive income (loss)		(71)
Treasury stock, at cost, common, 969,835 shares and 969,835 shares at December 31, 2006 and 2005, respectively		(14,575)
	-----	
Total stockholders' equity		40,303
	-----	
Total liabilities and stockholders' equity		\$342,806
	=====	

See notes to consolidated financial statements.

1ST INDEPENDENCE FINANCIAL GROUP, INC.  
Consolidated Statements of Income  
(in thousands except per share data)

	Year ended December 31, 2006	Year ended December 31, 2005	Thre e Dece
	-----	-----	-----
Interest and dividend income			
Loans, including fees	\$20,798	\$17,009	
Securities			
Taxable	649	693	
Tax exempt	183	125	
Federal funds sold	368	332	
Dividends	158	143	
Deposits with financial institutions	282	144	
	-----	-----	
Total interest and dividend income	22,438	18,446	
	-----	-----	
Interest expense			
Deposits	10,060	6,852	
FHLB advances	1,023	727	
Other	732	615	
	-----	-----	
Total interest expense	11,815	8,194	
	-----	-----	
Net interest income	10,623	10,252	
Provision for loan losses	847	354	
	-----	-----	
Net interest income after provision for loan losses	9,776	9,898	
	-----	-----	
Noninterest income			
Service charges	518	391	
Gain on loan sales	892	1,041	

Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

(Loss) on sale of premises and equipment	(32)	(156)
(Loss) on other real estate owned	(120)	-
Increase in cash value of life insurance	199	188
Net realized gains on sales of available-for-sale securities	-	4,883
Other	334	610
	-----	-----
Total noninterest income	1,791	6,957
	-----	-----
Noninterest expense		
Salaries and employee benefits	4,162	4,850
Net occupancy expense	1,586	1,431
Data processing fees	759	630
Professional fees	590	785
Marketing expense	104	362
Other	1,638	2,035
	-----	-----
Total noninterest expense	8,839	10,093
	-----	-----
Income from continuing operations before income taxes and minority interest	2,728	6,762
Income tax expense from continuing operations	788	2,273
	-----	-----
Income from continuing operations before minority interest and discontinued operations	1,940	4,489
Income from subsidiary held for disposal	-	6
Income tax expense from subsidiary held for disposal	-	2
	-----	-----
Income before minority interest	1,940	4,493
Minority interest in (income) of consolidated subsidiary and subsidiary held for disposal	-	(12)
	-----	-----
Net income	\$ 1,940	\$ 4,481
	=====	=====
Income per share from continuing operations		
Basic	\$1.00	\$2.38
Diluted	0.99	2.33
Income per share from subsidiary held for disposal		
Basic	\$0.00	\$0.00
Diluted	0.00	0.00
Net income per share		
Basic	\$1.00	\$2.37
Diluted	0.99	2.32
Weighted average shares outstanding		
Basic	1,941	1,889
Diluted	1,957	1,929

See notes to consolidated financial statements.

1ST INDEPENDENCE FINANCIAL GROUP, INC.  
Consolidated Statements of Comprehensive Income  
(in thousands)

Year ended	Year ended
December 31,	December 31,
2006	2005
-----	-----

Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

Net income	\$1,940	\$4,481
Other comprehensive income (loss), net of tax		
Change in unrealized gains and losses on available-for-sale securities	66	(686)
Less reclassification adjustment for realized gains (losses) included in net income	-	3,223
	-----	-----
Other comprehensive income (loss)	66	(3,909)
	-----	-----
Comprehensive income	\$2,006	\$ 572
	=====	=====

See notes to consolidated financial statements.

1ST INDEPENDENCE FINANCIAL GROUP, INC.  
Consolidated Statements of Changes in Stockholders' Equity  
(in thousands except share and per share data)

	Common Stock		Additional	Retained	Unearned	Unearned	
	Number of	Amount	Paid-in	Earnings	ESOP	Compensation	Co
	Shares		Capital		Compensation	Compensation	In
	-----	-----	-----	-----	-----	-----	-----
Balance September 30, 2004	1,913,368	\$288	\$38,535	\$ 9,882	\$ (516)	\$ -	\$
Net income	-	-	-	240	-	-	
Change in other comprehensive income, net of tax	-	-	-	-	-	-	
Exercise of stock options	3,000	1	29	-	-	-	
ESOP shares released	-	-	24	-	26	-	
	-----	-----	-----	-----	-----	-----	
Balance December 31, 2004	1,916,368	\$289	\$38,588	\$10,122	\$ (490)	\$ -	\$
Net income	-	-	-	4,481	-	-	
Cash dividends declared, \$0.40 per share	-	-	-	(754)	-	-	
Change in other comprehensive income (loss), net of tax	-	-	-	-	-	-	
Exercise of stock options	54,500	5	877	-	-	-	
Retirement of stock received as part of exercise of stock options	(20,960)	(2)	(411)	-	-	-	
Issuance of restricted stock	2,000	-	38	-	-	(38)	
Forfeiture of restricted stock	(500)	-	(9)	-	-	9	
Amortization of unearned compensation	-	-	-	-	-	5	
ESOP shares released	-	-	153	-	110	-	
	-----	-----	-----	-----	-----	-----	
Balance December 31, 2005	1,951,408	\$292	\$39,236	\$13,849	\$ (380)	\$ (24)	\$
Net income	-	-	-	1,940	-	-	
Cash dividends declared, \$0.32 per share	-	-	-	(620)	-	-	
Change in other comprehensive income (loss), net of tax	-	-	-	-	-	-	
Exercise of stock options	51,500	5	736	-	-	-	
Retirement of stock received as part of exercise of stock options	(14,314)	(1)	(246)	-	-	-	

Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

Issuance of restricted stock	7,000	1	(1)	-	-	-
Accrual of compensation expense for stock options	-	-	40	-	-	-
Amortization of unearned compensation	-	-	19	-	-	-
ESOP shares released	-	-	14	-	89	-
Other	-	(1)	(23)	-	-	24
	-----	-----	-----	-----	-----	-----
Balance December 31, 2006	1,995,594	\$296	\$39,775	\$15,169	\$(291)	\$ -
	=====	=====	=====	=====	=====	=====

See notes to consolidated financial statements.

1ST INDEPENDENCE FINANCIAL GROUP, INC.  
Consolidated Statements of Cash Flows  
(in thousands)

	Year ended December 31, 2006	Year ended December 31, 2005
	-----	-----
Cash Flows from Operating Activities:		
Net income	\$ 1,940	\$ 4,481
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation	716	613
Goodwill impairment	-	-
Provision for loan losses	847	354
Gain on loan sales	(892)	(1,041)
Origination of loans held for sale	(46,830)	(60,408)
Proceeds from loans held for sale	47,773	62,515
Compensation expense on stock options	40	-
ESOP compensation	103	210
Amortization of unearned compensation on restricted stock	19	5
Amortization of premiums and discounts on securities	32	117
Deferred income taxes	(395)	3
FHLB stock dividend	(122)	(100)
Amortization of loan fees	(358)	(330)
Amortization of intangibles, net	259	336
Net realized (gains) losses on available-for-sale securities	-	(4,883)
Loss on sale of premises and equipment	32	156
Minority interest in income of consolidated subsidiary and subsidiary held for disposal	-	12
Increase in cash value of life insurance	(199)	(188)
(Income) from subsidiary held for disposal	-	(4)
Changes in:		
(Increase) decrease in interest receivable and other assets	(70)	(594)
Increase (decrease) in interest payable and other liabilities	120	507
	-----	-----
Net cash provided by operating activities	3,015	1,761
	-----	-----
Cash Flows from Investing Activities:		
Purchase of interest-bearing deposits	(100)	-
Proceeds from maturities of interest-bearing deposits	100	-
Purchases of available-for-sale securities	(2,538)	(7,319)
Proceeds from maturities of available-for-sale securities	2,321	5,474
Proceeds from the sales of available-for-sale securities	-	11,267
Proceeds from maturities of held-to-maturity securities	68	165

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

Net (increase) in loans	(4,901)	(33,578)
Purchases of premises and equipment	(855)	(3,635)
Proceeds from sales of premises and equipment	-	24
Proceeds from sale of FHLB stock	498	-
Proceeds, net from sale of subsidiaries	-	2,260
	-----	-----
Net cash (used in) investing activities	(5,407)	(25,342)
	-----	-----
Cash Flows from Financing Activities:		
Net (decrease) increase in deposits	(10,245)	40,968
Net increase (decrease) in short-term borrowings	17,779	(4,486)
Repayment of long-term debt	(3,000)	(1,000)
Proceeds from exercise of stock options	494	470
Cash dividends paid	(620)	(754)
	-----	-----
Net cash provided by financing activities	4,408	35,198
	-----	-----
Net increase (decrease) in cash and cash equivalents	2,016	11,617
Cash and cash equivalents at beginning of period	21,563	9,946
	-----	-----
Cash and cash equivalents at end of period	\$23,579	\$21,563
	=====	=====
Supplemental Cash Flow Information:		
Interest paid	\$11,664	\$ 7,800
Income taxes paid	1,248	1,965
Net increase in cash and cash equivalents of discontinued operations		
Net cash (used in) provided by operating activities	-	(5)
Net cash provided by investing activities	-	1,647
Net cash (used in) financing activities	-	(361)
	-----	-----
Net increase in cash and cash equivalents of discontinued operations	-	1,281
	-----	-----
Real estate acquired in settlement of loans	710	33

See notes to consolidated financial statements.

### 1st INDEPENDENCE FINANCIAL GROUP, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 1. Basis of Presentation and Summary of Significant Accounting Policies

##### Nature of Operations

1st Independence Financial Group, Inc. (the "Company") is a holding company whose principal activity is the ownership and management of its wholly owned subsidiary, 1st Independence Bank, Inc. (the "Bank") and 1st Independence Mortgage, a division of the Bank. The Bank is primarily engaged in providing a full range of banking and financial services to individual and corporate customers in Indiana and Kentucky. The Bank is subject to competition from other financial institutions and is subject to the regulation of certain federal and state agencies and undergoes periodic examinations by those regulatory authorities. 1st Independence Mortgage engages in mortgage banking operations. The Bank sold its majority ownership in Foundation Title Company, LLC at the end of November 2005 after deciding to exit the title insurance business. As discussed in note 3, on January 28, 2005 the Company completed the sale of its entire interest in its majority owned subsidiary, Citizens Financial Bank, Inc. ("Citizens").

##### Principles of Consolidation

The consolidated financial statements include the accounts of the Company and

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

the Bank. All significant inter-company accounts and transactions have been eliminated in consolidation. The financial position and results of operations of Citizens were removed from the detail line items in the Company's financial statements and presented separately as "subsidiary held for disposal."

The Company changed its fiscal year-end from September 30 to December 31 in 2004. References to periods refer to the one year periods ended December 31, 2006 and 2005 and the three month period ended December 31, 2004, as appropriate.

### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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

### Cash Equivalents

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

### Securities

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

Held-to-maturity securities, which include any security for which the Company has the positive intent and ability to hold until maturity, are carried at historical cost adjusted for amortization of premiums and accretion of discounts.

Amortization of premiums and accretion of discounts are recorded as interest income from securities. Realized gains and losses are recorded as net security gains (losses). Gains and losses on sales of securities are determined on the specific-identification method.

### Mortgage Banking Activities

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or market value. To deliver closed loans to the secondary market and to control its interest rate risk prior to sale, the Company enters into "best efforts" contracts. The aggregate market value of mortgage loans held for sale considers the price of the sales contracts. No servicing is retained on loans sold into the secondary market.

### Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoffs are reported at their outstanding principal balances adjusted for any charge-offs, the allowance for loan losses, any deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans. Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the loan term. Generally, loans are placed on nonaccrual status at 90 days past due and interest is considered a loss unless the loan is well-secured and in the process of collection.

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

### Allowance for Loan Losses

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

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revisions as more information becomes available.

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

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment.

### Premises and Equipment

Depreciable assets and leasehold improvements are stated at cost less accumulated depreciation. Depreciation is charged to expense using the straight-line method over the estimated useful lives of the assets which generally range from 5 to 39 years for buildings and related components and from 3 to 10 years for furniture, fixtures and equipment.

### Federal Home Loan Bank Stock

Federal Home Loan Bank ("FHLB") stock is a required investment for institutions that are members of the FHLB system. The required investment in the common stock is based on a predetermined formula and is carried at cost.

### Bank Owned Life Insurance

The Bank has purchased life insurance policies on certain key executives. Company owned life insurance is recorded at its cash surrender value or the amount that can be realized.

### Goodwill

Goodwill is tested annually for impairment. If the implied fair value of goodwill is lower than its carrying amount, goodwill impairment is indicated and goodwill is written down to its implied fair value. Subsequent increases in goodwill value are not recognized in the consolidated financial statements.

### Treasury Stock

Treasury stock is stated at cost. Cost is determined by the average cost method.

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

### Stock Options

The Company has two stock-based employee compensation plans ("Plans"), which are described more fully in note 16. Prior to January 1, 2006, as permitted by Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"), the Company followed the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations in accounting for its stock option plans under the intrinsic value based method. Accordingly, no stock-based compensation expense was recognized for the year ended December 31, 2005 or the three months ended December 31, 2004 for stock options issued under the plans as all stock options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and basic and diluted net income per share had compensation expense been determined based on the fair value of the stock options at the grant date consistent with the provisions of SFAS No. 123 (in thousands except per share data):

	Year ended December 31, 2005 ----	Three months ended December 31, 2004 ----
Net income as reported	\$4,481	\$240
Less total stock-based employee compensation expense (including forfeitures of \$65 and \$0) determined under fair value method for all awards, net of related tax effects	(47)	4
	-----	-----
Pro forma net income	\$4,528	\$236
	=====	=====
Basic net income per share		
As reported	\$2.37	\$0.13
Pro forma	2.40	0.13
Diluted net income per share		
As reported	\$2.32	\$0.13
Pro forma	2.35	0.12

The weighted average fair value of stock options granted in 2006 and 2005 was \$4.87 and \$6.65, respectively, and was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	Year ended December 31, 2006 ----	Year ended December 31, 2005 ----
Risk-free interest rate	4.72%	4.17%
Dividend yield	1.80%	1.69%
Volatility factor	22%	27%
Expected term of options (in years)	7	10

There were no stock options granted in the three months ended December 31, 2004.

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No.123R, "Share-Based Payment" ("SFAS 123R"). This Statement requires expensing of stock options and other share-based payments over the related vesting period and supersedes FASB's earlier rule (the original SFAS 123) that had allowed companies to choose between expensing stock options and showing pro forma disclosure only. SFAS 123R



## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

permits companies to adopt its requirements using either a "modified prospective" method, or a "modified retrospective" method. Under the "modified prospective" method, compensation cost is recognized in the financial statements beginning with the effective date, based on the requirements of SFAS 123R for all share-based payments granted after that date, and based on the requirements of SFAS 123 for all unvested awards granted prior to the effective date of SFAS 123R. Under the "modified retrospective" method, the requirements are the same as under the "modified prospective" method but this method also permits entities to restate financial statements of previous periods based on proforma disclosures made in accordance with SFAS 123. Beginning in January 2006, the Company adopted the Statement as required and elected the "modified prospective" method and thus has not restated prior financial statements. For the year ended December 31, 2006, the Company recorded \$40,000 in employee stock-based compensation expense, which is included in salaries and employee benefits. As of December 31, 2006, there was \$22,000 of unrecognized stock-compensation expense for previously granted unvested options that will be recognized over a weighted-average period of 1.4 years.

### Income Taxes

Deferred tax assets and liabilities are recognized for the tax effects of differences between the consolidated financial statement and tax basis of assets and liabilities. A valuation allowance is established to reduce deferred tax assets if it is more likely than not that a deferred tax asset will not be realized. The Company files consolidated income tax returns with 1st Independence Bank.

### Employee Stock Ownership Plan ("ESOP")

The cost of shares issued to the ESOP, but not yet allocated to participants, is shown as a reduction to stockholders' equity. Compensation expense is based on the market price of shares as they are committed to be released to participant accounts. Dividends on allocated ESOP shares reduce retained earnings; dividends on unearned ESOP shares reduce debt and accrued interest. Effective January 1, 2006, the ESOP was combined with the Company's 401(k) plan and now a portion of the released shares are used as the Company's 401(k) match.

### Net Income Per Share

Net income per share has been computed based upon the weighted-average common shares outstanding during each year. Unearned ESOP shares have been excluded from the computation of average shares outstanding.

### Comprehensive Income

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale, which are recognized as a separate component of equity. Other comprehensive income (loss) includes \$9,794 of unrealized gains related to Citizens for the three month period ending December 31, 2004, for which deferred taxes were provided.

### Recently Issued Accounting Standards

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No.123R, "Share-Based Payment" ("SFAS 123R"). This Statement required expensing of stock options and other share-based payments over the related vesting period beginning in 2005, and superseded FASB's earlier rule (the original SFAS 123) that had allowed companies to choose between expensing stock options and showing pro forma disclosure only. The Statement required that public entities apply SFAS 123R as of the first interim or annual reporting period that began after June 15, 2005. However, in April 2005 the United States Securities and Exchange Commission issued a rule that revised the required date of adoption under SFAS 123R. The new rule allowed for public entities to adopt the provisions of SFAS 123R at the beginning of the first fiscal year beginning after June 15, 2005. The Company adopted the Statement in the first quarter of 2006 as required and the effects

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

of initial adoption were immaterial. See the previous section entitled, "Stock Options" in this footnote for additional information.

In July 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109" ("FIN 48"). The Interpretation clarifies the accounting for uncertainty in income taxes recognized in accordance with FASB Statement No. 109, "Accounting for Income Taxes". FIN 48 also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The evaluation of a tax position in accordance with this Interpretation is a two-step process. The first step is a recognition process to determine whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The second step is a measurement process whereby a tax position that meets the more likely than not recognition threshold is calculated to determine the amount of benefit to recognize in the financial statements. FIN 48 is effective for fiscal years beginning after December 15, 2006 and the cumulative effect of applying the provisions of this statement will be recognized as an adjustment to the beginning balance of retained earnings. The Company is currently evaluating the potential impact this Statement may have on the Company's financial position and results of operations, but does not believe the impact of the adoption will be material.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("SFAS 157"), which provides guidance on how to measure assets and liabilities that use fair value. SFAS 157 will apply whenever another US GAAP standard requires (or permits) assets or liabilities to be measured at fair value but does not expand the use of fair value to any new circumstances. This Statement also will require additional disclosures in both annual and quarterly reports. SFAS 157 will be effective for financial statements issued for fiscal years beginning after November 15, 2007, and will be adopted by the Company beginning in the first quarter of 2008. The Company is currently evaluating the potential impact this Statement may have on the Company's financial position and results of operations, but does not believe the impact of the adoption will be material.

In September 2006, the SEC staff issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 was issued in order to eliminate the diversity of practice in how public companies quantify misstatements of financial statements, including misstatements that were not material to prior years' financial statements. The Company initially adopted the provisions of SAB 108 in connection with the preparation of our annual financial statements for the year ending December 31, 2006 as required and the impact on the Company's financial position and results of operations was immaterial.

### Reclassifications

Certain prior year amounts have been reclassified to conform with current classifications. These reclassifications had no effect on net income.

### 2. Restrictions on Cash and Due from Banks

The Bank is required by law to maintain average reserve balances, in the form of vault cash and non-interest bearing balances with the Federal Reserve Bank, against a percentage of certain deposit liabilities. The reserve required was approximately \$2,252,000 and \$869,000 at December 31, 2006 and 2005, respectively.

### 3. Completion of Subsidiary Disposal

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

On January 28, 2005 the Company completed the sale of its entire interest in its majority owned subsidiary, Citizens Financial Bank, Inc., to Porter Bancorp, Inc. for \$2.3 million, pursuant to a Stock Purchase Agreement, dated as of October 22, 2004, between Porter Bancorp, Inc. and the Company. In accordance with Financial Accounting Standard No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", the financial position and results of operations of Citizens prior to the sale were removed from the detail line items in the Company's financial statements and presented separately as "subsidiary held for disposal." Recorded goodwill related to the Company's investment in Citizens in the amount of \$356,000 was written off as impaired in the fourth quarter of 2004.

In a related transaction, on January 28, 2005, the Company's subsidiary bank, 1st Independence Bank, Inc., purchased a commercial building located in Louisville, Kentucky, for \$2.3 million from Ascencia Bank, Inc., an affiliate of Porter Bancorp, Inc.

The following is a condensed balance sheet as of December 31, 2004 and a condensed statement of income for the three month period ended December 31, 2004 for Citizens (in thousands):

	December 31, 2004 -----
<b>Assets</b>	
Cash and cash equivalents	\$ 1,796
Available-for-sale securities	5,777
Loans, net of allowance for loan losses of \$596	28,930
Premises and equipment, net	209
Other real estate owned	404
Other assets	1,030
	-----
Total assets	\$38,146 =====
<b>Liabilities</b>	
Deposits	\$31,829
Federal funds purchased	254
FHLB advances	1,949
Other liabilities	97
	-----
Total liabilities	34,129
Stockholders' equity	4,017
	-----
Total liabilities and stockholders' equity	\$38,146 =====
<b>Three months ended</b>	
	December 31, 2004 -----
Interest income	\$554
Interest expense	236
	-----
Net interest income	318
Provision for loan losses	13
Noninterest income	56
Noninterest expense	337
Income tax expense	17
	-----
Net income	\$ 7 =====

Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

4. Securities

The amortized cost and approximate fair value of securities are as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)
	-----	-----	-----
Available-for-sale securities			
December 31, 2006			
U.S. government agencies	\$ 1,999	\$ -	\$ (14)
State and municipal	2,638	20	(17)
Mortgage-backed	11,892	30	(127)
	-----	---	-----
	\$16,529	\$50	\$ (158)
	=====	===	=====
December 31, 2005			
U.S. government agencies	\$ 1,999	\$ 1	\$ (26)
State and municipal	2,643	26	(59)
Mortgage-backed	11,705	16	(165)
	-----	---	-----
	\$16,347	\$43	\$ (250)
	=====	===	=====
Held-to-maturity securities			
December 31, 2006			
State and municipal	\$ 1,900	\$54	\$ (24)
Mortgage-backed	-	-	-
	-----	---	-----
	\$ 1,900	\$54	\$ (24)
	=====	===	=====
December 31, 2005			
State and municipal	\$ 1,975	\$40	\$ (41)
Mortgage-backed	-	-	-
	-----	---	-----
	\$ 1,975	\$40	\$ (41)
	=====	===	=====

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

	Available for Sale		Held to Ma
	Amortized Cost	Approximate Fair Value	Amortized Cost
	-----	-----	-----
Due within one year	\$ 1,185	\$ 1,170	\$ 90
Due after one year through five years	999	998	50
Due after five years through ten years	833	822	1,504
Due after ten years	1,620	1,636	256
Mortgage-backed securities	11,892	11,795	-
	-----	-----	-----

Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

\$16,529	\$16,421	\$1,900
=====	=====	=====

The approximate fair value of available-for-sale securities pledged as collateral to secure public deposits and for other purposes, was \$3,332,000 and \$2,365,000 at December 31, 2006 and 2005, respectively.

Gross gains of \$5,012,000 and gross losses of \$129,000 resulting from sales of available-for-sale securities were realized for the year ended December 31, 2005. There were no sales of securities for the year ended December 31, 2006 or for the three months ended December 31, 2004.

The following table is a summary of investment securities with gross unrealized losses at December 31, 2006 and December 31, 2005, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position (in thousands):

	Less than 12 months		12 months or longer		----- Fair Value -----
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	
December 31, 2006					
U.S. government agencies	\$ 998	\$ (1)	\$ 987	\$ (13)	\$ 1,9
State and municipal	-	-	2,757	(41)	2,7
Mortgage-backed	1,373	(5)	8,386	(122)	9,7
	-----	-----	-----	-----	-----
Total temporarily impaired	\$2,371	\$ (6)	\$12,130	\$ (176)	\$14,5
	=====	=====	=====	=====	=====
December 31, 2005					
U.S. government agencies	\$ 974	\$ (26)	\$ -	\$ -	\$ 9
State and municipal	2,098	(56)	794	(44)	2,8
Mortgage-backed	10,573	(165)	-	-	10,5
	-----	-----	-----	-----	-----
Total temporarily impaired	\$13,645	\$ (247)	\$ 794	\$ (44)	\$14,4
	=====	=====	=====	=====	=====

These declines primarily resulted from recent increases in market interest rates and failure of certain investments to maintain consistent credit quality ratings.

Based on evaluation of available evidence, including recent changes in market interest rates, credit rating information and information obtained from regulatory filings, management believes the declines in fair value for these securities are temporary.

Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other-than-temporary impairment is identified.

5. Loans and Allowance for Loan Losses

The composition of the loan portfolio at each of the dates indicated was as follows (in thousands):

Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

	December 31, 2006 ----	December 31, 2005 ----
Residential real estate	\$121,216	\$128,949
Commercial real estate	49,943	46,731
Commercial	20,393	23,757
Construction	64,244	51,877
Consumer	4,401	1,960
Home equity	14,026	16,615
	-----	-----
Total loans	274,223	269,889
Less allowance for loan losses	3,745	2,911
	-----	-----
Net loans	\$270,478	\$266,978
	=====	=====

Activity in the allowance for loan losses was as follows (in thousands):

	Year ended December 31, 2006 ----	Year ended December 31, 2005 ----	Three months ended December 31, 2004 ----
Balance at the beginning of period	\$2,911	\$2,549	\$2,560
Provision for loan losses	847	354	-
Loans charged off	(17)	(11)	(46)
Recoveries on loans	4	19	35
	-----	-----	-----
Balance at end of period	\$3,745	\$2,911	\$2,549
	=====	=====	=====

Impaired loans were as follows (in thousands):

	Year ended December 31, 2006 ----	Year ended December 31, 2005 ----	Three months ended December 31, 2004 ----
Impaired loans at end of period	\$3,398	\$514	\$565
Impaired loans at end of period with allowance allocated	3,351	448	181
Allowance allocated for impaired loans	610	128	102
Average impaired loans during the period	3,372	511	568
Interest income recognized during the period	114	19	8
Interest income received during the period	114	18	5

Nonperforming loans were as follows (in thousands):

	December 31, 2006 ----	December 31, 2005 ----
Loans past due 90 days or more and still on accrual	\$ 31	\$ 130
Nonaccrual loans	3,698	1,140
	-----	-----
Total nonperforming loans	\$3,729	\$1,270
	=====	=====

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

Loans held for sale activity is as follows (in thousands):

	Year ended December 31, 2006 ----	Year ended December 31, 2005 ----	Three months ended December 31, 2004 ----
Balance at the beginning of period	\$ 1,278	\$ 2,344	\$ 2,186
Origination of loans held for sale	46,830	60,408	18,247
Sales proceeds	(47,773)	(62,515)	(18,382)
Gain on sales of loans	892	1,041	293
	-----	-----	-----
Balance at end of period	\$ 1,227	\$ 1,278	\$ 2,344
	=====	=====	=====

In conjunction with the mortgage banking activities, the Company enters into commitments to originate and commitments to sell loans, both of which are considered derivatives. The Company's commitments are generally for fixed rate mortgage loans, lasting 45 days and are at market rates when initiated. The Company had commitments to originate \$5,773,000 and \$2,669,000 in loans as of December 31, 2006 and 2005, respectively, which it intends to sell.

### 6. Premises and Equipment

A summary of premises and equipment follows (in thousands):

	December 31, 2006 ----	December 31, 2005 ----
Land	\$ 1,487	\$1,387
Buildings and improvements	6,473	5,714
Furniture, fixtures and equipment	2,598	2,460
Construction in progress	63	151
	-----	-----
	10,621	9,712
Less accumulated depreciation	2,299	1,497
	-----	-----
Net premises and equipment	\$ 8,322	\$8,215
	=====	=====

Depreciation expense was \$716,000, \$613,000 and \$106,000 for the year ended December 31, 2006, the year ended December 31, 2005 and the three months ended December 31, 2004, respectively.

### 7. Goodwill and Intangible Assets

The change in the carrying amount of goodwill is as follows (in thousands):

	Year ended December 31, 2006 ----	Year ended December 31, 2005 ----	Three months ended December 31, 2004 ----
Balance at the beginning of period	\$11,142	\$11,142	\$11,188
Impairment	-	-	(46)
	-----	-----	-----
Balance at end of period	\$11,142	\$11,142	\$11,142
	=====	=====	=====

The Company also has a core deposit intangible of \$258,000 that was recorded in 2004 relating to an acquisition. The amount is being amortized over eight years using an accelerated method. Net core deposit intangible is as follows (in thousands):

Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

	December 31, 2006	December 31, 2005	December 31, 2004
	----	----	----
Core deposit intangible	\$258	\$258	\$258
Less accumulated amortization	125	78	24
	----	----	----
Net core deposit intangible	\$133	\$180	\$234
	====	====	====

Estimated amortization expense for each of the next five years follows (in thousands):

2007	\$40
2008	33
2009	26
2010	19
2011	11

8. Leases

A lease was entered into in December 2000 to lease an office facility which is now the Bank's New Albany, Indiana branch from an entity owned by the Company's Chairman of the Board of Directors under an operating lease for 15 years. Base monthly rentals are \$10,000, with increases in January 2006 and 2011 equal to the percentage increase in the U. S. Consumer Price Index - All Urban Consumers ("CPI-U") for the prior five-year period. The Company may purchase the facility at any time for \$1,187,000, plus an increase equal to the percentage increase in the CPI-U from January 1, 2001, until the month of purchase.

A lease was entered into in December 2001 to lease an office building for the Bank's Jeffersonville, Indiana branch. This three year operating lease was from January 1, 2002, through year-end 2004 with three three-year renewal options. In March 2005, the Bank exercised its option to purchase the facility for \$322,000.

A lease was entered into in August 2002 to lease an office facility for the Bank's mortgage banking operations. This three year operating lease was from August 1, 2002, to July 31, 2005, with a two-year renewal option. Monthly payments were \$2,200, \$2,300 and \$2,400 through July 2003, 2004 and 2005, respectively. The Bank moved its mortgage banking operations to a building that was purchased in 2005 by the Bank and did not renew this lease.

A lease was entered into in April 2003 to lease an office building for the Bank's St. Matthews, Kentucky branch. This 15-year operating lease is from May 1, 2003, through April 30, 2018, with a five-year renewal option. Monthly payments are \$4,000, \$4,500, \$5,000, \$6,500 and \$8,000 through April 2005, 2007, 2009, 2013 and 2018, respectively.

A lease was entered into in May 2004 to lease an office facility for the Bank's Clarksville, Indiana branch from an entity owned by the Company's Chairman of the Board of Directors under an operating lease starting in October 2004 for 15 years. In March 2006 that entity sold the office facility to an unrelated third party which assumed the lease arrangement. The lease contains a provision for additional rent in addition to the base rent for common area expenses. This common area expense rent adjusts annually based upon the actual expenses paid by the landlord. Monthly payments are \$4,550, \$5,155 and \$5,855 through September 2009, 2014 and 2019, respectively.

Rent expense for operating leases was \$260,000, \$267,000 and \$64,000 for the year ended December 31, 2006, the year ended December 31, 2005 and the three months ended December 31, 2004, respectively. Rent expense paid to related parties was \$140,000, \$181,000 and \$44,000 for the year ended December 31, 2006, the year ended December 31, 2005 and the three months ended December 31, 2004,



## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

respectively. Rent commitments under noncancelable operating leases at December 31, 2006 were as follows, before considering renewal options (in thousands):

2007	\$ 290
2008	235
2009	248
2010	260
2011	260
Thereafter	1,585
	-----
	\$2,878
	=====

### 9. Interest-bearing deposits

Interest-bearing time deposits in denominations of \$100,000 or more were \$60,929,000, \$68,962,000 and \$60,030,000 on December 31, 2006, December 31, 2005 and December 31, 2004, respectively. Time deposits include \$23,724,000, \$59,618,000 and \$35,525,000 of brokered deposits at December 31, 2006, December 31, 2005 and December 31, 2004, respectively.

At December 31, 2006, the scheduled maturities of time deposits are as follows (in thousands):

2007	\$139,442
2008	14,067
2009	2,188
2010	884
2011	1,027
Thereafter	125
	-----
	\$157,733
	=====

### 10. Short-term Borrowings

Short-term borrowings were as follows (in thousands):

	December 31, 2006 ----	December 31, 2005 ----	December 31, 2004 ----
Securities sold under agreements to repurchase	\$ 1,526	\$ 747	\$ 733
Single maturity FHLB advance with variable rate of 5.44% and maturity date of March 21, 2007	15,000	-	-
Single maturity FHLB advance with variable rate of 5.44% and maturity date of March 21, 2007	15,000	-	-
Single maturity FHLB advance with variable rate of 5.44% and maturity date of February 16, 2007	5,000	-	-
Single maturity FHLB advance with variable rate of 4.33% and maturity date of March 22, 2006	-	18,000	-
Single maturity FHLB advances with variable rate of 2.42% and maturity dates of January 14, 2005, through February 18, 2005	-	-	22,500
	-----	-----	-----
	\$36,526	\$18,747	\$23,233
	=====	=====	=====

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

Securities sold under agreements to repurchase consist of obligations of the Bank to other parties. The obligations are secured by the underlying securities and such collateral is held by First Tennessee Bank. The maximum amount of outstanding agreements at any month end during the year ended December 31, 2006, the year ended December 31, 2005 and the three months ending December 31, 2004, totaled \$1,526,000, \$747,000 and \$733,000, respectively, and the average of such agreements totaled \$912,000, \$514,000 and \$574,000 for the year ended December 31, 2006, the year ended December 31, 2005 and the three months ended December 31, 2004, respectively. The agreements at December 31, 2006, mature within one to three days.

The Company had a \$2.5 million line of credit with an unaffiliated institution that the Company elected to cancel in January 2006. The Company had never borrowed against the line of credit.

### 11. Long-term Debt

Long-term debt was as follows (in thousands):

	December 31, 2006 ----	December 31, 2005 ----	December 31, 2004 ----
FHLB advance with fixed rate of 5.20% with maturity date of March 7, 2011	\$ 1,000	\$ 1,000	\$ 1,000
FHLB advance with fixed rate of 1.95% with maturity date of June 9, 2006	-	3,000	3,000
FHLB advance with fixed rate of 2.32% with maturity date of September 12, 2005	-	-	968
Subordinated debentures	9,279	9,279	9,279
	-----	-----	-----
	\$10,279	\$13,279	\$14,247
	=====	=====	=====

The FHLB advances shown here and in note 10 are secured by mortgage loans; the minimum balance required was approximately \$45,000,000, \$27,800,000 and \$37,125,000 at December 31, 2006, December 31, 2005 and December 31, 2004, respectively. The advances are subject to restrictions or penalties in the event of prepayment.

Aggregate annual maturities of FHLB borrowings at December 31, 2006, were (in thousands):

2011	\$ 1,000
------	----------

The subordinated debentures relate to transactions entered into as part of the formation of two separate trusts in 2003. One trust (Harrodsburg Statutory Trust I) was formed by the Company and the other trust (Independence Bancorp Statutory Trust I) was formed by Independence Bancorp and acquired by the Company as part of the acquisition of Independence. Both trusts were formed to issue trust preferred securities as part of pooled offerings. The Company issued \$5,155,000 of subordinated debentures and Independence issued \$4,124,000 of subordinated debentures to the respective trusts in exchange for the proceeds of the offerings. Issuance costs are being amortized over the life of the preferred securities. Distributions on each issue are paid quarterly on March 26, June 26, September 26 and December 26 of each year.

The subordinated debentures, which mature March 26, 2033, are redeemable prior to the maturity date at the option of the Company on or after March 26, 2008 at their principal amount plus accrued interest. As defined in the trust

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

indentures, the prepayment would require prior approval of the Board of Governors of the Federal Reserve System. The Company also has the option to defer interest payments on the subordinated debentures from time to time for a period not to exceed twenty consecutive quarters. If payments are deferred, the Company is prohibited from paying dividends to its common stockholders.

The \$5,155,000 subordinated debentures bear interest at 6.4% through March 26, 2008 and thereafter a variable rate with repricing quarterly based on the three-month London Interbank Offering Rate ("LIBOR") plus 3.15%. The \$4,124,000 subordinated debentures bear interest at a variable rate repricing quarterly based on the three-month LIBOR plus 3.15%. At December 31, 2006 that rate was 8.52%.

### 12. Income Taxes

The provision for income taxes includes these components (in thousands):

	Year ended December 31, 2006	Year ended December 31, 2005	Three months ended December 31, 2004
Current	\$1,183	\$2,270	\$27
Deferred	(395)	3	68
	-----	-----	---
Income tax expense	\$ 788	\$2,273	\$95
	=====	=====	===

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

	Year ended December 31, 2006	Year ended December 31, 2005	Three months ended December 31, 2004
Computed at the statutory rate of 34%	\$928	\$2,296	\$114
Increase (decrease) resulting from:			
State income taxes	48	97	5
Tax exempt interest	(97)	(79)	(16)
Nondeductible expenses	15	13	4
Compensation expense on stock options	14	-	-
Increase in cash surrender value of life insurance	(68)	(64)	(15)
Other	(52)	10	3
	-----	-----	----
Income tax expense	\$788	\$2,273	\$ 95
	=====	=====	=====

The significant components of deferred tax assets and liabilities are reflected in the following table (in thousands):

	December 31, 2006	December 31, 2005	December 31, 2004
Deferred tax assets			
Allowance for loan losses	\$1,288	\$ 971	\$ 871
Basis differential in equity method investment	-	-	211
ESOP liability	35	57	67
Deferred loan fees	230	283	227

Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

Net operating loss and charitable contribution carryovers	-	-	119
Alternative minimum tax credit carryover	-	-	9
Transaction costs	35	35	38
Accrued expenses	27	-	17
Building donation	92	90	-
Unrealized losses on available-for-sale securities	37	71	-
Other	22	4	-
	-----	-----	-----
Total deferred tax assets	1,766	1,511	1,559
	-----	-----	-----
Deferred tax liabilities			
Depreciation	322	386	400
Federal Home Loan Bank stock dividends	580	532	511
Unrealized gains on available-for-sale securities	-	-	1,944
Core deposit intangible	48	64	78
Fair market value adjustments	67	141	236
Other	1	1	15
	-----	-----	-----
Total deferred tax liabilities	1,018	1,124	3,184
	-----	-----	-----
Net deferred tax (assets) liabilities	\$ (748)	\$ (387)	\$1,625
	=====	=====	=====

Retained earnings at December 31, 2006, December 31, 2005 and December 31, 2004, include approximately \$2,135,000 for which no deferred federal income tax liability has been recognized. This amount represents an allocation of income to bad debt deductions for tax purposes only. Reduction of amounts so allocated for purposes other than tax bad debt losses or adjustments arising from carryback of net operating losses would create income for tax purposes only, which would be subject to the then-current corporate income tax rate. The deferred income tax liabilities on the preceding amounts that would have been recorded if they were expected to reverse into taxable income in the foreseeable future were approximately \$726,000 at December 31, 2006, December 31, 2005 and December 31, 2004.

13. Capital Requirements and Restrictions on Retained Earnings

Banks and holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations involve quantitative measures of assets, liabilities and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required.

At year-end 2006, the Bank was considered well capitalized under these regulations. Actual and required capital amounts and ratios are presented below (in thousands except ratios).

Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

	Actual		For Capital Adequacy Purposes		Ca Pr Ac -- Am
	Amount	Ratio	Amount	Ratio	
	-----	-----	-----	-----	
As of December 31, 2006					
Total capital (to risk-weighted assets)					
Consolidated	\$41,233	15.9%	\$20,800	8.0%	\$
Bank	38,200	14.7	20,767	8.0	25
Tier 1 capital (to risk-weighted assets)					
Consolidated	37,977	14.6	10,400	4.0	
Bank	34,949	13.5	10,383	4.0	15
Tier 1 capital (to average assets)					
Consolidated	37,977	11.6	13,144	4.0	
Bank	34,949	10.7	13,099	4.0	16
As of December 31, 2005					
Total capital (to risk-weighted assets)					
Consolidated	\$38,987	15.1%	\$20,671	8.0%	\$
Bank	35,082	13.6	20,643	8.0	25
Tier 1 capital (to risk-weighted assets)					
Consolidated	33,845	13.1	10,335	4.0	
Bank	32,171	12.5	10,322	4.0	15
Tier 1 capital (to average assets)					
Consolidated	33,845	10.2	13,269	4.0	
Bank	32,171	9.7	13,212	4.0	16

The Bank is subject to certain regulations on the amount of dividends it may declare without prior regulatory approval. Under these regulations, the amount of dividends that may be paid in any year is limited to that year's net profits, as defined, combined with the retained net profits of the preceding two years, less dividends declared during those periods. The Company's ability to pay dividends is substantially determined by the Bank's ability to pay dividends to the Company. At January 1, 2007, the Bank could pay dividends of approximately \$7,883,000 to the Company without regulatory approval.

14. Related Party Transactions

Loans to executive officers and directors, including loans to affiliated companies of which executive officers and directors are principal owners, and loans to members of the immediate family of such persons are summarized as follows (in thousands):

	Year ended December 31, 2006	Year ended December 31, 2005	Three months ended December 31, 2004
	-----	-----	-----
Balance at beginning of period	\$9,983	\$5,397	\$4,571
Changes in composition of related parties	-	4,308	-
New loans, including renewals and advances	2,019	4,026	832
Payments, including renewals	(5,077)	(3,748)	(6)
Balance at end of period	\$6,925	\$9,983	\$5,397
	=====	=====	=====

In management's opinion, such loans and other extensions of credit and deposits were made in the ordinary course of business and were made on substantially the

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons. Further, in management's opinion, these loans did not involve more than normal risk of collectibility or present other unfavorable features.

Deposits from related parties held by the Bank at December 31, 2006, December 31, 2005 and December 31, 2004, totaled \$1,016,000, \$839,000 and \$1,578,000, respectively.

Leases from related parties are disclosed in Note 8.

### 15. Employee Benefits

The Bank has a retirement savings 401(k) plan covering substantially all employees. The Company amended the plan at the time of merger allowing employees to contribute up to 15% of their compensation with 1st Independence Bank, which is matched at a discretionary rate determined annually by the board of directors. Prior to the amendment, employees could contribute up to 15% of their compensation with the Bank matching 25% of the employee's contribution on the first 6% of the employee's compensation. Effective January 1, 2006, the 401(k) plan was combined with the Company's ESOP plan and now a portion of the released ESOP shares are used as the Company's 401(k) match. Employer contributions charged to expense for the year ended December 31, 2006, for the year ended December 31, 2005 and the three months ended December 31, 2004, were \$88,000, \$91,000 and \$21,000, respectively.

As part of the conversion of the Bank from the mutual to stock form of ownership, in 1995 the Company established an employee stock ownership plan ("ESOP") covering substantially all employees of the Bank. The ESOP acquired 174,570 shares of Company common stock at \$10 per share at the time of the conversion with funds provided by a loan from the Company. Accordingly, \$1,745,700 of common stock acquired by the ESOP was shown as a reduction of stockholders' equity. Shares are released to participants proportionately as the loan is repaid. Dividends on allocated shares are recorded as dividends and charged to retained earnings. Dividends on unallocated shares are used to reduce the Bank's obligation to repay the loan and are treated as compensation expense. Compensation expense is recorded equal to the fair market value of the stock when contributions are made to the ESOP.

ESOP expense for the year ended December 31, 2006, for the year ended December 31, 2005 and the three months ended December 31, 2004, was \$103,000, \$210,000 and \$50,000, respectively.

	December 31, 2006 ----	December 31, 2005 ----	December 31, 2004 ----
Allocated shares	120,563	119,925	117,268
Shares released for allocation	8,914	10,941	2,657
Unearned shares	29,110	38,024	48,965
Less shares distributed to former employees	-	(10,303)	-
	-----	-----	-----
Total ESOP shares	158,587	158,587	168,890
	=====	=====	=====
Fair value of unearned shares	\$477,404	\$703,444	\$929,356
	=====	=====	=====

### 16. Stock Incentives

The Company has two stock option plans. The 1996 plan is a fixed option plan under which the Company may grant options that vest over four years (20%

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

immediate and 20% on each of the next four anniversary dates) to selected employees and directors for up to 200,000 shares of common stock. The exercise price of each option is intended to equal the fair value of the Company's stock on the date of grant. An option's maximum term is 10 years. At December 31, 2006, 30,000 options remain available to be granted under this plan. Under the plan's terms, no options can be granted after January 28, 2007.

In July 2004, the Company formed a second plan for up to 300,000 shares of the Company's common stock. The plan allows for both incentive and non-qualified options to be granted to selected employees and directors at the discretion of the Company's board of directors, generally with ten year maturities and with a three year vesting schedule (25% immediate and 25% on each of the next three anniversary dates). Commensurate with the Company's acquisition of Independence Bancorp, 60,300 options of Independence Bancorp were transferred into the plan at their existing terms. At December 31, 2006, 223,450 options remain available to be granted under this plan.

In addition to the two stock option plans described above, the Company has a restricted stock plan that was approved by the stockholders of the Company in 2006. This plan superceded a previous restricted stock plan that had been approved by the stockholders of the Company in 1997. The current restricted stock plan allows for awards to selected employees for up to 80,500 shares of the Company's common stock. Awards made to employees and directors under the plan have a five year vesting schedule (20% on each of the five anniversary dates following the date of grant). The Company expenses the restricted stock awards over the years during which the shares vest based on the fair market value of the common stock at the date of the grant to the employee or director. As of December 31, 2006, 4,000 shares had been awarded under the current plan with 76,500 shares remaining available to be awarded. The previous plan had 4,500 shares that had been awarded that were still outstanding.

The following summarizes activity under the plans for the years 2004, 2005 and 2006:

	Options			Restricted Stock
	Shares	Range of Exercise Prices	Weighted Average Exercise Price	Shares
Outstanding September 30, 2004	255,300	\$8.00 to \$16.50	\$14.52	-
Granted	-	-	-	-
Exercised	(3,000)	\$10.00	\$10.00	-
Forfeited	-	-	-	-
Outstanding December 31, 2004	252,300	\$8.00 to \$16.50	\$14.58	-
Granted	10,000	\$18.99	\$18.99	2,000
Exercised	(54,500)	\$8.00 to \$16.50	\$15.61	-
Forfeited	(22,500)	\$13.50 to \$18.99	\$16.11	(500)
Outstanding December 31, 2005	185,300	\$8.00 to \$18.99	\$14.33	1,500
Granted	9,500	\$17.75	\$17.75	7,000
Exercised	(51,500)	\$8.00 to \$16.50	\$13.60	-
Forfeited	(10,750)	\$10.00 to \$16.50	\$16.41	-
Outstanding December 31, 2006	132,550	\$8.00 to \$18.99	\$14.69	8,500
	=====			=====
(Weighted average contractual				

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

life of 2.3 years)

Exercisable Options:			
December 31, 2004	250,300	\$8.00 to \$16.50	\$14.61
December 31, 2005	179,675	\$8.00 to \$18.99	\$14.18
December 31, 2006	122,050	\$8.00 to \$18.99	\$14.38

The aggregate intrinsic value of stock options outstanding at December 31, 2006 and stock options exercisable at December 31, 2006 was \$227,000 and \$247,000, respectively.

The following table summarizes information about stock options outstanding at December 31, 2006:

Range of Exercise Prices -----	Options Outstanding			Options Exercisable	
	Number Outstanding -----	Weighted Average Contractual Life ----	Weighted Average Exercise Price -----	Number Exercisable -----	W A Exer
\$8.00	21,300	3.1 years	\$8.00	21,300	
\$10.00	13,750	6.2 years	\$10.00	13,750	
\$16.50 to \$18.99	97,500	1.5 years	\$16.81	87,000	
\$8.00 to \$18.99	132,550	2.3 years	\$14.69	122,050	
	=====			=====	

The weighted average fair value of stock options granted in 2006 and 2005 was \$4.87 and \$6.65, respectively. The total intrinsic value of stock options exercised during 2006 and 2005 was \$198,000 and \$214,000, respectively. The total fair value of stock options vested during 2006 and 2005 was \$23,000 and \$17,000, respectively.

### 17. Net Income Per Share Computations

The following is a reconciliation of the numerator and denominator of the basic and diluted per share computations (in thousands except per share data):

	Year ended December 31, 2006 ----	Year ended December 31, 2005 ----
Income (numerator) amounts used for basic and diluted per share computations:		
Income from continuing operations	\$1,940	\$4,489
	=====	=====
Income from discontinued operations	\$ -	\$ 4
	=====	=====
Net income	\$1,940	\$4,481
	=====	=====



## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

Shares (denominator) used for basic per share computations:		
Weighted average shares of common stock outstanding	1,941 =====	1,889 =====
Shares (denominator) used for diluted per share computations:		
Weighted average shares of common stock outstanding	1,941	1,889
Plus: dilutive effect of stock options	16 -----	40 -----
Adjusted weighted average shares	1,957 =====	1,929 =====
Basic net income per share:		
Income from continuing operations	\$1.00	\$2.38
Income from discontinued operations	-	-
Net income	1.00	2.37
Diluted net income per share:		
Income from continuing operations	\$0.99	\$2.33
Income from discontinued operations	-	-
Net income	0.99	2.32

Options to purchase 16,500 and 7,500 common shares for the year ended December 31, 2006 and 2005, respectively, were excluded from the diluted calculations above because the exercise price on the options were greater than the average market price for certain periods within the year.

### 18. Disclosures About Fair Value of Financial Instruments

The following table presents estimated fair values of the Company's financial instruments. The fair values of certain of these instruments were calculated by discounting expected cash flows, which involves significant judgments by management and uncertainties. Fair value is the estimated amount at which financial assets or liabilities could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Because no market exists for certain of these financial instruments and because management does not intend to sell these financial instruments, the Company does not know whether the fair values shown below represent values at which the respective financial instruments could be sold individually or in the aggregate (in thousands).

	December 31, 2006		December 31, 2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	\$ 23,579	\$ 23,579	\$ 21,563	\$ 21,563
Interest-bearing deposits	100	100	100	100
Available-for-sale securities	16,421	16,421	16,140	16,140
Held-to-maturity securities	1,900	1,930	1,975	1,974
Loans held for sale	1,227	1,227	1,278	1,297
Loans, net of allowance for loan losses	270,478	271,995	266,978	266,091
FHLB stock	2,313	2,313	2,688	2,688
Interest receivable	1,927	1,927	1,665	1,665
Financial liabilities				
Deposits	\$254,077	\$253,764	\$264,323	\$263,115

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

Short-term borrowings	36,526	36,526	18,747	18,747
Long-term debt	10,279	10,264	13,279	13,268
Interest payable	817	817	666	666

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and Cash Equivalents, Interest-bearing Deposits, FHLB Stock and Interest Receivable The carrying amount approximates fair value.

### Securities

Fair values equal quoted market prices, if available. If quoted market prices are not available, fair value is estimated based on quoted market prices of similar securities.

### Loans

The fair value of loans, including loans held for sale, is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. Loans with similar characteristics were aggregated for purposes of the calculations. The carrying amount of accrued interest approximates its fair value.

### Deposits

Deposits include demand deposits, savings accounts, NOW accounts and certain money market deposits. The carrying amount approximates fair value. The fair value of fixed-maturity time deposits is estimated using a discounted cash flow calculation that applies the rates currently offered for deposits of similar remaining maturities.

Short-term Borrowings, FHLB Advances and Interest Payable The carrying amount approximates fair value.

### Long-term Debt

Rates currently available to the Company for debt with similar terms and remaining maturities are used to estimate the fair value of existing debt.

### Commitments to Originate Loans, Letters of Credit and Lines of Credit

The fair value of commitments to originate loans is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of forward sale commitments is estimated based on current market prices for loans of similar terms and credit quality. The fair values of letters of credit and lines of credit are based on fees currently charged for similar agreements or on the estimated cost to terminate or otherwise settle the obligations with the counterparties at the reporting date. The fair value of commitments to originate loans, letters of credit and lines of credit are not material.

### 19. Significant Estimates and Concentrations and Contingencies

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

The Company is currently a defendant in a lawsuit that asserts that the Company

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

made certain material misrepresentations in connection with certain statements made in connection with its offer to purchase up to 300,000 shares of stock in a tender offer in May 2003. The plaintiffs are seeking to recover damages in connection with the shares they sold in the tender offer and attorneys fees. This matter is currently scheduled for trial in July 2007. Based upon the advice of counsel, management records an estimate of the amount of ultimate expected loss for litigation, if any. Management has not recorded a loss provision for this litigation as, after discussion with legal counsel, management believes the ultimate results of this litigation will not have a material adverse effect on the Company's financial position, results of operations or cash flows. Events could occur that could cause the estimate of ultimate loss to differ materially in the near term.

### 20. Commitments and Credit Risks

#### Commitments to Originate Loans

Commitments to originate loans are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since a portion of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Each customer's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if deemed necessary, is based on management's credit evaluation of the counterparty. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, commercial real estate and residential real estate.

At December 31, 2006 and 2005, the Bank had outstanding commitments to originate loans aggregating approximately \$21,385,000 and \$3,283,000, respectively. Also at December 31, 2006 and 2005, the Bank had commitments to originate approximately \$5,773,000 and \$2,669,000, respectively, of fixed rate loans for sale into the secondary market. The commitments extended over varying periods of time with the majority being disbursed within a one-year period.

#### Letters of Credit

Letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

The Bank had total outstanding letters of credit amounting to approximately \$2,405,000 and \$2,474,000, at December 31, 2006 and 2005, respectively.

#### Lines of Credit

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

At December 31, 2006 and 2005, the Bank had granted unused lines of credit to borrowers aggregating approximately \$43,983,000 and \$57,117,000, respectively.

#### Cash and Cash Equivalents

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

At December 31, 2006 and 2005, the Company had approximately \$8,517,000 and \$5,871,000, respectively, of deposits with correspondent banks in excess of federally insured amounts.

### Bank Owned Life Insurance

As of December 31, 2006, the Company's investment in life insurance of \$3,435,000 was with one insurance company.

21. Selected Quarterly Financial Data (unaudited) All amounts are in thousands except per share data.

	Quarter		
	1st	2nd	3rd
2006			
-----			
Interest and dividend income	\$5,221	\$5,637	\$5,797
Interest expense	2,610	2,886	3,107
Net interest income	2,611	2,751	2,690
Provision for loan losses	81	31	543
Net interest income after provision for loan losses	2,530	2,720	2,147
Noninterest income	440	479	513
Noninterest expense	2,255	2,288	2,200
Net income	494	627	349
Net income per share:			
Basic	0.26	0.32	0.18
Diluted	0.25	0.32	0.18
2005			
-----			
Interest and dividend income	\$4,085	\$4,398	\$4,766
Interest expense	1,720	1,902	2,108
Net interest income	2,365	2,496	2,658
Provision for loan losses	202	-	60
Net interest income after provision for loan losses	2,163	2,496	2,598
Noninterest income	5,489	642	291
Noninterest expense	2,859	2,436	2,248
Net income	3,109	483	462
Net income per share:			
Basic	1.66	0.26	0.24
Diluted	1.62	0.25	0.24

The net income for the first quarter of 2005 includes a securities gain of \$3.3 million or \$1.77 per basic share and \$1.72 per diluted share securities.

22. 1st Independence Financial Group, Inc. (parent company only)

### Condensed Balance Sheets (in thousands)

December 31,                      December 31,

Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

	2006	2005
	-----	-----
Assets		
Cash and cash equivalents	\$ 1,366	\$ 1,420
Investment in subsidiaries	46,162	43,373
Available-for-sale securities	986	974
Note receivable	388	541
Debt issuance costs, net of accumulated amortization	122	127
Other assets	715	1,138
	-----	-----
Total assets	\$49,739	\$47,573
	=====	=====
Liabilities and Stockholders' Equity		
Subordinated debentures	\$ 9,279	\$ 9,279
Other liabilities	157	33
Stockholders' equity	40,303	38,261
	-----	-----
Total liabilities and stockholders' equity	\$49,739	\$47,573
	=====	=====

Condensed Statements of Income  
(in thousands)

	Year ended December 31, 2006	Year end December 2005
	-----	-----
Income		
Cash dividends from subsidiaries	\$ -	\$ -
Other income	103	85
	-----	-----
Total income	103	85
	-----	-----
Expenses		
Interest expense	675	600
Amortization of core deposit intangibles and debt issuance costs	5	5
Other expenses	520	732
	-----	-----
Total expenses	1,200	1,337
	-----	-----
Income (loss) from continuing operations before income taxes, equity in undistributed net income of subsidiary, and equity in undistributed net income of subsidiary held for disposal	(1,097)	(1,252)
Income tax expense (benefit) from continuing operations	(420)	(467)
	-----	-----
Income (loss) from continuing operations before equity in undistributed net income of subsidiary, and equity in undistributed net income of subsidiary held for disposal	(677)	(785)
Equity in undistributed net income of subsidiary from continuing operations	2,617	5,266
Equity in undistributed net income of subsidiary held for disposal	-	-
	-----	-----
Net income	\$1,940	\$4,481
	=====	=====

Condensed Statements of Cash Flows

Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

(in thousands)

	Year ended December 31, 2006	Year ended December 31, 2005
	-----	-----
Cash flows from operating activities:		
Net income	\$ 1,940	\$ 4,481
Adjustments to reconcile net income to net cash (used in) operations:		
Amortization of core deposit intangibles and debt issuance costs	5	5
Amortization of unearned compensation on restricted stock	19	5
Compensation expense on stock options	40	-
Deferred income taxes	-	-
Goodwill impairment	-	-
Undistributed net income of subsidiary	(2,617)	(5,266)
Undistributed net income of unconsolidated statutory trusts	-	2
Income from discontinued operations	-	-
Changes in:		
Decrease (increase) in other assets	418	(304)
Increase (decrease) in other liabilities	124	24
	-----	-----
Net cash (used in) operating activities	(71)	(1,053)
	-----	-----
Cash flows from investing activities:		
Repayment of note receivable	154	132
Proceeds from sale of subsidiary	-	2,300
Additional capital contributed to subsidiary	(11)	(20)
	-----	-----
Net cash provided by investing activities	143	2,412
	-----	-----
Cash flows from financing activities:		
Proceeds from exercise of stock options	494	470
Cash dividends paid	(620)	(754)
	-----	-----
Net cash (used in) provided by financing activities	(126)	(284)
	-----	-----
Net (decrease) increase in cash and cash equivalents	(54)	1,075
Cash and cash equivalents at beginning of period	1,420	345
	-----	-----
Cash and cash equivalents at end of period	\$ 1,366	\$ 1,420
	=====	=====

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures

Based on their evaluation as of the end of the period covered by this Annual Report on Form 10-K, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

Securities Exchange Act of 1934 (the "Exchange Act")) are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

### (b) Changes in Internal Control over Financial Reporting

There was no change in the Company's internal control over financial reporting identified by the principal executive officer or principal financial officer that occurred in the three month period ended December 31, 2006 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

### Item 9B. Other Information.

Not applicable.

## PART III

### Item 10. Directors, Executive Officers and Corporate Governance.

Other than the information set forth below regarding the Company's "Code of Ethics," information concerning this item is omitted from this report pursuant to General Instruction G. (3) of Form 10-K and instead is incorporated by reference to the Company's definitive Proxy Statement for the Annual Meeting of Stockholders pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, which the Company intends to file with the Commission not later than 120 days after December 31, 2006.

#### Code of Ethics

The Company adopted a Code of Conduct for its Principal Executive Officer and Senior Financial Officers (the "Code of Conduct") in June 2003. The Code of Conduct is available free of charge by writing to the Secretary of the Company at 8620 Biggin Hill Lane, Louisville, Kentucky, 40220-4117.

### Item 11. Executive Compensation.

Information concerning this item is omitted from this report pursuant to General Instruction G. (3) of Form 10-K and instead is incorporated by reference to the Company's definitive Proxy Statement for the Annual Meeting of Stockholders pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, which the Company intends to file with the Commission not later than 120 days after December 31, 2006.

### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Information concerning this item is omitted from this report pursuant to General Instruction G. (3) of Form 10-K and instead is incorporated by reference to the Company's definitive Proxy Statement for the Annual Meeting of Stockholders pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, which the Company intends to file with the Commission not later than 120 days after December 31, 2006.

### Item 13. Certain Relationships and Related Transactions, and Director Independence.

Information concerning this item is omitted from this report pursuant to General Instruction G. (3) of Form 10-K and instead is incorporated by reference to the Company's definitive Proxy Statement for the Annual Meeting of

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

Stockholders pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, which the Company intends to file with the Commission not later than 120 days after December 31, 2006.

### Item 14. Principal Accounting Fees and Services.

Information concerning this item is omitted from this report pursuant to General Instruction G. (3) of Form 10-K and instead is incorporated by reference to the Company's definitive Proxy Statement for the Annual Meeting of Stockholders pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, which the Company intends to file with the Commission not later than 120 days after December 31, 2006.

## PART IV

### Item 15. Exhibits, Financial Statement Schedules.

(a) The following exhibits are filed as part of this report.

Exhibit number	Description
2.1	Stock Purchase Agreement (incorporated by reference to Exhibit 2.1 to the Company's Form 8-K filed on October 22, 2004).
2.2	Contract of Sale (incorporated by reference to Exhibit 2.2 to the Company's Form 8-K filed on October 22, 2004).
3.1	Certificate of Incorporation (incorporated by reference from the Exhibits to the Company's Form S-1 Registration Statement, initially filed on June 14, 1995, Registration No. 33-93458).
3.2	Amended Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Form 10-KSB filed on December 29, 2004).
3.3	Bylaws (incorporated by reference from the Exhibits to the Company's Form S-1, Registration Statement, initially filed on June 14, 1995, Registration No. 33-93458).
10.1*	1996 Stock Option Plan (incorporated by reference to Exhibit 10.1 to the Company's Form 10-K filed on December 29, 1997).
10.2*	Restricted Stock Plan and Trust Agreement (incorporated by reference to Exhibit 10.2 to the Company's Form 10-K filed on December 29, 1997).
10.3*	Form of Employment Agreement for N. William White (incorporated by reference to Exhibit 10.6 to the Company's Form S-4 Registration Statement, initially filed on February 27, 2004, Registration No. 333-113163).
10.4*	Form of Employment Agreement for R. Michael Wilbourn (incorporated by reference to Exhibit 10.7 to the Company's Form S-4 Registration Statement, initially filed on February 27, 2004, Registration No. 333-113163).
10.5*	Form of Employment Agreement for Kathy L. Beach



## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

- (incorporated by reference to Exhibit 10.7 to the Company's Form 10-KSB filed on December 29, 2004).
- 10.6\* 2004 Omnibus Stock Option Plan (incorporated by reference to Appendix G to the proxy statement/prospectus contained in the Company's Form S-4 Registration Statement, initially filed on February 27, 2004, Registration No. 333-113163).
  - 10.7\* 1st Independence Restricted Stock Plan (incorporated by reference to Exhibit 99.1 to the Company's Form S-8 Registration Statement, initially filed on August 18, 2006, Registration No. 333-136725).
  - 10.8\* Form of Stock Option Award under the 1996 Stock Option Plan (incorporated by reference to Exhibit 99.3 to the Company's Form S-8 Registration Statement, initially filed on August 13, 2004, Registration No. 333-118198).
  - 10.9\* Form of Restricted Stock Agreement under the Restricted Stock Plan and Trust Agreement (incorporated by reference to Exhibit 99.5 to the Company's Form S-8 Registration Statement, initially filed on August 13, 2004, Registration No. 333-118198).
  - 10.10\* Form of Stock Award Agreement under the 2004 Omnibus Stock Option Plan (incorporated by reference to Exhibit 99.2 to the Company's Post Effective Amendment No. 1 Under Cover of Form S-8 to Form S-4 Registration Statement, initially filed on August 13, 2004, Registration No. 333-113163).
  - 10.11\* Form of Restricted Stock Award Agreement under the 1st Independence Restricted Stock Plan (incorporated by reference to Exhibit 99.2 to the Company's Form S-8 Registration Statement, initially filed on August 18, 2006, Registration No. 333-136725).
  - 10.12\* Severance Agreement and Release, dated March 31, 2005, by and among the Company, 1st Independence Bank and Arthur L. Freeman (incorporated by reference to Exhibit 10.13 to the Company's Form 8-K filed on April 1, 2005).
  - 10.13\* Form of Change of Control Agreement for Gregory A. DeMuth (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on March 31, 2006).
  - 14.1 Code of Ethics for Principal Executive Officer and Senior Financial Officers (incorporated by reference to Exhibit 14.0 to the Company's Form 10-KSB filed on December 23, 2003).
  - 21.1 Subsidiaries of the Registrant.
  - 23.1 Consent of BKD, LLP.
  - 31.1 Rule 13a-14 (a) / 15d-14 (a) Certification of Principal Executive Officer ("Section 302 Certifications").
  - 31.2 Rule 13a-14 (a) / 15d-14 (a) Certification of Principal Financial Officer ("Section 302 Certifications").
  - 32.1 Section 1350 Certifications ("Section 906 Certifications").

Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

\* Management contract or compensatory plan or arrangement.

SIGNATURES

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

1st INDEPENDENCE FINANCIAL GROUP, INC.

Date: March 15, 2007

By /s/ N. William White

-----  
N. William White, 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:

Signature -----	Title -----	Date ----
/s/ Matthew C. Chalfant ----- Matthew C. Chalfant	Chairman of the Board and Director	March 15, 2007
/s/ N. William White ----- N. William White	President, Chief Executive Officer and Director (Principal Executive Officer)	March 15, 2007
/s/ Jack L. Coleman, Jr. ----- Jack L Coleman, Jr.	Director	March 15, 2007
/s/ Thomas Les Letton ----- Thomas Les Letton	Director	March 15, 2007
/s/ Stephen R. Manecke ----- Stephen R. Manecke	Director	March 15, 2007
/s/ Charles L. Moore II ----- Charles L. Moore II	Director	March 15, 2007
/s/ Ronald L. Receveur ----- Ronald L. Receveur	Director	March 15, 2007
/s/ W. Dudley Shryock ----- W. Dudley Shryock	Director	March 15, 2007
/s/ H. Lowell Wainwright, Jr. ----- H. Lowell Wainwright, Jr.	Director	March 15, 2007

# Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

/s/ R. Michael Wilbourn  
-----

R. Michael Wilbourn	Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 15, 2007
---------------------	--	----------------

/s/ John F. Barron  
-----

John F. Barron	Senior Vice President and Controller	March 15, 2007
----------------	---	----------------

## Exhibit Index -----

Exhibit number	Description
2.1	Stock Purchase Agreement (incorporated by reference to Exhibit 2.1 to the Company's Form 8-K filed on October 22, 2004).
2.2	Contract of Sale (incorporated by reference to Exhibit 2.2 to the Company's Form 8-K filed on October 22, 2004).
3.1	Certificate of Incorporation (incorporated by reference from the Exhibits to the Company's Form S-1 Registration Statement, initially filed on June 14, 1995, Registration No. 33-93458).
3.2	Amended Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Form 10-KSB filed on December 29, 2004).
3.3	Bylaws (incorporated by reference from the Exhibits to the Company's Form S-1, Registration Statement, initially filed on June 14, 1995, Registration No. 33-93458).
10.1*	1996 Stock Option Plan (incorporated by reference to Exhibit 10.1 to the Company's Form 10-K filed on December 29, 1997).
10.2*	Restricted Stock Plan and Trust Agreement (incorporated by reference to Exhibit 10.2 to the Company's Form 10-K filed on December 29, 1997).
10.3*	Form of Employment Agreement for N. William White (incorporated by reference to Exhibit 10.6 to the Company's Form S-4 Registration Statement, initially filed on February 27, 2004, Registration No. 333-113163).
10.4*	Form of Employment Agreement for R. Michael Wilbourn (incorporated by reference to Exhibit 10.7 to the Company's Form S-4 Registration Statement, initially filed on February 27, 2004, Registration No. 333-113163).
10.5*	Form of Employment Agreement for Kathy L. Beach (incorporated by reference to Exhibit 10.7 to the Company's Form 10-KSB filed on December 29, 2004).

## Edgar Filing: 1ST INDEPENDENCE FINANCIAL GROUP, INC. - Form 10-K

- 10.6\* 2004 Omnibus Stock Option Plan (incorporated by reference to Appendix G to the proxy statement/prospectus contained in the Company's Form S-4 Registration Statement, initially filed on February 27, 2004, Registration No. 333-113163).
- 10.7\* 1st Independence Restricted Stock Plan (incorporated by reference to Exhibit 99.1 to the Company's Form S-8 Registration Statement, initially filed on August 18, 2006, Registration No. 333-136725).
- 10.8\* Form of Stock Option Award under the 1996 Stock Option Plan (incorporated by reference to Exhibit 99.3 to the Company's Form S-8 Registration Statement, initially filed on August 13, 2004, Registration No. 333-118198).
- 10.9\* Form of Restricted Stock Agreement under the Restricted Stock Plan and Trust Agreement (incorporated by reference to Exhibit 99.5 to the Company's Form S-8 Registration Statement, initially filed on August 13, 2004, Registration No. 333-118198).
- 10.10\* Form of Stock Award Agreement under the 2004 Omnibus Stock Option Plan (incorporated by reference to Exhibit 99.2 to the Company's Post Effective Amendment No. 1 Under Cover of Form S-8 to Form S-4 Registration Statement, initially filed on August 13, 2004, Registration No. 333-113163).
- 10.11\* Form of Restricted Stock Award Agreement under the 1st Independence Restricted Stock Plan (incorporated by reference to Exhibit 99.2 to the Company's Form S-8 Registration Statement, initially filed on August 18, 2006, Registration No. 333-136725).
- 10.12\* Severance Agreement and Release, dated March 31, 2005, by and among the Company, 1st Independence Bank and Arthur L. Freeman (incorporated by reference to Exhibit 10.13 to the Company's Form 8-K filed on April 1, 2005).
- 10.13\* Form of Change of Control Agreement for Gregory A. DeMuth (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on March 31, 2006).
- 14.1 Code of Ethics for Principal Executive Officer and Senior Financial Officers (incorporated by reference to Exhibit 14.0 to the Company's Form 10-KSB filed on December 23, 2003).
- 21.1 Subsidiaries of the Registrant.
- 23.1 Consent of BKD, LLP.
- 31.1 Rule 13a-14 (a) / 15d-14 (a) Certification of Principal Executive Officer ("Section 302 Certifications").
- 31.2 Rule 13a-14 (a) / 15d-14 (a) Certification of Principal Financial Officer ("Section 302 Certifications").
- 32.1 Section 1350 Certifications ("Section 906 Certifications").

\* Management contract or compensatory plan or arrangement.