From the President

Home Financial Bancorp emerged from fiscal 2014 in very good condition, despite a disappointing dip in earnings. I am pleased to report continued asset quality improvement, strong capital position and increased shareholder book value.

We are still in an environment of low loan demand, low interest rates, low yields on securities and the expectation of higher interest rates – sometime. Although overall funding costs are still declining, the pace and marginal benefit has subsided considerably. At the same time, lower loan origination volume and extremely low yields put downward pressure on earnings. With low interest rates and extraordinary competition for qualified borrowers, we have experienced heavy prepayments and declining portfolio yield as loans matured, were refinanced, or were lost to other lenders.

We are developing several routes to increase profitable loan production. Stuck in a world of weak loan demand and increasing interest rate risk, we are eager for growth, but cautious. We are pursuing prudent lending opportunities offering acceptable long-term risk-reward tradeoffs.

We worked through a lot of problem assets and recognized net loan loss of $364,000 in the process. Repossessed property expense for the year was also elevated; totaling $178,000. The troubled asset purge continued a sustained trend of improvement. Year-end non-performing assets were the lowest since June 30, 2003.

Costs incurred disposing of problem assets hurt recent earnings, but reduce risk to future earnings. Operation of the Bank's real estate subsidiary, BSF, Inc., was also concluded during the year. Real estate development is not a permitted activity for an Indiana chartered commercial bank. Consequently, liquidation of BSF operations and assets was a required condition for the Bank's 2011 charter conversion. Asset write-downs and costs associated with dissolution of BSF operations totaled $72,000 in 2014.

Total shareholders' equity increased 5% to $8.7 million. Tangible equity to total assets was 12.8%, up from 11.3% at year-end 2013. Our Community Bank continues to maintain a strong capital position which comfortably exceeds all regulatory capital requirements. For over fifteen years, Home Financial has consistently paid quarterly cash dividends. Dividends totaling $0.12 per share were distributed for fiscal 2014. Book value per share increased 4.5% to $7.27 during the year.

Community banking continues to move forward on a long precarious arc of change. As a share of the industry, assets and deposits for community banks have been declining since early 1990's. Industry disruption from the 2008 financial crisis added fuel to a trend stretching back at least two decades. Liberally defined as banks with less than $10 billion in total assets, there were more than 10,300 community banks at year-end 1994. At the end of 2007, there were about 7,200 community banks. Currently, there are about 5,800 community bank charters remaining in the United States. This dramatic reduction occurred despite the following consensus opinion:

> "Community banks are a critical component of our country's financial system and economy".
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> -- Jerome H. Powell, Governor, Federal Reserve Board of Governors, October, 2013

The Great Recession clearly weakened both big and small institutions throughout the banking industry. Between 2008 and 2013 400 bank failures occurred, but the overall number of community bank charters fell by about 1,400. Most of this decline since 2007 came from community banks experiencing a variety of challenges prior to merging with healthier institutions.

A wide range of pressures continue to cause community bank consolidation. However, the community bank business model remains a vital economic resource for small towns and rural communities in every county in this country. Allowed to operate on an equal basis with tax-favored and subsidized competitors, I am confident community banking would flourish and grow – greatly benefiting local and regional economies. Thomas Hoenig, Vice Chairman of the Federal Deposit Insurance Corporation (FDIC) recently stated the following:

> "The community bank business model is viable, but its success relies on a market system that is being undermined. To prosper as an industry, commercial banks must be allowed to compete and succeed or fail based on the fundamentals of commercial banking and individual performance. Community and Regional banks are dying a slow death waiting for regulators to carve them out as special. Rather than rely on the hope of a "carve out", they should insist on discipline across the entire commercial banking industry. Commercial banking is not "one industry" as long as the largest banks are subsidized to a greater degree, and are allowed to have less capital, less robust supervision and more leverage than the remainder of the industry."

Regardless of the obstacles created by harmful regulations and witless public policy, our talented team is doing an excellent job of navigating the way forward. The people who have enabled us to prosper when so many community banks have faltered are our dedicated staff members, both past and present. I am grateful for their efforts over the years. Also important are the contributions of our past and present directors, whose guidance has been vital.

I would especially like to recognize John A. Gillaspy who left our board at the end of his term in 2014. John is the former President of Spencer Evening World Holdings, Inc. and served since 2006 on the boards of Home Financial Bancorp, Our Community Bank, OCB Insurance Agency, Inc., and BSF, Inc. John also served on several board committees, including Executive Committee, Audit Committee, and Compensation Committee. John contributed greatly during his many years of service. His experience and keen judgment will be missed.

Thank you for your continued support of Home Financial Bancorp and Our Community Bank.

Kurt D. Rosenberger
President and Chief Executive Officer