PACIFIC PREMIER BANCORP INC
Form 10-Q
August 04, 2017
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q
(Mark One)
(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017
OR
( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _______ to _______
Commission File Number 0-22193

(Exact name of registrant as specified in its charter)

DELAWARE	33-0743196
(State or other jurisdiction of incorporation or organization)	(I.R.S Employer Identification No.)

17901 VON KARMAN AVENUE, SUITE 1200, IRVINE, CALIFORNIA 92614
(Address of principal executive offices and zip code)

(949) 864-8000
(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has 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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] No [_]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", “accelerated filer”, “smaller reporting company” and "emerging growth company" in Rule 12b-2 of the Exchange Act).

Large accelerated filer	[ ]	Accelerated filer[X]	Non-accelerated filer (Do not check if a smaller reporting company)	[ ]	Smaller reporting company	[ ]	Emerging growth company	[ ]

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]

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

The number of shares outstanding of the registrant’s common stock as of August 2, 2017 was 40,055,988.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements
PACIFIC PREMIER BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(dollars in thousands, except share data)
(unaudited)

ASSETS	June 30, 2017	December 31, 2016
Cash and due from banks	$35,686	$14,706
Interest-bearing deposits with financial institutions	193,595	142,151
Cash and cash equivalents	229,281	156,857
Interest-bearing time deposits with financial institutions	3,944	3,944
Investments held-to-maturity, at amortized cost (fair value of $7,703 and $8,461 as of June 30, 2017 and December 31, 2016, respectively)	7,750	8,565
Investment securities available-for-sale, at fair value	703,083	380,963
FHLB, FRB and other stock, at cost	56,612	37,304
Loans held for sale, at lower of cost or fair value	6,840	7,711
Loans held for investment	4,858,611	3,241,613
Allowance for loan losses	(25,055)	(21,296)
Loans held for investment, net	4,833,556	3,220,317
Accrued interest receivable	20,607	13,145
Other real estate owned	372	460
Premises and equipment	45,342	12,014
Deferred income taxes, net	22,201	16,807
Bank owned life insurance	74,982	40,409
Intangible assets	35,305	9,451
Goodwill	370,564	102,490
Other assets	30,192	25,874
Total Assets	$6,440,631	$4,036,311
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Deposit accounts:		
Noninterest-bearing checking	$1,810,047	$1,185,768
Interest-bearing:		
Checking	323,818	182,893
Money market/savings	2,006,131	1,202,361
Retail certificates of deposit	572,523	375,203
Wholesale/brokered certificates of deposit	233,912	199,356
Total interest-bearing	3,136,384	1,959,813
Total deposits	4,946,431	3,145,581
FHLB advances and other borrowings	397,267	327,971
Subordinated debentures	79,800	69,383
Accrued expenses and other liabilities	57,402	33,636
Total Liabilities	5,480,900	3,576,571
STOCKHOLDERS' EQUITY:		
Preferred stock, $.01 par value; 1,000,000 authorized; none issued and outstanding	—	—
Common stock, $.01 par value; 100,000,000 shares authorized; 40,048,758 shares at June 30, 2017 and 27,798,283 shares at December 31, 2016	396	274

Additional paid-in capital	815,329	345,138
Retained earnings	140,746	117,049
Accumulated other comprehensive loss, net of tax	3,260	(2,721)
Total Stockholders' Equity	959,731	459,740
Total Liabilities and Stockholders' Equity	$6,440,631	$4,036,311

Accompanying notes are an integral part of these consolidated financial statements.

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PACIFIC PREMIER BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(dollars in thousands, except share data)
(unaudited)

	Three Months Ended			Six Months Ended	
	June 30, 2017	March 31, 2017	June 30, 2016	June 30, 2017	June 30, 2016
INTEREST INCOME					
Loans	$63,554	$ 42,436	$ 39,035	$105,990	$ 74,442
Investment securities and other interest-earning assets	5,179	2,991	1,839	8,170	3,937
Total interest income	68,733	45,427	40,874	114,160	78,379
INTEREST EXPENSE					
Deposits	3,081	2,135	2,010	5,216	4,079
FHLB advances and other borrowings	1,175	604	324	1,779	649
Subordinated debentures	1,139	985	979	2,124	1,889
Total interest expense	5,395	3,724	3,313	9,119	6,617
Net interest income before provision for loan losses	63,338	41,703	37,561	105,041	71,762
Provision for loan losses	1,904	2,502	1,589	4,406	2,709
Net interest income after provision for loan losses	61,434	39,201	35,972	100,635	69,053
NONINTEREST INCOME					
Loan servicing fees	143	222	256	365	481
Deposit fees	1,646	847	817	2,493	1,645
Net gain from sales of loans	2,887	2,811	2,124	5,698	4,030
Net gain from sales of investment securities	2,093	—	532	2,093	1,285
Net gain from other real estate owned	94	—	18	94	18
Other income	1,896	803	703	2,699	1,839
Total noninterest income	8,759	4,683	4,450	13,442	9,298
NONINTEREST EXPENSE					
Compensation and benefits	21,623	14,887	13,098	36,510	24,837
Premises and occupancy	3,733	2,453	2,447	6,186	4,730
Data processing	2,439	1,187	887	3,626	1,798
Other real estate owned operations, net	44	12	(15)	56	(7)
FDIC insurance premiums	818	455	401	1,273	783
Legal, audit and professional expense	1,178	857	446	2,035	1,311
Marketing expense	1,006	818	803	1,824	1,433
Office, telecommunications and postage expense	922	433	573	1,355	1,054
Loan expense	1,068	468	540	1,536	943
Deposit expense	1,669	1,444	1,196	3,113	2,201
Merger-related expense	10,117	4,946	497	15,063	3,616
CDI amortization	1,761	511	645	2,272	989
Other expense	2,118	1,276	2,177	3,394	3,640
Total noninterest expense	48,496	29,747	23,695	78,243	47,328
Net income before income taxes	21,697	14,137	16,727	35,834	31,023
Income tax	7,521	4,616	6,358	12,137	12,100
Net Income	$14,176	$ 9,521	$ 10,369	$23,697	$ 18,923
EARNINGS PER SHARE					
Basic	$0.36	$ 0.35	$ 0.38	$0.71	$ 0.72
Diluted	$0.35	$ 0.34	$ 0.37	$0.69	$ 0.70
WEIGHTED AVERAGE SHARES OUTSTANDING					

Basic	39,586,524	27,528,940	27,378,930	33,591,040	26,467,292
Diluted	40,267,220	28,197,220	27,845,490	34,267,215	26,901,627

Accompanying notes are an integral part of these consolidated financial statements.

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PACIFIC PREMIER BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(dollars in thousands)
(unaudited)

	Three Months Ended			Six Months Ended	
	June 30,	March 31,	June 30,	June 30,	
	2017	2017	2016	2017	2016
Net income	$14,176	$9,521	$10,369	$23,697	$18,923
Other comprehensive income, net of tax:					
Unrealized holding gains/(loss) on securities arising during the period, net of income taxes (1)	6,336	1,013	947	7,349	2,512
Reclassification adjustment for net (gains)/losses on sale of securities included in net income, net of income taxes (2)	(1,368)	—	(308)	(1,368)	(744)
Other comprehensive income, net of tax	4,968	1,013	639	5,981	1,768
Comprehensive income, net of tax	$19,144	$10,534	$11,008	$29,678	$20,691

(1) Income tax (benefit) on the unrealized gains (losses) on securities was $4.3 million for the three months ended June 30, 2017, $714,000 for the three months ended March 31, 2017, $736,000 for the three months ended June 30, 2016, $5.0 million for the six months ended June 30, 2017 and $1.8 million for the six months ended June 30, 2016.

(2) Income tax (benefit) on the reclassification adjustment for net (gains) losses on sale of securities included in net income was $725,000 for the three months ended June 30, 2017, $0 for the three months ended March 31, 2017, $224,000 for the three months ended June 30, 2016, $725,000 for the six months ended June 30, 2017 and $541,000 for the six months ended June 30, 2016.

Accompanying notes are an integral part of these consolidated financial statements.

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PACIFIC PREMIER BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2017 AND 2016
(dollars in thousands)
(unaudited)

	Common Stock Shares	Common Stock	Additional Paid-in Capital	Accumulated Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balance at December 31, 2016	27,798,283	$ 274	$345,138	$ 117,049	$ (2,721)	$ 459,740
Net income	—	—	—	23,697	—	23,697
Other comprehensive income	—	—	—	—	5,981	5,981
Share-based compensation expense	—	—	2,797	—	—	2,797
Issuance of restricted stock, net	53,468	—	—	—	—	—
Common stock issued	11,959,022	120	464,862	—	—	464,982
Repurchase of common stock	—	—	(1,077)	—	—	(1,077)
Exercise of stock options	237,985	2	3,609	—	—	3,611
Balance at June 30, 2017	40,048,758	$ 396	$815,329	$ 140,746	$ 3,260	$ 959,731
Balance at December 31, 2015	21,570,746	$ 215	$221,487	$ 76,946	$ 332	$ 298,980
Net income	—	—	—	18,923	—	18,923
Other comprehensive income	—	—	—	—	1,768	1,768
Share-based compensation expense	—	—	1,048	—	—	1,048
Issuance of restricted stock, net	218,236	—	—	—	—	—
Common stock issued	5,815,051	58	119,325	—	—	119,383
Exercise of stock options	46,500	—	528	—	—	528
Balance at June 30, 2016	27,650,533	$ 273	$342,388	$ 95,869	$ 2,100	$ 440,630

Accompanying notes are an integral part of these consolidated financial statements.

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PACIFIC PREMIER BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(unaudited)

	Six Months Ended June 30, 2017	2016
Cash flows from operating activities:		
Net income	$ 23,697	$ 18,923
Adjustments to net income:		
Depreciation and amortization expense	2,049	1,348
Provision for loan losses	4,406	2,709
Share-based compensation expense	2,797	1,048
Loss on sale and disposal of premises and equipment	(200)	(18)
Loss on sale of or write down of other real estate owned	(94)	—
Net amortization on securities available-for-sale, net	3,745	7,080
Net accretion of discounts/premiums for loans acquired and deferred loan fees/costs	1,722	(6,713)
Gain on sale of investment securities available-for-sale	(2,093)	(1,285)
Other-than-temporary impairment recovery on investment securities, net	1	—
Originations of loans held for sale	(61,448)	(44,463)
Proceeds from the sales of and principal payments from loans held for sale	65,508	47,487
Gain on sale of loans	(5,698)	(4,030)
Deferred income tax expense (benefit)	912	(977)
Change in accrued expenses and other liabilities, net	4,480	(1,700)
Income from bank owned life insurance, net	(849)	(579)
Amortization of core deposit intangible	2,272	989
Change in accrued interest receivable and other assets,	2,064	5,904

net				
Net cash provided by operating activities	43,271		25,723	
Cash flows from investing activities:				
Proceeds from sale of real estate owned	182		468	
Increase in loans, net	(254,468	)	(204,505	)
Principal payments on securities available-for-sale	34,469		18,234	
Purchase of securities available-for-sale	(109,944	)	(5,135	)
Proceeds from sale or maturity of securities available-for-sale	216,804		211,303	
Proceeds from the sale of premises and equipment	—		6,987	
Proceeds from bank owned life insurance death benefit	199		—	
Purchases of premises and equipment	(274	)	(5,745	)
Change in FHLB, FRB, and other stock, at cost	(9,569	)	(4,692	)
Cash acquired in acquisitions, net	77,144		40,303	
Net cash (used in) provided by investing activities	(45,457	)	57,218	
Cash flows from financing activities:				
Net increase in deposit accounts	131,397		99,286	
Change in FHLB advances and other borrowings, net	(59,321	)	(75,873	)
Proceeds from exercise of stock options and warrants	3,611		528	
Repurchase of common stock	(1,077	)	—	
Net cash provided by financing activities	74,610		23,941	
Net increase in cash and cash equivalents	72,424		106,882	
Cash and cash equivalents, beginning of period	156,857		78,417	
Cash and cash equivalents, end of period	$ 229,281		$ 185,299	
Supplemental cash flow disclosures:				
Interest paid	$ 8,828		$ 4,182	
Income taxes paid	1,858		136	

Noncash investing activities during the period:		
Security (purchases) sales settled in subsequent period	(11,130)	—
Assets acquired (liabilities assumed and capital created) in acquisitions (See Note 4):		
Investment securities	442,923	190,254
FHLB and Other Stock	9,739	1,972
Loans	1,364,688	456,158
Core deposit intangible	28,123	4,319
Deferred income tax	11,623	6,748
Goodwill	268,075	51,658
Fixed assets	34,902	4,190
Other assets	45,475	9,362
Deposits	(1,669,550)	(636,591)
Other borrowings	(139,034)	—
Other liabilities	(8,061)	(8,843)
Common stock and additional paid-in capital	(464,982)	(120,174)

Accompanying notes are an integral part of these consolidated financial statements.

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PACIFIC PREMIER BANCORP, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017
(UNAUDITED)

Note 1 - Basis of Presentation

The consolidated financial statements include the accounts of Pacific Premier Bancorp, Inc. (the “Corporation”) and its wholly owned subsidiaries, including Pacific Premier Bank (the “Bank”) (collectively, the “Company,” “we,” “our” or “us”). A significant intercompany accounts and transactions have been eliminated in consolidation.

In the opinion of management, the consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the Company’s financial position as of June 30, 2017 and December 31, 2016, the results of its operations and comprehensive income for the three months ended June 30, 2017, March 31, 2017 and June 30, 2016 and the six months ended June 30, 2017 and June 30, 2016 and the changes in stockholders’ equity and cash flows for the six months ended June 30, 2017 and 2016. Operating results or comprehensive income for the six months ended June 30, 2017 are not necessarily indicative of the results or comprehensive income that may be expected for any other interim period or the full year ending December 31, 2017.

Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). The unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016 (the “2016 Annual Report”).

The Company accounts for its investments in its wholly owned special purpose entity, PPBI Trust I, under the equity method whereby the subsidiary’s net earnings are recognized in the Company’s statement of operations.

Note 2 – Recently Issued Accounting Pronouncements

Accounting Standards Adopted in 2017

In March 2016, the FASB issued ASU 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Accounting. The amendments simplify several aspects of the accounting for share-based payment award transactions, including accounting for excess tax benefits and tax deficiencies, classifying excess tax benefits on the statement of cash flows, accounting for forfeitures, classifying awards that permit share repurchases to satisfy statutory tax-withholding requirements and classifying tax payments on behalf of employees on the statement of cash flows. For public business entities, the amendment is effective for annual periods beginning after December 15, 2016 and interim periods within those annual periods. Early adoption is permitted for any organization in any interim or annual period. As a result of the adoption of ASU 2016-09, the Company began recognizing the tax effects of exercised or vested awards as discrete items in the reporting period in which they occur, resulting in a $461,000 tax benefit to the Company for the second quarter of 2017 compared with $1.1 million tax benefit in the first quarter of 2017.

In March 2016, the FASB issued ASU 2016-05, Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships. The amendments clarify that a change in the counterparty to a derivative instrument designated as a hedging instrument does not, in and of itself, require designation of that hedging relationship provided that all other hedge accounting criteria remain the same. The Update is effective for public business entities for fiscal years beginning after December 31, 2016, including interim

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periods within those years. The adoption of this standard did not have a material effect on the Company's operating results or financial condition.

Recent Accounting Guidance Not Yet Effective

In May 2017, the FASB issued ASU 2017-09, Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting. The amendments provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. Modification accounting will apply unless all of the following are the same immediately before and after the modification:

- The award’s fair value – or calculated value or intrinsic value, if an alternative method is used. If the modification does not affect any inputs to the valuation of the award, estimating the value immediately before and after the modification is not required.

- The award’s vesting provisions

- The award’s classification as an equity instrument or a liability instrument

The Update is effective for all entities for fiscal years beginning after December 15, 2017, including interim periods within those years. The amendments should be applied prospectively to awards modified on or after the effective date. The adoption of this standard will not material effect the Company's operating results or financial condition, as historically the Company has not modified share-based awards.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The amendments replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. For public business entities, the amendment is effective for annual periods beginning after December 15, 2019 and interim period within those annual periods. The Company is currently evaluating the effects of ASU 2016-13 on its financial statements and disclosures. The Company is in the process of compiling key data elements and considering software models that will meet the requirements of the new guidance.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The new standard is being issued to increase the transparency and comparability around lease obligations. Previously unrecorded off-balance sheet obligations will now be brought more prominently to light by presenting lease liabilities on the face of the balance sheet, accompanied by enhanced qualitative and quantitative disclosures in the notes to the financial statements. The Update is generally effective for public business entities in fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is in the early stages of its implementation assessment, which includes identifying the population of the Company's leases that are within the scope of the new guidance and gathering all key lease data that will facilitate application of the new accounting requirements.

ASU 2014-09, Revenue From Contracts With Customers (Topic 606), ASU 2015-14 Revenue from Contracts with Customers (Topic 606): Deferral of Effective Date, ASU 2016-08 Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), ASU 2016-10 Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, ASU 2016-11 Revenue Recognition (Topic 605) and Derivatives ad Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting, ASU 2016-12 Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients, and ASU 2016-20 Revenue from Contracts with Customers (Topic 606): Technical Corrections and Improvements to Topic 606. The FASB amended existing guidance related to revenue from contracts with customers, superseding and replacing nearly all existing revenue recognition guidance, including industry-specific guidance, establishing a new control-based revenue recognition model, changing the basis for deciding when revenue is recognized over time or at a point in time, providing new and more detailed

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guidance on specific topics and expanding and improving disclosures about revenue. In addition, this guidance specifies the accounting for some costs to obtain or fulfill a contract with a customer. The amendments are effective for public entities for annual reporting periods beginning after December 15, 2017. Substantially all of the Company's revenue is generated from interest income related to loans and investment securities, which are not within the scope of this guidance. The contracts that are within the scope of this guidance include service charges and fees on deposit accounts and the Company does not expect the adoption will have a significant impact on its Consolidated Financial Statements.

Note 3 – Significant Accounting Policies

Except as discussed below, our accounting policies are described in Note 1. Description of Business and Summary of Significant Accounting Policies, of our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2016 as filed with the Securities and Exchange Commission ("Form 10-K").

Certain Acquired Loans–As part of business acquisitions, the Bank acquires certain loans that have shown evidence of credit deterioration since origination. These acquired loans are recorded at the allocated fair value, such that there is no carryover of the seller’s allowance for loan losses. Such acquired loans are accounted for individually. The Bank estimates the amount and timing of expected cash flows for each purchased loan, and the expected cash flows in excess of the allocated fair value is recorded as interest income over the remaining life of the loan (accretable yield). The excess of the loan’s contractual principal and interest over expected cash flows is not recorded (non-accretable difference). Over the life of the loan, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded through the allowance for loan losses. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

Goodwill and Core Deposit Intangible–Goodwill is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually or more frequently if events and circumstances exist that indicate the necessity for such impairment tests to be performed. The Company has selected November 30 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on our balance sheet.

Core deposit intangible assets arising from whole bank acquisitions are amortized on either an accelerated basis, reflecting the pattern in which the economic benefits of the intangible assets is consumed or otherwise used up, or on a straight-line amortization method over their estimated useful lives, which range from 6 to 10 years.

Use of Estimates–The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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. Actual results could differ from those estimates.

Note 4 – Acquisitions

The Company accounted for the following transactions under the acquisition method of accounting which requires purchased assets and liabilities assumed to be recorded at their respective fair values at the date of acquisition. The Company determined the fair value of the loans, core deposit intangible, securities and deposits with the assistance of third party valuations.

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Heritage Oaks Bancorp Acquisition

The Company completed the acquisition, effective as of April 1, 2017, of Heritage Oaks Bancorp ("HEOP"), the holding company of Heritage Oaks Bank, a Paso Robles, California based state-chartered bank ("Heritage Oaks Bank") with $2.0 billion in total assets, $1.4 billion in gross loans and $1.7 billion in total deposits at March 31, 2017. Heritage Oaks Bank operates branches within San Luis Obispo and Santa Barbara Counties and a loan production office in Ventura County.

Pursuant to the terms of the merger agreement, each outstanding share of HEOP common stock was converted into the right to receive 0.3471 shares of Company common stock. The value of the total deal consideration was approximately $465 million, which included approximately $3.9 million of aggregate cash consideration payable to holders of Heritage Oaks share-based compensation awards, and the issuance of 11,959,022 shares of the Corporation's common stock, which had a value of $38.55 per share, which was the closing price of the Corporation's common stock on March 31, 2017, the last trading day prior to the consummation of the acquisition.

Goodwill in the amount of $268 million was recognized in the HEOP acquisition. Goodwill represents the future economic benefits arising from net assets acquired that are not individually identified and separately recognized and is attributable to synergies expected to be derived from the combination of the two entities. Goodwill recognized in this transaction is not deductible for income tax purposes.

The following table represents the assets acquired and liabilities assumed of HEOP as of April 1, 2017 and the fair value adjustments and amounts recorded by the Company in 2017 under the acquisition method of accounting:

	HEOP Book Value	Fair Value Adjustments	Fair Value
ASSETS ACQUIRED	(dollars in thousands)		
Cash and cash equivalents	$78,728	$ —	$78,728
Investment securities	447,520	(4,597)	442,923
FHLB stock	9,739	—	9,739
Loans, gross	1,387,949	(23,261)	1,364,688
Allowance for loan losses	(17,200)	17,200	—
Fixed assets	35,567	(665)	34,902
Core deposit intangible	—	28,123	28,123
Deferred tax assets	17,850	(7,291)	10,559
Other assets	45,484	(9)	45,475
Total assets acquired	$2,005,637	$ 9,500	$2,015,137
LIABILITIES ASSUMED			
Deposits	1,668,079	1,471	1,669,550
Borrowings	141,996	(2,962)	139,034
Other Liabilities	7,290	771	8,061
Total liabilities assumed	1,817,365	(720)	1,816,645
Excess of assets acquired over liabilities assumed	$188,272	$ 10,220	198,492
Consideration paid			464,982
Capitalized merger-related expense			1,585
Goodwill recognized			$268,075

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The fair values are preliminary estimates and are subject to adjustment for up to one year after the merger date or when additional information relative to the closing date fair values becomes available and such information is considered final, whichever is earlier.

Security California Bancorp Acquisition

On January 31, 2016, the Company completed its acquisition of Security California Bancorp ("SCAF") whereby we acquired $714 million in total assets, $456 million in loans and $637 million in total deposits. Under the terms of the merger agreement, each share of SCAF common stock was converted into the right to receive 0.9629 shares of the Corporation's common stock. The value of the total deal consideration was $120 million, which includes $788,000 of aggregate cash consideration to the holders of SCAF stock options and the issuance of 5,815,051 shares of the Corporation's common stock, valued at $119 million based on a closing stock price of $20.53 per share on January 29, 2016.

SCAF was the holding company of Security Bank of California, a Riverside, California, based state-chartered bank with six branches located in Riverside County, San Bernardino County and Orange County.

Goodwill in the amount of $51.7 million was recognized in the SCAF acquisition. Goodwill represents the future economic benefits arising from net assets acquired that are not individually identified and separately recognized and is attributable to synergies expected to be derived from the combination of the two entities. Goodwill recognized in this transaction is not deductible for income tax purposes.

The following table represents the assets acquired and liabilities assumed of SCAF as of January 31, 2016 and the fair value adjustments and amounts recorded by the Company in 2016 under the acquisition method of accounting:

	SCAF Book Value	Fair Value Adjustments	Fair Value
ASSETS ACQUIRED	(dollars in thousands)		
Cash and cash equivalents	$40,947	$ —	$40,947
Interest-bearing deposits with financial institutions	1,972	—	1,972
Investment securities	191,881	(1,627)	190,254
Loans, gross	467,197	(11,039)	456,158
Allowance for loan losses	(7,399)	7,399	—
Fixed assets	5,335	(1,145)	4,190
Core deposit intangible	493	3,826	4,319
Deferred tax assets	5,618	1,130	6,748
Other assets	10,589	(1,227)	9,362
Total assets acquired	$716,633	$ (2,683)	$713,950
LIABILITIES ASSUMED			
Deposits	$636,450	$ 141	$636,591
Other Liabilities	9,063	(220)	8,843
Total liabilities assumed	645,513	(79)	645,434
Excess of assets acquired over liabilities assumed	$71,120	$ (2,604)	68,516
Consideration paid			120,174
Goodwill recognized			$51,658

The fair values are estimates and are subject to adjustment for up to one year after the merger date or when additional information relative to the closing date fair values becomes available and such information is

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considered final, whichever is earlier. In the second quarter of 2016, the Company made a $146,000 adjustment to fixed assets and goodwill. As of March 31, 2017, the Company finalized its fair values with this acquisition.

For loans acquired from SCAF and HEOP, the contractual amounts due, expected cash flows to be collected, interest component and fair value as of the respective acquisition dates were as follows:

	Acquired Loans	
	SCAF	HEOP
	(dollars in thousands)	
Contractual amounts due	$539,806	$1,717,230
Cash flows not expected to be collected	2,765	4,442
Expected cash flows	537,041	1,712,788
Interest component of expected cash flows	80,883	348,100
Fair value of acquired loans	$456,158	$1,364,688

In accordance with generally accepted accounting principles, there was no carryover of the allowance for loan losses that had been previously recorded by SCAF and HEOP.

The operating results of the Company for the three months ended June 30, 2017, March 31, 2017 and June 30, 2016 and the six months ended June 30, 2017 and June 30, 2016 include the operating results of SCAF and HEOP since its acquisition date. The following table presents the net interest and other income, net income and earnings per share as if the acquisition of SCAF and HEOP were effective as of January 1, 2016. There were no material, nonrecurring adjustments to the pro forma net interest and other income, net income and earnings per share presented below:

	Three Months Ended			Six Months Ended	
	June 30,	March 31,	June 30,	June 30,	June 30,
	2017	2017	2016	2017	2016
	(dollars in thousands)				
Net interest and other income	$70,193	$62,362	$60,304	$132,555	$119,420
Net income	14,176	10,084	14,584	24,260	25,152
Basic earnings per share	0.36	0.26	0.37	0.62	0.64
Diluted earnings per share	0.35	0.25	0.37	0.60	0.63

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Note 5 – Investment Securities

The amortized cost and estimated fair value of securities were as follows:

	June 30, 2017			
	Amortized Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value
	(dollars in thousands)			
Investment securities available-for-sale:				
Agency	$54,388	$ 707	$ (24)	$55,071
Corporate	53,498	1,001	(150)	54,349
Municipal bonds	247,242	5,194	(358)	252,078
Collateralized mortgage obligation: residential	46,095	312	(86)	46,321
Mortgage-backed securities: residential	296,324	893	(1,953)	295,264
Total investment securities available-for-sale	697,547	8,107	(2,571)	703,083
Investment securities held-to-maturity:				
Mortgage-backed securities: residential	6,586	—	(47)	6,539
Other	1,164	—	—	1,164
Total investment securities held-to-maturity	7,750	—	(47)	7,703
Total investment securities	$705,297	$ 8,107	$ (2,618)	$710,786

	December 31, 2016			
	Amortized Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value
	(dollars in thousands)			
Investment securities available-for-sale:				
Corporate	$37,475	$ 372	$ (205)	$37,642
Municipal bonds	120,155	338	(1,690)	118,803
Collateralized mortgage obligation: residential	31,536	25	(173)	31,388
Mortgage-backed securities: residential	196,496	69	(3,435)	193,130
Total investment securities available-for-sale	385,662	804	(5,503)	380,963
Investment securities held-to-maturity:				
Mortgage-backed securities: residential	7,375	—	(104)	7,271
Other	1,190	—	—	1,190
Total investment securities held-to-maturity	8,565	—	(104)	8,461
Total investment securities	$394,227	$ 804	$ (5,607)	$389,424

At June 30, 2017, mortgage-backed securities ("MBS ") with an estimated par value of $56.0 million and a fair value of $58.0 million were pledged as collateral for the Bank’s three repurchase agreements which totaled $28.5 million and homeowner’s association (“HOA”) reverse repurchase agreements which totaled $20.9 million.

At December 31, 2016, MBS with an estimated par value of $63.6 million and a fair value of $65.3 million were pledged as collateral for the Bank’s three repurchase agreements which totaled $28.5 million and HOA reverse repurchase agreements which totaled $21.5 million.

At June 30, 2017 and December 31, 2016, there were not holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders' equity.

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The Company reviews individual securities classified as available-for-sale to determine whether a decline in fair value below the amortized cost basis is temporary because (i) those declines were due to interest rate changes and not to a deterioration in the creditworthiness of the issuers of those investment securities, and (ii) we have the ability to hold those securities until there is a recovery in their values or until their maturity.

If it is probable that the Company will be unable to collect all amounts due according to contractual terms of the debt security not impaired at acquisition, an other-than-temporary impairment ("OTTI") shall be considered to have occurred. If an OTTI occurs, the cost basis of the security will be written down to its fair value as the new cost basis and the write down accounted for as a realized loss.

The Company did not realize any OTTI recoveries or losses for the three months ended June 30, 2017. However, the Company did realize an OTTI recovery of $1,000 for the three months ended March 31, 2017, which relates to investment income from a previously charge-off investment. A $207,000 OTTI was taken in the first quarter of 2016, related to a CRA investment purchased in June of 2014 with a par value of $50, and a book value of $500,000. In March 2016, the shareholders of the investment voted to approve a sale of the institution at a per share acquisition price less the Bank's book value, and the sale closed in July 2016. The Company is currently waiting to receive the proceeds for its outstanding shares. As a result, the Company's current holdings were written down and the loss recognized.

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The table below shows the number, fair value and gross unrealized holding losses of the Company's investment securities by investment category and length of time that the securities have been in a continuous loss position.

	June 30, 2017								
	Less than 12 months			12 months or Longer			Total		
	Number	Fair Value	Gross Unrealized Holding Losses	Number	Fair Value	Gross Unrealized Holding Losses	Number	Fair Value	Gross Unrealized Holding Losses
	(dollars in thousands)								
Investment securities available-for-sale:									
Agency	1	$1,784	$(24)	—	$—	$—	1	$1,784	$(24)
Corporate	2	6,070	(150)	—	—	—	2	6,070	(150)
Municipal bonds	47	24,556	(353)	1	418	(5)	48	24,974	(358)
Collateralized mortgage obligation: residential	4	12,517	(86)	—	—	—	4	12,517	(86)
Mortgage-backed securities: residential	55	147,423	(1,638)	6	19,244	(315)	61	166,667	(1,953)
Total investment securities available-for-sale	109	192,350	(2,251)	7	19,662	(320)	116	212,012	(2,571)
Investment securities held-to-maturity:									
Mortgage-backed securities: residential	1	6,539	(47)	—	—	—	1	6,539	(47)
Total investment securities held-to-maturity	1	6,539	(47)	—	—	—	1	6,539	(47)
Total investment securities	110	$198,889	$(2,298)	7	$19,662	$(320)	117	$218,551	$(2,618)

	December 31, 2016								
	Less than 12 months			12 months or Longer			Total		
	Number	Fair Value	Gross Unrealized Holding Losses	Number	Fair Value	Gross Unrealized Holding Losses	Number	Fair Value	Gross Unrealized Holding Losses
	(dollars in thousands)								
Investment securities available-for-sale:									
Corporate	3	$7,609	$ (205)	—	$—	$ —	3	$7,609	$ (205)
Municipal bonds	152	85,750	(1,690)	—	—	—	152	85,750	(1,690)
Collateralized mortgage obligation: residential	5	19,092	(173)	—	—	—	5	19,092	(173)
Mortgage-backed securities: residential	55	149,740	(2,916)	4	16,039	(519)	59	165,779	(3,435)
Total investment securities available-for-sale	215	262,191	(4,984)	4	16,039	(519)	219	278,230	(5,503)
Investment securities held-to-maturity:									
Mortgage-backed securities: residential	1	7,271	(104)	—	—	—	1	7,271	(104)
Total investment securities held-to-maturity	1	7,271	(104)	—	—	—	1	7,271	(104)
Total investment securities	216	$269,462	$ (5,088)	4	$16,039	$ (519)	220	$285,501	$ (5,607)

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The amortized cost and estimated fair value of investment securities at June 30, 2017, by contractual maturity are shown in the table below.

	One Year or Less		More than One Year to Five Years		More than Five Years to Ten Years		More than Ten Years		Total	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(dollars in thousands)									
Investment securities available-for-sale:										
Agency	$—	$—	$—	$—	$15,123	$15,248	$39,265	$39,823	$54,388	$55,071
Corporate	—	—	—	—	53,498	54,349	—	—	53,498	54,349
Municipal bonds	3,104	3,107	35,725	36,012	75,712	77,010	132,701	135,949	247,242	252,078
Collateralized mortgage obligation: residential	—	—	—	—	3,613	3,661	42,482	42,660	46,095	46,321
Mortgage-backed securities: residential	2,636	2,630	6,327	6,348	49,626	49,839	237,735	236,447	296,324	295,264
Total investment securities available-for-sale	5,740	5,737	42,052	42,360	197,572	200,107	452,183	454,879	697,547	703,083
Investment securities held-to-maturity:										
Mortgage-backed securities: residential	—	—	—	—	—	—	6,586	6,539	6,586	6,539
Other	—	—	—	—	—	—	1,164	1,164	1,164	1,164
Total investment securities held-to-maturity	—	—	—	—	—	—	7,750	7,703	7,750	7,703
Total investment securities	$5,740	$5,737	$42,052	$42,360	$197,572	$200,107	$459,933	$462,582	$705,297	$710,786

Unrealized gains and losses on investment securities available-for-sale are recognized in stockholders' equity as accumulated other comprehensive income or loss. At June 30, 2017, the Company had an accumulated other comprehensive income of $5.5 million, or $3.3 million net of tax, compared to an accumulated other comprehensive loss of $4.7 million, or $2.7 million net of tax, at December 31, 2016.

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During the three months ended June 30, 2017 and June 30, 2016, the Company recognized gross gains on sales of available-for-sale securities in the amount of $2.1 million and $532,000, respectively. The Company did not recognize any gross gains on sales of available-for-sale securities during the three months ended March 31, 2017. During the three months ended June 30, 2017, the Company recognized gross losses on the sales of available-for-sale securities in the amount of $50,000. The Company did not recognize any gross losses on the sales of available-for sale securities during the three months ended March 31, 2017 and June 30, 2016. The Company had net proceeds from the sale of available-for-sale securities of $215 million during the three months ended June 30, 2017 and $21.1 million during the three months ended June 30, 2016. The Company had zero net proceeds from the sale of available-for-sale securities during the three months ended March 31, 2017.

During the six months ended June 30, 2017 and June 30, 2016, the Company recognized gross gains on sales of available-for-sale securities in the amount of $2.1 million and $1.3 million, respectively. During the six months ended June 30, 2017 and June 30, 2016, the Company recognized gross losses on sales of available-for-sale securities in the amount of $50,000 and $9,000, respectively. The Company had net proceeds from the sale of available-for-sale securities of $215 million during the six months ended June 30, 2017 and $207 million during the six months ended June 30, 2016.

FHLB, FRB and other stock

At June 30, 2017, the Company had $17.3 million in Federal Home Loan Bank (“FHLB”) stock, $25.0 million in Federal Reserve Bank of San Francisco (“FRB”) stock, and $14.4 million in other stock, all carried at cost. During the three months ended June 30, 2017, the Company acquired $7.9 million of FHLB stock through the HEOP acquisition, of which the FHLB subsequently repurchased $5.0 million through their stock repurchase program. During the three months ended June 30, 2016 and December 31, 2016, the FHLB did not repurchase any of the Company’s excess FHLB stock through their stock repurchase program. In addition, the Company acquired another $1.9 million of other stock through the HEOP acquisition and was required to increase its holdings of FRB stock by $14.1 million. The Company evaluates its investments in FHLB, FRB and other stock for impairment periodically, including their capital adequacy and overall financial condition. No impairment losses have been recorded through June 30, 2017.

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Note 6 – Loans Held for Investment

The following table sets forth the composition of our loan portfolio in dollar amounts at the dates indicated:

	June 30, 2017	December 31, 2016
	(dollars in thousands)	
Business loans:		
Commercial and industrial	$733,852	$ 563,169
Franchise	565,415	459,421
Commercial owner occupied (1)	729,476	454,918
SBA	108,224	96,705
Agriculture	98,842	—
Real estate loans:		
Commercial non-owner occupied	1,095,184	586,975
Multi-family	746,547	690,955
One-to-four family (2)	322,048	100,451
Construction	289,600	269,159
Farmland	136,587	—
Land	31,799	19,829
Other loans	7,309	4,112
Total gross loans (3)	4,864,883	3,245,694
Plus: Deferred loan origination costs/(fees) and premiums/(discounts), net	568	3,630
Total loans	4,865,451	3,249,324
Less: loans held for sale, at lower of cost or fair value	6,840	7,711
Loans held for investment	4,858,611	3,241,613
Allowance for loan losses	(25,055)	(21,296)
Loans held for investment, net	$4,833,556	$ 3,220,317

(1) Secured by real estate.
(2) Includes second trust deeds.
(3) Total gross loans for June 30, 2017 are net of the unaccreted fair value purchase discounts of $25.2 million.

From time to time, we may purchase or sell loans in order to manage concentrations, maximize interest income, change risk profiles, improve returns and generate liquidity.

The Company makes residential and commercial loans held for investment to customers located primarily in California. Consequently, the underlying collateral for our loans and a borrower's ability to repay may be impacted unfavorably by adverse changes in the economy and real estate market in the region.

Under applicable laws and regulations, the Bank may not make secured loans to one borrower in excess of 25% of the Bank's unimpaired capital plus surplus and likewise in excess of 15% for unsecured loans. These loans-to-one borrower limitations result in a dollar limitation of $261.4 million for secured loans and $156.8 million for unsecured loans at June 30, 2017. At June 30, 2017, the Bank's largest aggregate outstanding balance of loans to one borrower was $35.0 million of secured credit.

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Purchased Credit Impaired

The Company has purchased loans as part of its acquisitions of Canyon National Bank in 2011, Palm Desert National Bank in 2012, Independence Bank in 2015, Security Bank of California in 2016 and Heritage Oaks Bank in 2017 for which there was, at acquisition, evidence of deterioration of credit quality since origination and for which it was probable, at acquisition, that all contractually required payments would not be collected. The carrying amount of those loans is as follows:

	June 30, 2017	December 31, 2016
	(dollars in thousands)	
Business loans:		
Commercial and industrial	$3,679	$ 2,586
Commercial owner occupied	3,208	491
SBA	361	—
Real estate loans:		
Commercial non-owner occupied	1,151	1,088
Multi-family	237	—
One-to-four family	262	1
Construction/Land	549	—
Other loans	274	393
Total purchase credit impaired	$9,721	$ 4,559

On the acquisition date, the amount by which the undiscounted expected cash flows of the purchased credit impaired loans exceed the estimated fair value of the loan is the “accretable yield.” The accretable yield is measured at each financial reporting date and represents the difference between the remaining undiscounted expected cash flows and the current carrying value of the purchased credit impaired loan. At June 30, 2017, the Company had $9.7 million of purchased credit impaired loans, of which none were placed on nonaccrual status.

The following table summarizes the accretable yield on the purchased credit impaired loans for the three months ended June 30, 2017, March 31, 2017 and June 30, 2016 and for the six months ended June 30, 2017 and 2016:

	Three Months Ended			Six Months Ended	
	June 30, 2017	March 31, 2017	June 30, 2016	June 30, 2017	June 30, 2016
Balance at the beginning of period	$3,601	$ 3,747	$3,254	$3,747	$2,726
Additions	2,036	—	—	2,036	788
Accretion	(712)	(629)	(147)	(1,341)	(276)
Payoffs	—	—	(126)	—	(449)
Reclassification from (to) nonaccretable difference	(1,428)	483	—	(945)	192
Balance at the end of period	$3,497	$ 3,601	$2,981	$3,497	$2,981

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Impaired Loans

The following tables provide a summary of the Company’s investment in impaired loans as of the period indicated:

	Impaired Loans				
	Contractual Unpaid Principal Balance	Recorded Investment	With Specific Allowance	Without Specific Allowance	Specific Allowance for Impaired Loans
	(dollars in thousands)				
June 30, 2017					
Business loans:					
Commercial owner occupied	$240	$ 206	$ —	$ 206	$ —
SBA	146	73	—	73	—
Real estate loans:					
One-to-four family	135	104	—	104	—
Land	35	12	—	12	—
Totals	$556	$ 395	$ —	$ 395	$ —

	Impaired Loans				
	Contractual Unpaid Principal Balance	Recorded Investment	With Specific Allowance	Without Specific Allowance	Specific Allowance for Impaired Loans
	(dollars in thousands)				
December 31, 2016					
Business loans:					
Commercial and industrial	$1,990	$ 250	$ 250	$ —	$ 250
Commercial owner occupied	847	436	—	436	—
SBA	3,865	316	—	316	—
Real estate loans:					
One-to-four family	291	124	—	124	—
Land	36	15	—	15	—
Totals	$7,029	$ 1,141	$ 250	$ 891	$ 250

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	Impaired Loans					
	Three Months Ended					
	June 30, 2017		March 31, 2017		June 30, 2016	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(in thousands)					
Business loans:						
Commercial and industrial	$ 7	$ —	$ 200	$ 5	$ 350	$ 8
Franchise	—	—	—	—	1,461	24
Commercial owner occupied	125	2	192	3	494	9
SBA	222	4	307	5	247	4