First California Financial Group, Inc.
Form 10-Q
August 06, 2010

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

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2010

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ___________ to ___________

Commission file number 000-52498

FIRST CALIFORNIA FINANCIAL GROUP, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	38-3737811
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

3027 Townsgate Road, Suite 300 Westlake Village, California	91361
(Address of Principal Executive Offices)	(Zip Code)

Registrant's telephone number, including area code: (805) 322-9655

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

28,174,076 shares of Common Stock, $0.01 par value, as of August 4, 2010

FIRST CALIFORNIA FINANCIAL GROUP, INC.
QUARTERLY REPORT ON
FORM 10-Q

For the Quarterly Period Ended June 30, 2010

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

FIRST CALIFORNIA FINANCIAL GROUP, INC. AND SUBSIDIARIES
Consolidated Balance Sheets (unaudited)

(in thousands, except share and per share data)	June 30, 2010	December 31, 2009
Cash and due from banks	$ 33,618	$ 26,757
Interest bearing deposits with other banks	97,899	19,737
Securities available-for-sale, at fair value	286,100	349,645
Loans, net	875,089	922,741
Premises and equipment, net	19,729	20,286
Goodwill	60,720	60,720
Other intangibles, net	10,748	11,581
Deferred tax assets, net	3,811	6,046
Cash surrender value of life insurance	12,012	11,791
Foreclosed property	27,850	4,893
Accrued interest receivable and other assets	25,423	25,624
Total assets	$ 1,452,999	$ 1,459,821
Non-interest checking	$ 341,103	$ 317,610
Interest checking	79,796	82,806
Money market and savings	363,996	339,750
Certificates of deposit, under $100,000	75,470	116,012
Certificates of deposit, $100,000 and over	232,092	268,537
Total deposits	1,092,457	1,124,715
Securities sold under agreements to repurchase	45,000	45,000
Federal Home Loan Bank advances	83,750	98,500
Junior subordinated debentures	26,779	26,753
Accrued interest payable and other liabilities	6,629	7,627
Total liabilities	1,254,615	1,302,595
Perpetual preferred stock; authorized 2,500,000 shares		
Series A - $0.01 par value, 1,000 shares issued and outstanding as of June 30, 2010 and December 31, 2009	1,000	1,000
Series B - $0.01 par value, 25,000 shares issued and outstanding as of June 30, 2010 and December 31, 2009	23,399	23,170
Common stock, $0.01 par value; authorized 100,000,000 shares; 28,521,965 shares issued at June 30, 2010 and 11,969,294 shares issued at December 31, 2009; 28,175,564 and 11,622,893 shares outstanding at June 30, 2010 and December 31, 2009	283	118
Additional paid-in capital	174,909	136,635
Treasury stock, 346,401 shares at cost at June 30, 2010 and at December 31, 2009	(3,061)	(3,061)

Retained earnings	4,719	5,309
Accumulated other comprehensive loss	(2,865)	(5,945)
Total shareholders' equity	198,384	157,226
Total liabilities and shareholders' equity	$ 1,452,999	$ 1,459,821

See accompanying notes to consolidated financial statements.

FIRST CALIFORNIA FINANCIAL GROUP, INC. AND SUBSIDIARIES
Consolidated Statements of Operations (unaudited)

	Three months ended June 30,		Six months ended June 30,	
(in thousands, except per share data)	2010	2009	2010	2009
Interest and fees on loans	$ 12,819	$ 13,386	$ 25,806	$ 25,813
Interest on securities	1,508	3,431	3,097	7,028
Interest on federal funds sold and interest bearing deposits	59	235	79	290
Total interest income	14,386	17,052	28,982	33,131
Interest on deposits	1,884	3,214	4,056	6,581
Interest on borrowings	1,257	1,502	2,569	3,057
Interest on junior subordinated debentures	439	439	878	926
Total interest expense	3,580	5,155	7,503	10,564
Net interest income before provision for loan losses	10,806	11,897	21,479	22,567
Provision for loan losses	1,766	1,110	3,520	6,179
Net interest income after provision for loan losses	9,040	10,787	17,959	16,388
Service charges on deposit accounts and other banking-related fees	973	1,038	1,903	2,088
Loan sales and commissions	—	44	16	53
Net gain on sale of securities	130	2,000	262	2,671
Impairment loss on securities	—	(565)	(18)	(565)
Gain on transfer of foreclosed property	691	—	691	—
Earnings on cash surrender value of life insurance	109	109	220	216
Other income	51	113	73	191
Total noninterest income	1,954	2,739	3,147	4,654
Salaries and employee benefits	4,889	5,363	9,859	11,021
Premises and equipment	1,517	1,780	3,054	3,313
Data processing	597	479	1,192	950
Legal, audit and other professional services	590	597	772	1,217
Printing, stationery and supplies	113	211	125	403
Telephone	213	264	437	527
Directors’ expense	113	141	233	256
Advertising, marketing and business development	286	443	513	899
Postage	47	96	103	151
Insurance and regulatory assessments	780	1,346	1,580	1,655
Loss on and expense of foreclosed property	468	249	546	249
Amortization of intangible assets	417	417	833	793
Market loss on loans held-for-sale	—	709	—	709
Other expenses	721	781	1,420	1,510

Total noninterest expense	10,751	12,876	20,667	23,653
Income (loss) before provision for income taxes	243	650	439	(2,611)
Provision (benefit) for income taxes	96	433	175	(950)
Net income (loss)	147	217	264	(1,661)
Preferred stock dividends	(313)	(313)	(626)	(507)
Net loss available to common shareholders	$ (166)	$ (96)	$ (362)	$ (2,168)
Loss per common share:				
Basic	$ (0.01)	$ (0.01)	$ (0.02)	$ (0.19)
Diluted	$ (0.01)	$ (0.01)	$ (0.02)	$ (0.19)

See accompanying notes to consolidated financial statements.

FIRST CALIFORNIA FINANCIAL GROUP, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows (unaudited)

(in thousands)	Six Months Ended June 30, 2010	2009
Net income (loss)	$ 264	$ (1,661)
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Provision for loan losses	3,520	6,179
Stock-based compensation costs	348	531
Gain on sales of securities	(262)	(2,671)
Loss (gain) on sale and transfer of foreclosed property	(695)	15
Market loss on loans held-for-sale	—	709
Impairment loss on securities	18	565
Amortization of net premiums on securities available-for-sale	1,683	244
Depreciation and amortization of premises and equipment	938	883
Amortization of core deposit and trade name intangibles	833	793
Loss on disposal of premises and equipment	50	—
Proceeds from sale of, and payments received from, loans held-for-sale	—	181
Increase in cash surrender value of life insurance	(221)	(216)
(Increase) decrease in deferred tax assets	2,235	(436)
Increase in accrued interest receivable and other assets, net of effects of acquisition	(125)	(2,968)
Increase (decrease) in accrued interest payable and other liabilities, net of effects of acquisition	(998)	1,456
Net cash provided by operating activities	7,588	3,604
Purchases of securities available-for-sale, net of effects of acquisition	(75,334)	(51,775)
Proceeds from repayments and maturities of securities available-for-sale	62,587	30,021
Proceeds from sales of securities available-for-sale	79,917	71,094
Purchases of Federal Home Loan Bank and other stock	(6)	(49)
Redemption of Federal Home Loan Bank stock	313	—
Net change in federal funds sold and interest bearing deposits, net of effects from acquisition	(78,162)	52,075
Loan originations and principal collections, net of effects of acquisition	17,814	(28,868)
Purchases of premises and equipment, net of effects of acquisition	(375)	(787)
Proceeds from sale of foreclosed property	1,210	251
Net cash paid in acquisition	—	(48,790)
Net cash provided by investing activities	7,964	23,172
Net increase in noninterest-bearing deposits, net of effects of acquisition	23,494	9,350
Net decrease in interest-bearing deposits, net of effects of acquisition	(55,752)	(1,080)
Net decrease in FHLB advances and other borrowings	(14,724)	(10,724)
Dividends paid on preferred stock	(625)	(507)
Proceeds from issuance of common stock	38,916	—
Proceeds from exercise of stock options	—	8
Net cash used by financing activities	(8,691)	(2,953)

Change in cash and due from banks		6,861		23,823
Cash and due from banks, beginning of period		26,757		13,712
Cash and due from banks, end of period	$	33,618	$	37,535
Supplemental cash flow information:				
Cash paid for interest	$	7,287	$	10,620
Cash paid for income taxes	$	1,000	$	1,666
Supplemental disclosure of noncash items:				
Net change in fair value of securities available-for-sale, net of tax	$	3,352	$	4,559
Net change in fair value of cash flow hedges, net of tax	$	(86)	$	—
Loans transferred to foreclosed property	$	24,398	$	6,767
Transfer of loans held-for-sale to loans	$	—	$	31,221

See accompanying notes to consolidated financial statements.

NOTE 1 – NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Organization and nature of operations – First California Financial Group, Inc., or First California, or the Company, is a bank holding company incorporated under the laws of the State of Delaware and headquartered in Westlake Village, California. The principal asset of the Company is the capital stock of First California Bank, or the Bank. The Bank is a full-service commercial bank headquartered in Westlake Village, California, chartered under the laws of the State of California and subject to supervision by the California Department of Financial Institutions and the Federal Deposit Insurance Corporation, or the FDIC. The FDIC insures the Bank’s deposits up to the maximum legal limit.

On January 23, 2009, the Bank assumed the insured, non-brokered deposits of 1st Centennial Bank, totaling approximately $270 million from the FDIC. The Bank also purchased from the FDIC approximately $178 million in cash and cash equivalents, $89 million in securities and $101 million in loans related to 1st Centennial Bank. The assumption of deposits and purchase of assets from the FDIC, or the FDIC-assisted 1st Centennial Bank transaction, was an all-cash transaction with an aggregate transaction value of $48.8 million. The Bank recorded $10.6 million in goodwill in connection with this transaction. All six of the former 1st Centennial Bank branches have been fully integrated into the Bank’s full-service branch network.

The Bank serves the comprehensive financial needs of businesses and consumers in Los Angeles, Orange, Riverside, San Diego, San Bernardino and Ventura counties through 17 full-service branch locations.

Consolidation – The accompanying condensed consolidated financial statements include, in conformity with generally accepted accounting principles in the United States of America, the accounts of the Company, the Bank, Wendy Road Office Development LLC, a subsidiary of the Bank which manages and disposes of real estate, and SC Financial, an inactive subsidiary of First California. The Company does not consolidate the accounts of FCB Statutory Trust I and First California Statutory Trust I, or the Trusts, in the consolidated financial statements. The Company does include however the junior subordinated debentures issued by the Company to the Trusts on the consolidated balance sheets. Results of operations for the six months ended June 30, 2009 include the effects of the FDIC-assisted 1st Centennial Bank transaction from the date of the acquisition. All material intercompany transactions have been eliminated.

Basis of presentation – The unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 8-03 of Regulation S-X as promulgated by the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnote disclosures normally required by generally accepted accounting principles for complete financial statements. In our opinion, all normal recurring adjustments necessary for a fair presentation are reflected in the unaudited condensed consolidated financial statements. Operating results for the period ended June 30, 2010 are not necessarily indicative of the results of operations that may be expected for any other interim period or for the year ending December 31, 2010. The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company’s 2009 Annual Report on Form 10-K.

Reclassifications – Certain reclassifications have been made to the 2009 consolidated financial statements to conform to the current year presentation.

Management’s estimates and assumptions – The preparation of the consolidated 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 as of the date of the financial statements and the reported revenues and expenses for the reporting periods. Actual results could differ significantly from those estimates. Significant estimations made by management primarily involve the calculation of

the allowance for loan losses, the carrying amount of deferred tax assets, the assessments for impairment related to goodwill and securities, the estimated fair value of financial instruments and the effectiveness of derivative instruments in offsetting changes in fair value or cash flows of hedged items.

Allowance for loan losses – The allowance for loan losses is established through a provision charged to expense. Loans are charged against the allowance when management believes that the collectability of principal is unlikely. The allowance is an amount that management believes will be adequate to absorb estimated probable losses on existing loans that may become uncollectible, based on evaluations of the collectability of loans and prior loan loss experience. The evaluation includes an assessment of the following factors: any external loan review and any regulatory examination, estimated probable loss exposure on each pool of loans, concentrations of credit, value of collateral, the level of delinquent and nonaccrual loans, trends in the portfolio volume, effects of any changes in the lending policies and procedures, changes in lending personnel, present economic conditions at the local, state and national levels, the amount of undisbursed off-balance sheet commitments, and a migration analysis of historical losses and recoveries for the prior sixteen quarters. Individual loans are also evaluated for impairment and if a portion of a loan is impaired, the impaired amount is charged-off or a specific reserve is allocated for that loan. Various regulatory agencies, as a regular part of their examination process, periodically review the Company’s allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their judgment of information available to them at the time of their examinations. The allowance for loan losses was $16.5 million at both June 30, 2010 and December 31, 2009.

Deferred income taxes – Deferred income tax assets and liabilities represent the tax effects of the differences between the book and tax basis of the various balance sheet assets and liabilities. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. An estimate of probable income tax benefits that will not be realized in future years is required in determining the necessity for a valuation allowance for deferred tax assets. There was no valuation allowance at June 30, 2010 or December 31, 2009. There were net deferred tax assets of $3.8 million at June 30, 2010 and $6.0 million at December 31, 2009.

Derivative instruments and hedging – The Company assesses the effectiveness of derivative instruments designated in cash flow hedging relationships in off-setting changes in the overall cash flows of designated hedged transactions on a quarterly basis. To the extent these instruments are not effective, the unrealized gains or losses on these instruments are reflected directly in current period earnings. In December 2009, the Company purchased a $10.3 million notional forward-starting interest rate cap to limit the variable interest rate payments on the Company’s $10.3 million junior subordinated debentures. The first and second quarter 2010 and fourth quarter 2009 effectiveness assessments indicated that this instrument was effective for those periods.

Assessments of impairment – Goodwill is assessed for impairment on an annual basis or at interim periods if an event occurs or circumstances change which may indicate a change in the implied fair value of the goodwill. The implied fair value of goodwill is estimated by comparing the estimated fair value of the Company to the estimated fair value of the Company’s individual assets, liabilities, and identifiable intangible assets. Impairment exists when the carrying amount of goodwill exceeds this implied fair value. First California uses independent data where possible in determining the fair value of the Company and in determining appropriate market factors used in the fair value calculations. At December 31, 2009, the annual assessment resulted in the conclusion that goodwill was not impaired. At June 30, 2010, an interim assessment was not performed as 2010 year-to-date results were not materially different than the estimates used in the year-end assessment.

An impairment assessment is performed quarterly on the securities available-for-sale portfolio in accordance with Financial Accounting Standards Board, or FASB, accounting standards codification guidance related to the consideration of impairment related to certain debt and equity securities. All of the securities classified as available-for-sale are debt securities.

If the Company does not intend to sell, and it is more likely than not that the Company is not required to sell, a debt security before recovery of its cost basis, other-than-temporary impairment is separated into (a) the amount representing credit loss and (b) the amount related to other factors. The amount of the other-than-temporary impairment related to credit loss is recognized in earnings and other-than-temporary impairment related to other factors is recognized in other comprehensive income (loss). Other-than-temporary declines in fair value are assessed based on the duration the security has been in a continuous unrealized loss position, the severity of the decline in value, the rating of the security, the long-term financial outlook of the issuer, the expected future cash flows from the security and the Company’s ability and intent to hold the security until the fair value recovers. Please see the “Securities” section of Management’s Discussion and Analysis in this document for a detailed explanation of the impairment analysis process. The Company will continue to evaluate the securities portfolio for other-than-temporary impairment at each reporting date and can provide no assurance there will not be an other-than-temporary impairment in future periods.

For 2009, other-than-temporary impairment related to the credit loss on three debt securities and recognized in earnings was $1.1 million. In addition, an impairment of $0.4 million on a $1.0 million community development-related equity investment was recognized in earnings in 2009. There was an additional impairment of

$18,000 recognized in the six months ended June 30, 2010 related to the community development-related equity investment.

NOTE 2 – RECENTLY ISSUED AND ADOPTED ACCOUNTING PRONOUNCEMENTS

Improving Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. In July 2010, the FASB issued guidance requiring more robust and disaggregated disclosures about the credit quality of an entity’s financing receivables and its allowance for credit losses. As a result of this guidance, an entity is required to disaggregate, by portfolio segment or class of financing receivable, certain existing disclosures and provide certain new disclosures about its financing receivables and related allowance for credit losses. The objective of enhancing these disclosures is to improve financial statement users’ understanding of (1) the nature of an entity’s credit risk associated with its financing receivables and (2) the entity’s assessment of that risk in estimating its allowance for credit losses as well as changes in the allowance and the reasons for those changes. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. This guidance will only result in increased financial statement disclosures and will not have an impact on the Company’s results of operations, financial condition, or cash flows.

Effect of a Loan Modification When the Loan is part of a Pool that is Accounted for as a Single Asset. In April 2010, the FASB issued guidance to account for the modification of a loan which is part of an acquired pool that is accounted for as a single asset. This new guidance clarifies that modifications of acquired loans do not result in the removal of those loans from the pool even if the modification would otherwise be considered a troubled debt restructuring. An entity will continue to be required to consider whether the pool of assets in which the loan is included is impaired if expected cash flows for the pool change. The guidance also allows an entity to make a one-time election to prospectively terminate accounting for loans as a pool. An entity shall apply this election on a pool-by-pool basis. In addition, this election does not preclude an entity from accounting for future loan acquisitions as a pooled unit. The new guidance is to be applied prospectively for any modification of a loan (or loans) accounted for within a pool occurring in the first interim or annual period ending on or after July 15, 2010. The Company does not expect the adoption of this guidance to have a material impact on the Company’s results of operations, financial condition, or cash flows.

Fair Value Measurements and Disclosures – Improving Disclosures about Fair Value Measurements. In January 2010, the FASB issued amended guidance for fair value measurement disclosures. The update requires a reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. Furthermore, this update requires a reporting entity to present separately information about purchases, sales, issuances, and settlements in the reconciliation for fair value measurements using significant unobservable inputs; clarifies existing fair value disclosures about the level of disaggregation and about inputs and valuation techniques used to measure fair value; and amends guidance on employers’ disclosures about postretirement benefit plan assets to require that disclosures be provided by classes of assets instead of by major categories of assets. The new guidance is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. In the period of initial adoption, entities will not be required to provide the amended disclosures for any previous periods presented for comparative purposes. The Company adopted this guidance effective January 1, 2010, which resulted in increased financial statement disclosures and did not have any impact on the Company’s financial condition, results of operations, or cash flows.

Accounting for Consolidation of Variable Interest Entities. In June 2009, the FASB issued guidance for amending certain requirements of consolidation of variable interest entities, or VIEs. This guidance is to improve financial reporting by enterprises involved with VIEs and to provide more relevant and reliable information to users of financial statements. This guidance is effective as of the beginning of each reporting entity’s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application was prohibited. The Company evaluated its investments in VIEs held as of January 1, 2010, and determined that consolidation accounting is not required under the new accounting guidance. Therefore, the adoption of this guidance did not have a material impact on the Company’s financial condition, results of operations, or cash flows.

Accounting for Transfers of Financial Assets. In June 2009, the FASB issued guidance intended to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor’s continuing involvement in transferred financial assets. This guidance is effective as of the beginning of each reporting entity’s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application was prohibited. The Company adopted this guidance as of January 1, 2010, and the adoption did not have a material impact on the Company’s financial condition, results of operations, or cash flows.

NOTE 3 – ACQUISITION

On January 23, 2009, or the Transaction Date, the Bank assumed the insured, non-brokered deposits of 1st Centennial Bank from the FDIC, acting in its capacity as receiver of 1st Centennial Bank. Under the terms of the purchase and assumption agreement between the Bank and the FDIC, the Bank also purchased certain assets from the FDIC at the close of the transaction. The Bank paid cash consideration of $48.8 million to the FDIC for the assets acquired and liabilities assumed. The Bank continues to operate the former 1st Centennial Bank's six branch locations as part of the Bank's seventeen branch locations. The Company desired this transaction to enter into new markets and to assume a diversified deposit portfolio with a large percentage of stable core deposits.

Under the acquisition method of accounting, the Bank recorded the assets acquired and liabilities assumed based on their estimated fair values as of the Transaction Date. Results of operations for the six months ended June 30, 2009 include the effects of the assumption of deposits and purchase of assets from the FDIC from the Transaction Date. The excess of the purchase price over the estimated fair values of the underlying assets acquired, the identified intangible assets, and liabilities assumed was allocated to goodwill. Goodwill represents intangible assets that do not qualify for separate recognition.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed as of the Transaction Date.

(Dollars in thousands)	
Assets Acquired:	
Federal Funds sold	$113,090
Securities	88,969
Loans	101,217
Goodwill	10,606
Core deposit intangible	4,755
Other assets	1,365
Total assets acquired	320,002
Liabilities Assumed:	
Deposits	269,688
Other liabilities	1,524
Total liabilities assumed	271,212
Total cash consideration paid to FDIC	$48,790

The Bank based the allocation of the purchase price above on the fair values of the assets acquired and the liabilities assumed. All of the resulting goodwill is expected to be deductible for tax purposes.

The following information presents the pro forma results of operations for the six months ended June 30, 2009, as though the transaction had occurred on January 1, 2009. The pro forma data was derived by combining the historical consolidated financial information of First California and the results of operations from the assets purchased and liabilities assumed from the FDIC using the acquisition method of accounting for business combinations. The pro forma results do not necessarily indicate results that would have been obtained had the transaction actually occurred on January 1, 2009 or the results that may be achieved in the future.

(in thousands, except per share data)	Pro forma Six months ended June 30, 2009	
Net interest income	$	23,173
Noninterest income		4,741
Noninterest expense		23,875
Provision for loan losses		6,179
Loss before provision for income taxes		(2,140)
Income tax benefit		779
Net loss	$	(1,361)
Pro forma loss per common share:		
Basic	$	(0.16)
Diluted	$	(0.16)
Pro forma weighted average shares:		
Basic		11,528

Diluted	11,528

NOTE 4 – SECURITIES

The amortized cost, gross unrealized gains, gross unrealized losses and estimated fair values of securities available-for-sale at June 30, 2010 and December 31, 2009 are summarized as follows:

	June 30, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
U.S. Treasury notes/bills	$ 45,863	$ 66	$ —	$ 45,929
U.S. government agency notes	92,410	345	(20)	92,735
U.S. government agency mortgage-backed securities	54,099	1,209	—	55,308
U.S. government agency collateralized mortgage obligations	57,991	595	(63)	58,523
Private label collateralized mortgage obligations	29,490	36	(4,830)	24,696
Municipal securities	5,933	31	(52)	5,912
Other domestic debt securities	4,801	—	(1,804)	2,997
Securities available-for-sale	$ 290,587	$ 2,282	$ (6,769)	$ 286,100

	December 31, 2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
U.S. Treasury notes/bills	$ 142,617	$ 114	$ (71)	$ 142,660
U.S. government agency notes	77,097	170	(102)	77,165
U.S. government agency mortgage-backed securities	47,034	280	(467)	46,847
U.S. government agency collateralized mortgage obligations	47,028	68	(156)	46,940
Private label collateralized mortgage obligations	32,984	17	(7,456)	25,545
Municipal securities	7,985	98	(55)	8,028
Other domestic debt securities	4,848	—	(2,388)	2,460
Securities available-for-sale	$ 359,593	$ 747	$ (10,695)	$ 349,645

As of June 30, 2010, securities available-for-sale with a fair value of $70.0 million were pledged as collateral for borrowings, public deposits and other purposes as required by various statutes and agreements.

The following table shows the gross unrealized losses and amortized cost of the Company’s securities with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2010 and December 31,

2009. This table excludes the three securities with other-than-temporary impairments at June 30, 2010 and December 31, 2009.

	At June 30, 2010					
	Less Than 12 Months		Greater Than 12 Months		Total	
	Amortized Cost	Unrealized Losses	Amortized Cost	Unrealized Losses	Amortized Cost	Unrealized Losses
	(in thousands)					
U.S. Treasury notes/bills	$ —	$ —	$ —	$ —	$ —	$ —
U.S. government agency notes	17,526	(20)	—	—	17,526	(20)
U.S. government agency mortgage-backed securities	—	—	—	—	—	—
U.S. government agency collateralized mortgage obligations	11,214	(63)	—	—	11,214	(63)
Private-label collateralized mortgage obligations	—	—	14,975	(2,045)	14,975	(2,045)
Municipal securities	3,882	(50)	172	(2)	4,054	(52)
Other domestic debt securities	—	—	4,801	(1,804)	4,801	(1,804)
	$ 32,622	$ (133)	$ 19,948	$ (3,851)	$ 52,570	$ (3,984)

	At December 31, 2009					
	Less Than 12 Months		Greater Than 12 Months		Total	
	Amortized Cost	Unrealized Losses	Amortized Cost	Unrealized Losses	Amortized Cost	Unrealized Losses
	(in thousands)					
U.S. Treasury notes/bills	$ 55,962	$ (71)	$ —	$ —	$ 55,962	$ (71)
U.S. government agency notes	17,613	(102)	—	—	17,613	(102)
U.S. government agency mortgage-backed securities	38,349	(467)	—	—	38,349	(467)
U.S. government agency collateralized mortgage obligations	19,113	(156)	—	—	19,113	(156)
Private-label collateralized mortgage obligations	—	—	17,424	(4,147)	17,424	(4,147)
Municipal securities	4,399	(53)	172	(2)	4,571	(55)
Other domestic debt securities	—	—	4,848	(2,388)	4,848	(2,388)
	$ 135,436	$ (849)	$ 22,444	$ (6,537)	$ 157,880	$ (7,386)

An impairment analysis on our debt and equity securities is performed each quarter by the Company. When the Company does not intend to sell, and it is more-likely-than-not that the Company is not required to sell, a debt security before recovery of its cost basis, the Company separates other-than-temporary impairment into (a) the amount representing credit loss and (b) the amount related to other factors. The Company recognizes in earnings the amount of other-than-temporary impairment related to credit loss. The Company recognizes in other comprehensive income the amount of other-than-temporary impairment related to other factors. The Company's assessment of other-than-temporary declines in fair value considers the duration the debt security has been in a continuous unrealized loss position, the severity of the decline in value, the rating of the debt security, and the long-term financial outlook of the issuer. In addition, the Company considers the expected future cash flows of the debt security and our

ability and intent on holding the debt security until the fair values recover. For 2009, other-than-temporary impairment related to the credit loss on three debt securities and recognized in earnings was $1.1 million. In addition, the Company recognized an impairment of $0.4 million on a $1.0 million community development-related equity investment. There was an additional impairment of $18,000 recognized in the six months ended June 30, 2010 related to the community development-related equity investment.

The Company will continue to evaluate the securities portfolio for other-than-temporary impairment at each reporting date and can provide no assurance there will not be further other-than-temporary impairments in future periods.

The following table presents the other-than-temporary impairment activity related to credit loss, which is recognized in earnings, and the other-than-temporary impairment activity related to all other factors, which are recognized in other comprehensive income.

	Six Months Ended June 30, 2010		
(in thousands)	Impairment Related to Credit Loss	Impairment Related to Other Factors	Total Impairment
Recognized as of beginning of period	$ 1,115	$ —	$ 1,115
Charges on securities for which OTTI was previously recognized	—	—	—
Recognized as of end of period	$ 1,115	$ —	$ 1,115

The amortized cost and estimated fair value of securities by contractual maturities are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	At June 30, 2010	
	Amortized Cost	Fair Value
	(in thousands)	
Due in one year or less	$ 74,414	$ 74,524
Due after one year through five years	60,407	60,672
Due after five years through ten years	17,197	17,187
Due after ten years	138,569	133,717
Total	$ 290,587	$ 286,100

NOTE 5 – LOANS AND ALLOWANCE FOR LOAN LOSSES

The loan portfolio by type consists of the following:

(in thousands)	At June 30, 2010	At December 31, 2009
Commercial mortgage	$ 389,077	$ 381,334
Commercial loans and lines of credit	209,684	235,849
Multifamily mortgage	137,870	138,548
Construction and land development	59,914	86,609
Home mortgage	51,253	51,036
Home equity loans and lines of credit	38,309	40,122
Installment and credit card	5,434	5,748
Total loans	891,541	939,246
Allowance for loan losses	(16,452)	(16,505)
Loans, net	$ 875,089	$ 922,741

At June 30, 2010, loans with a balance of $534.1 million were pledged as security for Federal Home Loan Bank, or FHLB, advances. Loan balances include net deferred fees of $1.2 million and $1.5 million at June 30, 2010 and

December 31, 2009, respectively.

Most of the Company’s lending activity is with customers located in the six Southern California counties where our branches are located. The Company has no significant credit exposure to any individual customer; however, the economic condition in Southern California could adversely affect customers. A significant portion of our loans are collateralized by real estate. Changes in the economic condition in Southern California could adversely affect the value of real estate.

Changes in the allowance for loan losses were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(Dollars in thousands)			
Beginning balance	$15,598	$11,275	$16,505	$8,048
Provision for loan losses	1,766	1,110	3,520	6,179
Loans charged-off	(1,111)	(664)	(3,844)	(2,511)
Recoveries on loans charged-off	199	234	271	239
Ending balance	$16,452	$11,955	$16,452	$11,955
Allowance to gross loans	1.85%	1.27%	1.85%	1.27%

Past due loans and foreclosed assets consist of the following:

(dollars in thousands)	At June 30, 2010	At December 31, 2009
Accruing loans past due 30 - 89 days	$ 1,078	$ 14,592
Accruing loans past due 90 days or more	$ —	$ 200
Nonaccrual loans	$ 13,192	$ 39,958
Foreclosed assets	$ 27,850	$ 4,893

There were $13.2 million and $27.0 million of nonaccrual loans at June 30, 2010 and June 30, 2009, respectively. Had these loans performed according to their original terms, additional interest income of approximately $541,000 and $487,000 would have been recognized in the three months ended June 30, 2010 and 2009, respectively. Had these loans performed according to their original terms, additional interest income of approximately $1,106,000 and $642,000 would have been recognized in the six months ended June 30, 2010 and 2009, respectively.

We had ten restructured loans for $4.2 million at June 30, 2010. Two loans for $1.9 million are reported as current at June 30, 2010. Eight loans for $2.3 million are reported as nonaccrual loans at June 30, 2010. We had one $0.6 million restructured loan which was reported as a nonaccrual loan at December 31, 2009.

The Company considers a loan to be impaired when, based on current information and events, the Company does not expect to be able to collect all amounts due according to the loan contract, including scheduled interest payments. Due to the size and nature of the loan portfolio, impaired loans are determined by periodic evaluation on an individual loan basis. The average balance of impaired loans was $34.0 million for the six months ended June 30, 2010 and $32.1 million for the six months ended June 30, 2009. Impaired loans were $14.4 million at June 30, 2010 and $40.0 million at December 31, 2009. Loan loss allowances for individually impaired loans are computed in accordance with FASB accounting standards related to accounting by creditors for impairment of a loan and are based on either the estimated collateral value less estimated selling costs (if the loan is a collateral-dependent loan), or the present value of expected future cash flows discounted at the loan's effective interest rate. Of the $14.4 million of impaired loans at June 30, 2010, $3.1 million had specific allowances of $1.8 million. Of the $40.0 million of impaired loans at December 31, 2009, $3.5 million had specific allowances of $2.7 million.

NOTE 6 – GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill was $60.7 million at June 30, 2010 and at December 31, 2009. No impairment loss was recognized for the periods ended June 30, 2010 and June 30, 2009.

Core deposit intangibles, net of accumulated amortization, were $8.1 million at June 30, 2010 and $8.7 million at December 31, 2009. Amortization expense for the three months ended June 30, 2010 and 2009 was $317,000 in each period. Amortization expense for the six months ended June 30, 2010 and 2009 was $633,000 and $593,000, respectively.

Trade name intangible, net of accumulated amortization, was $2.7 million at June 30, 2010 and $2.9 million at December 31, 2009. Amortization expense for the three months ended June 30, 2010 and 2009 was $100,000 in each period. Amortization expense for the six months ended June 30, 2010 and 2009 was $200,000 in each period.

NOTE 7 — DERIVATIVES AND HEDGING ACTIVITY

Risk Management Objective of Using Derivatives

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity, and credit risk, primarily by managing the amount, sources, and duration of its assets and liabilities through the use of derivative financial instruments. Specifically, the Company enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company's derivative financial instruments are used to manage differences in the amount, timing, and duration of the Company's known or expected cash receipts and its known or expected cash payments principally related to certain variable-rate loan assets and borrowings. The Company does not use derivatives for trading or speculative purposes and currently does not have any derivatives that are not designated in qualifying hedging relationships.

Fair Values of Derivative Instruments on the Balance Sheet

The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the balance sheets as of June 30, 2010 and December 31, 2009.

Tabular Disclosure of Fair Values of Derivative Instruments

	Asset Derivatives				Liability Derivatives			
	As of June 30, 2010		As of December 31, 2009		As of June 30, 2010		As of December 31, 2009	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments								
Interest Rate Products	Other Assets	$ 47,141	Other Assets	$ 194,680	Other Liabilities	$ —	Other Liabilities	$ —
Total derivatives designated as hedging instruments		$ 47,141		$ 194,680		$ —		$ —

Cash Flow Hedges of Interest Rate Risk

The Company's objectives in using interest rate derivatives are to add stability to interest income and expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps and caps as part of its interest rate risk management strategy. For hedges of the Company's variable-rate loan assets, interest rate swaps designated as cash flow hedges involve the receipt of fixed amounts from a counterparty in exchange for the Company making variable payments over the life of the agreements without exchange of the underlying notional amount. For hedges of the Company's variable-rate borrowings, interest rate caps designated as cash flow hedges involve the receipt of variable amounts from a counterparty if interest rates rise above the strike rate on the contract in exchange for an up-front premium. As of June 30, 2010, and December 31, 2009, the

Company had one interest rate cap with a notional amount of $10.3 million that was designated as a cash flow hedge associated with the Company's variable-rate borrowings. The cap is forward-starting and will become effective December 15, 2010.

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in Other Comprehensive Income and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. During the three and six months ended June 30, 2010, such derivatives were used to hedge the forecasted variable cash outflows associated with subordinated debt related to trust preferred securities. No hedge ineffectiveness was recognized during the three and six months ended June 30, 2010. The Company did not have any outstanding derivatives during the three and six months ended June 30, 2009.

Amounts reported in Other Comprehensive Income related to derivatives will be reclassified to interest expense as interest payments are made on the Company's variable-rate liabilities. During the next twelve months, the Company estimates that an additional $7,560 will be reclassified as an addition to interest expense.

Effect of Derivative Instruments on the Income Statement

The tables below present the effect of the Company's derivative financial instruments on the statements of operations for the three and six months ended June 30, 2010.

	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)		Location of Gain or (Loss) Reclassified from Accumulated	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)		Location of Gain or (Loss) Recognized in	Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	
	Three Months Ended June 30, 2010	Six Months Ended June 30, 2010	OCI into Income (Effective Portion)	Three Months Ended June 30, 2010	Six Months Ended June 30, 2010	Income on Derivative (Ineffective Portion)	Three Months Ended June 30, 2010	Six Months Ended June 30, 2010
Interest Rate Products	$ (34,468)	$ (85,550)	Interest income	$ -	$ -	Other non-interest income	$ -	$ -
Total	$ (34,468)	$ (85,550)		$ -	$ -		$ -	$ -

Credit-risk-related Contingent Features

The terms of the one outstanding interest rate cap at June 30, 2010 does not contain any credit-risk-related contingent features. Therefore, consideration of the counterparty's credit risk is not applicable.

The Company has no derivatives payable, so consideration of the Company's own credit risk is not applicable.

NOTE 8 – EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share, or EPS, excludes dilution and is computed by dividing income (loss) available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if common shares were issued pursuant to the exercise of common stock options under the Company's stock option plans and if common shares were issued from the conversion of the convertible preferred stock.

The following table illustrates the computations of basic and diluted EPS for the periods indicated:

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009

(in thousands, except per share data)	Diluted	Basic	Diluted	Basic	Diluted	Basic	Diluted	Basic
Net income (loss) as reported	$147	$147	$217	$217	$264	$264	$(1,661)	$(1,661)
Less preferred stock dividend declared	(313)	(313)	(313)	(313)	(625)	(625)	(507)	(507)
Loss available to common shareholders	$(166)	$(166)	$(96)	$(96)	$(361)	$(361)	$(2,168)	$(2,168)
Weighted average common shares outstanding (1)	28,182	28,182	11,633	11,633	20,588	20,588	11,581	11,581
Earnings (loss) per common share	$(0.01)	$(0.01)	$(0.01)	$(0.01)	$(0.02)	$(0.02)	$(0.19)	$(0.19)

(1) In accordance with FASB accounting standards related to earnings per share, due to the net loss for the periods presented, the impact of securities convertible to common stock is not included as its effect would be anti-dilutive. These securities include convertible preferred stock, restricted stock and warrants to acquire common stock. The dilutive calculation excludes 323,115 and 343,449 weighted average shares for the three months ended June 30, 2010 and 2009, respectively. The dilutive calculation excludes 321,238 and 335,994 weighted average shares for the six months ended June 30, 2010 and 2009, respectively.

The increase in weighted average common shares outstanding for the 2010 periods compared to prior periods was the result of the Company's consummation of an underwritten public offering of common stock at a price of $2.50 per share in March 2010. The Company sold 16,560,000 common shares, which include the exercise by the underwriter of its over-allotment option, for gross proceeds of $41.4 million. The Company contributed $36.0 million to our bank subsidiary. The Company intends to use the net proceeds of this public offering for general corporate purposes, including funding working capital requirements, supporting the growth of our business from internal efforts and from whole bank or failed bank acquisitions, and regulatory capital needs related to any such growth and acquisitions.

NOTE 9 – COMPREHENSIVE INCOME

Other comprehensive income is the change in equity during a period from transactions and other events and circumstances from non-owner sources. Total comprehensive income was as follows:

	Three months ended June 30,		Six months ended June 30,	
(dollars in thousands)	2010	2009	2010	2009
Other comprehensive income:				
Unrealized loss on interest rate cap	$ (59)	$ —	$ (148)	$ —
Unrealized gain on securities available-for-sale	2,758	3,264	5,461	4,559
Reclassification adjustment for gains included in net income (loss)	(130)	(2,000)	(262)	(2,671)
Other comprehensive income, before tax	2,569	1,264	5,051	1,888
Income tax expense related to items of other comprehensive income	(1,135)	(532)	(2,235)	(65)
Other comprehensive income	1,434	732	2,816	1,823
Net income (loss)	147	217	264	(1,661)
Comprehensive income	$ 1,581	$ 949	$ 3,080	$ 162

NOTE 10 – FAIR VALUE MEASUREMENT

The FASB accounting standards codification related to fair value measurements defines fair value, establishes a framework for measuring fair value including a three-level valuation hierarchy, and expands disclosures about fair value measurement. This standard applies to all financial assets and liabilities that are being measured and reported at fair value on a recurring and non-recurring basis.

As defined in the FASB accounting standards codification, fair value is the exchange price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date reflecting assumptions that a market participant would use when pricing an asset or liability. The following table presents information about the Company's assets and liabilities measured at fair value on a recurring and non-recurring basis as of June 30, 2010.The hierarchy uses three levels of inputs to measure the fair value of assets and liabilities as follows:

- Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2: Observable inputs other than Level 1, including quoted prices for similar assets and liabilities in active markets; quoted prices in less active markets, or other observable inputs that can be corroborated by observable

market data, either directly or indirectly, for substantially the full term of the financial instrument. This category generally includes available-for-sale securities which are regularly priced in an active market.

- Level 3: Inputs to a valuation methodology that are unobservable, supported by little or no market activity, and significant to the fair value measurement. These valuation methodologies generally include pricing models, discounted cash flow models, or a determination of fair value that requires significant management judgment or estimation. This category also includes observable inputs from a pricing service not corroborated by observable market data.

The Company uses fair value to measure certain assets, primarily securities available-for-sale, on a recurring basis when fair value is the primary measure for accounting. Fair value is used on a nonrecurring basis to measure certain assets when applying lower of cost or market accounting or when adjusting carrying values, such as for loans held-for-sale, collateral dependent impaired loans, and foreclosed property. Fair value is also used when evaluating impairment on certain assets, including securities, goodwill, core deposit and other intangibles, for valuing assets and liabilities acquired in a business combination and for disclosures of financial instruments as required by the FASB accounting standards codification related to fair value disclosure reporting.

The following tables present information on the assets measured and recorded at fair value on a recurring and nonrecurring basis at June 30, 2010.

	Fair value at June 30, 2010	Financial Assets Measured at Fair Value on a Recurring Basis at June 30, 2010, Using		
		Quoted prices in active markets for identical assets (Level 1)	Other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	(in thousands)			
Available-for-sale securities	$ 286,100	$ —	$ 286,100	$ —
Total assets measured at fair value	$ 286,100	$ —	$ 286,100	$ —

	Fair value at June 30, 2010	Financial Assets Measured at Fair Value on a Non-Recurring Basis at June 30, 2010, Using			
		Quoted prices in active markets for identical assets (Level 1)	Other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total gains (losses)
	(in thousands)				
Impaired loans	$ 1,352	$ —	$ —	$ 1,352	$ (382)
Foreclosed property	27,850	—	—	27,850	554
Total assets measured at fair value	$ 29,202	$ —	$ —	$ 29,202	$ 172

There were no significant transfers of assets into or out of Level 1, Level 2 or Level 3 of the fair value hierarchy during the quarter ended June 30, 2010. There have been no changes in valuation techniques for the quarter ended June 30, 2010 and such techniques are consistent with techniques used in prior periods.

The following methods were used to estimate the fair value of each class of financial instrument above:

Available-for-sale securities – Fair values for securities are based on quoted market prices of identical securities, where available (Level 1). When quoted prices of identical securities are not available, the fair value estimate is based on quoted market prices of similar securities, adjusted for differences between the securities (Level 2). Adjustments may include amounts to reflect differences in underlying collateral, interest rates, estimated prepayment speeds, and counterparty credit quality. In determining the fair value of the securities categorized as Level 2, the Company obtains a report from a nationally recognized broker-dealer detailing the fair value of each security in our portfolio as of each reporting date. The broker-dealer uses observable market information to value our securities, with the primary source

being a nationally recognized pricing service. The Company reviews the market prices provided by the broker-dealer for our securities for reasonableness based upon our understanding of the marketplace and we consider any credit issues related to the bonds. As the Company has not made any adjustments to the market quotes provided to us and they are based on observable market data, they have been categorized as Level 2 within the fair value hierarchy.

Impaired loans – Impaired loans are measured and recorded at the fair value of the loan's collateral on a nonrecurring basis as the impaired loans shown are collateral dependent. The fair value of each loan's collateral is generally based on estimated market prices from an independently prepared appraisal, which is then adjusted for the estimated cost related to liquidating such collateral; such valuation inputs result in a nonrecurring fair value measurement that is categorized as a Level 3 measurement.

Foreclosed property – Foreclosed property is initially measured at fair value at acquisition and carried at the lower of this new cost or fair value on a nonrecurring basis. The foreclosed property shown is collateral dependent and, accordingly, is measured based on the fair value of such collateral. The fair value of collateral is generally based on estimated market prices from an independently prepared appraisal, which is then adjusted for the estimated cost related to liquidating such collateral; such valuation inputs result in a nonrecurring fair value measurement that is categorized as a Level 3 measurement.

The FASB accounting standards codification requires that the Company disclose estimated fair values for its financial instruments during annual and interim reporting periods. Fair value estimates, methods and assumptions, set forth below for our financial instruments, are made solely to comply with the requirements of the disclosures regarding fair value of financial instruments. The following describes the methods and assumptions used in estimating the fair values of financial instruments, excluding financial instruments already recorded at fair value as described above.

Cash and cash equivalents – The carrying amounts of cash and interest bearing deposits at other banks is assumed to be the fair value given the liquidity and short-term nature of these deposits.

Loans – Loans are not measured at fair value on a recurring basis. Therefore, the following valuation discussion relates to estimating the fair value to be disclosed under fair value disclosure requirements. Loans were divided into three major groups. The loan groups included (1) loans that mature or re-price in three months or less, (2) loans that amortize or mature in more than three months, and (3) impaired loans. We estimated the fair value of impaired loans and loans that mature or re-price within three months at their carrying value. We used discounted cash flow methodology to estimate the fair value of loans that amortize or mature in more than three months. We developed pools of these loans based on similar characteristics such as underlying type of collateral, fixed or adjustable rate of interest, payment or amortization method, credit risk categories and other factors. We projected monthly principal and interest cash flows based on the contractual terms of the loan, adjusted for assumed prepayments and defaults, and discounted these at a rate that considered funding costs, a market participant’s required rate of return and adjusted for servicing costs and a liquidity discount. Loans are not normally purchased and sold by the Company, and there are no active trading markets for much of this portfolio.

Deposits – The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The carrying amounts of variable-rate money market accounts and fixed-term certificates of deposit (CDs) approximate their fair values at the reporting date. Fair values for fixed-rate CDs are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Federal Home Loan Bank advances and other borrowings – The fair value of the FHLB advances and other borrowings is estimated using a discounted cash flow analysis based on the Company’s current incremental borrowing rates for similar types of borrowing arrangements.

Junior subordinated debentures – The fair value of the debentures is estimated using a discounted cash flow analysis based on current incremental borrowing rates for similar types of borrowing arrangements.

Off-balance sheet instruments – Off-balance sheet instruments include unfunded commitments to extend credit and standby letters of credit. The fair value of these instruments is not considered practicable to estimate because of the lack of quoted market prices and the inability to estimate fair value without incurring excessive costs.

The following table estimates fair values and the related carrying amounts of the Company’s financial instruments:

	At June 30, 2010	
(in thousands)	Carrying Amount	Estimated Fair Value
Financial assets:		
Cash, due from banks and interest bearing deposits with other banks	$ 131,517	$ 131,517
Securities available-for-sale	286,100	286,100
FHLB and other stock	9,177	9,177

Loans	891,541	753,704
Interest rate cap	47	47
Financial liabilities:		
Demand deposits, money market and savings	$ 784,895	$ 784,895
Time certificates of deposit	307,562	308,116
FHLB advances and other borrowings	128,750	134,190
Junior subordinated debentures	26,779	16,485

These fair value disclosures represent the Company's best estimates based on relevant market information and information about the financial instruments. Fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of the various instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in the above methodologies and assumptions could significantly affect the estimates.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

This discussion contains certain forward-looking statements about us; we intend these statements to fall under the safe harbor for "forward-looking statements" provided by the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact are forward-looking statements. Such statements involve inherent risks and uncertainties, many of which are difficult to predict and are generally beyond our control. We caution readers that a number of important factors could cause actual results to differ materially from those expressed in, implied or projected by, such forward-looking statements. Risks and uncertainties include, but are not limited to:

- revenues are lower than expected;
- credit quality deterioration, which could cause an increase in the provision for loan losses;
- competitive pressure among depository institutions increases significantly;
- changes in consumer spending, borrowings and savings habits;
- our ability to successfully integrate acquired entities or to achieve expected synergies and operating efficiencies within expected time-frames or at all;
- technological changes;
- the cost of additional capital is more than expected;
- a change in the interest rate environment reduces interest margins;
- asset/liability repricing risks and liquidity risks;
- general economic conditions, particularly those affecting real estate values, either nationally or in the market areas in which we do or anticipate doing business are less favorable than expected;
- legislative, accounting or regulatory requirements or changes adversely affecting our business;
- the effects of and changes in monetary and fiscal policies and laws, including the interest rate policies of the Board of Governors of the Federal Reserve, or the Federal Reserve Board;
- recent volatility in the credit or equity markets and its effect on the general economy;
- regulatory approvals for acquisitions cannot be obtained on the terms expected or on the anticipated schedule; and
- demand for the products or services of First California and the Bank, as well as their ability to attract and retain qualified people.

If any of these risks or uncertainties materializes, or if any of the assumptions underlying such forward-looking statements proves to be incorrect, our results could differ materially from those expressed in, implied or projected by, such forward-looking statements. For information with respect to factors that could cause actual results to differ from the expectations stated in the forward-looking statements, see “Risk Factors” under Part I, Item 1A in our 2009 Annual Report on Form 10-K and under Part II, Item 1A of this Quarterly Report on Form 10-Q. We urge investors to consider all of these factors carefully in evaluating the forward-looking statements contained in this Quarterly Report on Form 10-Q. We make these forward-looking statements as of the date of this document and we do not intend, and assume no obligation, to update the forward-looking statements or to update the reasons why actual results could differ from those expressed in, or implied or projected by, the forward-looking statements. All forward-looking statements contained in this document and all subsequent written and oral forward-looking statements attributable to us or any other person acting on our behalf, are expressly qualified by these cautionary statements.

Overview

First California Financial Group, Inc., or First California, or the Company, is a bank holding company which serves the comprehensive banking needs of businesses and consumers in Los Angeles, Orange, Riverside, San Bernardino, San Diego and Ventura counties through our wholly-owned subsidiary, First California Bank, or the Bank. The Bank is a state chartered commercial bank that provides traditional business and consumer banking products through 17 full-service branch locations. The Company also has two unconsolidated statutory business trust subsidiaries, First California Capital Trust I and FCB Statutory Trust I, which raised capital through the issuance of trust preferred securities.

At June 30, 2010, we had consolidated total assets of $1.5 billion, total loans of $891.5 million, deposits of $1.1 billion and shareholders’ equity of $198.4 million. At December 31, 2009, we had consolidated total assets of $1.5 billion, total loans of $939.2 million, deposits of $1.1 billion and shareholders’ equity of $157.2 million.

For the second quarter of 2010, we had net income of $0.1 million, compared with net income of $0.2 million for the second quarter of 2009. Our net income for the first six months of 2010 was $0.3 million, compared with a loss of $1.7 million for the first six months of 2009. The net loss for the first six months of 2009 was due largely to the $6.2 million provision for loan losses.

After dividend payments on our Series B preferred shares of $312,500 in the second quarter of 2010 and 2009, we incurred a loss per diluted common share of $0.01 for both the 2010 and 2009 second quarters. Our net loss for the first six months of 2010, after Series B preferred share dividends of $625,000, was $0.02 per diluted common share. Our net loss for the first six months of 2009, after Series B preferred dividends of $507,000, was $0.19 per diluted common share.

Critical accounting policies

We base our discussion and analysis of our consolidated results of operations and financial condition on our unaudited consolidated interim financial statements and our audited consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, income and expense, and the related disclosures of contingent assets and liabilities at the date of these consolidated financial statements. We believe these estimates and assumptions to be reasonably accurate; however, actual results may differ from these estimates under different assumptions or circumstances. The following are our critical accounting policies and estimates.

Allowance for loan losses

We establish the allowance for loan losses through a provision charged to expense. We charge-off loan losses against the allowance when we believe that the collectability of the loan is unlikely. We perform periodic and systematic detailed reviews of the loan portfolio to identify trends and to assess the overall collectability of the loan portfolio. The allowance is an amount that we believe will be adequate to absorb estimated probable losses on existing loans that may become uncollectible, based on evaluations of the collectability of loans and prior loan loss experience. We believe the accounting estimate related to the allowance for loan losses is a "critical accounting estimate" because: changes in it can materially affect the provision for loan losses and net income, it requires management to predict borrowers' likelihood or capacity to repay, and it requires management to distinguish between losses incurred as of a balance sheet date and losses expected to be incurred in the future. Accordingly, this is a highly subjective process and requires significant judgment since it is often difficult to determine when specific loss events may actually occur. Our evaluation includes an assessment of the following factors: any external loan review and any regulatory examination, estimated probable loss exposure on each pool of loans, concentrations of credit, value of collateral, the level of delinquent and nonaccrual loans, trends in the portfolio volume, effects of any changes in the lending policies and procedures, changes in lending personnel, present economic conditions at the local, state and national levels, the amount of undisbursed off-balance sheet commitments, and a migration analysis of historical losses and recoveries for the prior sixteen quarters. We also evaluate individual loans for impairment and if a portion of a loan is impaired, we charge-off the impaired amount or allocate a specific reserve for that loan. Various regulatory agencies, as a regular part of their examination process, periodically review our allowance for loan losses. Such agencies may require us to recognize additions to the allowance based on their judgment of information available to them at the time of their examinations. The allowance for loan losses was $16.5 million at both June 30, 2010 and December 31, 2009.

Deferred income taxes

We recognize deferred tax assets subject to our judgment that realization of the assets are more-likely-than-not. We establish a valuation allowance when we determine that realization of income tax benefits may not occur in future years. There were net deferred tax assets of $3.8 million at June 30, 2010 and $6.0 million at December 31, 2009. There was no valuation allowance at either period end.

Derivative instruments and hedging

We record all derivatives on the balance sheet at fair value. For derivative instruments designated in cash flow hedging relationships, we assess the effectiveness of the instruments in offsetting changes in the overall cash flows of designated hedged transactions on a quarterly basis. We recognize the unrealized gains or losses directly in current period earnings to the extent these instruments are not effective. In December 2009, we purchased a $10.3 million notional forward-starting interest rate cap to limit the variable interest rate payments on our $10.3 million junior subordinated debentures. Our first and second quarter 2010 and fourth quarter 2009 effectiveness assessments indicated that this instrument was effective for those periods.

Assessments of impairment

We assess goodwill for impairment on an annual basis as of December 31, or at interim periods if an event occurs or circumstances change which may indicate a change in the implied fair value of the goodwill. We estimate the implied fair value of goodwill by comparing the estimated fair value of the Company to the estimated fair value of the Company’s individual assets, liabilities, and identifiable intangible assets. Impairment exists when the carrying amount of goodwill exceeds this implied fair value. Based on the results of our assessment, we concluded that the fair value of goodwill was greater than our carrying value and that no goodwill impairment existed at December 31, 2009. At June 30, 2010, we did not perform an interim assessment because results for the first half of 2010 were not materially different from the estimates used in our year-end assessment.

We also undertake an impairment analysis on our debt and equity securities each quarter. When we do not intend to sell, and it is more likely than not that we are not required to sell, a debt security before recovery of its cost basis, we separate other-than-temporary impairment into (a) the amount representing credit loss and (b) the amount related to other factors. We recognize in earnings the amount of the other-than-temporary impairment related to credit loss. We recognize in other comprehensive income the amount of other-than-temporary impairment related to other factors. Our assessment of other-than-temporary declines in fair value considers the duration the security has been in a continuous unrealized loss position, the severity of the decline in value, the rating of the security, and the long-term financial outlook of the issuer. In addition, we consider the expected future cash flows from the security and our ability and intent to hold the security until the fair value recovers.

For 2009, other-than-temporary impairment related to the credit loss on three debt securities and recognized in earnings was $1.1 million. In addition, we recognized an impairment loss of $0.4 million on a $1.0 million community development-related equity investment in our 2009 earnings. We recognized an additional impairment loss of $18,000 on this community development-related equity investment in the first quarter of 2010.

Results of operations – for the three and six months ended June 30, 2010 and 2009

Net interest income

Our earnings are derived predominantly from net interest income, which is the difference between interest and fees earned on loans, securities and federal funds sold (these asset classes are commonly referred to as interest-earning assets) and the interest paid on deposits, borrowings and debentures (these liability classes are commonly referred to as interest-bearing funds). The net interest margin is net interest income divided by average interest-earning assets.

Our net interest income for the three months ended June 30, 2010 declined to $10.8 million from $11.9 million for the same period last year. For the first six months of 2010, our net interest income declined to $21.5 million from $22.6 million for the same period a year ago. The decline in net interest income for both periods principally reflects the decline in interest income from securities. Interest income for the 2010 second quarter was $14.4 million, down $2.7 million from the 2009 second quarter. The decline in interest income was due to lower yielding securities. Interest expense for the 2010 second quarter was $3.6 million, down $1.6 million from the 2009 second quarter. The decrease in interest expense was due to lower rates paid on interest-bearing deposits. For the first half of 2010, interest income was $29.0 million, down $4.1 million from the same period last year. The decline in interest income was again due to lower yielding securities. Interest expense for the first half of 2010 was $7.5 million, down $3.1 million from the same period a year ago. The decline in interest expense was again due to lower rates paid on interest-bearing deposits.

Our net interest margin (tax equivalent) for the second quarter of 2010 was 3.40 percent compared with 3.75 percent for the same quarter last year. For the first half of 2010, our net interest margin was 3.39 percent compared with 3.66 percent for the first half of 2009. The decline in our net interest margin was primarily due to lower yields on our securities and reflects the shift in the composition of our securities to lower yielding, shorter-term securities. The yield on interest-earning assets for the second quarter of 2010 was 4.77 percent, down 57 basis points from 5.34 percent for the second quarter a year ago. The reduction in the cost of our interest-bearing liabilities, which equaled 1.56 percent for the 2010 second quarter, down 53 basis points from 2.09 percent for the second quarter a year ago, partially offset that decline. The yield on interest-earning assets for the six months ended June 30, 2010 was 4.57 percent compared with 5.34 percent for the same period last year. Partially offsetting that decline was the decline in the cost of our interest-bearing liabilities. The rate paid on interest-bearing liabilities fell to 1.61 percent for the first half of 2010 compared with 2.19 percent for the same period last year.

The following table presents the distribution of our average assets, liabilities and shareholders' equity in combination with the total dollar amounts of interest income from average interest earning assets and the resultant yields, and the dollar amounts of interest expense and average interest bearing liabilities, expressed in both dollars and rates for the three and six months ended June 30, 2010 and 2009.

Average Balance Sheet and Analysis of Net Interest Income

	Three months ended June 30,					
	2010			2009		
(dollars in thousands)	Average Balance	Interest Income/ Expense	Weighted Average Yield/Rate	Average Balance	Interest Income/ Expense	Weighted Average Yield/Rate
Loans1	$ 913,251	$ 12,819	5.63 %	$ 929,027	$ 13,386	5.78%
Securities	278,395	1,508	2.22%	276,072	3,431	5.30%
Federal funds sold and deposits with banks	86,380	59	0.27%	92,042	235	1.02%
Total earning assets	1,278,026	$ 14,386	4.77%	1,297,141	$ 17,052	5.34%
Non-earning assets	155,955			153,751		
Total average assets	$ 1,433,981			$ 1,450,892		
Interest bearing checking	$ 82,043	$ 67	0.33%	$ 75,797	$ 57	0.30%
Savings and money market	360,668	866	0.96%	258,452	720	1.12%
Certificates of deposit	316,472	951	1.21%	467,460	2,437	2.09%
Total interest bearing deposits	759,183	1,884	1.00%	801,709	3,214	1.61%
Borrowings	130,698	1,257	3.86%	158,706	1,502	3.80%
Junior subordinated debentures	26,772	439	6.56%	26,716	439	6.59%
Total borrowed funds	157,470	1,696	4.30%	185,422	1,941	4.20%
Total interest bearing funds	916,653	$ 3,580	1.56%	987,131	$ 5,155	2.09%

Noninterest checking	310,943		290,660	
Other liabilities	8,784		12,785	
Shareholders’ equity	197,601		160,316	
Total liabilities and shareholders’ equity	$ 1,433,981		$ 1,450,892	
Net interest income		$ 10,806		$ 11,897
Net interest margin (tax equivalent) 2		3.40%		3.75%

	Six months ended June 30,					
		2010			2009	
(dollars in thousands)	Average Balance	Interest Income/ Expense	Weighted Average Yield/Rate	Average Balance	Interest Income/ Expense	Weighted Average Yield/Rate
Loans1	$ 921,408	$ 25,806	5.65%	$ 901,773	$ 25,813	5.77%
Securities	309,967	3,097	2.05%	278,686	7,028	5.33%
Federal funds sold and deposits with banks	48,976	79	0.32%	81,490	290	0.72%
Total earning assets	1,280,351	$ 28,982	4.57%	1,261,949	$ 33,131	5.34%
Non-earning assets	156,207			155,994		
Total average assets	$ 1,436,558			$ 1,417,943		
Interest bearing checking	$ 80,859	$ 130	0.32%	$ 75,358	$ 103	0.28%
Savings and money market	354,212	1,783	0.82%	238,829	1,239	1.05%
Certificates of deposit	339,574	2,143	1.27%	469,350	5,239	2.25%
Total interest bearing deposits	774,645	4,056	1.06%	783,537	6,581	1.69%
Borrowings	136,981	2,569	3.78%	161,787	3,057	3.81%
Junior subordinated debentures	26,766	878	6.56%	26,714	926	6.99%
Total borrowed funds	163,747	3,447	4.22%	188,501	3,983	4.26%
Total interest bearing funds	938,392	$ 7,503	1.61%	972,038	$ 10,564	2.19%
Noninterest checking	308,014			272,199		
Other liabilities	9,428			13,496		
Shareholders' equity	180,724			160,210		
Total liabilities and shareholders' equity	$ 1,436,558			$ 1,417,943		
Net interest income		$ 21,479			$ 22,567	
Net interest margin (tax equivalent) 2			3.39%			3.66%

1 Yields and amounts earned on loans include loan fees of $-0.2 million and $0.1 million for the three months ended June 30, 2010 and 2009, respectively, and $-0.4 million and $0.1 million for the six months ended June 30, 2010 and 2009, respectively. The average loan balance includes loans held-for-sale and nonaccrual loans; however, there is no interest income related to nonaccrual loans in the amount earned on loans.

2 Includes tax equivalent adjustments primarily related to tax-exempt income on securities.

Our net interest income changes with the level and mix of average interest-earning assets and average interest-bearing funds. We call the changes between periods in interest-earning assets and interest-bearing funds balance changes. We measure the effect on our net interest income from balance changes by multiplying the change in the average balance between the current period and the prior period by the prior period average rate.

Our net interest income also changes with the average rate earned or paid on interest-earning assets and interest-bearing funds. We call the changes between periods in average rates earned and paid rate changes. We measure the effect on our net interest income from rate changes by multiplying the change in average rates earned or paid between the current period and the prior period by the prior period average balance.

We allocate the change in our net interest income attributable to both balance and rate on a pro rata basis to the change in average balance and the change in average rate. The following table presents the change in our interest income and interest expense.

Increase (Decrease) in Net Interest Income/Expense Due to Change in Average Volume and Average Rate (1)

	Three months ended June 30, 2010 to 2009 due to:		
(in thousands)	Rate	Volume	Total
Interest income			
Interest on loans	$(340)	$(227)	$(567)
Interest on securities	(1,952)	29	(1,923)
Interest on Federal funds sold and deposits with banks	(162)	(14)	(176)
Total interest income	(2,454)	(212)	(2,666)
Interest expense			
Interest on deposits	1,160	170	1,330
Interest on borrowings	(20)	265	245
Interest on junior subordinated debentures	—	—	—
Total interest expense	1,140	435	1,575
Net interest income	$(1,314)	$223	$(1,091)

	Six months ended June 30, 2010 to 2009 due to:		
(in thousands)	Rate	Volume	Total
Interest income			
Interest on loans	$(569)	$562	$(7)
Interest on securities	(4,720)	789	(3,931)
Interest on Federal funds sold and deposits with banks	(96)	(115)	(211)
Total interest income	(5,385)	1,236	(4,149)
Interest expense			
Interest on deposits	2,450	75	2,525
Interest on borrowings	(22)	510	488
Interest on junior subordinated debentures	50	(2)	48
Total interest expense	2,478	583	3,061
Net interest income	$(2,907)	$1,819	$(1,088)

(1) The change in interest income or interest expense that is attributable to both changes in average balance and average rate has been allocated to the changes due to (i) average balance and (ii) average rate in proportion to the relationship of the absolute amounts of changes in each.

(2) Tables do not include interest income that would have been earned on nonaccrual loans.

Provision for loan losses

The provision for loan losses was $1.8 million for the three months ended June 30, 2010 compared with $1.1 million for the three months ended June 30, 2009. For the first six months of 2010, the provision for loan losses was $3.5 million compared with $6.2 million for the same period last year. We revised upward in the second quarter of 2010 and in the first quarter of 2009, our estimated loss factors for the qualitative considerations used in the determination of the adequacy of our allowance for loan losses. The change in our estimated loss factors for the 2010 period was less than the change for the 2009 period; however, the changes resulted in a higher ratio of the allowance for loan losses to loans. At June 30, 2010, the ratio of the allowance for loan losses to loans was 1.85 percent compared with 1.76 percent at December 31, 2009. A year ago, the ratio of the allowance for loan losses to loans was 1.27 percent at June 30, 2009 compared with 1.02 percent at December 31, 2008.

Noninterest income

Noninterest income was $2.0 million for the 2010 second quarter compared with $2.7 million for the same period a year ago. Noninterest income was $3.1 million for the first six months of 2010 compared with $4.7 million for the same period last year. The decline in each instance reflects principally a smaller amount of securities gains period to period offset by a market gain on foreclosed assets in the 2010 second quarter and higher impairment losses on securities in the 2009 second quarter.

The following table presents a summary of noninterest income:

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
	(in thousands)			
Service charges on deposit accounts and other banking-related fees	$973	$1,038	$1,903	$2,088
Earnings on cash surrender value of life insurance	109	109	220	216
Commissions on brokered loans	—	44	16	53
Net gain on sale of securities	130	2,000	262	2,671
Impairment loss on securities	—	(565)	(18)	(565)
Gain on transfer of foreclosed assets	691	—	691	—
Other income	51	113	73	191
Total noninterest income	$1,954	$2,739	$3,147	$4,654

Our service charges on deposit accounts for the three months ended both June 30, 2010 and 2009 were $1.0 million. Service charges on deposit accounts for the six months ended June 30, 2010 were $1.9 million, down from the $2.1 million in the six months ended June 30, 2009. The decrease reflects a lower incidence of customers drawing checks against their deposit account when insufficient funds are on deposit.

During the first six months of 2010 and 2009, we did not sell any loans. However, we brokered loans for commissions of $16,000 for the first six months of 2010 compared with $53,000 for the first six months of 2009.

We also recognized in noninterest income an impairment loss of $18,000 on a $1.0 million community development-related equity investment in the first quarter of 2010. A year ago, we recognized other-than-temporary impairment losses on securities of $565,000 in the second quarter of 2009. We will continue to evaluate our securities portfolio for other-than-temporary impairment at each reporting date and we can provide no assurance there will not be other impairment losses in future periods.

In the 2010 second quarter we completed the foreclosure on a $21.0 million completed office construction project. This project consists of 20 completed units ranging from approximately 1,650 square feet to 14,600 square feet in size. We obtained a current appraisal, evaluated the estimated retail sales prices as well as the estimated costs to sell and determined the fair value of this project to be $21.7 million. Accordingly, for the 2010 second quarter, we recognized a market value gain of $691,000. Subsequent to June 30, 2010, one unit of approximately 4,100 square feet was sold resulting in net proceeds of approximately $1.0 million.

In the second quarter of 2010, we sold $44.5 million of securities and realized net gains of $130,000. For the second quarter of 2009 we sold $51.2 million of securities and realized net gains of $2.0 million. In the first six months of 2010, we sold $79.9 million of securities and realized net gains of $262,000. For the first six months of 2009, we sold $68.4 million of securities and realized net gains of $2.7 million.

Noninterest expense

Our noninterest expense for the three months ended June 30, 2010 was $10.8 million, down 17 percent from $12.9 million for the three months ended June 30, 2009. For the first half of 2010, noninterest expense was $20.7 million, down 13 percent from $23.7 million for the same period last year. The decline in noninterest expense reflects the

workforce reduction effected in the 2009 third quarter. In addition, in the first half of 2009, we incurred costs associated with the FDIC-assisted 1st Centennial Bank transaction. Noninterest expense for the three and six months ended June 30, 2009 included integration and conversion expenses related to the FDIC-assisted 1st Centennial Bank transaction of approximately $250,000 and $723,000, respectively.

The following table presents a summary of noninterest expense:

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
	(in thousands)			
Salaries and employee benefits	$4,889	$5,363	$9,859	$11,021
Premises and equipment	1,517	1,780	3,054	3,313
Data processing	597	479	1,192	950
Legal, audit, and other professional services	590	597	772	1,217
Printing, stationery, and supplies	113	211	125	403
Telephone	213	264	437	527
Directors' expense	113	141	233	256
Advertising, marketing and business development	286	443	513	899
Postage	47	96	103	151
Insurance and regulatory assessments	780	1,346	1,580	1,655
Loss on and expense of foreclosed property	468	249	546	249
Amortization of intangible assets	417	417	833	793
Market loss on loans held-for-sale	—	709	—	709
Other expenses	721	781	1,420	1,510
Total noninterest expense	$10,751	$12,876	$20,667	$23,653

Salaries and benefits fell 9 percent to $4.9 million for the 2010 second quarter from $5.4 million for the same period last year. For the first half of 2010, salaries and benefits declined 11 percent to $9.9 million from $11.0 million. The decline reflects the 2009 third quarter workforce reduction and the completion of the integration and conversion effort related to the FDIC-assisted 1st Centennial Bank transaction. Our workforce declined approximately 10 percent to 245 full-time equivalent employees at June 30, 2010 from 273 a year ago.

The FDIC charges all financial institutions for deposit insurance. The 2009 second quarter included a $675,000 special assessment the FDIC charged all institutions. In addition, the FDIC increased regular insurance assessments. With a larger deposit base and increased premiums, our regular FDIC insurance expense for the first half of 2010 was $1.3 million compared with $0.7 million for the same period last year.

In the second quarter of 2009, we determined not to pursue the sale of $31.2 million of loans previously classified held-for-sale and returned these performing, multi-family loans to our regular portfolio. As such, we recognized a market loss of $709,000 to write down these loans to the lower of cost or market value.

We acquired real estate through three foreclosures and sold previously foreclosed upon real estate in the quarter ended June 30, 2010. The cost of foreclosed real estate and the loss on sale of foreclosed real estate was $468,000 for the second quarter of 2010 compared with $249,000 for the second quarter of 2009.

Our efficiency ratio was 82 percent for the second quarter of 2010 compared with 99 percent for the second quarter of 2009. Our efficiency ratio for the first half of 2010 was 81 percent compared with 93 percent for the same period last year. The efficiency ratio is the percentage relationship of noninterest expense, excluding amortization of intangibles, to the sum of net interest income and noninterest income, excluding gains or losses on security sales. The improvement in the efficiency ratio for the second quarter of 2010 as compared to the second quarter of 2009 was due primarily to lower noninterest expense.

Income taxes

The income tax provision was $0.2 million for the six months ended June 30, 2010 compared with an income tax benefit of $1.0 million for the same period in 2009. The combined federal and state effective tax rate for the six months ended June 30, 2010 was 39.9 percent compared with 36.4 percent for the same period in 2009.

Financial position – June 30, 2010 compared with December 31, 2009

Lending and credit risk

We provide a variety of loan and credit-related products and services to meet the needs of borrowers primarily located in the six Southern California counties where our branches are located. Business loans, represented by commercial real estate loans, commercial loans and construction loans comprise the largest portion of the loan portfolio. Consumer or personal loans, represented by home mortgage, home equity and installment loans, comprise a smaller portion of the loan portfolio. We attempt to avoid the risk of an undue concentration of credits in a particular property type or with an individual customer.

Credit risk is the risk to earnings or capital arising from an obligor's failure to meet the terms of any contract with us or otherwise to perform as agreed. All activities in which success depends on counterparty, issuer, or borrower performance have credit risk. Credit risk is present any time we extend, commit or invest funds; whenever we enter into actual or implied contractual agreements for funds, whether on or off the balance sheet, credit risk is present.

All categories of loans present credit risk. Major risk factors applicable to all loan categories include changes in international, national and local economic conditions such as interest rates, inflation, unemployment levels, consumer and business confidence and the supply and demand for goods and services.

Commercial real estate loans rely upon the cash flow originating from the underlying real property. Commercial real estate is a cyclical industry; general economic conditions and local supply and demand affect the commercial real estate industry. In the office sector, the demand for office space is highly dependent on employment levels. Consumer spending and confidence affect the demand for retail space and the levels of retail rents in the retail sector. The industrial sector has exposure to the level of exports, defense spending and inventory levels. Vacancy rates, location and other factors affect the amount of rental income for commercial property. Tenants may relocate, fail to honor their lease or go out of business. In the multifamily residential sector, the affordability of ownership housing, employment conditions and the vacancy of existing inventory heavily influences the demand for apartments. Population growth or decline and changing demographics, such as increases in the level of immigrants or retirees, are also factors influencing the multifamily residential sector.

Construction loans provide developers or owners with funds to build or improve properties; developers ultimately sell or lease these properties. Generally, construction loans involve a higher degree of risk than other loan categories because they rely upon the developer's or owner's ability to complete the project within specified cost and time limits. Cost overruns can cause the project cost to exceed the project sales price or exceed the amount of the committed permanent funding. Any number of reasons, such as poor weather, material or labor shortages, labor difficulties, or redoing substandard work to pass inspection, can delay construction projects. Furthermore, changes in market conditions or credit markets may affect a project's viability once completed.

Commercial loans rely upon the cash flow originating from the underlying business activity of the enterprise. The manufacture, distribution or sale of goods or sale of services are not only affected by general economic conditions but also by the ability of the enterprise's management to adjust to local supply and demand conditions, maintain good labor, vendor and customer relationships, as well as market, price and sell their goods or services for a profit. Customer demand for goods and services of the enterprise may change because of competition or obsolescence.

Home mortgages and home equity loans and lines of credit use first or second trust deeds on a borrower's real estate property, typically their principal residence, as collateral. These loans depend on a person's ability to regularly pay the principal and interest due on the loan and, secondarily, on the value of real estate property that serves as collateral for

the loan. Generally, home mortgages involve a lower degree of risk than other loan categories because of the relationship of the loan amount to the value of the residential real estate and a person's reluctance to forego their principal place of residence. General economic conditions and local supply and demand, however, affect home real estate values. Installment loans and credit card lines also depend on a person's ability to pay principal and interest on a loan; however, generally these are unsecured loans or, if secured, the collateral value can rapidly decline, as is the case for automobiles. A person's ability to service debt is highly dependent upon their continued employment or financial stability. Job loss, divorce, illness and bankruptcy are just a few of the risks that may affect a person's ability to service their debt.

We obtain appraisals when extending credit for real estate secured loans as follows:

1. All business loans in excess of $1,000,000 where real estate was taken as collateral but where the sale or rental of the real estate is not the primary source of repayment;

2. All business loans in excess of $250,000 where real estate was taken as collateral and where the sale or rental of the real estate is the primary source of repayment; and

3. All other real estate secured loans in excess of $250,000.

All real estate secured loans, at the time of origination, renewal or extension, require a current appraisal. A current appraisal is an appraisal with an "as of" date not more than six months before the date of funding or renewal or extension. We also obtain updated appraisals when the useful life of the appraisal ceases. Under the Uniform Standards of Professional Appraisal Practice guidelines, the useful life of an appraisal, regardless of the dollar amount, is the life of the loan. However, useful life ends when (a) there has been a deterioration in the borrower's performance and there is an increasing likelihood of a forced liquidation of the property and the existing appraisal is older than two years old, or (b) there has been deterioration in the property's value due to a significant depreciation in local real estate values, lack of maintenance, change in zoning, environmental contamination or other circumstances.

Since the risks in each category of loan changes based on a number of factors, it is not possible to state whether a particular type of lending carries with it a greater or lesser degree of risk at any specific time in the economic cycle. Generally, in a stabilized economic environment, home mortgage loans have the least risk, followed by home equity loans, multifamily property loans, commercial property loans, commercial loans and lines and finally construction loans. However, this ordering may vary from time to time and the degree of risk from the credits with the least risk to those with the highest risk profile may expand or contract with the general economy.

We manage credit risk through Board-approved policies and procedures. At least annually, the Board of Directors reviews and approves these policies. Lending policies provide us with a framework for consistent loan underwriting and a basis for sound credit decisions. Lending policies specify, among other things, the parameters for the type or purpose of the loan, the required debt service coverage and the required collateral requirements. Credit limits are also established and certain loans require approval by the Directors' Loan Committee. In addition, we have a well-defined set of standards for evaluating the loan portfolio, and management utilizes a comprehensive loan grading system to determine the risk potential in the portfolio. The Directors' Audit Committee also engages a third party to perform an independent review of the loan portfolio to review credit quality, adequacy of documentation, appropriate loan grading administration, compliance with lending policies and assist in the evaluation of the credit risk inherent in the loan portfolio.

Loans

Loans decreased $47.7 million, or 5 percent, to $891.5 million at June 30, 2010 from $939.2 million at December 31, 2009. The $26.7 million decline in construction and land development loans principally reflects the $21.0 million completed office construction loan transferred to foreclosed assets. The $26.2 million decline in commercial loans and lines reflects slow loan demand in our market area. Usage under commercial lines of credit declined to 53 percent at June 30, 2010 from 59 percent at December 31, 2009.

(in thousands)	At June 30, 2010	At December 31, 2009
Commercial mortgage	$ 389,077	$ 381,334
Commercial loans and lines of credit	209,684	235,849
Multifamily mortgage	137,870	138,548
Construction and land development	59,914	86,609
Home mortgage	51,253	51,036
Home equity loans and lines of credit	38,309	40,122
Installment and credit card	5,434	5,748
Total loans	891,541	939,246
Allowance for loan losses	(16,452)	(16,505)

Loans, net	$	875,089	$	922,741

The loan categories above are derived from bank regulatory reporting standards for loans secured by real estate; however, a portion of the mortgage loans above are loans that we consider to be a commercial loan for which we have taken real estate collateral as additional support or from an abundance of caution. In these instances, we are not looking to the real property as its primary source of repayment, but rather as a secondary or tertiary source of repayment.

Commercial mortgage loans, the largest segment of our portfolio, were 44 percent of total loans at June 30, 2010 compared with 41 percent at December 31, 2009. We had 368 commercial mortgage loans with an average balance of $1,059,000 at June 30, 2010. Many different commercial property types collateralize our commercial mortgage loans. Our top three categories have been office, industrial, and retail, representing approximately 65 percent of commercial mortgage loans. In addition, most of our commercial property lending is in the six Southern California counties where our branches are located. The following is a table of our commercial mortgage lending by county.

Commercial mortgage loans by region/county (in thousands)	At June 30, 2010	At December 31, 2009
Southern California		
Los Angeles	$ 199,463	$ 195,306
Orange	30,910	30,954
Ventura	98,189	93,899
Riverside	19,732	21,148
San Bernardino	16,384	17,518
San Diego	15,132	15,555
Santa Barbara	233	236
Total Southern California	380,043	374,616
Northern California		
Alameda	346	319
Contra Costa	397	408
Fresno	2,463	2,479
Imperial	361	369
Kern	967	1,037
Madera	543	550
Placer	620	625
Sacramento	351	358
San Mateo	2,418	—
Solano	275	278
Tulare	293	295
Total Northern California	9,034	6,718
Total commercial mortgage loans	$ 389,077	$ 381,334

The following table shows the distribution of our commercial mortgage loans by property type.

Commercial mortgage loans by property type (in thousands)	At June 30, 2010	At December 31, 2009
Industrial/warehouse	$ 88,938	$ 90,379
Office	88,579	87,923
Retail	73,494	70,140
Self storage	28,670	20,024
Mixed use	17,072	18,292
Hotel	13,714	13,955
Medical	13,701	11,469
Assisted living	12,177	11,332
Restaurant	9,981	9,584
All other	42,751	48,236
Total commercial mortgage loans	$ 389,077	$ 381,334

The following table shows the maturity of our commercial mortgage loans by origination year.

Commercial mortgage loans by origination year/maturity year
(in thousands)

Origination Year	Year of maturity 2010	2011	2012	2013	2014 and Thereafter	Total
2005 and earlier	$6,575	$6,735	$8,382	$21,880	$77,254	$120,826
2006	3,216	4,377	6,352	7,108	38,806	59,859
2007	7,740	6,934	16,627	759	38,833	70,893
2008	10,404	3,239	10,454	1,945	57,162	83,204
2009	10,443	-	1,662	-	35,106	47,211
2010	141	22	-	2,267	4,654	7,084
Total	$38,519	$21,307	$43,477	$33,959	$251,815	$389,077

We generally underwrote commercial mortgage loans with a maximum loan-to-value of 70 percent and a minimum debt service coverage ratio of 1.25. Beginning in the third quarter of 2009 we changed the maximum loan-to-value to 60 percent and the minimum debt service coverage ratio to 1.35. We believe these changes to our loan origination policies were prudent given the current economic environment. The weighted average loan-to-value percentage of our commercial real estate portfolio was 57.5 percent and the weighted average debt service coverage ratio was 1.74 at June 30, 2010. These criteria may become more conservative depending on the type of property. We focus on cash flow; consequently, regardless of the value of the collateral, the commercial real estate project must provide sufficient cash flow, or alternatively the principals must supplement the project with other cash flow, to service the debt. We generally require the principals to guarantee the loan. We also "stress-test" commercial mortgage loans to determine the potential effect changes in interest rates, vacancy rates, and lease or rent rates would have on the cash flow of the project. Additionally, at least on an annual basis, we require updates on the cash flow of the project and, where practicable, we visit the properties.

Commercial loans represent the next largest category of loans. These loans were 24 percent of total loans at June 30, 2010, down from 25 percent at December 31, 2009. We had 872 commercial loans with an average balance of $240,000 at June 30, 2010. Unused commitments on commercial loans were $104.3 million at June 30, 2010 compared with $88.8 million at December 31, 2009. Working capital, equipment purchases or business expansion are the typical purposes for commercial loans. Commercial loans may be unsecured or secured by assets such as equipment, inventory, accounts receivables, and real property. Personal guarantees of the business owner may also be present. These loans may also have partial guarantees from the U.S. Small Business Administration, or SBA, or other federal or state agencies. Broadly diversified business sectors with the largest sectors in real estate/construction, finance and insurance, healthcare, manufacturing and professional services comprise the commercial loan portfolio. Below is a table of our loans by business sector.

Commercial loans by industry/sector (in thousands)	At June 30, 2010	At December 31, 2009
Information	$ 54,229	$ 62,086
Real estate	52,050	51,714
Services	49,122	61,629
Trade	18,604	26,119

Manufacturing		17,565		16,141						
Healthcare		15,182		12,566						
$	395.9		100.0	$	1,295.4	100.0	$1,147.3	100.0		
Gross profit	163.7		36.7		152.4	38.5	478.7	37.0	427.0	37.2
Operating expenses	98.4		22.1		86.3	21.8	285.9	22.1	254.2	22.2
Amortization expense	7.6		1.7		7.3	1.8	22.7	1.8	21.7	1.9
Impairment charge	—		—		—	—	63.4	4.9	—	—
Interest expense	5.5		1.2		6.5	1.6	17.8	1.4	18.9	1.6
Other (expense) income, net	(0.8)		0.2		(1.1)	0.3	(2.4)	0.2	(3.0)	0.3
Income taxes	15.2		3.4		16.6	4.2	52.5	4.1	38.2	3.3
Net income (1)	35.9		8.0		32.9	8.3	32.1	2.5	88.0	7.7

(1) Net income attributable to Hillenbrand.

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Three Months Ended June 30, 2018 Compared to Three Months Ended June 30, 2017

Net revenue increased $50.1 (13%), which included favorable foreign currency impact (3%).

•The Process Equipment Group's net revenue increased $57.8 (22%), primarily due to higher volume (17%). Foreign currency impact increased net revenue by 5%.

•Batesville's net revenue decreased $7.7 (6%) primarily due to a decrease in volume (3%), the impact of a multi-year contract renewal with a key customer that included an upfront incentive (2%), and a decrease in average selling price (1%).

Gross profit increased $11.3 (7%), which included favorable foreign currency impact (3%). Gross profit margin decreased 180 basis points to 36.7%.

•The Process Equipment Group's gross profit increased $18.4 (18%), primarily due to higher volume. Foreign currency impact increased gross profit by 4%. Gross profit margin decreased 130 basis points to 37.7%, primarily driven by the increased proportion of lower margin, large system projects in plastics.
The Process Equipment Group's gross profit included restructuring and restructuring related charges of $0.3 in 2018. Excluding these charges, adjusted gross profit increased $18.7 (19%), which included favorable foreign currency impact (4%). Adjusted gross profit margin decreased 120 basis points to 37.8%, primarily driven by the increased proportion of lower margin, large system projects in plastics.
•Batesville's gross profit decreased $7.1 (14%) and gross profit margin decreased 330 basis points to 34.3%. The decrease in gross profit and gross profit margin was primarily due to inflation in commodities, fuel, wages and benefits, the impact of the key customer contract renewal, the decline in volume, and supply chain inefficiencies. These items were partially offset by productivity gains, including benefits resulting from the manufacturing footprint reduction in the prior year.

Batesville's gross profit included restructuring and restructuring related charges of $0.3 in 2017. Excluding these charges, adjusted gross profit decreased $7.4 (14%) and adjusted gross profit margin decreased 350 basis points to 34.3%.

Operating expenses increased $12.1 (14%), primarily due to an increase in growth investments, litigation expenses, and variable compensation, as well as cost inflation, partially offset by a decrease in restructuring and restructuring related charges and business acquisition, development, and integration costs. Foreign currency impact increased operating expenses by 3%.

Operating expenses as a percentage of net revenue increased 30 basis points to 22.1%. Operating expenses included the following items:

	Three Months Ended June 30,	
	2018	2017
Business acquisition, development, and integration costs	$0.1	$0.4
Restructuring and restructuring related charges	0.2	0.5

On an adjusted basis, which excludes business acquisition, development, and integration costs and restructuring and restructuring related charges, operating expenses increased $12.7 (15%), which included unfavorable foreign currency impact (3%). Adjusted operating expenses as a percentage of net revenue increased 40 basis points in 2018 to 22.0%.

Amortization expense increased $0.3, due to unfavorable foreign currency impact of $0.3.

Interest expense decreased $1.0, primarily due to lower average borrowings and a reduction in the Facility fee.

Other (expense) income, net was $0.8 of other expense in fiscal 2018, compared to $1.1 of other expense in fiscal 2017. The decrease in expense was driven primarily by higher equity earnings from affiliates, partially offset by an increase in foreign currency exchange loss.

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The effective tax rate was 29.6% in fiscal 2018, compared to 32.4% in fiscal 2017. The Tax Act resulted in a reduced domestic statutory tax rate (21% versus 35%) as compared to the same quarter in the prior year. The Internal Revenue Code provides that our fiscal year ending September 30, 2018 has a domestic blended corporate tax rate of 24.5%, which is based on a proration of the applicable tax rates before and after the effective date of the Tax Act. The domestic statutory tax rate of 21% will apply to future years. The reduction in the effective tax rate resulting from the Tax Act was partially offset by an increase in the reserve for unrecognized tax benefits.

Our adjusted effective income tax rate, which excludes the impact of the Transition Tax and the revaluation of the deferred tax balances as a result of the Tax Act, was 29.2% in fiscal 2018, compared to 32.4% in fiscal 2017. The reduction in the effective tax rate resulting from the Tax Act was partially offset by an increase in the reserve for unrecognized tax benefits. We expect the Tax Act to favorably impact the Company’s net income, diluted earnings per share, and cash flows in future periods, due primarily to the reduction in the federal corporate tax rate from 35% to 21%. Additionally, the Tax Act could incentivize additional investments in facilities and infrastructure in the U.S. that may increase future demand for equipment in the end-markets that the Company serves.

Management currently estimates that the Company’s consolidated adjusted effective income tax rate for full-year fiscal 2018 will be approximately 26% to 28%, compared with nearly 32% for the prior year. The aforementioned tax-related estimates may differ from actual results, possibly materially, due to changes in interpretations of the Tax Act and assumptions made by the Company, as well as guidance that may be issued by the Internal Revenue Service, and actions the Company may take as a result of the Tax Act.

Nine Months Ended June 30, 2018 Compared to Nine Months Ended June 30, 2017

Net revenue increased $148.1 (13%), which included favorable foreign currency impact (4%).

•The Process Equipment Group’s net revenue increased $156.2 (22%), primarily due to higher volume (14%). Foreign currency impact increased net revenue by 6%.

•Batesville’s net revenue decreased $8.1 (2%), primarily due to a decrease in volume (1%) and the impact of a multi-year contract renewal with a key customer that included an upfront incentive (1%).

Gross profit increased $51.7 (12%), which included favorable foreign currency impact (4%). Gross profit margin decreased 20 basis points to 37.0%.

•The Process Equipment Group’s gross profit increased $57.9 (21%), primarily due to higher volume. Foreign currency impact increased gross profit by 6%. Gross profit margin decreased 10 basis points to 37.3% in 2018, primarily driven by the increased proportion of lower margin, large systems projects in plastics, partially offset by productivity and pricing improvements.

The Process Equipment Group’s gross profit included restructuring and restructuring related charges of $0.2 in 2018. Excluding these charges, adjusted gross profit increased $58.1 (21%), which included favorable foreign currency impact (6%). Adjusted gross profit margin remained flat at 37.4% compared to prior year.

•Batesville’s gross profit decreased $6.2 (4%) and gross profit margin decreased 70 basis points to 36.2%. The decrease in gross profit and gross profit margin was primarily due to inflation in commodities, fuel, wages and benefits, the decline in volume, and the impact of the key customer contract renewal, along with supply chain inefficiencies. These items were partially offset by productivity gains, including benefits resulting from the manufacturing footprint reduction in the prior year.

Batesville's gross profit included restructuring and restructuring related charges ($0.1 in 2018 and $7.0 in 2017). Excluding these charges, adjusted gross profit decreased $13.1 (8%) and adjusted gross profit margin decreased 240 basis points to 36.2%.

Operating expenses increased $31.2 (12%), primarily due to an increase in variable compensation, litigation expenses, and growth investments, as well as cost inflation and higher business acquisition, development, and integration costs, partially offset by a decrease in restructuring and restructuring related charges. Foreign currency impact increased operating expenses by 4%.

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Operating expenses as a percentage of net revenue improved 10 basis points to 22.1%. Operating expenses included the following items:

	Nine Months Ended June 30,	
	2018	2017
Business acquisition, development, and integration costs	$2.6	$ 1.0
Restructuring and restructuring related charges	1.4	3.2

On an adjusted basis, which excludes business acquisition, development, and integration costs and restructuring and restructuring related charges, operating expenses increased $31.4 (13%), which included unfavorable foreign currency impact (4%). Adjusted operating expenses as a percentage of net revenue remained flat at 21.8% compared to the same period in the prior year.

Amortization expense increased $1.0, due to unfavorable foreign currency impact of $1.0.

Impairment charge increased $63.4 due to the goodwill and trade name impairments recorded in the second quarter of 2018. See Note 5 of Part I of this Form 10-Q for further information on the impairment charges.

Interest expense decreased $1.1, primarily due to lower average borrowings and a reduction in the Facility fee.

Other (expense) income, net was $2.4 of other expense in fiscal 2018, compared to $3.0 of other expense in fiscal 2017. The decrease in expense was primarily driven by higher equity earnings from affiliates.

The effective tax rate was 60.7% in fiscal 2018 compared to 29.7% in fiscal 2017. The higher effective tax rate in the period primarily results from the nondeductible portion of the impairment charge recorded in the Process Equipment Group segment. Additionally, the impact of the Tax Act resulted in a higher tax rate as compared to the prior year driven by the items discussed below. The Tax Act resulted in a reduced domestic statutory rate (21% versus 35%). The Internal Revenue Code provides that our fiscal year ending September 30, 2018 has a domestic blended corporate tax rate of 24.5%, which is based on a proration of the applicable tax rates before and after effective date of the Tax Act. The domestic statutory tax rate of 21% will apply to future years. The impact of the tax rate reduction was recognized in the rate applied to earnings as well as a provisional tax benefit of $14.9 related to the revaluation of our domestic net deferred tax liability. While we are able to make a reasonable estimate of the impact of the reduction in corporate rate on the deferred tax balances, we are continuing to analyze the temporary differences that existed on the date of enactment and the temporary differences that have originated since. As a result, we have recorded an additional $0.7 of temporary difference originating in the current fiscal year related to the change in the tax rate.

The favorable adjustments related to the revaluation of our domestic net deferred tax liability were more than offset by the provisional recognition of an estimated $28.9 tax expense for the Transition Tax. We will not be able to precisely determine the amount of the Transition Tax until the end of fiscal 2018 because certain cash and cash equivalent balances at September 30, 2018 and current year earnings are key inputs in the calculation. Additionally, other information including cumulative foreign earnings must be verified, to precisely compute the amount of the Transition Tax. Therefore, tax expense associated with these provisions may be adjusted throughout the year as we refine our estimate.

Our adjusted effective income tax rate, which excludes the impact of the impairment charge, Transition Tax, and the revaluation of the deferred tax balances as a result of the Tax Act, was 25.8% in fiscal 2018, compared to 30.3% in

fiscal 2017. The reduction in the effective tax rate resulting from the Tax Act was partially offset by an increase in the reserve for unrecognized tax benefits.

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OPERATIONS REVIEW — PROCESS EQUIPMENT GROUP

	Three Months Ended June 30,				Nine Months Ended June 30,			
	2018		2017		2018		2017	
	Amount	% of Net Revenue	Amount	% of Net Revenue	Amount	% of Net Revenue	Amount	% of Net Revenue
Net revenue	$316.7	100.0	$258.9	100.0	$880.8	100.0	$724.6	100.0
Gross profit	119.3	37.7	100.9	39.0	328.8	37.3	270.9	37.4
Operating expenses	64.8	20.5	54.9	21.2	184.5	20.9	160.6	22.2
Amortization expense	7.6	2.4	7.2	2.8	22.7	2.6	21.5	3.0
Impairment charge	—	—	—	—	63.4	7.2	—	—

Three Months Ended June 30, 2018 Compared to Three Months Ended June 30, 2017

Net revenue increased $57.8 (22%), primarily due to higher volume (17%) largely driven by increased demand for plastics projects, parts and service, and screening and separating equipment (including equipment that processes proppants for hydraulic fracturing). Foreign currency impact increased net revenue by 5%. Order backlog increased $176.6 (29%) from $606.2 on June 30, 2017, to $782.8 on June 30, 2018, primarily due to orders for polyolefin projects in the plastics industry, partially offset by lower orders in screening and separating equipment. Foreign currency impact increased order backlog by 1%.

On a sequential basis, order backlog increased $30.1 (4%) to $782.8 at June 30, 2018, up from $752.7 at March 31, 2018. This increase was primarily driven by orders in the plastics industry, partially offset by a decrease in separation equipment orders related to processing proppants.

Gross profit increased $18.4 (18%), primarily due to higher volume largely driven by increased demand for plastics projects, parts and service, and screening and separating equipment. Foreign currency impact increased gross profit by 4%. Gross profit margin decreased 130 basis points to 37.7% in 2018, primarily driven by the increased proportion of lower margin, large system projects in plastics.
The Process Equipment Group's gross profit included restructuring and restructuring related charges of $0.3 in 2018. Excluding these charges, adjusted gross profit increased $18.7 (19%), which included favorable foreign currency impact (4%). Adjusted gross profit margin decreased 120 basis points to 37.8%, primarily driven by the increased proportion of lower margin, large system projects in plastics.
Operating expenses increased $9.9 (18%), primarily due to an increase in variable compensation and litigation expenses, and cost inflation. Foreign currency impact increased operating expenses by 4%. Operating expenses as a percentage of net revenue improved 70 basis points to 20.5% in 2018.

Operating expenses included restructuring and restructuring related charges ($0.2 in 2018 and $0.4 in 2017) and business acquisition, development, and integration costs ($0.3 in 2017). Excluding these items, adjusted operating expenses increased $10.4 (19%), which included unfavorable foreign currency impact (4%). Adjusted operating expenses as a percentage of net revenue improved 50 basis points to 20.4% in 2018.

Amortization expense increased $0.4, primarily due to unfavorable foreign currency impact of $0.3.

Nine Months Ended June 30, 2018 Compared to Nine Months Ended June 30, 2017

Net revenue increased $156.2 (22%), primarily due to higher volume (14%) largely driven by increased demand for screening and separating equipment (including equipment that processes proppants for hydraulic fracturing), plastics

projects, and parts and service. Foreign currency impact increased net revenue by 6%.

Gross profit increased $57.9 (21%), primarily due to higher volume largely driven by increased demand for screening and separating equipment (including equipment that processes proppants for hydraulic fracturing), plastics projects, and parts and service. Foreign currency impact increased gross profit by 6%. Gross profit margin decreased 10 basis points to 37.3% in 2018, primarily driven by the increased proportion of lower margin, large systems projects in plastics, partially offset by productivity and pricing improvements.

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The Process Equipment Group's gross profit included restructuring and restructuring related charges of $0.2 in 2018. Excluding these charges, adjusted gross profit increased $58.1 (21%), which included favorable foreign currency impact (6%). Adjusted gross profit margin remained flat at 37.4% compared to prior year.

Operating expenses increased $23.9 (15%), primarily driven by an increase in variable compensation and litigation expenses, and cost inflation. Foreign currency impact increased operating expenses by 6%. Operating expenses as a percentage of net revenue improved 130 basis points to 20.9% in 2018.

Operating expenses included restructuring and restructuring related charges ($0.4 in 2018 and $0.8 in 2017). Excluding these items, adjusted operating expenses increased $24.8 (16%), which included unfavorable foreign currency impact (6%). Adjusted operating expenses as a percentage of net revenue improved 110 basis points to 20.9% in 2018.

Amortization expense increased $1.2, primarily due to unfavorable foreign currency impact of $1.0.

Impairment charge increased $63.4 due to the goodwill and trade name impairments recorded in the second quarter of 2018. See Note 5 of Part I of this Form 10-Q for further information on the impairment charges.

OPERATIONS REVIEW — BATESVILLE

	Three Months Ended June 30,				Nine Months Ended June 30,			
	2018		2017		2018		2017	
	Amount	% of Net Revenue	Amount	% of Net Revenue	Amount	% of Revenue	Amount	% of Revenue
Net revenue	$129.3	100.0	$137.0	100.0	$414.6	100.0	$422.7	100.0
Gross profit	44.4	34.3	51.5	37.6	149.9	36.2	156.1	36.9
Operating expenses	20.6	15.9	20.5	15.0	63.6	15.3	62.2	14.7
Amortization expense	—	—	0.1	0.1	—	—	0.2	—

Three Months Ended June 30, 2018 Compared to Three Months Ended June 30, 2017

Net revenue decreased $7.7 (6%), primarily due to a decrease in volume (3%), the impact of a multi-year contract renewal with a key customer that included an upfront incentive (2%), and a decrease in average selling price (1%). The decrease in volume was primarily driven by the estimated increased rate at which families opted for cremation.

Gross profit decreased $7.1 (14%) and gross profit margin decreased 330 basis points to 34.3%. The decrease in gross profit and gross profit margin was primarily due to inflation in commodities, fuel, wages and benefits, the impact of the key customer contract renewal, the decline in volume, and supply chain inefficiencies. These items were partially offset by productivity gains, including benefits resulting from the manufacturing footprint reduction in the prior year.

Gross profit included restructuring and restructuring related charges of $0.3 in 2017. Excluding these charges, adjusted gross profit decreased $7.4 (14%) and adjusted gross profit margin decreased 350 basis points to 34.3%.

Operating expenses increased $0.1 (0.5%) to $20.6, and operating expenses as a percentage of net revenue increased 90 basis points to 15.9%, primarily due to wage and benefit inflation.

Nine Months Ended June 30, 2018 Compared to Nine Months Ended June 30, 2017

Net revenue decreased $8.1 (2%), primarily due to a decrease in volume (1%) and the impact of a multi-year contract renewal with a key customer that included an upfront incentive (1%). The decrease in volume was primarily driven by the estimated increased rate at which families opted for cremation.

Gross profit decreased $6.2 (4%) and gross profit margin decreased 70 basis points to 36.2%. The decrease in gross profit and gross profit margin was primarily due to inflation in commodities, fuel, wages and benefits, the decline in volume, and the impact of the key customer contract renewal, along with supply chain inefficiencies. These items were partially offset by productivity gains, including benefits resulting from the manufacturing footprint reduction in the prior year.

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Gross profit included restructuring and restructuring related charges ($0.1 in 2018 and $7.0 in 2017). Excluding these charges, adjusted gross profit decreased $13.1 (8%) and adjusted gross profit margin decreased 240 basis points to 36.2%.

Operating expenses increased $1.4 (2%) to $63.6, and operating expenses as a percentage of net revenue increased 60 basis points to 15.3%, primarily due to wage and benefit inflation, an increase in variable compensation, and an increase in restructuring and restructuring related charges, partially offset by current year productivity improvements.

Operating expenses included $0.2 of restructuring and restructuring related charges in 2018. Excluding these charges, adjusted operating expenses increased $1.2 (2%), and adjusted operating expenses as a percentage of net revenue increased 60 basis points to 15.3% in 2018.

REVIEW OF CORPORATE EXPENSES

	Three Months Ended June 30,				Nine Months Ended June 30,			
	2018		2017		2018		2017	
	Amount	% of Net Revenue	Amount	% of Net Revenue	Amount	% of Net Revenue	Amount	% of Net Revenue
Core operating expenses	$12.9	2.9	$10.7	2.7	$34.4	2.7	$29.0	2.5
Business acquisition, development, and integration costs	0.1	—	0.1	—	2.6	0.2	0.5	0.1
Restructuring and restructuring related charges	—	—	0.1	—	0.8	—	2.4	0.2
Operating expenses	$13.0	2.9	$10.9	2.7	$37.8	2.9	$31.9	2.8

Core operating expenses primarily represent operating expenses excluding restructuring and restructuring related charges and costs related to business acquisition, development, and integration, which we incur as a result of our strategy to grow through selective acquisitions.

Business acquisition, development, and integration costs include legal, tax, accounting, and other advisory fees and due diligence costs associated with investigating opportunities (including acquisition and disposition) and integrating completed acquisitions.

Three Months Ended June 30, 2018 Compared to Three Months Ended June 30, 2017

Operating expenses increased $2.1 (19%), primarily due to an increase in growth investments and cost inflation, partially offset by a decrease in restructuring and restructuring related charges. These expenses as a percentage of net revenue were 2.9%, an increase of 20 basis points from 2017.

Core operating expenses increased $2.2 (21%). These expenses as a percentage of net revenue were 2.9%, an increase of 20 basis points from 2017.

Nine Months Ended June 30, 2018 Compared to Nine Months Ended June 30, 2017

Operating expenses increased $5.9 (18%), primarily due to an increase in business acquisition, development, and integration costs, variable compensation, and growth investments, partially offset by a decrease in restructuring and restructuring related charges. These expenses as a percentage of net revenue were 2.9%, an increase of 10 basis points from 2017.

Core operating expenses increased $5.4 (19%). These expenses as a percentage of net revenue were 2.7%, an increase of 20 basis points from 2017.

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NON-GAAP OPERATING PERFORMANCE MEASURES

The following is a reconciliation from the most directly comparable GAAP operating performance measure to our non-GAAP adjusted EBITDA.

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2018	2017	2018	2017
Consolidated net income	$36.2	$34.6	$34.0	$90.5
Interest income	(0.3)	(0.2)	(1.1)	(0.5)
Interest expense	5.5	6.5	17.8	18.9
Income tax expense	15.2	16.6	52.5	38.2
Depreciation and amortization	14.2	13.5	42.0	42.1
EBITDA	$70.8	$71.0	$145.2	$189.2
Impairment charge	—	—	63.4	—
Business acquisition, development, and integration	0.1	0.4	2.6	1.0
Restructuring and restructuring related	0.5	0.9	1.7	8.8
Adjusted EBITDA	$71.4	$72.3	$212.9	$199.0

Consolidated net income increased $1.6 (5%) for the three months ended June 30, 2018, compared to the same period in fiscal 2017. The increase was primarily due to higher volume in the Process Equipment Group, as well as pricing and productivity improvements, favorable impact of the Tax Act on the effective tax rate, and a decrease in interest expense driven by lower average borrowings. This increase was partially offset by cost inflation, increased proportion of large plastics projects with lower margins, and the impact of a multi-year contract renewal with a key customer at Batesville that included an upfront incentive. Foreign currency impact increased consolidated net income by 3%.

Consolidated adjusted EBITDA decreased $0.9 (1%) for the three months ended June 30, 2018, compared to the same period in fiscal 2017. The decrease was primarily driven by cost inflation, increased proportion of large plastics projects with lower margins, and the impact of a multi-year contract renewal with a key customer at Batesville that included an upfront incentive. This decrease was partially offset by higher volume in the Process Equipment Group, as well as pricing and productivity improvements. Foreign currency impact increased adjusted EBITDA by 2%.

Consolidated net income decreased $56.5 (62%) for the nine months ended June 30, 2018, compared to the same period in fiscal 2017. The decrease was primarily due to the impairment charges recorded in the Process Equipment Group segment in 2018 of $63.4. In addition, net income was negatively impacted by cost inflation, increased proportion of large plastics projects with lower margins, an increase in variable compensation, an increase in business acquisition, development, and integration costs, and the unfavorable impact of the Tax Act on the effective tax rate. This decrease in consolidated net income was partially offset by higher volume in the Process Equipment Group, as well as pricing and productivity improvements, a decrease in interest expense driven by lower average borrowings, and a decrease in restructuring and restructuring related charges. Foreign currency impact increased consolidated net income by 4%.

Consolidated adjusted EBITDA increased $13.9 (7%) for the nine months ended June 30, 2018, compared to the same period in fiscal 2017. The increase was primarily driven by higher volume in the Process Equipment Group, as well as pricing and productivity improvements. This increase in adjusted EBITDA was partially offset by cost inflation, increased proportion of lower margin, large system projects in plastics, and an increase in variable compensation. Foreign currency impact increased adjusted EBITDA by 3%.

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LIQUIDITY AND CAPITAL RESOURCES

In this section, we discuss our ability to access cash to meet business needs. We discuss how we see cash flow being affected for the next twelve months and how we intend to use it. We describe actual results in generating and utilizing cash by comparing the first nine months of 2018 to the same period last year. Finally, we identify other significant matters that could affect liquidity on an ongoing basis.

Ability to Access Cash

Our debt financing includes long-term notes and our Facility as part of our overall financing strategy. We believe we have ready access to capital markets and regularly review the optimal mix of fixed-rate and variable-rate debt. In addition to cash balances and our ability to access additional long-term financing, we had $717.1 of borrowing capacity available under the Facility as of June 30, 2018, of which $698.7 of borrowing capacity is immediately available based on our most restrictive covenant at June 30, 2018, with additional amounts available in the event of a qualifying acquisition. The available borrowing capacity reflects a reduction of $7.3 for outstanding letters of credit issued under the Facility. The Company may request an increase of up to $450.0 in the total borrowing capacity under the Facility, subject to approval of the lenders.

In the normal course of business, the Process Equipment Group provides to certain customers bank guarantees and other credit arrangements in support of performance, warranty, advance payment, and other contractual obligations. This form of trade finance is customary in the industry and, as a result, we are required to maintain adequate capacity to provide the guarantees. As of June 30, 2018, we had guarantee arrangements totaling $250.3, under which $208.0 was utilized for this purpose. These arrangements include the €150.0 L/G Facility Agreement under which unsecured letters of credit, bank guarantees, or other surety bonds may be issued. The Company may request an increase to the total capacity under the L/G Facility Agreement by an additional €70.0, subject to approval of the lenders.

We have significant operations outside the U.S. The majority of foreign earnings is considered to be indefinitely reinvested in foreign jurisdictions where the Company has made, and intends to continue to make, substantial investments to support the ongoing development and growth of our international operations. Pursuant to the Tax Act, we have recognized a provisional accrued Transition Tax of $28.9 on the unrepatriated earnings of our foreign subsidiaries. The cash at our international subsidiaries totaled $64.3 at June 30, 2018. With the enactment of the Tax Act, we are evaluating our future plans for deployment of this cash.

12-month Outlook

We believe the 12-month outlook for our business remains positive. Although cash flow from operations in the Process Equipment Group naturally experiences substantial fluctuations driven by changes in working capital requirements at Coperion (due to the type of product and geography of customer projects in process at any point in time), we believe we have significant flexibility to meet our financial commitments, including working capital needs, capital expenditures, and financing obligations.

We expect to continue to use a combination of some of our cash flows from operations and our Facility to fund acquisitions. In considering attractive targets, we often look for companies with a relatively low physical asset base, in order to limit the need to invest significant additional cash into targets post-acquisition.

The Tax Act will require the Company to pay tax on remitted earnings of its foreign subsidiaries in an estimated amount of $28.9. The portion of this tax we anticipate to pay in the next twelve months is $2.3, with the remainder to be paid over the next seven years. In addition, we expect the lower corporate tax rate of 21% to benefit our cash flow in current and future periods; however, the amount and use of those benefits has not yet been determined.

Our anticipated contribution to our pension plans in 2018 is $9.9, of which $8.2 was made during the nine months ended June 30, 2018. We will continue to monitor plan funding levels, performance of the assets within the plans, and overall economic activity, and we may make additional discretionary funding decisions based on the net impact of the above factors.

We currently expect to pay quarterly cash dividends in the future comparable to those we paid in 2017, which will require approximately $13.0 each quarter based on our outstanding common stock at June 30, 2018. We increased our quarterly dividend in 2018 to $0.2075 per common share from $0.2050 per common share paid in 2017. We are authorized by our Board of Directors to purchase up to $200.0 of our common stock in total under our existing share repurchase program, and may make such purchases, depending on market conditions and other needs for cash consistent with our growth strategy. We repurchased approximately 471,500 shares of our common stock during the third quarter of fiscal 2018, at a total cost of approximately

$21.7. At June 30, 2018, we had approximately $40.0 remaining for share repurchases under the existing authorization by the Board of Directors.

We believe existing cash, cash flows from operations, and the issuance of debt will be sufficient to fund our operating activities and cash commitments for investing and financing activities. Based on these factors, we believe our current liquidity position is strong and will continue to meet all of our financial commitments for the foreseeable future.

Cash Flows

	Nine Months Ended June 30,	
(in millions)	2018	2017
Cash flows provided by (used in)		
Operating activities	$156.3	$103.7
Investing activities	(15.7)	(12.3)
Financing activities	(134.5)	(72.5)
Effect of exchange rates on cash and cash equivalents	(1.0)	0.6
Increase in cash and cash equivalents	$5.1	$19.5

Operating Activities

Operating activities provided $156.3 of cash during the first nine months of fiscal year 2018, and provided $103.7 of cash during the first nine months of fiscal year 2017, a $52.6 (51%) increase. The increase in operating cash flow was primarily due to our $80.0 contribution to the Company's U.S. defined benefit pension plan in 2017, partially offset by an increase in working capital requirements and an increase of $17.0 in cash paid for taxes.

Working capital requirements for the Process Equipment Group may fluctuate in the future due primarily to the type of product and geography of customer projects in process at any point in time. Working capital needs are lower when advance payments from customers are more heavily weighted toward the beginning of the project. Conversely, working capital needs are higher when a larger portion of the cash is to be received in later stages of manufacturing.

Investing Activities

The $3.4 increase in cash used in investing activities in the first nine months of fiscal 2018 was primarily due to an increase in capital expenditures and decrease in proceeds from sales of property, plant, and equipment.

Financing Activities

Cash used in financing activities was largely impacted by net borrowing activity. Our general practice is to utilize our cash to pay down debt unless it is needed to fund an acquisition. Daily borrowing and repayment activity under the Facility may fluctuate significantly between periods as we fulfill the capital needs of our business units. Cash used in financing activities during the first nine months of 2018 was $134.5, including $39.2 of debt repayments, net of proceeds. Cash used in financing activities in the first nine months of fiscal 2017 was $72.5. The increase in cash used in financing activities was primarily due to an increase in payments on the Facility and an increase in repurchases of common stock in 2018. This increase was partially offset by borrowings used to fund the $80.0 contribution to the Company's U.S. defined benefit pension plan in 2017 that did not repeat in 2018.

We returned approximately $39.1 to shareholders during the first nine months of 2018 in the form of quarterly dividends. We increased our quarterly dividend in 2018 to $0.2075 per common share from $0.2050 per common share paid during 2017. We repurchased approximately 1,377,000 shares of our common stock in 2018, at a total cost

of approximately $60.6.

Off-Balance Sheet Arrangements

There were no significant changes in off-balance sheet arrangements, as described in Management's Discussion and Analysis of Financial Condition and Results of Operations, Liquidity and Capital Resources, in our Annual Report on Form 10-K for 2017.

Recently Adopted and Issued Accounting Standards

For a summary of recently issued and adopted accounting standards applicable to us, see Item 1, Note 2 of Part I of this Form 10-Q.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

A discussion of quantitative and qualitative disclosures about market risk may be found in Item 7A of our 2017 Form 10-K filed with the SEC on November 15, 2017. There have been no material changes in this information since the filing of our 2017 Form 10-K.

Item 4. CONTROLS AND PROCEDURES

Our management, with the participation of our President and Chief Executive Officer and our Senior Vice President and Chief Financial Officer (the "Certifying Officers"), evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")). Based upon that evaluation, the Certifying Officers concluded that our disclosure controls and procedures as of the end of the period covered by this report are effective.

There have been no changes in internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) for the period covered by this report that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

Information pertaining to legal proceedings can be found in Note 14 to the interim consolidated financial statements included in Part I, Item 1 of this Form 10-Q.

Item 1A. RISK FACTORS

For information regarding the risks we face, see the discussion under Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended September 30, 2017, and the revised risk factors below.

Changes in the United States political environment and global trade disruption could negatively impact our business.

The 2016 presidential and congressional elections in the United States have resulted in significant uncertainty with respect to, and have resulted in and could result in additional changes in, legislation, regulation and government policy. While it is not possible to predict whether and when any such additional changes will occur, changes at the local, state or federal level could significantly impact our business and the industries in which we compete. Specific legislative and regulatory proposals discussed during and after the election that could have a material impact on us include, but are not limited to, changes to existing trade agreements or entry into new trade agreements, import and export regulations, tariffs and customs duties, public company reporting requirements, environmental regulation and antitrust enforcement. In addition, countries that are central to our businesses have imposed and been subject to imposition and threatened imposition of retaliatory tariffs upon various raw materials and finished goods, including steel and others that are important to our businesses. To the extent changes in the political environment have a negative impact on the Company or our markets, it may materially and adversely impact our business, results of operations and financial condition in the periods to come.

The effective tax rate of the Company may be negatively impacted by economic downturns as well as changes to tax laws in jurisdictions in which we operate.

We are subject to income taxes in the United States and various other global jurisdictions. Our effective tax rate could be adversely affected by changes in the mix of earnings by jurisdiction and the valuation of deferred tax assets and liabilities. We recognize deferred tax assets and liabilities based on the differences between the financial statement carrying amounts and the tax basis of assets and liabilities. Significant judgment is required in determining our provision for income taxes. We regularly review our deferred tax assets for recoverability and establish a valuation allowance if it is more likely than not that some portion or all of a deferred tax asset will not be realized. If we are unable to generate sufficient future taxable income, if there is a material change in the actual effective tax rates, or if there is a change to the time period within which the underlying temporary differences become taxable or deductible, we could be required to increase our valuation allowance against our deferred tax assets, which could result in a material increase in our effective tax rate.

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In addition, the recently enacted Tax Act makes significant changes to the U.S. Internal Revenue Code. Such changes include a reduction in the domestic corporate tax rate, limitations on certain corporate deductions and credits, and a Transition Tax on the deemed repatriation of foreign earnings. Some of the Tax Act changes could have a negative impact on our business. The estimated impact of the new law is based on management’s current knowledge and assumptions; recognized impacts could be materially different from current estimates based on actual results in 2018 and our further analysis of the new law. Changes in other tax laws or tax rulings could also have a material impact on our effective tax rate. Additionally, many countries in the European Union, as well as a number of other countries and organizations such as the Organization for Economic Cooperation and Development, are actively considering changes to existing tax laws. Certain proposals could include recommendations that could increase our tax obligations in many countries where we do business. Any changes in the taxation of our activities in such jurisdictions may result in a material increase in our effective tax rate.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table summarizes repurchases of common stock during the three months ended June 30, 2018.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Amount that May Yet be Purchased Under Plans or Programs
April	275,470	$ 45.91	275,470	$ 49.0
May	191,410	$ 46.26	191,410	$ 40.2
June	4,643	$ 46.00	4,643	$ 40.0
Total	471,523	$ 46.05	471,523	$ 40.0

On July 24, 2008, our Board of Directors approved a stock repurchase program for the repurchase of up to $100.0 of our common stock. On February 23, 2017, our Board of Directors approved an increase of $100.0 to the existing stock repurchase program. The authorization brings the maximum cumulative repurchase authorization up to $200.0. The repurchase program has no expiration date, but may be terminated by the Board of Directors at any time. As of June 30, 2018, we had repurchased approximately 4,950,000 shares for approximately $160 in the aggregate. Such shares were classified as treasury stock. We repurchased approximately 471,500 shares of our common stock during the third quarter of fiscal 2018, at a total cost of approximately $21.7. At June 30, 2018, we had approximately $40.0 remaining for share repurchases under the existing authorization by the Board of Directors.

Item 6. EXHIBITS

The exhibits filed with this report are listed on the Exhibit Index, which is incorporated herein by reference. In reviewing any agreements included as exhibits to this report, please remember that they are included to provide you with information regarding their terms and are not intended to provide any other factual or disclosure information about us or the other parties to the agreements. The agreements may contain representations and warranties by the parties to the agreements, including us. Except where explicitly stated otherwise, these representations and warranties have been made solely for the benefit of the other parties to the applicable agreement and:

- should not necessarily be treated as categorical statements of fact, but rather as a way of allocating the risk to one of the parties if those statements prove to be inaccurate;
- may have been qualified by disclosures that were made to the other party in connection with the negotiation of the applicable agreement, which disclosures are not necessarily reflected in the agreement;

•may apply standards of materiality in a way that is different from what may be viewed as material to you or other investors; and
•were made only as of the date of the applicable agreement or such other date or dates as may be specified in the agreement and are subject to more recent developments.

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Accordingly, these representations and warranties may not describe the actual state of affairs as of the date they were made or at any other time.

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SIGNATURES

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

		HILLENBRAND, INC.
Date: August 1, 2018	BY:	/s/ Kristina A. Cerniglia Kristina A. Cerniglia Senior Vice President and Chief Financial Officer
Date: August 1, 2018		/s/ Megan A. Walke Megan A. Walke Interim Chief Accounting Officer

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EXHIBIT INDEX

Exhibit 3.1	Restated and Amended Articles of Incorporation of Hillenbrand, Inc., effective March 31, 2008 (Incorporated by reference to Exhibit 3.1 to Quarterly Report on Form 10-Q filed August 12, 2008)
Exhibit 3.2	Articles of Correction of the Restated and Amended Articles of Incorporation of Hillenbrand, Inc., effective March 31, 2008 (Incorporated by reference to Exhibit 3.2 to Quarterly Report on Form 10-Q filed August 12, 2008)
Exhibit 3.3	Articles of Amendment of the Restated and Amended Articles of Incorporation of Hillenbrand, Inc., effective February 27, 2015 (Incorporated by reference to Exhibit 3.3 to Quarterly Report on Form 10-Q filed May 11, 2015)
Exhibit 3.4	Amended and Restated Code of By-laws of Hillenbrand, Inc. (Incorporated by reference to Exhibit 3.1 to Current Report on Form 8-K filed August 31, 2017)
Exhibit 31.1*	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2*	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1*	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 32.2*	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 101.INS	Instance document
Exhibit 101.SCH	Schema document
Exhibit 101.CAL	Calculation linkbase document
Exhibit 101.LAB	Labels linkbase document
Exhibit 101.PRE	Presentation linkbase document
Exhibit 101.DEF	Definition linkbase document

* Filed herewith.