

OLD SECOND BANCORP INC

Form 10-Q

August 08, 2016

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2016

OR

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

For transition period from to

Commission File Number 0 -10537

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction)

36-3143493
(I.R.S. Employer Identification Number)

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of incorporation or organization)

37 South River Street, Aurora, Illinois 60507

(Address of principal executive offices) (Zip Code)

(630) 892-0202

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes 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 registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Act). (check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: As of August 5, 2016, the Registrant had outstanding 29,554,716 shares of common stock, \$1.00 par value per share.



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OLD SECOND BANCORP, INC.

Form 10-Q Quarterly Report

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Old Second Bancorp, Inc. and Subsidiaries

Consolidated Balance Sheets

(In thousands, except share data)

	(Unaudited) June 30, 2016	December 31, 2015
Assets		
Cash and due from banks	\$ 32,806	\$ 26,975
Interest bearing deposits with financial institutions	7,525	13,363
Cash and cash equivalents	40,331	40,338
Securities available-for-sale, at fair value	764,551	456,066
Securities held-to-maturity, at amortized cost	-	247,746
Federal Home Loan Bank and Federal Reserve Bank stock	7,918	8,518
Loans held-for-sale	5,589	2,849
Loans	1,161,151	1,133,715
Less: allowance for loan losses	15,822	16,223
Net loans	1,145,329	1,117,492
Premises and equipment, net	38,953	39,612
Other real estate owned	16,252	19,141
Mortgage servicing rights, net	4,698	5,847
Bank-owned life insurance (BOLI)	59,653	59,049
Deferred tax assets, net	57,738	64,552
Other assets	18,762	15,818
Total assets	\$ 2,159,774	\$ 2,077,028
Liabilities		
Deposits:		
Noninterest bearing demand	\$ 477,883	\$ 442,639
Interest bearing:		
Savings, NOW, and money market	902,576	908,598
Time	401,666	407,849
Total deposits	1,782,125	1,759,086
Securities sold under repurchase agreements	43,138	34,070
Other short-term borrowings	50,000	15,000
Junior subordinated debentures	57,567	57,543
Subordinated debt	45,000	45,000
Notes payable and other borrowings	500	500
Other liabilities	13,823	9,900
Total liabilities	1,992,153	1,921,099

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Stockholders' Equity		
Common stock	34,533	34,427
Additional paid-in capital	116,311	115,918
Retained earnings	121,080	114,209
Accumulated other comprehensive loss	(8,083)	(12,659)
Treasury stock	(96,220)	(95,966)
Total stockholders' equity	167,621	155,929
Total liabilities and stockholders' equity	\$ 2,159,774	\$ 2,077,028

	June 30, 2016		December 31, 2015	
	Preferred Stock \$ 1	Common Stock \$ 1	Preferred Stock \$ 1	Common Stock \$ 1
Par value				
Liquidation value	-	N/A	-	N/A
Shares authorized	300,000	60,000,000	300,000	60,000,000
Shares issued	-	34,532,734	-	34,427,234
Shares outstanding	-	29,554,716	-	29,483,429
Treasury shares	-	4,978,018	-	4,943,805

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Income

(In thousands, except per share data)

	(unaudited) Three Months Ended		(unaudited) Six Months Ended	
	June 30, 2016	2015	June 30, 2016	2015
Interest and dividend income				
Loans, including fees	\$ 13,039	\$ 13,467	\$ 26,097	\$ 26,685
Loans held-for-sale	39	72	67	115
Securities:				
Taxable	4,382	3,372	8,593	6,747
Tax exempt	220	163	399	304
Dividends from Federal Reserve Bank and Federal Home Loan Bank stock	84	77	168	154
Interest bearing deposits with financial institutions	15	19	34	31
Total interest and dividend income	17,779	17,170	35,358	34,036
Interest expense				
Savings, NOW, and money market deposits	193	183	384	362
Time deposits	869	771	1,691	1,578
Other short-term borrowings	26	7	46	16
Junior subordinated debentures	1,083	1,071	2,167	2,143
Subordinated debt	243	202	482	399
Notes payable and other borrowings	2	-	4	4
Total interest expense	2,416	2,234	4,774	4,502
Net interest and dividend income	15,363	14,936	30,584	29,534
Loan loss reserve release	-	(2,300)	-	(2,300)
Net interest and dividend income after release for loan losses	15,363	17,236	30,584	31,834
Noninterest income				
Trust income	1,502	1,596	2,871	3,082
Service charges on deposits	1,646	1,779	3,205	3,320
Secondary mortgage fees	280	281	473	525
Mortgage servicing (loss) / gain, net of changes in fair value	(311)	500	(931)	292
Net gain on sales of mortgage loans	1,642	1,695	2,854	3,318
Securities loss, net	-	(12)	(61)	(121)
Increase in cash surrender value of bank-owned life insurance	319	299	604	779
Debit card interchange income	1,049	1,050	1,996	2,009
Other income	1,150	1,076	2,541	3,033
Total noninterest income	7,277	8,264	13,552	16,237
Noninterest expense				
Salaries and employee benefits	8,814	9,149	17,840	18,404
Occupancy expense, net	1,009	1,094	2,238	2,365
Furniture and equipment expense	1,078	1,065	2,036	2,066

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FDIC insurance	362	377	565	650
General bank insurance	272	310	570	667
Advertising expense	435	353	782	558
Debit card interchange expense	620	400	823	752
Legal fees	191	420	352	643
Other real estate expense, net	879	2,388	1,617	3,740
Other expense	3,040	3,371	6,141	6,235
Total noninterest expense	16,700	18,927	32,964	36,080
Income before income taxes	5,940	6,573	11,172	11,991
Provision for income taxes	2,095	2,444	4,005	4,363
Net income	\$ 3,845	\$ 4,129	\$ 7,167	\$ 7,628
Preferred stock dividends and accretion of discount	-	710	-	1,534
Net income available to common stockholders	\$ 3,845	\$ 3,419	\$ 7,167	\$ 6,094
Basic earnings per share	\$ 0.13	\$ 0.12	\$ 0.24	\$ 0.21
Diluted earnings per share	0.13	0.12	0.24	0.21

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income

(In thousands)

	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
	2016	2015	2016	2015
Net Income	\$ 3,845	\$ 4,129	\$ 7,167	\$ 7,628
Unrealized holding gains (losses) on available-for-sale securities arising during the period	8,076	(575)	5,767	346
Related tax (expense) benefit	(3,233)	228	(2,308)	(210)
Holding gains (losses) after tax on available-for-sale securities	4,843	(347)	3,459	136
Less: Reclassification adjustment for the net losses realized during the period				
Net realized losses	-	(12)	(61)	(121)
Income tax benefit on net realized losses	-	3	25	48
Net realized losses after tax	-	(9)	(36)	(73)
Other comprehensive income (loss) on available-for-sale securities	4,843	(338)	3,495	209
Accretion and reversal of net unrealized holding gains on held-to-maturity securities	5,715	254	5,939	497
Related tax expense	(2,354)	(104)	(2,446)	(204)
Other comprehensive income on held-to-maturity securities	3,361	150	3,493	293
Changes in fair value of derivatives used for cashflow hedges	(1,597)	-	(4,024)	-
Related tax benefit	640	-	1,612	-
Other comprehensive loss on cashflow hedges	(957)	-	(2,412)	-
Total other comprehensive income (loss)	7,247	(188)	4,576	502
Total comprehensive income	\$ 11,092	\$ 3,941	\$ 11,743	\$ 8,130

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(In thousands)

	(Unaudited) Six Months Ended	
	June 30, 2016	2015
Cash flows from operating activities		
Net income	\$ 7,167	\$ 7,628
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of leasehold improvement	1,097	1,216
Change in fair value of mortgage servicing rights	1,774	513
Loan loss reserve release	-	(2,300)
Provision for deferred tax expense	3,717	4,206
Originations of loans held-for-sale	(83,698)	(114,718)
Proceeds from sales of loans held-for-sale	83,324	115,940
Net gain on sales of mortgage loans	(2,854)	(3,318)
Change in current income taxes receivable	259	27
Increase in cash surrender value of bank-owned life insurance	(604)	(392)
Change in accrued interest receivable and other assets	(3,152)	(2,167)
Change in accrued interest payable and other liabilities	(185)	(2,475)
Net premium (accretion)/amortization/discount on securities	(385)	154
Securities losses, net	61	121
Amortization of junior subordinated debentures issuance costs	24	24
Stock based compensation	325	344
Net gain on sale of other real estate owned	(67)	(337)
Provision for other real estate owned losses	940	2,697
Net cash provided by operating activities	7,743	7,163
Cash flows from investing activities		
Proceeds from maturities and calls including pay down of securities available-for-sale	25,687	28,292
Proceeds from sales of securities available-for-sale	44,993	56,121
Purchases of securities available-for-sale	(122,700)	(98,806)
Proceeds from maturities and calls including pay down of securities held-to-maturity	3,372	6,983
Proceeds from sales of Federal Home Loan Bank stock	600	787
Net change in loans	(28,805)	(7,582)
Improvements in other real estate owned	(12)	-
Proceeds from sales of other real estate owned	2,996	4,673
Net purchases of premises and equipment	(438)	(577)
Net cash used in investing activities	(74,307)	(10,109)
Cash flows from financing activities		
Net change in deposits	23,039	28,497
Net change in securities sold under repurchase agreements	9,068	11,379
Net change in other short-term borrowings	35,000	(25,000)

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Redemption of preferred stock	-	(15,778)
Dividends paid preferred stock	-	(1,716)
Dividends paid common stock	(296)	-
Purchase of treasury stock	(254)	(117)
Net cash provided by (used in) financing activities	66,557	(2,735)
Net change in cash and cash equivalents	(7)	(5,681)
Cash and cash equivalents at beginning of period	40,338	44,197
Cash and cash equivalents at end of period	\$ 40,331	\$ 38,516

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Cash Flows - Continued

(In thousands)

	(Unaudited)	
	Six Months Ended	
	June 30,	
	2016	2015
Supplemental cash flow information		
Income taxes paid, net	\$ 100	\$ 130
Interest paid for deposits	2,053	1,993
Interest paid for borrowings	2,665	2,564
Non-cash transfer of loans to other real estate owned	968	7,015
Non-cash transfer of securities held-to-maturity to securities available-for-sale	244,823	-
Change in dividends accrued and declared but not paid	-	(182)

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Changes in

Stockholders' Equity

(In thousands)

	Common Stock	Preferred Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2014	\$ 34,365	\$ 47,331	\$ 115,332	\$ 100,697	\$ (7,713)	\$ (95,849)	\$ 194,163
Net income				7,628			7,628
Other comprehensive gain, net of tax					502		502
Change in restricted stock	58		(58)				-
Tax effect from vesting of restricted stock			33				33
Stock based compensation			344				344
Purchase of treasury stock						(117)	(117)
Redemption of preferred stock		(15,778)					(15,778)
Preferred stock accretion and declared dividends				(1,534)			(1,534)
Balance, June 30, 2015	\$ 34,423	\$ 31,553	\$ 115,651	\$ 106,791	\$ (7,211)	\$ (95,966)	\$ 185,241
Balance, December 31, 2015	\$ 34,427	\$ -	\$ 115,918	\$ 114,209	\$ (12,659)	\$ (95,966)	\$ 155,929
Net income				7,167			7,167
Other comprehensive gain, net of tax					4,576		4,576
Dividends declared and paid, \$0.01 per share				(296)			(296)
Change in restricted stock	106		(106)				-

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Tax effect from vesting of restricted stock			174				174
Stock based compensation			325				325
Purchase of treasury stock						(254)	(254)
Balance, June 30, 2016	\$ 34,533	\$ -	\$ 116,311	\$ 121,080	\$ (8,083)	\$ (96,220)	\$ 167,621

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Table amounts in thousands, except per share data, unaudited)

Note 1 – Summary of Significant Accounting Policies

The accounting policies followed in the preparation of the interim consolidated financial statements are consistent with those used in the preparation of the annual financial information. The interim consolidated financial statements reflect all normal and recurring adjustments that are necessary, in the opinion of management, for a fair statement of results for the interim period presented. Results for the period ended June 30, 2016, are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. These interim consolidated financial statements are unaudited and should be read in conjunction with the audited financial statements and notes included in Old Second Bancorp, Inc.'s (the "Company") annual report on Form 10-K for the year ended December 31, 2015. Unless otherwise indicated, amounts in the tables contained in the notes to the consolidated financial statements are in thousands. Certain items in prior periods have been reclassified to conform to the current presentation.

The Company's consolidated financial statements are prepared in accordance with United States generally accepted accounting principles ("GAAP") and follow general practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the consolidated financial statements. Future changes in information may affect these estimates, assumptions, and judgments, which, in turn, may affect amounts reported in the consolidated financial statements.

All significant accounting policies are presented in Note 1 to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015. These policies, along with the disclosures presented in the other financial statement notes and in this discussion, provide information on how significant assets and liabilities are valued in the consolidated financial statements and how those values are determined.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09 "Revenue from Contracts with Customers (Topic 606)." The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. In August 2015, the FASB issued ASU 2015-14 "Revenue from Contracts with Customers (Topic 606) Deferral of the Effective Date." This accounting standards update defers the effective date of ASU 2014-09 for an additional year. ASU 2015-14 will be effective for annual reporting periods beginning after December 15, 2017. The amendments can be applied retrospectively to each prior reporting period or retrospectively with the cumulative effect of initially applying this update recognized at the date of initial application. Early application is not permitted. In March 2016, the FASB issued ASU 2016-08 "Revenue from Contracts with Customers (TOPIC 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)." and in April 2016, the FASB issued ASU 2016-10 "Revenue from Contracts with Customers (TOPIC 606): Identifying Performance Obligations and Licensing." ASU 2016-08 requires the entity to determine if it is acting as a principal with control over the goods or services it is contractually obligated to provide, or an agent with no control over specified goods or services provided by another party to a customer. ASU 2016-10 was issued to further clarify ASU 2014-09 implementation regarding identifying performance obligation materiality, identification of key contract components, and scope. The Company is assessing the impact of ASU 2014-09 and other related ASUs as noted above on its accounting and disclosures.

In April 2015, the FASB issued ASU No. 2015-03 "Simplifying the Presentation of Debt Issuance Costs." ASU 2015-03 amended prior guidance to simplify the presentation of debt issuance costs. The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. ASU 2015-03 is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The adoption of this standard did not have a material effect to the Company's operating results or financial condition. This standard was adopted by the Company effective January 2016.

In March 2016, the FASB issued ASU No. 2016-09 "Improvements to Employee Share-Based Payment Accounting." FASB issued this ASU as part of the Simplification Initiative. This ASU involves several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liability, and classification on the statement of cash flows. ASU 2016-09 is effective for financial statements issued for fiscal years beginning after December 15, 2016. The Company is assessing the impact of ASU 2016-09 on its accounting and disclosures.

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In June 2016, the FASB issued ASU No. 2016-13 “Measurement of Credit Losses on Financial Instruments:” ASU 2016-13 was issued to provide financial statement users with more useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date to enhance the decision making process. ASU 2016-13 is effective for financial statements issued for fiscal years beginning after December 15, 2019. The Company is assessing the impact of ASU 2016-13 on its accounting and disclosures.

Subsequent Events

On July 19, 2016, the Company’s Board of Directors declared a cash dividend of 1 cent per share payable on August 9, 2016, to stockholders of record as of July 29, 2016.

On August 1, 2016, the Company announced the Bank has agreed to acquire the Chicago branch of Talmer Bank and Trust, the banking subsidiary of Talmer Bancorp, Inc. (“Talmer”), including approximately \$82 million of deposits and \$237 million of loans. The acquisition is expected to close in the fourth quarter of 2016, subject to regulatory approval, the completion of Talmer’s pending merger with Chemical Financial Corporation and other customary closing conditions.

Note 2 – Securities

Investment Portfolio Management

Our investment portfolio serves the liquidity needs and income objectives of the Company. While the portfolio serves as an important component of the overall liquidity management at the Bank, portions of the portfolio also serve as income producing assets. The size and composition of the portfolio reflects liquidity needs, loan demand and interest income objectives.

Portfolio size and composition will be adjusted from time to time. While a significant portion of the portfolio consists of readily marketable securities to address liquidity, other parts of the portfolio may reflect funds invested pending future loan demand or to maximize interest income without undue interest rate risk.

Investments are comprised of debt securities and non-marketable equity investments. Securities available-for-sale are carried at fair value. Unrealized gains and losses, net of tax, on securities available-for-sale are reported as a separate component of equity. This balance sheet component changes as interest rates and market conditions change. Unrealized gains and losses are not included in the calculation of regulatory capital.

In the second quarter of 2016, the securities held-to-maturity portfolio was reclassified to available-for-sale to allow for portfolio restructuring and to fund loan growth. This transfer of \$244.8 million was approved by the Board of Directors, and will preclude any holdings of securities held-to-maturity for a two year period.

Nonmarketable equity investments include Federal Home Loan Bank of Chicago (“FHLBC”) stock and Federal Reserve Bank of Chicago (“Reserve Bank”) stock. FHLBC stock was recorded at \$3.2 million at June 30, 2016, and \$3.7 million at December 31, 2015. Reserve Bank stock was recorded at \$4.8 million at June 30, 2016, and December 31, 2015. Our FHLBC stock is necessary to maintain access to FHLBC advances.

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The following table summarizes the amortized cost and fair value of the securities portfolio at June 30, 2016, and December 31, 2015, and the corresponding amounts of gross unrealized gains and losses (in thousands):

	Amortized	Gross	Gross	Fair
June 30, 2016	Cost	Unrealized	Unrealized	
		Gains	Losses	