

OLD SECOND BANCORP INC  
Form 10-Q  
November 06, 2015  
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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 September 30, 2015

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 November 4, 2015, the Registrant had outstanding 29,483,429 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) September 30, 2015	December 31, 2014
<b>Assets</b>		
Cash and due from banks	\$ 35,443	\$ 30,101
Interest bearing deposits with financial institutions	18,329	14,096
Cash and cash equivalents	53,772	44,197
Securities available-for-sale, at fair value	408,836	385,486
Securities held-to-maturity, at amortized cost	250,044	259,670
Federal Home Loan Bank and Federal Reserve Bank stock	8,271	9,058
Loans held-for-sale	3,899	5,072
Loans	1,132,912	1,159,332
Less: allowance for loan losses	16,613	21,637
Net loans	1,116,299	1,137,695
Premises and equipment, net	39,701	42,335
Other real estate owned	24,451	31,982
Mortgage servicing rights, net	5,470	5,462
Bank-owned life insurance (BOLI)	57,647	56,807
Deferred tax assets, net	65,150	70,141
Other assets	16,054	13,882
Total assets	\$ 2,049,594	\$ 2,061,787
<b>Liabilities</b>		
<b>Deposits:</b>		
Noninterest bearing demand	\$ 430,810	\$ 400,447
<b>Interest bearing:</b>		
Savings, NOW, and money market	878,226	865,103
Time	411,443	419,505
Total deposits	1,720,479	1,685,055
Securities sold under repurchase agreements	27,074	21,036
Other short-term borrowings	35,000	45,000
Junior subordinated debentures	58,378	58,378
Subordinated debt	45,000	45,000
Notes payable and other borrowings	500	500
Other liabilities	9,520	12,655
Total liabilities	1,895,951	1,867,624

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Stockholders' Equity		
Preferred stock	-	47,331
Common stock	34,423	34,365
Additional paid-in capital	115,773	115,332
Retained earnings	110,376	100,697
Accumulated other comprehensive loss	(10,963)	(7,713)
Treasury stock	(95,966)	(95,849)
Total stockholders' equity	153,643	194,163
Total liabilities and stockholders' equity	\$ 2,049,594	\$ 2,061,787

	September 30, 2015		December 31, 2014	
	Preferred Stock	Common Stock	Preferred Stock	Common Stock
	\$ 1	\$ 1	\$ 1	\$ 1
Par value				
Liquidation value	-	n/a	1,000	n/a
Shares authorized	300,000	60,000,000	300,000	60,000,000
Shares issued	-	34,422,234	47,331	34,364,734
Shares outstanding	-	29,478,429	47,331	29,442,508
Treasury shares	-	4,943,805	-	4,922,226

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 September 30,		(unaudited) Nine Months Ended September 30,	
	2015	2014	2015	2014
Interest and dividend income				
Loans, including fees	\$ 13,353	\$ 13,362	\$ 40,038	\$ 39,346
Loans held-for-sale	38	38	153	92
Securities:				
Taxable	3,471	3,586	10,218	10,440
Tax exempt	122	110	426	376
Dividends from Federal Reserve Bank and Federal Home Loan Bank stock	76	78	230	232
Interest bearing deposits with financial institutions	12	25	43	60
Total interest and dividend income	17,072	17,199	51,108	50,546
Interest expense				
Savings, NOW, and money market deposits	185	175	547	562
Time deposits	799	1,073	2,377	3,604
Other short-term borrowings	6	5	22	10
Junior subordinated debentures	1,072	1,072	3,215	3,847
Subordinated debt	205	199	604	593
Notes payable and other borrowings	1	4	5	12
Total interest expense	2,268	2,528	6,770	8,628
Net interest and dividend income	14,804	14,671	44,338	41,918
Loan loss reserve release	(2,100)	-	(4,400)	(2,000)
Net interest and dividend income after provision for loan losses	16,904	14,671	48,738	43,918
Noninterest income				
Trust income	1,444	1,483	4,526	4,619
Service charges on deposits	1,766	1,838	5,086	5,354
Secondary mortgage fees	190	174	715	441
Mortgage servicing (loss) gain, net of changes in fair value	(274)	252	18	269
Net gain on sales of mortgage loans	1,359	914	4,677	2,614
Securities (loss) gain, net	(57)	1,231	(178)	1,457
Increase in cash surrender value of bank-owned life insurance	203	304	840	1,028
Debit card interchange income	1,004	1,011	3,013	2,771
Loss on disposal and transfer of fixed assets	(1,143)	(121)	(1,143)	(121)
Other income	1,156	1,237	4,331	3,693
Total noninterest income	5,648	8,323	21,885	22,125
Noninterest expense				
Salaries and employee benefits	8,260	8,856	26,664	27,140
Occupancy expense, net	1,156	1,143	3,521	3,809

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Furniture and equipment expense	1,110	989	3,176	2,956
FDIC insurance	373	649	1,023	1,555
General bank insurance	308	371	975	1,203
Amortization of core deposit	-	154	-	1,177
Advertising expense	434	291	992	1,053
Debit card interchange expense	379	418	1,131	1,208
Legal fees	279	332	922	998
Other real estate expense, net	977	2,007	4,717	4,665
Other expense	2,968	3,134	9,203	9,148
Total noninterest expense	16,244	18,344	52,324	54,912
Income before income taxes	6,308	4,650	18,299	11,131
Provision for income taxes	2,384	1,726	6,747	3,984
Net income	\$ 3,924	\$ 2,924	\$ 11,552	\$ 7,147
Preferred stock dividends and accretion of discount	339	1,065	1,873	3,985
Dividends waived upon preferred stock redemption	-	-	-	(5,433)
Gain on preferred stock redemption	-	-	-	(1,348)
Net income available to common stockholders	\$ 3,585	\$ 1,859	\$ 9,679	\$ 9,943
Basic earnings per share	\$ 0.12	\$ 0.06	\$ 0.33	\$ 0.41
Diluted earnings per share	0.12	0.06	0.33	0.41

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 September 30,		(Unaudited) Nine Months Ended September 30,	
	2015	2014	2015	2014
Net Income	\$ 3,924	\$ 2,924	\$ 11,552	\$ 7,147
Unrealized holding (losses) gains on available-for-sale securities arising during the period	(5,191)	(2,224)	(4,845)	397
Related tax benefit (expense)	2,079	918	1,869	(161)
Holding (losses) gains after tax on available-for-sale securities	(3,112)	(1,306)	(2,976)	236
Less: Reclassification adjustment for the net (losses) gains realized during the period				
Net realized (losses) gains	(57)	1,231	(178)	1,457
Income tax benefit (expense) on net realized (losses) gains	23	(504)	71	(597)
Net realized (losses) gains after tax	(34)	727	(107)	860
Other comprehensive loss on available-for-sale securities	(3,078)	(2,033)	(2,869)	(624)
Accretion of net unrealized holding gains on held-to-maturity securities transferred from available-for-sale securities	242	237	739	731
Related tax expense	(100)	(97)	(304)	(301)
Other comprehensive income on held-to-maturity securities	142	140	435	430
Changes in fair value of derivatives used for cashflow hedges	(816)	-	(816)	-
Total other comprehensive loss	(3,752)	(1,893)	(3,250)	(194)
Total comprehensive income	\$ 172	\$ 1,031	\$ 8,302	\$ 6,953

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)	
	Nine Months Ended	
	September 30,	
	2015	2014
Cash flows from operating activities		
Net income	\$ 11,552	\$ 7,147
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization of leasehold improvement	1,816	1,887
Change in fair value of mortgage servicing rights	1,201	761
Loan loss reserve release	(4,400)	(2,000)
Provision for deferred tax expense	6,485	4,063
Originations of loans held-for-sale	(153,990)	(85,172)
Proceeds from sales of loans held-for-sale	158,621	87,569
Net gain on sales of mortgage loans	(4,677)	(2,614)
Change in current income taxes receivable (payable)	11	(79)
Increase in cash surrender value of bank-owned life insurance	(840)	(1,028)
Change in accrued interest receivable and other assets	(2,161)	(3,633)
Change in accrued interest payable and other liabilities	(3,386)	(22,108)
Net premium amortization/discount (accretion) on securities	226	(1,408)
Securities losses (gains), net	178	(1,457)
Amortization of core deposit	-	1,177
Stock based compensation	466	189
Net gain on sale of other real estate owned	(769)	(610)
Provision for other real estate owned losses	3,825	2,781
Net loss on disposal of fixed assets	4	-
Loss on transfer of premises to other real estate owned	1,139	121
Net cash provided by (used in) operating activities	15,301	(14,414)
Cash flows from investing activities		
Proceeds from maturities and calls including pay down of securities available-for-sale	33,035	15,430
Proceeds from sales of securities available-for-sale	70,176	264,502
Purchases of securities available-for-sale	(131,956)	(268,639)
Proceeds from maturities and calls including pay down of securities held-to-maturity	10,689	5,934
Purchases of securities held-to-maturity	-	(11,212)
Proceeds from sales of Federal Home Loan Bank stock	787	1,234
Net change in loans	18,403	(53,037)
Improvements in other real estate owned	-	(637)
Proceeds from sales of other real estate owned	12,336	12,746
Proceeds from disposition of premises and equipment	-	1
Net purchases of premises and equipment	(793)	(721)

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Net cash provided by (used in) investing activities	12,677	(34,399)
Cash flows from financing activities		
Net change in deposits	35,424	(25,373)
Net change in securities sold under repurchase agreements	6,038	6,878
Net change in other short-term borrowings	(10,000)	35,000
Redemption of preferred stock	(47,331)	(24,321)
Proceeds from the issuance of common stock	-	64,395
Dividends paid on preferred stock	(2,417)	(11,323)
Purchase of treasury stock	(117)	(46)
Net cash (used in) provided by financing activities	(18,403)	45,210
Net change in cash and cash equivalents	9,575	(3,603)
Cash and cash equivalents at beginning of period	44,197	47,660
Cash and cash equivalents at end of period	\$ 53,772	\$ 44,057

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Cash Flows - Continued

(In thousands)

	(Unaudited)	
	Nine Months Ended	
	September 30,	
Supplemental cash flow information	2015	2014
Income taxes paid	\$ 250	\$ -
Interest paid for deposits	2,964	4,412
Interest paid for borrowings	3,848	21,425
Non-cash transfer of loans to other real estate owned	7,393	11,460
Non-cash transfer of premises to other real estate owned	468	2,160
Change in dividends accrued	(544)	(9,123)
Accretion on preferred stock discount	-	58

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, 2013	\$ 18,830	\$ 72,942	\$ 66,212	\$ 92,549	\$ (7,038)	\$ (95,803)	\$ 147,692
Net income				7,147			7,147
Other comprehensive loss, net of tax					(194)		(194)
Change in restricted stock	10		(10)				-
Tax effect from vesting of restricted stock			29				29
Stock based compensation			189				189
Purchase of treasury stock						(46)	(46)
Redemption of preferred stock		(25,669)		1,348			(24,321)
Common stock offering	15,525		48,870				64,395
Preferred stock accretion and declared dividends		58		(2,258)			(2,200)
Balance, September 30, 2014	\$ 34,365	\$ 47,331	\$ 115,290	\$ 98,786	\$ (7,232)	\$ (95,849)	\$ 192,691
Balance, December 31, 2014	\$ 34,365	\$ 47,331	\$ 115,332	\$ 100,697	\$ (7,713)	\$ (95,849)	\$ 194,163
Net income				11,552			11,552
Other comprehensive loss, net of tax					(3,250)		(3,250)
Change in restricted stock	58		(58)				-
			33				33

Tax effect from vesting of restricted stock							
Stock based compensation			466				466
Purchase of treasury stock					(117)		(117)
Redemption of preferred stock	(47,331)						(47,331)
Preferred stock accretion and declared dividends				(1,873)			(1,873)
Balance, September 30, 2015	\$ 34,423	\$ -	\$ 115,773	\$ 110,376	\$ (10,963)	\$ (95,966)	\$ 153,643

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 September 30, 2015, are not necessarily indicative of the results that may be expected for the year ending December 31, 2015. 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, 2014. 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, 2014. 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. ASU 2014-09 was to be effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. 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. The Company is assessing the impact of ASU 2014-09 on its accounting and disclosures. 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 for an additional year. ASU 2015-14 will be effective for annual reporting periods beginning after December 15, 2017.

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 will be effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within fiscal years. The adoption of this standard will not have a material effect to the Company's operating results or financial condition.

## 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 will 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.





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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.

Securities held-to-maturity are carried at amortized cost and the discount or premium created in the 2013 transfer from available-for-sale securities or at the time of purchase thereafter is accreted or amortized to the maturity or expected payoff date but not an earlier call. In accordance with GAAP, the Company has the positive intent and ability to hold the securities to maturity.

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 \$3.5 million at September 30, 2015, and \$4.3 million at December 31, 2014. Reserve Bank stock was recorded at \$4.8 million at September 30, 2015, and December 31, 2014. Our FHLBC stock is necessary to maintain access to FHLBC advances.

The following table summarizes the amortized cost and fair value of the securities portfolio at September 30, 2015, and December 31, 2014, and the corresponding amounts of gross unrealized gains and losses (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2015:				
Securities Available-for-Sale				
U.S. Treasury	\$ 1,514	\$ 1	\$ -	\$ 1,515
U.S. government agencies	1,690	-	(113)	1,577
U.S. government agencies mortgage-backed States and political subdivisions	2,049	-	(15)	2,034