

HERITAGE FINANCIAL CORP /WA/

Form 10-Q

August 03, 2012

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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, 2012

OR

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

Commission File Number 0-29480

HERITAGE FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

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Washington
(State or other jurisdiction of
incorporation or organization)

201 Fifth Avenue SW,
Olympia, WA
(Address of principal executive offices)

91-1857900
(I.R.S. Employer
Identification No.)

98501
(Zip Code)

(360) 943-1500
(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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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.

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the last practicable date:

As of July 13, 2012 there were 15,144,079 common shares outstanding, with no par value, of the registrant.

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Forward Looking Statements

Safe Harbor statement under the Private Securities Litigation Reform Act of 1995: This Form 10-Q contains forward-looking statements that are subject to risks and uncertainties, including, but not limited to: the credit and concentration risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs and changes in our allowance for loan losses and provision for loan losses that may be impacted by deterioration in the housing and commercial real estate markets; changes in general economic conditions, either nationally or in our market areas; changes in the levels of general interest rates, and the relative differences between short and long term interest rates, deposit interest rates, our net interest margin and funding sources; risks related to acquiring assets in or entering markets in which we have not previously operated and may not be familiar; fluctuations in the demand for loans, the number of unsold homes and other properties and fluctuations in real estate values in our market areas; results of examinations of us by the Board of Governors of the Federal Reserve System (the Federal Reserve Board) and of our bank subsidiaries by the Federal Deposit Insurance Corporation (the FDIC), the Washington State Department of Financial Institutions, Division of Banks (the Washington DFI) or other regulatory authorities, including the possibility that any such regulatory authority may, among other things, require us to increase our reserve for loan losses, write-down assets, change our regulatory capital position or affect our ability to borrow funds or maintain or increase deposits, which could adversely affect our liquidity and earnings; legislative or regulatory changes that adversely affect our business including changes in regulatory policies and principles, including the interpretation of regulatory capital or other rules including changes from the Dodd-Frank Wall Street Reform and Consumer Protection Act and regulations that have been or will be promulgated thereunder; our ability to control operating costs and expenses; the use of estimates in determining fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation; difficulties in reducing risk associated with the loans on our balance sheet; staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our workforce and potential associated charges; computer systems on which we depend could fail or experience a security breach; our ability to recruit and retain key members of our senior management team and staff; costs and effects of litigation, including settlements and judgments; our ability to implement our expansion strategy; our ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we have acquired including the Cowlitz Bank and Pierce Commercial Bank transactions or may in the future acquire into our operations and our ability to realize related revenue synergies and cost savings within expected time frames and any goodwill charges related thereto; risks relating to acquiring assets or entering markets in which we have not previously operated and may not be familiar; changes in consumer spending, borrowing and savings habits; the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions; adverse changes in the securities markets; inability of key third-party providers to perform their obligations to us; changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards Board, including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products and services; and other risks detailed from time to time in our filings with the Securities and Exchange Commission.

The Company cautions readers not to place undue reliance on any forward-looking statements. Moreover, you should treat these statements as speaking only as of the date they are made and based only on information then actually known to the Company. The Company does not undertake and specifically disclaims any obligation to revise any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements. These risks could cause our actual results for the remainder of 2012 and beyond to differ materially from those expressed in any forward-looking statements by, or on behalf of, us, and could negatively affect the Company's operating and stock price performance.

As used throughout this report, the terms we, our, us, or the Company refer to Heritage Financial Corporation and its consolidated subsidiaries, unless the context otherwise requires.

Table of Contents**ITEM 1. HERITAGE FINANCIAL CORPORATION****HERITAGE FINANCIAL CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION****(Dollars in thousands, except for per share amounts)****(Unaudited)**

	June 30, 2012	December 31, 2011
Assets		
Cash on hand and in banks	\$ 31,245	\$ 30,193
Interest earning deposits	52,011	93,566
Cash and cash equivalents	83,256	123,759
Investment securities available for sale	149,778	144,602
Investment securities held to maturity (fair value of \$12,059 and \$12,881)	11,190	12,093
Loans held for sale	1,174	1,828
Originated loans receivable	853,633	837,924
Less: Allowance for loan losses	(20,843)	(22,317)
Originated loans receivable, net	832,790	815,607
Purchased covered loans receivable, net of allowance for loan losses of (\$3,973 and \$3,963)	97,357	105,394
Purchased non-covered loans receivable, net of allowance for loan losses of (\$4,667 and \$4,635)	72,273	83,479
Total loans receivable, net	1,002,420	1,004,480
FDIC indemnification asset	8,212	10,350
Other real estate owned (\$563 and \$774 covered by FDIC loss share, respectively)	8,634	4,484
Premises and equipment, net	23,166	22,975
Federal Home Loan Bank stock, at cost	5,594	5,594
Accrued interest receivable	4,683	5,117
Prepaid expenses and other assets	14,982	8,190
Deferred income taxes, net	10,739	10,988
Other intangible assets, net	1,299	1,513
Goodwill	13,012	13,012
Total assets	\$ 1,338,139	\$ 1,368,985
Liabilities and Stockholders Equity		
Deposits	\$ 1,113,346	\$ 1,136,044
Securities sold under agreement to repurchase	13,656	23,091
Accrued expenses and other liabilities	11,002	7,330
Total liabilities	1,138,004	1,166,465
Stockholders equity:		
Preferred stock, no par value, 2,500,000 shares authorized; no shares issued and outstanding at June 30, 2012 and December 31, 2011		
Common stock, no par value, 50,000,000 shares authorized; 15,143,189 and 15,456,297 shares outstanding at June 30, 2012 and December 31, 2011, respectively	121,955	126,622
Unearned compensation Employee Stock Ownership Plan (ESOP)	(50)	(94)
Retained earnings	76,434	74,256
Accumulated other comprehensive income, net	1,796	1,736

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Total stockholders' equity	200,135	202,520
Total liabilities and stockholders' equity	\$ 1,338,139	\$ 1,368,985

See Notes to Condensed Consolidated Financial Statements.

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(Dollars in thousands, except for per share amounts)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
INTEREST INCOME:				
Interest and fees on loans	\$ 16,465	\$ 18,829	\$ 33,483	\$ 35,401
Taxable interest on investment securities	604	768	1,256	1,431
Nontaxable interest on investment securities	267	199	523	378
Interest on interest bearing deposits	53	61	116	141
Total interest income	17,389	19,857	35,378	37,351
INTEREST EXPENSE:				
Deposits	1,163	1,682	2,440	3,557
Other borrowings	16	20	34	42
Total interest expense	1,179	1,702	2,474	3,599
Net interest income	16,210	18,155	32,904	33,752
Provision for loan losses on originated loans	200	1,995	200	4,590
Provision for loan losses on purchased loans	419	1,529	310	3,307
Net interest income after provision for loan losses	15,591	14,631	32,394	25,855
NON-INTEREST INCOME:				
Gains on sales of loans, net	53	35	116	186
Service charges on deposits	1,345	1,278	2,650	2,516
Merchant Visa income, net	182	129	352	259
Change in FDIC indemnification asset	(19)	(1,712)	(195)	(912)
Other income	503	521	1,049	1,111
Total non-interest income	2,064	251	3,972	3,160
NON-INTEREST EXPENSE:				
Impairment loss on investment securities	62	19	98	64
Less: Portion recorded as other comprehensive loss	(38)		(38)	(20)
Impairment loss on investment securities, net	24	19	60	44
Salaries and employee benefits	7,287	7,075	14,485	13,712
Occupancy and equipment	1,832	1,719	3,617	3,565
Data processing	668	636	1,259	1,458
Marketing	369	379	772	694
Professional services	628	413	1,182	1,047
State and local taxes	320	369	630	725
Federal deposit insurance premium	263	432	538	889
Other real estate owned, net	196	48	452	