

HERITAGE FINANCIAL CORP /WA/

Form 10-Q

November 03, 2011

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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 September 30, 2011

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 October 18, 2011 there were 15,583,141 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 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; 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 retain key members of our senior management team; 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 2011 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)**

	<b>September 30, 2011</b>	<b>December 31, 2010</b>
<b>Assets</b>		
Cash on hand and in banks	\$ 30,081	\$ 37,179
Interest earning deposits	121,921	129,822
Federal funds sold		1,990
Investment securities available for sale	141,747	125,175
Investment securities held to maturity (market value of \$13,358 and \$14,290)	12,446	13,768
Loans held for sale	922	764
Originated loans receivable	802,941	742,019
Less: Allowance for loan losses	(22,387)	(22,062)
Originated loans receivable, net	780,554	719,957
Purchased covered loans receivable, net of allowance for loan losses of (\$3,682 and \$0)	111,392	128,715
Purchased non-covered loans receivable, net of allowance for loan losses of (\$2,366 and \$0)	92,364	131,049
Total loans receivable, net	984,310	979,721
FDIC indemnification asset	12,079	16,071
Other real estate owned (\$588 & \$0 covered by FDIC loss share, respectively)	2,590	3,030
Premises and equipment, at cost, net	22,788	21,750
Federal Home Loan Bank stock, at cost	5,594	5,594
Accrued interest receivable	5,137	4,626
Prepaid expenses and other assets	11,432	8,974
Deferred income taxes, net	3,411	4,255
Intangible assets, net	1,620	1,953
Goodwill	13,012	13,012
Total assets	\$ 1,369,090	\$ 1,367,684
<b>Liabilities and Stockholders Equity</b>		
Deposits	\$ 1,137,445	\$ 1,136,276
Securities sold under agreement to repurchase	18,770	19,027
Accrued expenses and other liabilities	6,760	10,102
Total liabilities	1,162,975	1,165,405
Stockholders equity:		
Common stock, no par, 50,000,000 shares authorized; 15,583,141 and 15,568,471 shares outstanding at September 30, 2011 and December 31, 2010, respectively	127,780	128,436
Unearned compensation ESOP and other	(116)	(182)
Retained earnings	76,681	73,648
Accumulated other comprehensive income, net	1,770	377
Total stockholders equity	206,115	202,279
Total liabilities and stockholders equity	\$ 1,369,090	\$ 1,367,684

See Notes to Condensed Consolidated Financial Statements.

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(Dollars in thousands, except for per share amounts)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
<b>INTEREST INCOME:</b>				
Interest and fees on loans	\$ 17,850	\$ 14,053	\$ 53,252	\$ 37,927
Taxable interest on investment securities	792	629	2,223	2,049
Nontaxable interest on investment securities	214	146	592	297
Interest on federal funds sold and interest bearing deposits	65	112	206	232
Total interest income	18,921	14,940	56,273	40,505
<b>INTEREST EXPENSE:</b>				
Deposits	1,604	2,238	5,161	6,330
Other borrowings	18	23	61	64
Total interest expense	1,622	2,261	5,222	6,394
Net interest income	17,299	12,679	51,051	34,111
Provision for loan losses	395	2,195	4,985	9,095
Provision for loan losses on purchased loans	2,821		6,128	
Net interest income after provision for loan losses	14,083	10,484	39,938	25,016
<b>NON-INTEREST INCOME:</b>				
Gains on bank acquisition		438		438
Gains on sales of loans, net	58	26	245	127
Service charges on deposits	1,332	1,212	3,847	3,318
Merchant Visa income	754	823	2,184	2,333
Change in FDIC indemnification asset	(1,666)		(2,578)	
Other income	383	367	1,495	850
Total non-interest income	861	2,866	5,193	7,066
<b>NON-INTEREST EXPENSE:</b>				
Impairment loss on investment securities	28	28	93	291
Less: Portion recorded as other comprehensive income			(20)	(18)
Impairment loss on investment securities, net	28	28	73	273
Salaries and employee benefits	6,495	5,191	20,207	13,406
Occupancy and equipment	1,749	1,250	5,314	3,268
Data processing	553	549	2,011	1,385
Marketing	390	261	1,084	895
Merchant Visa	622	680	1,793	1,937
Professional services	517	598	1,564	1,222
State and local taxes	290	295	1,015	668
Federal deposit insurance premium	384	423	1,272	1,125
Other real estate owned	31	5	596	(33)